Kraken Robotics Inc.

(formerly Kraken Sonar Inc.)

Condensed Consolidated Interim Financial Statements

For the nine months ended September 30, 2017 and 2016
(Expressed in Canadian Dollars)

(Unaudited)

Q3 Fiscal 2017

KRAKEN

September 30, 2017

CONTENTS

KRAKEN

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

	September 30, 2017	December 31, 2016
ASSETS		
Current assets:		
Cash	**$ 574,809**	$ 85,650
Trade and other receivables (note 5)	**934,368**	550,696
Investment tax credits recoverable (note 6)	**96,174**	-
Inventory (note 7)	**1,318,196**	1,116,429
Prepayments (note 8)	**146,591**	19,123
	3,070,138	1,771,898
Note receivable (note 9)	**150,773**	-
Derivative asset (note 9)	**10,440**	-
Investments (note 9)	**30,530**	157,320
Property and equipment (note 10)	**1,770,245**	259,360
TOTAL ASSETS	**$ 5,032,126**	$ 2,188,578
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities:		
Bank indebtedness (note 12)	**$ -**	$ 150,000
Trade and other payables	**2,913,442**	1,266,353
Deferred revenue	**1,042,214**	-
	3,955,656	1,416,353
Shareholders' equity:		
Share capital (note 14)	**5,951,687**	4,086,270
Contributed surplus	**2,022,564**	1,647,963
Cumulative translation adjustment	**(211,678)**	-
Deficit	**(6,686,103)**	(4,962,008)
	1,076,470	772,225
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	**$ 5,032,126**	$ 2,188,578

Going concern (note 2)
Commitment (note 18)
Subsequent event (note 19)

On Behalf of the Board:

"Karl Kenny" Director ***"Shaun McEwan"*** Director

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

	Three months ended		Nine months ended	
	Sept 30, 2017	Sept 30, 2016	Sept 30, 2017	Sept 30, 2016
Product Revenue	$1,008,244	$944,941	$1,416,659	$2,121,174
Service Revenue	577,420	-	577,420	-
	1,585,664	944,941	1,994,079	2,121,174
Cost of sales (note 16)	419,694	366,967	1,095,438	820,021
	1,165,970	577,974	898,641	1,301,153
Administrative expenses	550,856	368,270	1,766,510	1,253,503
Research and development costs	449,899	187,790	1,437,334	480,137
Share-based compensation (note 14(c))	18,100	5,900	130,700	108,500
Investment tax credits recoverable	-	-	(96,174)	-
Income (loss) from operating activities	147,115	16,014	(2,339,729)	(540,987)
Foreign exchange loss (gain)	25,264	(9,774)	72,945	22,375
Loss on settlement of liability (note 14 (e))	-	5,700	-	5,700
Financing costs – line of credit	12,140	854	18,984	4,561
Gain on sale of investment (note 9)	-	-	(707,562)	-
Net income (loss) for the period	$109,712	$19,234	$(1,724,095)	$(573,623)
Basic and diluted income (loss) per share	$ (0.00)	$ 0.00	$ (0.02)	$ (0.01)
Basic and diluted weighted average number of shares outstanding	90,794,938	75,038,038	86,269,666	72,413,994

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

	Three months ended		Nine months ended	
	Sept 30, 2017	**Sept 30, 2016**	**Sept 30, 2017**	**Sept 30, 2016**
Income (loss) for the period	**$109,712**	**$19,234**	**$(1,724,095)**	**$(573,623)**
Other comprehensive loss				
Items that may be reclassified to profit or loss				
Currency translation adjustment	**(152,572)**	**-**	**(211,678)**	**-**
Other comprehensive loss for the period	**(152,572)**	**-**	**(211,678)**	**-**
Comprehensive income (loss) for the period	**$(42,860)**	**$19,234**	**$(1,935,773)**	**$(573,623)**

