

# Kraken Sonar Inc.

(formerly Anergy Capital Inc.)



## Condensed Consolidated Interim Financial Statements

For the three and nine months ended September 30, 2015 and 2014  
(Expressed in Canadian Dollars)

**Q3 Fiscal 2015**

## **NOTICE TO READER**

Under National Instrument 51-102, Part 4, subsection 4.3(3)(a) issued by the Canadian Securities Administrators, if an auditor has not performed a review of the interim financial statements, they must be accompanied by a notice indicating that the financial statements have not been reviewed by an auditor.

The accompanying unaudited condensed consolidated interim financial statements of Kraken Sonar Inc. as at September 30, 2015 and for the three and nine months ended September 30, 2015 and 2014, notes to unaudited condensed consolidated interim financial statements and related Management's Discussion and Analysis have been prepared by and are the responsibility of management.

The Company's independent auditor has not performed a review of these condensed consolidated interim financial statements in accordance with the standards established by the Chartered Professional Accountants - Canada for a review of interim financial statements by an entity's auditor.



June 30, 2015

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

	September 30, 2015	December 31, 2014
<b>ASSETS</b>		
Current assets:		
Cash (note 6)	\$ 682,065	\$ 1,343,167
Trade and other receivables (note 7)	559,421	851,957
Loans receivable from a director (note 10)	191,947	-
Investment tax credits recoverable (note 8)	-	244,462
Inventory, work in progress	313,227	329,371
Prepayments	10,461	45,000
	<b>1,757,121</b>	<b>2,813,957</b>
<b>Property and equipment, net</b>	<b>181,832</b>	<b>129,346</b>
<b>TOTAL ASSETS</b>	<b>\$ 1,938,953</b>	<b>\$ 2,943,303</b>

**LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIENCY)**

Current Liabilities:		
Trade and other payables	\$ 586,173	\$ 744,366
Deferred revenue	-	112,500
Convertible debt (note 12)	-	2,045,129
Loans from director	-	148,764
	<b>586,173</b>	<b>3,050,759</b>
Shareholders' equity (deficiency):		
Equity portion of convertible debt (note 12)	-	215,317
Share capital (note 11)	3,072,426	1,226,650
Contributed Surplus	1,395,410	-
Deficit	(3,115,056)	(1,549,423)
	<b>1,352,780</b>	<b>(107,456)</b>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIENCY)</b>	<b>\$ 1,938,953</b>	<b>\$ 2,943,303</b>

Corporate information (note 1)  
Going concern (note 2)  
Commitments (note 17)  
Subsequent events (note 19)

**On Behalf of the Board:**

"Karl Kenny"

Director

"Roman Kocur"

Director



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

	Three months ended		Nine months ended	
	Sept 30, 2015	Sept 30, 2014	Sept 30, 2015	Sept 30, 2014
Product sales	<b>\$493,558</b>	\$317,830	<b>\$1,596,152</b>	\$1,328,128
Contract research	-	18,500	-	279,725
Cost of sales (note 14)	<b>187,050</b>	184,376	<b>820,757</b>	751,913
	<b>306,508</b>	151,954	<b>775,395</b>	855,940
Administrative expenses	<b>327,863</b>	241,700	<b>770,616</b>	715,470
Share-based payments (note 11)	<b>7,100</b>	-	<b>88,700</b>	-
Employee costs	<b>365,477</b>	107,392	<b>670,170</b>	259,498
Investment tax credit recoverable	-	(176,000)	-	(176,000)
RTO Listing expense (note 5)	-	-	<b>526,695</b>	-
	<b>700,440</b>	173,092	<b>2,056,181</b>	798,968
<b>(Loss) income from operating activities</b>	<b>(393,932)</b>	(197,138)	<b>(1,280,786)</b>	56,972
Transaction costs (note 5)	-	-	<b>225,000</b>	-
Finance costs	-	40,907	<b>59,847</b>	59,629
<b>Net loss, being comprehensive loss</b>	<b>\$(393,932)</b>	\$ (62,045)	<b>\$(1,565,633)</b>	\$ (2,657)
Basic and diluted income (loss) income per share	<b>\$ (0.01)</b>	\$(0.00)	<b>\$ (0.02)</b>	\$(0.00)
Basic and diluted weighted average number of shares outstanding	<b>71,068,214</b>	40,416,667	<b>67,526,666</b>	40,416,667



