Kraken Sonar Inc.

Condensed Consolidated Interim Financial Statements

For the three and six months ended June 30, 2016 and 2015
(Expressed in Canadian Dollars)

(Unaudited)

Q2 Fiscal 2016

KRAKEN

June 30, 2016

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KRAKEN

Condensed Consolidated Interim Statements of Financial Position
(Unaudited)
(Expressed in Canadian Dollars)

	June 30, 2016	December 31, 2015
ASSETS		
Current assets:		
Cash and cash equivalents (note 5)	**$ 81,028**	$ 771,940
Trade and other receivables (note 6)	**546,825**	376,571
Loans receivable from a director (note 9)	**-**	194,317
Inventory	**841,568**	507,042
Prepayments	**-**	7,863
	1,469,421	1,857,733
Investment (note 7)	**52,164**	-
Property and equipment, net	**218,733**	184,943
TOTAL ASSETS	**$ 1,740,318**	$ 2,042,676
LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIENCY)		
Current Liabilities:		
Trade and other payables	**$ 1,194,044**	$ 872,509
Deferred revenue	**60,228**	201,864
	1,254,272	1,074,373
Shareholders' equity:		
Share capital (note 10)	**3,080,426**	3,072,426
Contributed surplus	**1,540,310**	1,437,710
Deficit	**(4,134,690)**	(3,541,833)
	486,046	968,303
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	**$ 1,740,318**	$ 2,042,676

Corporate information (note 1)
Going concern (note 2)
Commitments (note 15)
Subsequent events (note 17)

On Behalf of the Board:

"Karl Kenny" Director ***"Roman Kocur"*** Director

The accompanying notes form part of the condensed consolidated interim financial statements.

KRAKEN

Condensed Consolidated Interim Statements of Net Loss and Comprehensive Loss
(Unaudited)
(Expressed in Canadian Dollars)

	Three months ended		Six months ended	
	June 30, 2016	June 30, 2015	June 30, 2016	June 30, 2015
Product sales	$465,543	$426,588	$1,176,233	$1,102,594
Cost of sales (note 12)	282,279	334,543	466,739	633,707
	183,264	92,045	709,494	468,887
Administrative expenses	369,492	250,935	673,602	469,568
Share-based payments (note 10(c))	32,500	2,500	102,600	81,600
Employee costs	252,509	166,297	494,000	304,693
RTO Listing expense	-	-	-	526,695
	654,501	419,732	1,270,202	1,382,556
Loss from operating activities	(471,237)	(327,687)	(560,708)	(913,669)
Foreign exchange loss (gain)	4,024	5,528	32,149	(26,815)
Transaction costs	-	-	-	225,000
Finance costs	-	-	-	59,847
Net loss, being comprehensive loss	$(475,261)	$(333,215)	$(592,857)	$(1,171,701)
Basic and diluted loss income per share	$ (0.01)	$(0.01)	$ (0.01)	$ (0.02)
Basic and diluted weighted average number of shares outstanding	71,087,555	71,038,055	71,106,895	65,730,410

KRAKEN

Condensed Consolidated Interim Statements of Changes in Shareholders' Equity (Deficiency)
(Unaudited)
(Expressed in Canadian Dollars)

2016

	Number of Shares	Share capital (Note 10)	Contributed Surplus	Equity portion of convertible debt	Deficit	Total
Balance at January 1, 2016	**71,068,214**	**$ 3,072,426**	**$ 1,437,710**	**$ -**	**$ (3,541,833)**	**$ 968,303**
Net loss	-	-	-	-	(592,857)	**(592,857)**
Transactions with shareholders, recorded directly in equity:						
Issue of common shares on warrant exercises	53,333	8,000	-	-	-	**8,000**
Share-based compensation	-	-	102,600	-	-	**102,600**
Shareholders' equity (deficiency) as at June 30, 2016	**71,121,547**	**$ 3,080,426**	**$ 1,540,310**	**$ -**	**$ (4,134,690)**	**$ 486,046**