KRAKEN

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

2017	Number of Shares	Share capital (note 10)	Contributed Surplus	Cumulative Translation Adjustment	Deficit	Total
Balance at January 1, 2017	**78,519,414**	**$ 4,086,270**	**$ 1,647,963**	$ -	**$ (4,962,008)**	**$ 772,225**
Net loss	-	**-**	-	**-**	**(1,724,095)**	**(1,724,095)**
Other comprehensive loss	**-**	**-**	**-**	**(211,678)**		**(211,678)**
Transactions with shareholders, recorded directly in equity:						
Issue of common shares on private placement	**11,806,660**	**1,840,299**	**284,900**	-	**-**	**2,125,199**
Issue of common shares on warrant exercises	**466,666**	**111,000**	**(41,000)**	-	**-**	**70,000**
Share-based compensation (note 14)	-	**-**	**130,700**	-	**-**	**130,700**
Share issue costs	-	**(85,882)**				**(85,882)**
Shareholders' equity as at September 30, 2017	**90,792,740**	**$ 5,951,687**	**$ 2,022,563**	**$(211,678)**	**$ (6,686,103)**	**$ 1,076,470**

2016	Number of Shares	Share capital (note 10)	Contributed Surplus	Cumulative Translation Adjustment	Deficit	Total
Balance at January 1, 2016	**71,068,214**	**$ 3,072,426**	**$ 1,437,710**	$ -	**$ (3,541,833)**	**$ 968,303**
Net loss	-	**-**	-	**-**	**(573,623)**	**(573,623)**
Transactions with shareholders, recorded directly in equity:						
Issue of common shares on private placement	7,159,534	944,630	129,300			**1,073,930**
Issue of common shares on warrant exercises	58,333	9,189	(439)			**8,750**
Issue of common shares for debt settlement	233,333	35,000	5,700			**40,700**
Share issue costs		(42,783)				**(42,783)**
Share-based compensation	-	-	108,500	-	-	**108,500**
Shareholders' equity as at September 30, 2016	**78,519,414**	**$ 4,018,462**	**$ 1,680,771**	**$ -**	**$ (4,115,456)**	**$ 1,583,778**

KRAKEN

Condensed Consolidated Interim Statements of Cash Flows
(Unaudited)
For the Nine Months Ended September 30, 2017 and 2016
(Expressed in Canadian Dollars)

	September 30, 2017	September 30, 2016
Cash flows used in operating activities		
Net loss	$ (1,724,095)	$ (573,623)
Adjustments for items not involving cash:		
Depreciation	92,168	41,112
Share-based payments	130,700	108,500
Loss on settlement of liability (note 14(e))	-	5,700
Non-cash finance costs	949	-
Investment tax credits receivable	(96,174)	-
Gain on sale of investment	(707,562)	-
Changes in non-cash working capital	652,264	(1,181,066)
Net cash flows used in operating activities	(1,651,750)	(1,599,377)
Cash flows from (used in) investing activities		
Proceeds on disposal of investment (note 9)	864,882	(157,320)
Investment, note receivable and derivative asset (note 9)	(192,691)	-
Purchase of property, plant and equipment	(492,078)	(97,021)
Decrease in bank indebtedness	(150,000)	-
	30,113	(254,341)
Cash flows from (used in) financing activities		
Proceeds from issuance of shares	2,125,199	-
Proceeds from private placement	-	1,073,930
Proceeds from exercise of warrants	70,000	8,750
Share issue costs	(85,882)	(42,783)
Increase (decrease) in loans to (from) a director	-	194,317
	2,109,317	1,234,214
Net decrease in cash	487,680	(619,504)
Effect of foreign exchange on cash	1,479	-
Cash at beginning of period	85,650	771,940
Cash at end of period	$ 574,809	$ 152,436

1. Corporate Information:

Kraken Robotics Inc. (“Kraken” or the “Company”) (formerly Kraken Sonar 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 100 King Street. West, #1600, Toronto, Ontario, M5X 1G5.

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 Robotic Systems Inc., and Anergy changed its name to Kraken Robotics Inc. (together, “the Company”).

The Company’s principal business is the design, manufacture and sale of software-centric sensors and underwater robotic systems.