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

<b>2015</b>						
	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)
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 (notes 11 & 12)	14,063,326	1,008,293	1,312,000	(215,317)	-	2,104,976
Issue of common shares as Finder's fee (note 5)	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	-	2,000	-	-	-	2,000
Share-based compensation	-	-	88,700	-	-	88,700
Net loss	-	-	-	-	(1,565,633)	(1,565,633)
<b>Shareholders' equity (deficiency) as at September 30, 2015</b>	<b>71,068,214</b>	<b>\$ 3,072,426</b>	<b>\$ 1,395,410</b>	<b>\$ -</b>	<b>\$ (3,115,056)</b>	<b>\$ 1,352,780</b>
<b>2014</b>						
	Number of Shares	Share capital (Note 10)	Contributed Surplus	Equity portion of convertible debt	Deficit	Total
Balance at January 1, 2014	40,416,667	\$ 150	\$ -	\$ -	\$ (239,183)	\$ (239,033)
Issuance of convertible debt (note 12)	-	-	-	163,667	-	163,667
Net loss	-	-	-	-	(2,657)	(2,657)
<b>Shareholders' equity (deficiency) as at September 30, 2014</b>	<b>40,416,667</b>	<b>\$ 150</b>	<b>\$ -</b>	<b>\$ 163,667</b>	<b>\$ (241,840)</b>	<b>\$ (78,023)</b>

The accompanying notes are an integral part of these unaudited condensed consolidated interim financial statements.



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

	9 months ended Sept 30, 2015	9 months ended Sept 30, 2014
<b>Cash flows used in operating activities</b>		
Net loss	\$ (1,565,633)	\$ (2,657)
<b>Adjustments for items not involving cash:</b>		
Depreciation	23,715	5,693
Finance costs	59,847	59,629
Interest paid	-	(21,703)
Share-based payments	88,700	-
RTO consideration included in listing expenses (note 5)	526,695	-
Transaction costs – finder’s fee (note 5)	225,000	-
Changes in non-cash working capital (note 16)	316,988	(221,366)
<b>Net cash flows used in operating activities</b>	<b>(324,688)</b>	<b>(180,404)</b>
<b>Cash flows from (used in) investing activities</b>		
Cash acquired on RTO (note 5)	61,832	-
Purchase of property, plant and equipment	(76,202)	(81,171)
	<b>(14,370)</b>	<b>(81,171)</b>
<b>Cash flows from (used in) financing activities</b>		
Decrease in employee stock option receivable	2,000	-
Proceeds from exercise of warrants	16,667	-
Proceeds from issuance of convertible debt (note 12)	-	1,605,000
Increase (decrease) in loans to (from) a director	(340,711)	(107,634)
	<b>(322,044)</b>	<b>1,497,366</b>
<b>Net change in cash</b>	<b>(661,102)</b>	<b>1,235,791</b>
<b>Cash at beginning of period</b>	<b>1,343,167</b>	<b>3,361</b>
<b>Cash at end of period</b>	<b>\$ 682,065</b>	<b>\$ 1,239,152</b>



**Notes to the Condensed Consolidated Interim Financial Statements  
(Unaudited)  
For the Nine Months Ended September 30, 2015**

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**1. Corporate Information:**

Kraken Sonar Inc. ("Kraken" or the "Company") (formerly Anergy Capital Inc.) was 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") (note 5).

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

**2. Going concern:**

These unaudited 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 September 30, 2015 has a deficit of \$3,115,056 (December 31, 2014 - \$1,549,423).

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. 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 unaudited 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 unaudited condensed consolidated interim financial statements are prepared in accordance with International Accounting Standard ("IAS") 34, Interim Financial Reporting ("IAS 34") as issued by the International Accounting Standards Board ("IASB") and the accounting policies the Company has adopted in accordance with International Financial Reporting Standards ("IFRS"). These unaudited condensed consolidated interim financial statements were prepared using the same accounting policies, estimates and methods of computation as Kraken Sonar Systems Inc.'s financial statements for the year ended December 31, 2014. These unaudited condensed consolidated interim financial statements should be read in conjunction with Kraken Sonar System's financial statements for the year ended December 31, 2014.