2015

	Number of Shares	Share capital (note 10)	Contributed Surplus	Equity portion of convertible debt	Deficit	Total
Balance at January 1, 2015	51,500,000	$ 1,226,650	$ -	$ 215,317	$ (1,549,423)	$ (107,456)
Net loss	-	-	-	-	(1,171,701)	(1,171,701)
Transactions with shareholders, recorded directly in equity:						
Issue of common shares to former Anergy shareholders	3,893,777	584,067	-	-	-	584,067
Issue of options to former Anergy shareholders	-	-	4,460	-	-	4,460
Issue of common shares and share purchase warrants on conversion of bridge loan	14,063,326	1,008,293	1,312,000	(215,317)	-	2,104,976
Issue of common shares as Finder's fee	1,500,000	225,000	-	-	-	225,000
Issue of common shares on warrant exercises	111,111	26,416	(9,750)	-	-	16,666
Reduction of share subscriptions receivable	-	1,000		-	-	1,000
Share-based compensation	-	-	81,600	-	-	81,600
Shareholders' equity (deficiency) as at June 30, 2015	**71,068,214**	**$ 3,071,426**	**$ 1,388,510**	**$ -**	**$ (2,271,124)**	**1,738,612**

Condensed Consolidated Interim Statements of Cash Flows
(Unaudited)
(Expressed in Canadian Dollars)

	6 months ending June 30, 2016	6 months ending June 30, 2015
Cash flows used in operating activities		
Net loss	$ (592,857)	$ (1,171,701)
Adjustments for items not involving cash:		
Depreciation	25,991	14,381
Finance costs – convertible debt	-	59,847
Share-based payments	102,600	81,600
RTO consideration included in listing expenses	-	526,695
Transaction costs – finder's fee	-	225,000
Changes in non-cash working capital (note 14)	(317,018)	120,201
Net cash flows used in operating activities	(781,284)	(143,977)
Cash flows from (used in) investing activities		
Cash acquired on RTO	-	61,832
Investment (note 7)	(52,164)	
Purchase of property, plant and equipment	(59,781)	(24,405)
	(111,945)	37,427
Cash flows from (used in) financing activities		
Decrease in employee stock option receivable	-	1,000
Proceeds from exercise of warrants	8,000	16,666
Increase in loans to (from) a director	194,317	(338,341)
	202,317	(320,675)
Net decrease in cash	(690,912)	(427,225)
Cash at beginning of period	771,940	1,343,167
Cash at end of period	$ 81,028	$ 915,942

1. Corporate Information:

Kraken Sonar Inc. ("Kraken" or the "Company") (formerly Anergy Capital Inc.) incorporated on May 14, 2008 under the *Business Corporations Act, British Columbia*), is a publicly traded company, and its registered office is located at Suite 700, 595 Burrard Street, PO Box 49290, Vancouver, BC V7X 1S8.

The Company was incorporated as Anergy Capital Inc. ("Anergy") under the Business Corporations Act, British Columbia and was classified as a Capital Pool Company ("CPC") as defined under Policy 2.4 of the TSX Venture Exchange. The principal business of the Company at that time was the identification of an asset or business acquisition that would meet the requirements as a Qualifying Transaction ("QT") as defined in Policy 2.4.

On February 18, 2015 the Company closed its Qualifying Transaction pursuant to an agreement between Anergy and Kraken Sonar Systems Inc., and Anergy changed its name to Kraken Sonar Inc. (together, "the Company").

The Company's principal business is the design, manufacture and sale of underwater sonar and acoustic sensor equipment.

2. Going concern:

These condensed consolidated interim financial statements have been prepared on a going concern basis, which assumes the Company will continue in operation for the foreseeable future and be able to realize its assets and discharge its liabilities and commitments in the normal course of business. In assessing whether the going concern assumption is appropriate, management takes into account all available information about the future, which is at least, but is not limited to, twelve months from the end of the reporting period. Management is aware, in making its assessment, of material uncertainties related to events or conditions that cast significant doubt upon the Company's ability to continue as a going concern, as the Company experienced significant losses and negative cash flows from operations since inception and at June 30, 2016 has a deficit of $4,134,690 (December 31, 2015 - $3,541,833).