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 September 30, 2017 has a working capital deficit of $885,518 and a deficit of $6,686,103 (December 31, 2016 - $4,962,008).

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 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, 2016.

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, 2016 prepared in accordance with IFRS as issued by the IASB.

These consolidated financial statements were approved by the Board of Directors on November 29, 2017.

3. Basis of presentation (continued):

(b) Reclassification of comparative figures

Due to increased growth in revenue and employee base, detailed time tracking has been implemented for improved accounting to Costs of Sales, Research and Development, and Administrative expenses. As a result, comparative figures for Wages and Benefits that were previously presented as Employee Costs have been reclassified for presentation purposes. In addition, Government Assistance that was previously reported separately has been reclassified as a reduction to these amounts and allocated by department accordingly (refer to note 16).

(c) Accounting estimates and judgments:

The preparation of consolidated 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 consolidated 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:

(d) Derivative financial instruments

The Company records the fair value of derivative assets using valuation models where the fair value cannot be determined in active markets. The inputs used in the fair value models contain inherent uncertainties, estimates and use of judgment as certain valuation inputs are unobservable.

4. Significant accounting policies:

(a) Embedded derivatives:

Embedded derivatives are contained in non-derivative host contacts and are treated as separate derivatives when they meet the definition of a derivative, and their risks and characteristics are not closely related to those of the host contracts. Embedded derivatives are recorded at fair market value with mark-to-market adjustments recorded in profit or loss.

(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, 2017:

Amendments to IAS 7, Statement of Cash Flows:

In January 2016, the IAS issued amendments to IAS 7, Statement of Cash Flows. The amendments require disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flow and non-cash changes. One way to meet this new disclosure requirement is to provide a reconciliation between the opening and closing balances for liabilities from financing activities. These amendments became effective for annual periods beginning on or after January 1, 2017 and the Company will adopt these changes for the 2017 annual financial statements.

Amendments to IAS 12, Income Taxes:

In January 2016, the IASB issued amendments to IAS 12, Income Taxes. The amendments clarify that the existence of a deductible temporary difference depends solely on a comparison of the carrying amount of an asset and its tax base at the end of the reporting period, and is not affected by possible future changes in the carrying amount or expected manner of recovery of the asset. The amendments also clarify the methodology to determine the future taxable profits used for assessing the utilization of deductible temporary differences. The amendments became effective for annual periods beginning on or after January 1, 2017 and adoption of the amendments did not have a material impact on the consolidated financial statements.

4. Significant accounting policies (continued):

(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, 2017, and have not been applied in preparing these consolidated financial statements.

IFRIC 23, Uncertainty over Income Tax Treatments:

The Interpretation provides guidance on the accounting for current and deferred tax labilities and assets in circumstances in which there is uncertainty over income tax treatments. It requires an entity to contemplate whether uncertain tax treatments should be considered separately, or together as a group, based on which approach provides better predictions of the resolution. Probability will be determined whether the tax authorities will accept the uncertain tax treatment, and if it is not probable that the uncertain tax treatment will be accepted, they will measure the tax uncertainty based on the most likely amount or expected value, depending on whichever method better predicts the resolution of the uncertainty. The Company intends to adopt the Interpretation in its financial statements for the annual period beginning on January 1, 2019. The Company does not expect the Interpretation to have a material impact on the 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.

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 extent of the impact of adoption of the standard has not yet been determined.

Amendments to IFRS 2, Share-based Payments:

In June 2016, the IASB issued amendment to IFRS 2, Shares-based Payments, clarifying how to account for certain types of share-based payment transactions. The amendments provide requirements on the accounting for a) the effects of vesting and non-vesting conditions on the measurement of cash-settled share-based payments; b) share-based payment transactions with a net settlement feature for withholding tax obligations; and c) a modification to the terms and conditions of a share-based payment that changes the classification of the transaction from cash-settled to equity-settled. The amendments apply for annual periods beginning on or after January 1, 2018. As a practical simplification, the amendments can be applied prospectively. The Company intends to adopt the amendments to IFRS 2 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.