**Notes to the Condensed Consolidated Interim Financial Statements  
(Unaudited)  
For the Nine Months Ended September 30, 2015**

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**3. Basis of presentation (continued):**

(a) Statement of compliance (continued):

These unaudited condensed consolidated interim financial statements reflect all adjustments that are, in the opinion of management, necessary to present fairly, the Company's financial position as at September 30, 2015 and financial performance, comprehensive loss and cash flows for the three and nine months ended September 30, 2015 and 2014.

These financial statements were approved and authorized for issue by the Board of Directors on November 27, 2015.

(b) Basis of measurement:

These financial statements have been prepared on a historical cost basis.

The financial statements are presented in Canadian dollars, which is the Company's functional and presentation currency.

(c) Accounting estimates and judgments:

The preparation of financial statements in accordance with IFRS requires management to make estimates and judgments that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates and may have an impact on future periods. The more significant areas requiring the use of management estimates and judgments are discussed below:

i) Estimates of useful lives of property and equipment

Useful lives and residual value of property and equipment are reviewed by management on a regular basis to ensure assumptions are still valid. Property and equipment is reviewed for impairment whenever events or changes in circumstances indicate that the carrying value may not be fully recoverable. If an asset's recoverable amount is less than the asset's carrying amount, an impairment loss is recognized.

Any changes in estimates would impact the economic useful lives and the residual values of the assets and, therefore, future depreciation charges could be revised.

ii) Recovery of deferred tax assets

Deferred tax assets, including those arising from tax loss carry-forwards, capital losses and temporary differences are recognized only where it is considered probable that they will be recovered, which is dependent on the generation of sufficient future taxable profits. Assumptions about the generation of future taxable profits depend on management's estimates of future cash flows.

Judgments are also required about the application of income tax legislation. These judgments and assumptions are subject to risk and uncertainty, hence there is a possibility that changes in circumstances will alter expectations, which may impact the amount of deferred tax assets and deferred tax liabilities recognized on the statement of financial position and the amount of other tax losses and temporary differences not yet recognized. In such circumstances, some or all of the carrying amounts of recognized deferred tax assets and liabilities may require adjustment, resulting in a corresponding credit or charge to the statement of net income (loss) and comprehensive income (loss).



**Notes to the Condensed Consolidated Interim Financial Statements  
(Unaudited)  
For the Nine Months Ended September 30, 2015**

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**3. Basis of presentation (continued):**

(c) Accounting estimates and judgments (continued):

iii) Investment tax credits

Investment tax credits arise from claims filed under the Scientific Research and Experimental Development related to qualifying expenditures on research and development. Judgments are required about the recoverability of amounts claimed under the program, which are subject to assessment and audit by the Canada Revenue Agency. As the result of such assessments or audits, the amounts of recognized investment tax credits may require adjustment, which would typically result in a corresponding decrease (increase) in net income (loss) and comprehensive income (loss).

iv) Compound financial instruments

The Company presents convertible debentures separately in its debt and equity components on the statement of financial position. The fair value of a compound instrument at issuance is assigned to its respective debt and equity components. The fair value of the liability component is established first, using an interest market rate for a similar borrowing that does not include an equity component. The equity component is determined by deducting the fair value of the liability component from the fair value of the compound instrument as a whole. Thus, the estimate for determining the fair value of the conversion option included in convertible debentures could affect interest expense for the year recorded in the financial statements if it was inadequate.

v) Share-based payments

The amounts recorded for share-based compensation are based on estimates. The Black Scholes model is used to estimate the fair value of stock options at the date of grant based on estimates of assumptions for share price, expected volatility, expected number of options to vest, dividend yield, risk-free interest rate, expected forfeitures and expected life of the options. Changes in these assumptions may result in a material change to the amounts recorded for the issuance of stock options.

**4. Significant accounting policies:**

(a) Revenue recognition:

i) Sale of goods:

Revenue from the sale of goods is recognized when the significant risks and rewards of ownership have transferred to the customer, recovery of the consideration is probable, the associated costs and possible return of goods can be estimated reliably, there is no continuing management involvement with the goods, and the amount of revenue can be estimated reliably.

ii) Contract research:

The Company recognizes revenue from rendering of services in proportion to the stage of completion of the transaction at the reporting date. The stage of completion is assessed based on surveys of work performed.

