



**KRAKEN ROBOTICS INC.  
MANAGEMENT DISCUSSION AND ANALYSIS  
FOR THE THREE MONTH PERIOD ENDING MARCH 31, 2020**

*This Management Discussion and Analysis (“MD&A”) of Kraken Robotics Inc. (the “Company” or “Kraken”) provides analysis of the Company’s financial results for the three month period ended March 31, 2020 and should be read in conjunction with the Company’s audited financial statements and the notes thereto for the three month period ended March 31, 2020, which are available on SEDAR at [www.sedar.com](http://www.sedar.com). This MD&A is current as at May 29, 2020, the date of preparation.*

*The March 31, 2020 condensed consolidated interim financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”) applicable to the preparation of interim financial statements. The Company has adopted IFRS 16 with a date of initial application of January 1, 2019. Except as noted under “Use of Estimates” and “New and Revised IFRS Accounting Pronouncements”, 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, 2019. 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, 2019 prepared in accordance with IFRS as issued by the International Accounting Standards Board (“IASB”). All amounts are expressed in Canadian dollars, unless otherwise stated.*

**Forward-Looking Statements**

*Certain statements contained in the following MD&A constitute forward-looking statements. Such forward-looking statements involve a number of known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of the Company to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements.*

**NATURE OF BUSINESS**

Kraken Robotics Inc. (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 at 100 King Street West, #1600, Toronto, Ontario, M5X 1G5.

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

**Company Overview**

Kraken Robotics Inc. (PNG: TSX-V) is a marine technology company supplying advanced sonar and optical sensors, batteries, and underwater robotics equipment for military and commercial applications. The Company is recognized as world leading innovators of Synthetic Aperture Sonar (SAS) - a revolutionary underwater imaging technology that dramatically improves seabed surveys by providing ultra-high resolution imagery at superior coverage rates. Both military and commercial markets are showing encouraging growth as they are now incorporating unmanned vehicles and intelligent sensors in their procurement plans and budgets.

**AQUAPIX® MINSAS SENSOR FOR UNDERWATER VEHICLES**

The AquaPix® MINSAS (Miniature Interferometric Synthetic Aperture Sonar) sensor is based upon Kraken’s core Synthetic Aperture Sonar technology. The MINSAS compact receiver array length of only 60cm recently improved the AquaPix® SAS image resolution from 3.0 x 3.3 cm (across along track) to an industry-leading 1.9 x 2.1 cm while maintaining a constant Ultra HD resolution across ranges up to 120M per side. The lightweight array is integrated into a modular payload section of less than eight-inch diameter, which can be easily mobilized in customers’ Unmanned Underwater Vehicles (UUVs) of all sizes. The MINSAS payload section also includes Kraken’s latest generation Real Time SAS Processor, the RTSAS MK-II. The RTSAS enables real-time, onboard processing of SAS imagery and bathymetry at full resolution and allows operators to leverage

Kraken's suite of post-processing tools, including the newly developed SASView 3D sonar visualization and control software. The MINSAS plus RTSAS provides operators with an area coverage rate of higher than 3km<sup>2</sup> per hour at full SAS resolution, enabling highly efficient survey operations. Development continues our new Multispectral SAS product and we expect to have a complete system in the water for testing in the summer of 2020. This product will provide a unique capability, enabling simultaneous ultra-high-resolution acoustic imagery and buried object detection from the same sensor. Kraken currently has under development a new, low power, man portable AquaPix<sup>®</sup> MINSAS sensor and expects to make its first product delivery to the United States Navy under their Foreign Comparative Test program in Q2, 2020.

### ***SEAVISION<sup>®</sup> 3D LASER SYSTEM FOR UNDERWATER VEHICLES***

Kraken Robotik GmbH ("KRG"), a wholly-owned subsidiary of the Company, commenced operations in January 2017 in Bremen, Germany. Its focus is the development of 3D imaging sensors, machine learning, and artificial intelligence (AI) algorithms for underwater robotic platforms.

KRG, with support from Kraken engineers in Canada, has developed the SeaVision<sup>®</sup> 3D laser system. SeaVision<sup>®</sup> is the world's first RGB underwater laser imaging system that offers the resolution, range and scan rate to deliver dense full colour 3D point cloud images of subsea infrastructure with millimeter accuracy, in real time. The ability to generate accurate 3D reconstruction of underwater infrastructure is an important requirement for commercial, military and ocean research applications. The initial system is designed for deployment on underwater robotic platforms such as Remotely Operated Vehicles (ROVs) and AUVs. Kraken has seen significant interest in SeaVision<sup>®</sup> from customers across many industries from defense to oil and gas, to renewable energy and nuclear. The Company is currently building SeaVision inventory for shipment for customer trials and demos.

In collaboration with an international oil and gas company, Kraken's development of a unique, non-contact mooring chain inspection tool continues, with commercialization scheduled for Q4, 2020. This tool, utilizing SeaVision<sup>®</sup> platform can be used to support existing offshore oil and gas inspection requirements, as well as upcoming offshore wind inspection requirements. This new platform is anticipated to significantly reduce the cost of inspecting critical infrastructure, which must be inspected regularly.