5. Trade and other receivables:

Trade and other receivables consist of the following:

	September 30, 2017	December 31, 2016
Trade receivables	$ 535,510	$ 248,386
Unbilled accounts receivable	153,729	153,729
Government assistance receivable and other	245,129	148,581
	$ 934,368	$ 550,696

6. Investment tax credit receivable

At September 30, 2017, the Company had filed Scientific Research and Experimental Development (SR&ED) Expenditures Claim with the Canada Revenue Agency for the fiscal years ended December 31, 2015 and is entitled to a refundable Provincial Investment Tax Credit of approximately $96,174 (December 31, 2016 - $Nil).

7. Inventory

As at September 30, 2017, the Company held $1,318,196 (2016 - $1,116,429) in inventory, consisting of $442,810 (2016 - $1,116,429) in raw materials and $875,386 (2016 - $Nil) in work-in-progress.

8. Prepayments

As at September 30, 2017, the Company had made prepayments of $146,591 (2016 - $Nil) towards inventory, which included an amount of $113,210 paid to one vendor.

9. Note receivable and Investment

(a) During 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 December 31, 2016, the Company had invested CAD$157,320 (US$120,000) in the company.

During the first quarter of Fiscal 2017, the Company disposed of its investment in Square Robot Inc., a non-core asset, for consideration of US$700,000, half of which was received on February 28, 2017, with the balance in the form of a note receivable due no later than June 27, 2017. A gain of $380,178 was realized upon the sale of the investment. Subsequently, the Company reduced the amount owing from $458,835 (US$350,000) to $393,287 (US$300,000) in exchange for early settlement of the note receivable which occurred on May 15, 2017. A gain of $327,384 was recorded in respect of the proceeds receivable upon extinguishment of the note. The net result of this activity was a gain on sale of investment of $707,562.

(b) During the second quarter of Fiscal 2017, the Company acquired a minority interest in ENITECH Subsea GmbH of Rostock, Germany and that company has been renamed Kraken Power GmbH. Under the agreement, Kraken has taken a 19.9% equity interest and provided a €110,000 (CAD $162,162) convertible loan. The loan pays interest at 5% per annum and has a term of three years. Through the conversion of the loan to equity and a further investment capped at €200,000, the Company may acquire a further 55.1% equity interest, for an aggregate 75% ownership stake position, in Kraken Power GmbH.

9. Note receivable and Investment (continued)

The Company does not have any power or significant influence over Kraken Power GmBH, so the investment is classified as available for sale and has been recorded at fair market value. The conversion option is a derivative financial asset that is recorded at fair value, with changes in fair value recognized through profit or loss. The premium paid for the derivative at inception of $11,389 represents the initial fair value, which was determined using an option pricing model. As the derivative is out-of-the money at Sept 30, 2017, the fair value has been estimated based on amortizing the premium on a straight-line basis over the term of the option agreement.

As at September 30, 2017 and December 31, 2016, the Company's investments were:

	September 30, 2017		**December 31, 2016**	
	EUR	**CAD**	**USD**	**CAD**
Square Robot, Inc.	€ -	$ -	$ 120,000	$ 157,320
Kraken Power GmbH	€ 110,000	$ 150,773	$ -	$ -
Kraken Power GmbH	€ 20,520	$ 30,530	$ -	$ -