(b) Government grants:

Government grants are initially recognized as deferred income at fair value if there is reasonable assurance that they will be received and the Company will comply with the conditions associated with the grant; they are netted against the cost of the associated assets.

Grants that compensate the Company for expenses incurred are recognized in profit or loss on a systematic basis in the periods in which the expenses are recognized.



**Notes to the Condensed Consolidated Interim Financial Statements  
(Unaudited)  
For the Nine Months Ended September 30, 2015**

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**4. Significant accounting policies (continued):**

(c) Foreign currency transactions:

Transactions in foreign currencies other than the Company's functional currency (foreign currencies) are recognized at the rates of exchange prevailing at the dates of the transactions. At the end of each reporting period, monetary items denominated in foreign currencies are retranslated at the rates prevailing at that date. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

Exchange differences on monetary items are generally recognized in profit or loss in the period in which they arise.

(d) Income tax:

Income tax expense comprises current and deferred tax. Current tax and deferred tax are recognized in profit or loss except to the extent that it relates to a business combination, or items recognized directly in equity or in other comprehensive income.

Current tax is the expected tax payable or receivable on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantively enacted by the reporting date and are expected to apply when the related deferred income tax asset is realized or the deferred income tax liability is settled.

Deferred income tax assets are recognized to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilized. Deferred tax is not recognized for the following temporary differences: the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit or loss, and differences relating to investments in subsidiaries and jointly controlled entities to the extent that it is probable that they will not reverse in the foreseeable future. In addition, deferred tax is not recognized for taxable temporary differences arising on the initial recognition of goodwill.

(e) Inventories:

Inventories are recorded at the lower of cost and net realizable value. Cost is determined on a first-in, first-out basis.

(f) Property and equipment:

All items of property and equipment are measured at historical cost less accumulated depreciation and accumulated impairment losses.

Cost includes expenditures that are directly attributable to the acquisition of the asset. Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognized. The costs of the day-to-day servicing of property and equipment are recognized in profit or loss as incurred.

Depreciation is calculated using to allocate their cost, net of estimated residual values, over their estimated useful lives using the following methods and at the following annual rates:



**Notes to the Condensed Consolidated Interim Financial Statements  
(Unaudited)  
For the Nine Months Ended September 30, 2015**

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**4. Significant accounting policies (continued):**

(f) Property and equipment (continued):

Asset	Basis	Rate
Computer equipment	Declining balance	50%
Leasehold improvements	Straight-line	20%
Computer software	Straight-line	20%
Furniture and fixtures	Declining balance	20%
Tools and equipment	Straight-line	10%

Depreciation methods, useful lives and residual values are reviewed at each financial year end and adjusted prospectively, if appropriate.

(g) Research and development:

Research costs are expensed as incurred. Development costs are capitalized only if the expenditure can be measured reliably, the product or process is technically and commercially feasible, future economic benefits are probable and the Company intends to and has sufficient resources to complete development and to use or sell the asset. Otherwise, such costs are expensed as incurred. Subsequent to initial recognition, development costs are measured at cost less accumulated amortization and any accumulated impairment losses. To date, no development costs have been capitalized.

(h) Financial instruments:

i) Financial assets

The Company initially recognizes loans and receivables and deposits on the date that they originate. All other financial assets are recognized initially on trade date at which the Company becomes party to the contractual provision of the instrument.

The Company derecognizes a financial asset when the contractual rights to the cash flows from the asset expire, or the rights to receive the contractual cash flows on the financial asset are transferred.

The Company has the following non-derivative financial assets: loans and receivables.

*Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are recognized initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition loans and receivables are measured at amortized cost using the effective interest method, less any impairment losses.

Loans and receivables comprise cash and trade and other receivables.

Cash comprises cash on hand and balances on deposit with Tier 1 Canadian chartered banks.

Fair Value:

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value hierarchy establishes three levels to classify the inputs to valuation techniques used to measure fair value.

Level 1: Inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities.