The ability of the Company to continue as a going concern and to realize its assets and discharge its liabilities when due is dependent on its ability to achieve and maintain profitable operations and positive cash flows from operations in the future and/or upon securing additional financing. Subsequent to the end of the second quarter, the Company completed a private placement financing that raised gross proceeds of $1,073,930 (note 17). The timing and availability of additional financing will be determined largely by the performance of the Company and market conditions and there is no certainty that the Company will be able to raise funds as they are required in the future.

These condensed consolidated interim financial statements do not reflect adjustments that would be necessary if the going concern assumption were not appropriate. If the going concern basis was not appropriate, then adjustments would be necessary in the carrying amount of assets and liabilities, the reported revenues and expenses, and the statement of financial position classifications used.

3. Basis of presentation:

(a) Statement of compliance:

These condensed consolidated interim financial statements, including comparatives, have been prepared in accordance with IAS 34, Interim Financial Reporting as issued by the International Accounting Standards Board ("IASB"). These financial statements were prepared using the same accounting policies and methods of computation, and are subject to the same use of estimates and judgments, as the Company's consolidated financial statements for the year ended December 31, 2015, except as noted in note 4(a) below.

These condensed consolidated interim financial statements do not include all disclosures required by International Financial Reporting Standards ("IFRS") for annual consolidated financial statements and accordingly should be read in conjunction with the Company's audited consolidated financial statements for the year ended December 31, 2015 prepared in accordance with IFRS as issued by the IASB.

These condensed consolidated interim financial statements were approved by the Board of Directors on August 26, 2016.

4. Significant accounting policies:

(a) Investments:

The investments in equity instruments that do not have a quoted price in an active market and for which fair value cannot be reliably measured, are initially recorded at fair value at the date of acquisition and are subsequently recorded at cost.

(b)Application of new or revised IFRS and interpretations:

The following standards and amendments to existing standards have been adopted by the Company effective January 1, 2016:

Transfer of assets between an investor and its associate or joint venture:

The Amendments address an acknowledged inconsistency between the requirements in IFRS 10 and those in IAS 28 (2011), in dealing with the sale or contribution of assets between an investor and its associate or joint venture. The Company intends to adopt these amendments in its consolidated financial statements for the annual period beginning on January 1, 2016. The adoption of these amendments did not have any impact on the condensed consolidated interim financial statements.

Annual Improvements to IFRS (2012-2014) cycle:

In September 2014, the IASB issued narrow-scope amendments to a total of four standards as part of its annual improvements process. The Company intends to adopt these amendments in its consolidated financial statements for the annual period beginning on January 1, 2016. The adoption of the amendments did not have a material impact on the condensed consolidated interim financial statements.

Disclosure Initiative (Amendments to IAS 1):

In December 2014, the IASB issued amendments to IAS 1 Presentation of Financial Statements as part of its major initiative to improve presentation and disclosure in financial reports. These amendments will not require any significant change to current practice, but should facilitate improved financial statement disclosure. The adoption of these amendments did not have any impact on the condensed consolidated interim financial statements

Business combination accounting for interest in a joint operation (Amendments to IFRS 11):

The amendments require business combination accounting to be applied to acquisitions of interest in a joint operation that constitute a business. The adoption of the amendments to IFRS 11 did not have a significant impact on the Company's condensed consolidated interim financial statements.

(c) Future changes in accounting policies:

A number of new standards, and amendments to standards and interpretations under IFRS, are not yet effective for the year ended December 31, 2016, and have not been applied in preparing these condensed consolidated financial statements.

IFRS 15, Revenue from Contracts with Customers:

The standard contains a single model that applies to contracts with customers and two approaches to recognizing revenue: at a point in time or over time. The model features a contract-based five-step analysis of transactions to determine whether, how much and when revenue is recognized. New estimated and judgmental thresholds have been introduced, which may affect the amount and/or timing of revenue recognized. The Company intends to adopt IFRS 15 in its consolidated financial statements for the annual period beginning on January 1, 2018. The extent of the impact of adoption of the standard has not yet been determined.