10. Property and equipment

	Furniture and Equipment	**Computer equipment**	**Computer software**	**Leasehold improvements**	**AUV Vehicle**	**Total**
Cost						
Balance at December 31, 2015	**$ 61,096**	**$ 23,504**	**$ 64,027**	**$ 93,996**	**$ -**	**$ 242,623**
Additions	31,085	32,855	57,119	10,892	-	131,951
Balance at December 31, 2016	**$ 92,181**	**$ 56,359**	**$ 121,146**	**$ 104,888**	**$ -**	**374,574**
Additions	30,095	21,596	51,397	10,789	1,489,175	1,603,052
Balance at September 30, 2017	**$ 122,276**	**$ 77,955**	**$ 172,543**	**$ 115,677**	**$ 1,489,175**	**$ 1,977,626**
Depreciation						
Balance at December 31, 2015	**$ 10,783**	**$ 8,530**	**$ 17,876**	**$ 20,491**	**$ -**	**$ 57,680**
Depreciation	8,964	11,958	20,084	16,528	-	57,534
Balance at December 31, 2016	**$ 19,747**	**$ 20,488**	**$ 37,960**	**$ 37,019**	**$ -**	**$ 115,214**
Depreciation	8,181	15,596	23,733	13,943	30,714	92,167
Balance at September 30, 2017	**$ 27,928**	**$ 36,084**	**$ 61,693**	**$ 50,962**	**$ 30,714**	**$ 207,381**
Carrying amounts						
At December 31, 2015	**$ 50,313**	**$ 14,974**	**$ 46,151**	**$ 73,505**	**$ -**	**$ 184,943**
At December 31, 2016	**$ 72,434**	**$ 35,871**	**$ 83,186**	**$ 67,869**	**$ -**	**$ 259,360**
At September 30, 2017	**$ 94,348**	**$ 41,872**	**$ 110,850**	**$ 64,715**	**$ 1,458,461**	**$ 1,770,245**

11. 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:

	September 30, 2017	December 31, 2016
Cash	$ 574,809	$ 85,650
Trade and other receivables	934,368	550,696
Investment tax credits receivable	96,174	-
Note receivable	150,773	-
Derivative asset	10,440	-
Share subscription receivable	76,833	76,833
	$ 1,843,397	$ 713,179

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 83% and 66% of the Company's revenue in the three and nine months ended September 30, 2017, respectively (2016 – top 3 customers represented 83% and 75%). At September 30, 2017, 89% of the trade receivables balance was owing from 2 customers (2016 – 82% of the trade receivables was owing from 3 customers). At September 30, 2017, the Company had recorded deferred revenues of $1,042,214 (2016 – $Nil)

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 September 30, 2017, the Company had a cash balance of $574,809 (December 31, 2016 - $85,650) to settle current liabilities of $3,955,656 (December 31, 2016 - $1,416,353). At September 30, 2017, an amount of $1,110,975 (Euro 750,000) was included in accrued liabilities, representing the three remaining quarterly payments of Euro 250,000 each, in respect of the acquisition of a next generation Autonomous Underwater Vehicle (AUV) from the Fraunhofer Institute. Refer to note 2 for discussion of going concern risk.

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, 2017, the Company has cash balances of $574,809 and has drawn $0 against its line of credit. The Company is exposed to interest rate risk on its line of credit balance.

(b) Foreign currency risk

The Company's exposure to foreign currency risk is limited to sales in USD and GBP, certain purchases of inventory in USD, GBP and EUR, and its note receivable. 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:

	September 30, 2017	**December 31, 2016**
Financial liabilities denominated in foreign currency:		
Trade and other payables USD	$ 98,692	$ 87,295
Trade and other payables GBP	89,922	65,196
Trade and other payables EUR	39,566	1,247
Financial assets denominated in a foreign currency:		
Trade and other receivables USD	124,212	378,856
Trade and other receivables GBP	-	-
Trade and other receivables EUR	386,240	-

For the three and nine months ended September 30, 2017, with other variables remaining constant, a 10% increase (decrease) in the exchange rate of the US dollar, British Pound and Euro to Canadian dollar exchange rate would have increased (decreased) the Company's net loss by approximately $175,000 and $106,000 respectively (2016 - $52,000 and $87,000).

Fair Value:

During the nine months ended September 30, 2017, 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:

September 30, 2017	**Level 1**	**Level 2**	**Level 3**
Financial assets classified as loans and receivables:			
Cash	$ 574,809	$ -	$ -
Trade and other receivables	-	934,368	-
Investment tax credits recoverable	-	96,174	-
Note receivable	-	150,773	-
Derivative asset	-	-	10,440
Investment	-	-	30,530
Share subscription receivables	-	76,833	-
Financial liabilities at amortized cost:			
Bank indebtedness	-	-	-
Trade and other payables	-	2,913,442	-