**Notes to the Condensed Consolidated Interim Financial Statements  
(Unaudited)  
For the Nine Months Ended September 30, 2015**

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**4. Significant accounting policies (continued):**

(h) Financial instruments (continued):

i) Financial assets (continued)

Level 2: Inputs are quoted prices in markets that are not active, quoted prices for similar assets or liabilities in active markets, inputs other than quoted prices that are observable for the asset or liability (for example, interest rate and yield curves observable at commonly quoted intervals, forward pricing curves used to value currency and commodity contracts, volatility measurements used to value option contracts and observable credit default swap spreads to adjust for credit risk where appropriate), or inputs that are derived principally from or corroborated by observable market data or other means.

Level 3: Inputs are unobservable (supported by little or no market activity).

The fair value hierarchy gives the highest priority to Level 1 inputs and the lowest priority to Level 3 inputs.

ii) Financial liabilities

The Company initially recognizes other financial liabilities on the trade date at which the Company becomes party to the contractual provisions of the instrument. Such financial liabilities are recognized initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition, these financial liabilities are measured at amortized cost using the effective interest method.

The Company derecognizes financial liabilities when its contractual obligations are discharged or cancelled or expire.

The Company has the following non-derivative other financial liabilities: trade and other payables, due to shareholder and convertible debt.

iii) Share capital

Common shares are classified as equity. Incremental costs directly attributable to the issue of common shares and share options are recognized as a deduction from equity, net of any tax effects.

(i) Impairment:

i) Financial assets (including receivables)

Financial assets, other than those at fair value through profit or loss, are assessed for objective evidence of impairment at the end of each reporting period. Financial assets are considered to be impaired when there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows have been affected.

For financial assets carried at amortized cost, the amount of the impairment loss recognized is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate. Losses are recognized in profit or loss and reflected in an allowance account against accounts receivable. When a subsequent event causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through profit or loss.

ii) Non-Financial assets

The carrying amounts of the Company's non-financial assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indications exist, the asset's recoverable amount is estimated.



**Notes to the Condensed Consolidated Interim Financial Statements  
(Unaudited)  
For the Nine Months Ended September 30, 2015**

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**4. Significant accounting policies (continued):**

(i) Impairment (continued):

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For the purpose of impairment testing, assets are grouped together into the smallest group of assets which generates cash inflows from continuing use that is largely independent of the cash inflows of other assets or groups of assets (the “cash-generating-unit” or “CGU”).

(j) Earnings (loss) per share:

The Company presents basic and diluted earnings (loss) per share for its common shares. Basic earnings (loss) per share is calculated by dividing the profit or loss attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the period. Diluted earnings (loss) per share is determined by adjusting the profit or loss attributable to common shareholders and the weighted average number of shares outstanding adjusted for the effects of all dilutive potential common shares.

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

***Annual Improvements to IFRS:***

Amendments were made to clarify the following in their respective standards: the definition of “vesting condition” in IFRS 2 “Share-based payment”; classification and measurement of contingent consideration and scope exclusion for the formation of joint arrangements in IFRS 3, “Business combinations”; measurement of short-term receivables and payables and scope of portfolio exception in IFRS 13, “Fair value measurement”; definition of “related party” in IAS 24, “Related party disclosure”; and inter-relationship of IFRS 3 and IAS 40 in IAS 40, “Investment property”. Special transitional requirements have been set for amendments to IFRS 2 and IAS 40. The amendments became effective on January 1, 2015. The adoption of these changes did not have a significant impact on the Company’s financial statements.

(l) 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, 2015, and have not been applied in preparing these 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 Company intends to adopt the amendments to IFRS 11 in its financial statements for the annual period beginning on January 1, 2016. The extent of the impact of adoption of the amendments has not yet been determined.

***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 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.



**Notes to the Condensed Consolidated Interim Financial Statements  
(Unaudited)  
For the Nine Months Ended September 30, 2015**

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**4. Significant accounting policies (continued):**

(l) 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 financial statements based on the characteristics of financial instruments outstanding at the time of adoption.

***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 financial statements for the annual period beginning on January 1, 2016. The extent of the impact of adoption of the amendments has not yet been determined.

***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 financial statements for the annual period beginning on January 1, 2016. The extent of the impact of adoption of the amendments has not yet been determined.

***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 Company intends to adopt these amendments in its financial statements for the annual period beginning on January 1, 2016. The extent of the impact of adoption of the amendments has not yet been determined.