4. Significant accounting policies (continued):

(c) Future changes in accounting policies (continued):

IFRS 9, Financial Instruments:

IFRS 9, Financial Instruments, will replace IAS 39, Financial Instruments: Recognition and Measurement, and some of the requirements of IFRS 7, Financial Instruments: Disclosures. The Objective of IFRS 9 is to establish principles for the financial reporting of financial assets and financial liabilities that will present relevant and useful information to users of financial statements for their assessment of the amounts, timing and uncertainty of an entity's future cash flows. The IASB has determined the revised effective date for IFRS 9 will be for annual periods beginning on or after January 1, 2018. The Company will evaluate the impact of the change to the consolidated financial statements based on the characteristics of financial instruments outstanding at the time of adoption.

IFRS 16, Leases:

In January 2016, the IASB issued IFRS 16 *Leases*. This standard introduces a single lessee accounting model and requires a lessee to recognize assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value. A lessee is required to recognize a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments. This standard substantially carries forward the lessor accounting requirements of IAS 17, while requiring enhanced disclosures to be provided by lessors. Other areas of the lease accounting model have been impacted, including the definition of a lease. Transitional provisions have been provided. The new standard is effective for annual periods beginning on or after January 1, 2019. The Company is currently evaluating the impact of this standard on the consolidated financial statements.

5. Cash and cash equivalents

Cash and cash equivalents consist of the following:

	June 30, 2016	**December 31, 2015**
Cash	**$ 81,028**	$ 653,212
Demand deposit	**-**	118,728
	$ 81,028	$ 771,940

As at December 31, 2015, the Company's demand deposit consisted of an advance payment guarantee from the Royal Bank of Canada. The demand deposit was security against a letter of credit and expired on January 31, 2016.

6. Trade and other receivables:

Trade and other receivables consist of the following:

	June 30, 2016	**December 31, 2015**
Trade receivables	**$ 671,368**	$ 520,345
Allowance for doubtful accounts	**(175,863)**	(175,863)
Government assistance receivable and other	**51,320**	32,089
	$ 546,825	$ 376,571

7. Investment

As at June 30, 2016, the Company had entered into an agreement with Square Robot, Inc., a private US-based company, in respect of the co-design of small robots for large above ground storage tanks. Pursuant to the agreement, as at June 30, 2016, the Company had invested US$40,000 with two remaining payments of US$40,000 each to be made in Q3, 2016. The investment is recorded at cost.

	USD	**CAD**
Investment	$ 40,000	$ 52,164

8. Financial instruments:

Credit Risk:

The carrying amount of financial assets represents the maximum credit exposure. The maximum exposure to credit risk at the reporting date was:

	June 30, 2016	**December 31, 2015**
Cash and cash equivalents	**$ 81,028**	$ 771,940
Trade and other receivables	**546,825**	376,571
Share subscription receivable	**76,833**	76,833
Loans receivable from a director	**-**	194,317
	$ 704,686	$ 1,419,661

The Company manages credit risk by holding the majority of its cash with high quality financial institutions in Canada, where management believes the risk of loss to be low.

Revenues from the top 3 customers represented 100% and 97% of the Company's revenue in the three and six months ended June 30, 2016, respectively (2015 - 100 % and 85%). At June 30, 2016, 92% of the trade receivables balance were owing from 4 customers (2015 – 88% of the trade receivables was owing from 3 customers). At June 30, 2016, an amount of $175,863 (2015 - $Nil) was recorded as an allowance for doubtful accounts.

The share subscription receivables relate to the exercise price for options issued to employees and subsequently exercised, and are recorded as a reduction of share capital.

Liquidity Risk:

Liquidity risk is the risk that the Company will encounter difficulty in meeting the obligations associated with its financial liabilities that are settled by delivering cash or another financial asset. The Company's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions. As of June 30, 2016, the Company had a cash and cash equivalents balance of $81,028 (December 31, 2015 - $771,940), of which $Nil (December 31, 2015 - $118,728) was restricted and held as a demand deposit, to settle current liabilities of $1,254,272 (December 31, 2015 - $1,074,373). Refer to note 2.

Market Risk:

Market risk is the risk of loss that may arise from changes in market factors such as interest rates, foreign exchange rates, and commodity and equity prices.

(a) Interest rate risk

At June 30, 2016, the Company has cash balances of $81,028 and convertible debt was converted into common shares during fiscal 2015 so the Company is not exposed to any significant interest rate risk.