December 31, 2016	**Level 1**	**Level 2**	**Level 3**
Financial assets classified as loans and receivables:			
Cash	$ 85,650	$ -	$ -
Trade and other receivables	-	550,696	-
Share subscription receivables	-	76,833	-
Financial liabilities at amortized cost:			
Bank indebtedness	-	150,000	-
Trade and other payables	-	1,296,353	-

12. Bank indebtedness:

At September 30, 2017, the Company had a $250,000 line of credit for general operating purposes (the "operating line"). The operating line bears interest at the bank's prime rate plus 2%, payable monthly. As at September 30, 2017, a total of $0 (December 31, 2016 - $150,000) was drawn against this facility.

13. Related party transactions:

Included in share subscription receivables at September 30, 2017 is $60,608 (December 31, 2016 - $60,608) owing from key management personnel.

14. Share capital:

Authorized: Unlimited number of common shares

See the consolidated statements of changes in shareholders' equity (deficiency) for a summary of changes in Share capital and Contributed surplus for the periods ended September 30, 2017 and 2016

(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 Robotic 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.

Two grants of warrants were issued pursuant to a private placement completed by Anergy in October 2014, prior to completion of the RTO:

i) Each full Warrant A warrant entitled 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). During the year ended December 31, 2016, 58,333 (2015 – 111,111) warrants were exercised for proceeds of $8,750 (2015 - $16,666). The weighted average share price on the dates on which the warrants were exercised during the year was $0.20 (2015 - $0.17). On October 14, 2016, the remaining 275,000 warrants expired unexercised.

ii) Each full Warrant B warrant entitled the holder to acquire one common share at a price of $0.40 after adjusting for the consolidation (or $0.17777777 prior to consolidation). A total of 444,444 warrants expired unexercised on October 14, 2016.

A total of 3,579,767 share purchase warrants were issued in August 2016 upon closing the non-brokered private placement offering.

A further 116,666 share purchase warrants were issued in August 2016 in respect of a debt settlement arrangement.

In April 2017, the Company issued an additional 5,903,330 share purchase warrants in connection with the closing of a non-brokered private placement offering.

Share purchase warrant transactions are summarized for the periods ending September 30, 2017 and December 31, 2016:

14. Share capital (continued):

	Nine months ended September 30, 2017		**Year ended December 31, 2016**	
	Number of Warrants	Weighted Average Exercise Price	Number of Warrants	Weighted Average Exercise Price
Opening balance	17,759,759	$ 0.18	14,841,103	$ 0.16
Issued for private placement	5,903,330	0.30	3,579,767	0.30
Issued for debt settlement	-	-	116,666	0.30
Warrants exercised	(466,666)	0.15	(58,333)	0.15
Warrants expired	-	-	(719,444)	0.30
Ending balance	23,196,423	$ 0.21	17,759,759	$ 0.18
Warrants exercisable	23,196,423	$ 0.21	17,759,759	$ 0.18

At September 30, 2017 and December 31, 2016, the following share purchase warrants were outstanding:

Expiry Date	**Exercise Price**	**September 30, 2017**	**December 31, 2016**	**Weighted Average Remaining Contractual Life**
February 18, 2018	$0.15	13,596,660	14,063,326	0.39 years
August 12, 2018	$0.30	3,579,767	3,579,767	.87 years
August 22, 2018	$0.30	116,666	116,666	.89 years
April 11, 2019	$0.30	5,903,330	-	1.53 years
	$0.21	**23,196,423**	**17,759,759**	**.92 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.