**5. Reverse Acquisition**

On February 18, 2015, Kraken Sonar Systems Inc. and Anergy Capital Inc., a company classified as a Capital Pool Company as defined under Policy 2.4 of the TSX Venture Exchange, completed a reverse take-over transaction ("RTO") through the closing of a Share Exchange Agreement ("SEA") dated November 20, 2014, as amended January 29, 2015. The SEA constitutes Anergy Capital Inc.'s Qualifying Transaction.

Under the terms of the SEA, Anergy issued 51,500,000 post-consolidated (2.25:1) common shares in exchange for the same number of common shares of Kraken Sonar Systems Inc. In addition, at the time of the RTO 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 and share purchase warrants convertible into the same number of shares. Anergy was subsequently renamed Kraken Sonar Inc. A finder's fee of 1,500,000 common shares of the Company issued at a deemed price of \$0.15 per share was paid in connection with the RTO for a total value of \$225,000 which was expensed in the three months ended March 31, 2015. Following completion of the transaction, the Company had an aggregate 70,957,103 common shares issued and outstanding.



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**5. Reverse Acquisition (continued)**

For accounting purposes the transaction constitutes a reverse acquisition, as the shareholders of Kraken Sonar Systems Inc. acquired control of the consolidated entity. Kraken Sonar Systems Inc. is considered the acquiring and continuing entity, and Anergy was the acquired entity. The unaudited consolidated interim financial statements are in the name of Kraken Sonar Inc. (formerly Anergy); however, these are a continuation of the financial statements of Kraken Sonar Systems Inc. The results of operations of Anergy are included in the unaudited consolidated interim financial statements of Kraken from the date of the reverse acquisition on February 18, 2015.

The following summarizes the reverse acquisition of Anergy by Kraken Sonar Systems Inc. and the net assets acquired and liabilities assumed at February 18, 2015.

Fair value of consideration paid to former Anergy holders of:	
Common shares (3,893,777 common shares @ \$0.15 per common share)	\$ 584,067
Options (note 11(c))	4,460
Total consideration	<u>\$ 588,527</u>
Identifiable assets acquired:	
Cash	61,832
RTO Listing expense	<u>\$ 526,695</u>

The transaction allowed Kraken Sonar Systems Inc., a private company, to obtain a listing on the TSX Venture Exchange without having to complete an initial public offering. As the acquisition was not considered a business combination, a total of \$526,695, being the excess of the fair value of the consideration paid to obtain the listing over the fair value of the net assets acquired, was recorded as a RTO listing expense in the condensed consolidated interim statement of loss and comprehensive loss.

**6. Cash**

Cash consists of the following:

	<b>September 30, 2015</b>	<b>December 31, 2014</b>
Cash	\$ 563,337	\$ 1,343,167
Demand deposit	118,728	-
	<u>\$ 682,065</u>	<u>\$ 1,343,167</u>

**7. Trade and other receivables:**

Trade and other receivables consist of the following:

	<b>September 30, 2015</b>	<b>December 31, 2014</b>
Trade receivables	\$ 478,408	\$ 729,754
Government assistance receivable	81,013	122,203
	<u>\$ 559,421</u>	<u>\$ 851,957</u>

**8. Investment tax credits recoverable:**

The Company has filed Scientific Research and Experimental Development (SR&ED) Expenditures Claims with the Canada Revenue Agency. At September 30, 2015, the Company is entitled to a refundable Federal Investment Tax Credit of approximately \$Nil (December 31, 2014 - \$115,021) and a refundable Provincial Investment Tax Credit of approximately \$Nil (December 31, 2014 - \$129,441).





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**9. 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:

	<b>September 30, 2015</b>	<b>December 31, 2014</b>
Cash	\$ 682,065	\$ 1,343,167
Trade and other receivables	559,421	851,957
Share subscription receivable	76,833	78,833
Loans receivable from a director	191,947	-
	<b>\$ 1,510,266</b>	<b>\$ 2,273,957</b>

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 99% of the Company's revenue in the three months ended September 30, 2015 (2014 – top 2 customers represented 82% of revenue). At September 30, 2015, 86% of the trade receivables balance was owing from 3 customers (2014 – 81% of the trade receivables was owing from 2 customers).