During Q3, 2019, KRG was awarded a contract to deliver 3,000 meter rated SeaVision<sup>®</sup> laser scanning sensors to the GEOMAR Helmholtz Centre for Ocean Research in Germany. GEOMAR is a leading global institute for marine research with approximately 1,000 employees. Under this contract, Kraken will deliver a twin pod SeaVision<sup>®</sup> 3D laser scanner as well as three SeaVision<sup>®</sup> profilers (each consisting of a Kraken SmartCam<sup>™</sup> and separate laser). The contract value is approximately \$0.5 million with delivery expected during Q2, 2020.

During Q4 2019, Kraken signed a Canadian government contract for our SeaVision<sup>®</sup> underwater laser imaging platform. We expect to be working with Parks Canada's Underwater Archaeology Team in the Arctic this summer, as a continuation of the 2014 Franklin Expedition.

### ***KATFISH<sup>™</sup> TOWED UNDERWATER VEHICLE***

Kraken has developed the Kraken Active Towed Fish (KATFISH<sup>™</sup>) for high speed, high resolution seabed mapping. The system enables real-time seabed imagery, bathymetry and advanced 3D digital terrain models of the seabed – optimized for both manned and unmanned surface vessels. Coupled with Kraken's revolutionary AquaPix<sup>®</sup> MINSAS, it is especially well-suited for both military and commercial seabed surveys. Kraken's KATFISH<sup>™</sup> product offering lists for US\$1.5 million (Commercial Off The Shelf: COTS) to US\$2.5 million (Military Standard: MIL-STD).

In the commercial seabed survey market, KATFISH<sup>™</sup> offers offshore energy companies the advantage of comprehensive, high-resolution surveys of existing infrastructure, such as pipelines and subsea stations, completed in at least half the time as more conventional methods. KATFISH<sup>™</sup> operates at speeds up to 10 knots, versus the slow moving 1-2 knots of ROV or the medium 3-4 knots of the passively stable sonar systems, thus reducing operating time and cost.

In the defence market, there is a growing global requirement for modernization of mine countermeasure (MCM) solutions. The previous generation of single-role mine hunting vessels designed and built between the 1970's - 1990's are now being withdrawn from service. This leaves a growing requirement for high resolution, high speed seabed imaging platforms.

The ability of the KATFISH™ platform to generate centimetre-scale sonar resolution in all three dimensions can provide significant improvement in the detection, classification and identification of small seabed objects for both military and commercial seabed survey missions.

Kraken has high expectations for the KATFISH™ which provides high performance underwater mapping and mine hunting capabilities from a towed platform for both the military and commercial markets. The Company has in the past and will in the future partner as a supplier to large defense contractors who are involved in various multi-unit bids.

Recent updates and developments with KATFISH™ include:

- In 2019, we completed several customer demonstrations at sea in both the U.S. and Canada. Several military and commercial companies are in various stages of evaluating KATFISH™ along with our Autonomous Launch and Recovery Systems (ALARS). Given where we are in the sales cycle with several of these customers, we feel confident in our ability to deliver significant growth from this platform in 2020 and 2021.
- In September 2019, Kraken received a second purchase order from ThayerMahan Inc., for a KATFISH™180 system. This follows a first KATFISH™ order in June 2019. ThayerMahan Inc. is a US-based company specializing in the design, integration, and operation of autonomous maritime systems for government, industry, and academic customers. The contract value is \$2.9 million, with delivery made in Q1, 2020. ThayerMahan will deploy Kraken's KATFISH 180 as part of its SeaScout® expeditionary system for seabed mapping and intelligence.
- In October 2019, Kraken received notification that the Company was chosen as the successful bidder on a program for the acquisition of new sonar systems for an unnamed international navy. Under the program, Kraken will deliver multiple KATFISH as well as autonomous launch and recovery systems (ALARS) to the customer. The total contract value is expected to be approximately C\$35-\$40 million. The customer notified Kraken that it intended to enter a contract with the Company after the expiration of a standstill period. However, in this case, one of the losing bidders filed a protest and the complaint process is still ongoing.

#### ***THUNDERFISH® AUTONOMOUS UNDERWATER VEHICLE (AUV)***

Kraken continues its ThunderFish® AUV development program. The ThunderFish® AUV is a technical upgrade of Fraunhofer's DeDave AUV, however it is still a prototype. Kraken will pay Fraunhofer a royalty based on a percentage of each sale with minimum commitments starting in 2022. Kraken is exclusively licensing Fraunhofer software and hardware IP and technology for large AUVs. In 2017, the Company took delivery of the 6000m rated DeDave AUV which Kraken rebranded ThunderFish® Alpha AUV. This AUV is designed for deep sea military, commercial and scientific applications for use as a sensor and robotics technology demonstration platform to support ongoing development of the Company's underwater sensor and robotics programs. As described below, a ThunderFish® Alpha AUV was sold during Q3, 2019.