The following options were outstanding as at September 30, 2017 and December 31, 2016:

	September 30, 2017		**December 31, 2016**	
	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
Opening balance	4,960,000	$ 0.21	4,260,000	$ 0.23
Granted	600,000	0.17	900,000	0.15
Expired	(400,000)	0.25	(200,000)	0.15
Ending balance	5,160,000	$ 0.21	4,960,000	$ 0.21
Options exercisable	3,410,000	$ 0.22	2,226,666	$ 0.22

(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	1,310,000	1,310,000	0.46 years
0.20	May 13, 2018	250,000	250,000	0.62 years
0.21	June 1, 2020	2,000,000	1,250,000	2.67 years
0.21	July 1, 2018	100,000	100,000	0.75 years
0.15	October 12, 2019	600,000	200,000	2.03 years
0.15	December 1, 2019	300,000	100,000	2.17 years
0.17	March 8, 2020	250,000	83,333	2.44 years
0.17	September 8, 2020	350,000	116,667	2.94 years
$ 0.21		**5,160,000**	**3,410,000**	**1.76 years**

(c) Share-based compensation

During the three-month and nine-month period ended September 30, 2017, the Company recorded share-based compensation totaling $18,100 and $130,700, respectively (2016 - $5,900 and $108,500), 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:

	Nine Months ended September 30, 2017	Year ended December 31, 2016
Risk-free interest rate	0.61 to 0.96%	0.61 to 0.76%
Expected life of options	3 years	3 years
Expected volatility	195.10 to 228.68%	222.68 to 228.68%
Weighted average fair value per option	$0.11 to $0.15	$0.11 to $0.13
Dividend yield	Nil	Nil

(d) Escrowed shares

At September 30, 2017, there are a total of 7,647,107 (2016 – 22,941,323) common shares subject to escrow restrictions. The escrow shares will be released on February 18, 2018.

(e) Debt settlement

On August 22, 2016 the Company settled debt of $35,000 by issuing 233,333 common shares and 116,666 share purchase warrants exercisable to acquire one common share of Kraken at $0.30 for a period of 24 months from the date of issuance. The share purchase warrants were valued at $5,700 and credited to contributed surplus. Fair value was determined using the Black-Scholes valuation model, based on a risk free interest rate of 0.57%, an expected life of two years, an expected volatility of 78.98% and a dividend yield rate of nil.

15. 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, and bank indebtedness. 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.

16. Government assistance:

During the three and nine months ended September 30, 2017, the Company received government assistance in the amount of $340,413 and $878,128, respectively (2016 - $109,025 and $684,692). Government Assistance that was previously reported separately has been reclassified as a reduction to Cost of Sales, and Research & Development expense. The table below identifies the reclassification for the last 7 quarters.

	Government Assistance ($)	Cost of Sales ($)	Research & Development Costs ($)
Q3 2017	340,413	(114,751)	(225,662)
Q2 2017	253,041	(72,824)	(180,217)
Q1 2017	284,674	(68,593)	(216,081)
Q4 2016	209,875	(80,693)	(129,222)
Q3 2016	109,025	(60,067)	(48,958)
Q2 2016	289,968	(79,969)	(210,000)
Q1 2016	285,699	(115,991)	(169,708)

17. 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:

	Nine months ended September 30, 2017	**Three months ended September 30, 2017**	Nine months ended September 30, 2016	Three months ended September 30, 2016
Total revenues:				
Germany	**$ 266,377**	**$ 172,104**	$ 494,312	$ 69,261
France	**424,463**	**424,463**	91,332	-
Israel	**271,140**	**-**	865,679	356,260
United States	**86,757**	**86,757**	608,362	486,193
Canada	**899,426**	**899,426**	-	-
Other	**45,916**	**2,914**	61,489	33,227
	$ 1,994,079	**$ 1,585,664**	$ 2,121,174	$ 944,941

18. Commitment:

The Company has entered into an agreement with Fraunhofer Institute of Optronic, System Technologies and Image Exploitation ("Fraunhofer IOSB") of Germany whereby it has committed to grant research and development projects to Fraunhofer IOSB of a minimum EUR 300,000 over a period of five years, commencing in 2017.

19. Subsequent event:

(a) On November 16, 2017, the Company was awarded contract funding by Petroleum Research Newfoundland and Labrador (PRNL), InnovateNL and industry partners. The contract is expected to commence in the fourth quarter of fiscal 2017 and conclude in the fourth quarter of fiscal 2018 and is valued at approximately $750,000 for the development of underwater sensors and robotics that will advance digitalization of integrated operations within Newfoundland and Labrador's offshore oil and gas sector.