The share subscription receivables relate to the exercise price for options issued to employees 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 September 30, 2015, the Company had a cash balance of \$682,065 (December 31, 2014 - \$1,343,167) to settle current liabilities of \$586,173 (December 31, 2014 - \$3,050,759). 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 September 30, 2015, the Company has cash balances of \$682,065 and convertible debt was converted into common shares during Q1 2015 (note 12) so the Company is not exposed to any significant interest rate risk.

(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.



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**9. Financial instruments (continued):**

**Fair Value:**

During the three months ended September 30, 2015, 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:

<b>September 30, 2015</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
Financial assets classified as loans and receivables:			
Cash	\$ 682,065	\$ -	\$ -
Trade and other receivables	-	559,421	-
Share subscription receivables	-	76,833	-
Loans to director	-	191,947	-
Financial liabilities at amortized cost:			
Trade and other payables	-	586,173	-

**10. Related party transactions:**

- (a) Loans receivable from a director are unsecured, bear interest at 5% per annum, and are repayable as a lump sum payment of principal and interest on March 31, 2016. The loan is payable in whole or in part at any time prior to March 31, 2016 without penalty or premium.
- (b) Compensation of key management personnel:

	<b>September 30, 2015</b>	<b>June 30, 2014</b>
Share-based payments	\$ 72,059	\$ -

Included in share subscription receivables at September 30, 2015 is \$60,608 (December 31, 2014 - \$60,608) owing from key management personnel.

**11. 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 statements of changes in shareholders' deficiency for a summary of changes in Share capital and Reserves share based for the periods ended September 30, 2015 and 2014.

(a) Private placements

On October 14, 2014, Anergy closed a private placement for aggregate gross proceeds of \$200,000 by the issuance of 4,000,000 units priced at \$0.05 per unit. Each unit is comprised of one common share and one-fourth (1/4) of one Warrant A warrant and one-fourth (1/4) of one Warrant B warrant. A finder's fee of \$5,295 was paid in connection with a portion of the private placement. The Anergy private placement shares and share purchase warrants were subject to consolidation on a 2.25:1 basis pursuant to the terms of the RTO.



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**11. Share capital (continued):**

(a) Private placements (continued)

Subsequent to the RTO, 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.

Subsequent to the RTO, 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 A warrants shall expire thirty (30) days following the date of issue of a news release announcing such occurrence.

(b) Share purchase warrants

On February 18, 2015, as part of the RTO (note 5) 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.

Share purchase warrant transactions are summarized for the period ending September 30, 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 period ended December 31, 2014.

	<b>September 30, 2015</b>	
	Number of Warrants	Weighted Average Exercise Price
Opening balance, January 1, 2015	-	\$ -
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	(111,111)	0.15
Ending balance	14,841,103	\$ 0.16
Warrants exercisable	14,841,103	\$ 0.16

At September 30, 2015 the following share purchase warrants were outstanding:

Expiry Date	Exercise Price	Sept 30, 2015	Weighted Average Remaining Contractual Life
October 14, 2016	\$0.15	333,333	1.04 years
October 14, 2016	\$0.40	444,444	1.04 years
February 18, 2018	\$0.15	14,063,326	2.39 years
	<b>\$0.16</b>	<b>14,841,103</b>	<b>1.49 years</b>



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**11. Share capital (continued):**

(c) 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. 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 options outstanding for the period ended December 31, 2014.

The following options were outstanding as at September 30, 2015:

	<b>September 30, 2015</b>	
	Number of Options	Weighted Average Exercise Price
Opening balance, January 1, 2015	0	-
Granted	4,918,888	\$ 0.22
Cancelled	(571,388)	0.25
Ending balance	4,347,500	\$ 0.22
Options exercisable	793,333	\$ 0.23

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

<b>Weighted Average</b>		<b>Weighted Average</b>		
Exercise Price	Expiry Date	Number Outstanding	Number Exercisable	Remaining Contractual Life
\$ 0.25	March 17, 2018	1,972,500	705,833	2.46 years
0.25	April 9, 2018	25,000	25,000	2.53 years
0.20	May 13, 2018	250,000	-	2.62 years
0.21	June 1, 2020	2,000,000	-	4.67 years
0.21	July 1, 2018	100,000	-	2.75 years
<b>\$ 0.23</b>		<b>4,347,500</b>	<b>793,333</b>	<b>3.01 years</b>

(e) Share-based compensation

During the three and nine month periods ended September 30, 2015, the Company recorded share-based compensation totaling \$7,100 and \$88,700, respectively which was expensed in operations with a corresponding increase in reserves-share based.