8. Financial instruments (continued):

Market Risk (continued):

(b) Foreign currency risk

The Company's exposure to foreign currency risk is limited to US$ sales and certain purchases of inventory. The Company does not use any form of hedging against fluctuations in foreign exchange.

The Company's exposure to foreign currency risk was as follows:

	June 30, 2016	December 31, 2015
Financial liabilities denominated in foreign currency:		
Trade and other payables USD	$ 88,108	$ 14,681
Trade and other payables in GBP	55,862	-
Trade and other payables in EUR	1,555	-
Trade and other payables in AUD	8,438	-

For the three and six months ended June 30, 2016, with other variables remaining constant, a 10% increase (decrease) in the exchange rate of the US dollar, British Pound, Euro and Australian dollar to the Canadian dollar would have increased (decreased) the Company's deficit by approximately $11,600 and $22,300, respectively.

Fair Value:

During the six months ended June 30, 2016, there were no transfers between level 1, level 2 and level 3 classified assets and liabilities. The fair values of the Company's financial instruments are considered to approximate the carrying amounts. The following table provides the disclosures of the fair value and the level in the hierarchy:

June 30, 2016	Level 1	Level 2	Level 3
Financial assets classified as loans and receivables:			
Cash and cash equivalents	$ 81,028	$ -	$ -
Trade and other receivables	-	546,825	-
Share subscription receivables	-	76,833	-
Loans to director	-	-	-
Financial liabilities at amortized cost:			
Trade and other payables	-	1,194,044	-

December 31, 2015	Level 1	Level 2	Level 3
Financial assets classified as loans and receivables:			
Cash and cash equivalents	$ 771,940	$ -	$ -
Trade and other receivables	-	376,571	-
Share subscription receivables	-	76,833	-
Loans to director	-	194,317	-
Financial liabilities at amortized cost:			
Trade and other payables	-	872,509	-

9. Related party transactions:

(a) Loans receivable from a director are unsecured, and bear interest at 5% per annum. The terms of the arrangement are as agreed to between the parties. The loans were repaid on April 22, 2016.

9. Related party transactions (continued):

(b) Compensation of key management personnel:

	Six months ended June 30, 2016	**Three months ended June 30, 2016**	Six months ended June 30, 2015	Three months ended June 30, 2015
Share-based payments	**$ 85,700**	**$ 27,700**	$ 72,059	$ -
Salaries	**198,750**	**96,250**	116,667	66,667
Short-term benefits	**11,644**	**3,999**	8,159	4,084

Included in share subscription receivables at June 30, 2016 is $60,608 (December 31, 2015 - $60,608) owing from key management personnel.

10. Share capital:

Authorized:

Unlimited number of common shares

On October 3, 2014, the Company completed a consolidation of its issued and outstanding common shares on 6.19:1 basis, reducing the issued and outstanding common shares to 40,416,667 from 250,000,000.

See the consolidated interim statements of changes in shareholders' equity (deficiency) for a summary of changes in Share capital and Contributed surplus for the periods ended June 30, 2016 and 2015.

(a) Share purchase warrants

On February 18, 2015, as part of the RTO (note 1) the lenders of a $2,109,500 bridge loan to Kraken Sonar Systems Inc. converted the indebtedness into 14,063,326 common shares in the Company. On conversion of the bridge loan, the lenders also received share purchase warrants convertible into the same number of shares exercisable at a price of $0.15 per warrant for a period of thirty-six (36) months from the date of issuance.

There are two outstanding grants of warrants issued pursuant to a private placement completed by Anergy in October 2014, prior to completion of the RTO:

i) Each full Warrant A warrant entitles the holder thereof to acquire one common share of the Company at a price of $0.15 after adjusting for the consolidation (or $0.0666666 prior to consolidation). The warrants expire twenty-four (24) months after the date of issue, provided that where the volume weighted average price of the shares of the Company trade at or above $0.45 for twenty (20) consecutive trading days, the term of the Warrant A warrants shall expire thirty (30) days following the date of issue of a news release announcing such occurrence. During the year ended December 31, 2015, 111,111 (2014 – $Nil) warrants were exercised for proceeds of $16,666 (2014 - $Nil). During the six months ended June 30, 2016, an additional 53,333 warrants were exercised for proceeds of $8,000.