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 assumptions used to calculate the fair value were as follows:



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**11. Share capital (continued):**

(e) Share-based compensation (continued)

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

	<b>September 30, 2015</b>
Risk-free interest rate	0.49%
Expected life of options	3 years
Expected volatility	101.28%
Weighted average fair value per option	\$0.10
Dividend yield	Nil

**12. Convertible debt:**

During the year ended December 31, 2014, the Company received proceeds of \$2,109,500 from a private placement issuance of a zero coupon, unsecured loan, which is convertible into Units at a rate of \$0.15 per Unit. Each Unit consists of one common share and one share purchase warrant exercisable at \$0.15 per share for a period of up to 36 months from the date of issue. The convertible debt was determined to be a compound instrument. As the debt was convertible into common shares and share purchase warrants, the liability and equity components were presented separately. The initial carrying amount of the financial liability was determined by discounting the stream of future payments of interest and principal at a market interest rate of 24%.

Upon completion of the RTO, the accreted value of the loan of \$2,104,976 and the value assigned to the conversion option of \$215,317 were converted into Units. The fair value of the warrants issued on the conversion, recorded as \$1,312,000, was calculated using the Black-Scholes option-pricing model with the following assumptions: risk-free rate of 0.42%, expected life of warrants of 3 years, expected volatility of 101.28%, weighted average fair value per warrant of \$0.09 and a \$nil dividend yield.

**13. 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), advances from directors and a promissory note. 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.

**14. Cost of sales:**

Included in cost of sales for the three and nine month periods are inventory of \$90,990 and \$440,157, respectively (2014 - \$181,481 and \$691,186).

**15. Government assistance:**

During the three and nine months ended September 30, 2015, the Company received government assistance in the amount of \$100,895 and \$388,454, respectively (2014 - \$71,602 and \$267,823) which has been recorded as a reduction of administrative expenses.



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**16. Change in non-cash working capital:**

	September 30, 2015	September 30, 2014
Decrease (increase) in trade and other receivables	\$ 292,536	\$ (501,478)
Decrease (increase) in investment tax credit receivables	244,462	-
Decrease (increase) in inventory	16,144	73,737
Decrease (increase) in prepayments	34,539	(11,973)
Increase (decrease) in trade and other payables	(158,193)	19,698
Increase (decrease) in deferred revenue	(112,500)	193,800
	<b>\$ 316,988</b>	<b>\$ (226,216)</b>

**17. Commitments:**

The following is a summary of the minimum contractual obligations and commitments as at September 30, 2015:

	2015	2016
Operating lease	\$ 13,500	\$ 54,000

The current lease agreement expires on December 31, 2016 with the option to extend for one to three years at the current lease rate adjusted for Newfoundland and Labrador Consumer Price Index (CPI). The Company has prepaid \$4,500 of the lease commitment for the current fiscal year ended December 31, 2015.

**18. 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 segment is as follows:

	3 months ended September 30, 2015	3 months ended September 30, 2014	3 months ended September 30, 2015	9 months ended September 30, 2014
Total revenues:				
Canada	\$ -	\$ 67,079	\$ 9,873	\$ 734,969
United States	142,523	-	920,857	112,500
Other	351,035	269,251	665,422	480,659
	<b>\$ 493,558</b>	<b>\$ 336,330</b>	<b>\$ 1,596,152</b>	<b>\$ 1,328,128</b>

**19. Subsequent events:**

Subsequent to September 30, 2015, the Company:

- (a) received a \$1.5 million contract from a major international defence contractor for a KATFISH sonar system. Along with spare parts and support, the initial order could exceed \$2 million;
- (b) was awarded \$750,000 by the Research & Development Corporation (RDC) of Newfoundland and Labrador; and
- (c) obtained a \$250,000 line of credit from a major Canadian financial institution, bearing an interest rate of prime +2%.