ii) Each full Warrant B warrant entitles the holder to acquire one common share at a price of $0.40 after adjusting for the consolidation (or $0.17777777 prior to consolidation). The warrants expire twenty-four (24) months after the date of issue, provided that where the volume weighted average price of the shares of the Company trade at or above $0.60 for twenty (20) consecutive trading days, the term of the Warrant B warrants shall expire thirty (30) days following the date of issue of a news release announcing such occurrence. There were no warrant exercises during the six months ended June 30, 2016.

Share purchase warrant transactions are summarized for the year ending December 31, 2015. As Kraken Sonar Systems Inc. is the continuing entity for accounting purposes, the comparative figures presented herein are that of the private company which had no share purchase warrants outstanding for the six months ended June 30, 2016.

10. Share capital (continued):

(a) Share purchase warrants (continued)

	Six months ended June 30, 2016		Year ended December 31, 2015	
	Number of Warrants	Weighted Average Exercise Price	Number of Warrants	Weighted Average Exercise Price
Opening balance	14,841,103	$ 0.16	-	$ -
Anergy private placement 'A' warrants	-	-	444,444	0.15
Anergy private placement 'B' warrants	-	-	444,444	0.40
Issued on conversion of bridge loan	-	-	14,063,326	0.15
Warrants exercised	(53,333)	0.15	(111,111)	0.15
Ending balance	**14,787,770**	**$ 0.16**	**14,841,103**	**$ 0.16**
Warrants exercisable	**14,787,770**	**$ 0.16**	**14,841,103**	**$ 0.16**

At June 30, 2016, the following share purchase warrants were outstanding:

Expiry Date	Exercise Price	June 30, 2016	Weighted Average Remaining Contractual Life
October 10, 2016	$0.15	280,000	0.29 years
October 10, 2016	$0.40	444,444	0.29 years
February 18, 2018	$0.15	14,063,326	1.64 years
	$0.16	**14,787,770**	**0.74 years**

(b) Share options

The Company has a share option plan, under which the Board of Directors is authorized to grant options to employees, directors, officers and consultants, enabling them to acquire up to 10% of the issued and outstanding share capital of the Company. The exercise price of each option is based on the market price of the Company's share as calculated on the date of grant. The options can be granted for a maximum term of five years. Options granted to investor relations consultants are subject to vesting provisions, as established by regulatory authorities, over a twelve month period, with no more than ¼ vesting during any three month period. Vesting provisions for other options are determined by the Company's Board of Directors.

Prior to the RTO, Anergy had outstanding a total of 470,000 share options with an exercise price of $0.10 per share. Post-completion of the RTO, the options were consolidated on a 2.25:1 basis, resulting in 208,888 share options exercisable at $0.225 per share which expired unexercised on August 26, 2015.

The following options were outstanding as at June 30, 2016 and December 31, 2015:

	Six months ended June 30, 2016		Year ended December 31, 2015	
	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
Opening balance	4,260,000	$0.23	-	-
Granted	-	-	4,918,888	$ 0.22
Expired	-	-	(658,888)	0.24
Ending balance	**4,260,000**	**$ 0.23**	**4,260,000**	**$ 0.23**
Options exercisable	**2,076,666**	**$ 0.23**	**1,018,333**	**$ 0.23**

10. Share capital (continued):

(b) Share options (continued)

All share options had exercise prices that were higher or equal to market prices at the date of grant.

Weighted Average Exercise Price	Expiry Date	Number Outstanding	Number Exercisable	Weighted Average Remaining Contractual Life
$ 0.25	March 17, 2018	1,910,000	1,276,666	1.71 years
0.20	May 13, 2018	250,000	250,000	1.87 years
0.21	June 1, 2020	2,000,000	500,000	3.92 years
0.21	July 1, 2018	100,000	50,000	2.00 years
$ 0.23		**4,260,000**	**2,076,666**	**2.38 years**

(c) Share-based compensation

During the three and six month period ended June 30, 2016, the Company recorded share-based compensation totaling $32,500 and $102,600, respectively (2015 - $2,500 and $81,600), which was expensed in operations with a corresponding increase in contributed surplus.

The fair value of share options was estimated on the measurement date using the Black-Scholes option-pricing model and is amortized over the vesting period of the underlying options.

The fair values of the options granted were estimated using the Black-Scholes option pricing model with the following assumptions:

	Six months ended June 30, 2016	Year ended December 31, 2015
Risk-free interest rate	Nil	0.49 to 0.90%
Expected life of options	Nil	3 years
Expected volatility	Nil	98.96 to 106.93%
Weighted average fair value per option	Nil	$0.10 to $0.13
Dividend yield	Nil	Nil

(d) Escrowed shares

At June 30, 2016, there are a total of 30,601,764 (2015 – 45,922,646) common shares subject to escrow restrictions. The escrow shares will be released in tranches every six months until February 18, 2018.

11. Capital management:

The Company’s objectives when managing its capital are to maintain a financial position suitable for supporting its operations and growth strategies, to provide an adequate return to shareholders and to meet its current obligations.

The Company’s capital structure consists of shareholders’ equity (deficiency) and advances from directors. The Company makes adjustments to the capital structure depending on economic conditions, its financial position and performance. In order to maintain or adjust the capital structure, the Company may issue new shares, buyback shares or pay dividends, issue new debt and sell assets to reduce debt.

12. Cost of sales:

Included in cost of sales for the three and six months ended June 30, 2016 is inventory of $170,277 and $235,208, respectively (2015 - $168,040 and $349,167).

13. Government assistance:

During the three and six months ended June 30, 2016, the Company received government assistance in the amount of $289,968 and $575,667, respectively (2015 - $137,220 and $287,559) which has been recorded as a reduction of administrative expenses.

14. Change in non-cash working capital:

	June 30, 2016	June 30, 2015
Decrease (increase) in trade and other receivables	**$ (170,254)**	$ 175,141
Decrease (increase) in investment tax credit receivables	**-**	244,462
Decrease (increase) in inventory	**(334,527)**	153,438
Decrease (increase) in prepayments	**7,863**	14,214
Increase (decrease) in trade and other payables	**321,536**	(354,554)
Decrease in deferred revenue	**(141,636)**	(112,500)
	$ (317,018)	$ 120,201

15. Commitments:

The following is a summary of the minimum contractual obligations and commitments as at June 30, 2016:

	2016	2017
Operating lease	$ 56,792	$ 5,417

The current lease agreement expires on December 31, 2016 and provides the Company with an option to extend for one to three years at the current lease rate adjusted for Newfoundland and Labrador Consumer Price Index (CPI).

16. Segmented information:

The Company operates in one reportable operating segment, being the design, manufacture and sale of underwater sonar and acoustic sensor equipment. The summarized financial information for revenue derived by geographic location is as follows:

	Six months ended June 30, 2016	**Three months ended June 30, 2016**	Six months ended June 30, 2015	Three months ended June 30, 2015
Total revenues:				
United States	**$ 122,169**	**$ 122,169**	$ 778,334	$ 336,790
Germany	**425,052**	**1,774**	150,000	-
France	**91,332**	**-**	-	-
Israel	**509,418**	**313,696**	79,925	79,925
Other	**28,263**	**27,904**	94,335	-
	$ 1,176,233	**$ 465,543**	$ 1,102,594	$ 416,715

17. Subsequent events:

Subsequent to June 30, 2016, the Company:

(a) completed a non-brokered private placement of 7,159,534 units priced at $0.15 per unit for aggregate gross proceeds of $1,073,930. Each unit consists of one common share and one-half of one common share purchase warrant with each whole common share purchase warrant entitling the holder thereof to acquire an additional common share of the Company at a price of $0.30 for a period of 24 months. Cash finder's fees of $18,025 were paid in connection with the placement; and,

(b) entered into a debt settlement agreement with an arms' length creditor whereby it will issue 233,333 common shares from treasury at a deemed price of $0.15 per share and 116,666 share purchase warrants exercisable at $0.30 per warrant for a period of 24 months to settle debt of $35,000.