Kraken has established a long-term technical co-operation program with Fraunhofer for technologies that can be deployed in Kraken's ThunderFish® AUV program. While Kraken is committed to grant research and development projects to Fraunhofer of €300,000 per year for a period of three more years (2019-2021), these projects will be awarded to Fraunhofer as various statement of works are agreed upon and purchase orders issued. The remaining commitment under this program is \$736,700. These projects will be expensed as incurred.

In March 2019, Kraken was awarded a \$1 million contract for a ThunderFish® 300, a shallow water version of its AUV that had been pre-qualified under the Canada's Build in Canada Innovation Program (BCIP). Kraken continued development and sea trials on the ThunderFish® 300 during Q2 and delivery to DRDC occurred in Q3, 2019. With the sale to DRDC, Kraken has recorded a gain on sale of disposal of assets of \$0.6 million. Components of the ThunderFish® Alpha AUV that were not sold have been reclassified to inventory.

#### ***AUTONOMOUS LAUNCH AND RECOVERY SYSTEMS (ALARS)***

Launch and recovery of equipment offshore is one of the most dangerous phases of any ROV or AUV operation. Through the hiring of former Rolls Royce Marine employees in 2016, Kraken's Handling Systems Division has an experienced LARS engineering team with a proven track record. This group is developing both an intelligent winch system (TENTACLE™ and an autonomous LARS system that can launch AUVs from vessels, host facilities and docking stations. Kraken expects its winch

and ALARS products will range in price from \$250,000 to \$1 million. This group's capabilities are integral to various customer opportunities that Kraken is involved in or pursuing.

Kraken has successfully demonstrated its Tentacle™ Intelligent Winch as part of a fully integrated SeaScout® service offering with ThayerMahan Inc. at the US Navy's ANTX event in Rhode Island in 2018, and with the National Oceanic and Atmospheric Administration (NOAA) in July 2019 as well as numerous trials in Canada that included Canadian Hydrographic Services (CHS).

#### ***KRAKEN POWER GMBH***

Effective December 31, 2019, Kraken owns a 100% of Kraken Power GmbH, an increase from 75% at the end of Q3, 2019. Kraken Power GmbH designs and manufactures unique pressure tolerant thrusters, drives, batteries, battery management systems, and electronics. These are specialized deep-sea components for AUVs and ROVs. Kraken Power's unique pressure tolerant gel encapsulation technology for lithium polymer batteries provides an attractively priced, eco-friendly and superior alternative to oil compensated batteries currently used for subsea battery applications. Kraken Power's technology and products enable a significant reduction in bill of material costs for our ThunderFish® AUV over acquiring conventional batteries.

On December 31, 2019 Kraken acquired the remaining 25% of Kraken Power not currently owned for €350,000, consisting of €250,000 in cash and the issuance of 236,258 common shares of the Company at \$0.62 per share. The shares issued have a four-month statutory hold period commencing on the date of issuance. The transaction triggered a change of control payment to an arm's length third-party lender to Kraken Power in an amount equal to €120,000 payable in two tranches of €60,000 over calendar 2020 for which Kraken is responsible. The purchase price has been reflected in the Statement of Changes in Shareholders' Equity while the change in control payment has been recognized on the income statement in Q4 2019.

In Q3, 2018, Kraken announced a \$9.0 million deep-sea battery contract with Ocean Infinity. Ocean Infinity noted that by using Kraken's battery technology, "we can increase our energy capacity by over 50% in the same physical form factor as our existing conventional batteries. From an operational perspective this gives us considerable flexibility to optimise mission plans, increase area coverage, manage weather impact and ultimately increase value for our customers." During Q3/Q4 2019 sixteen 6000-meter rated pressure tolerant battery systems were delivered to Ocean Infinity, representing approximately 1,300 kWh. Ocean Infinity has noted that they are achieving AUV mission lengths of almost 700-line kilometers with Kraken batteries as compared to approximately 300-line kilometers with the original AUV batteries. This has resulted in launch and recovery operations being reduced by approximately 50%, yielding increased safety and cost efficiencies. Based on the success of this order, we are expecting follow on orders from existing customers in 2020 as well as new customer announcements and deliveries.

During Q3, 2019 Kraken was awarded a contract for approximately \$2.0 million by a military customer to provide a high capacity battery solution for an underwater robotics application. This is the same customer that placed a \$0.6 million order in April 2019. For confidentiality reasons, the customer name will not be disclosed. Product delivery for this follow-on order occurred in Q1, 2020.

#### ***ACOUSTIC SIGNAL PROCESSING GROUP (ASPG)***

Kraken's Acoustic Signal Processing Group (ASPG) was established in mid 2018 and its employees have 80+ years of combined experience in sonar systems development and integration. Their core competency is implementation of digital signal processing and user interface software for Anti-Submarine Warfare (ASW) sonar applications. This work frequently involves integration with embedded processing platforms for shipboard or shore-based analysis systems. The group can process and display data from fixed and mobile underwater as well as airborne systems to take advantage of machine automation, active and passive array technology improvements, hardware and software upgrades of submarine, surface and airborne ASW systems.

During 2019 ASPG continued to work towards completion of a \$1 million, 1-year sonar signal processing software contract from an international defense contractor. Kraken has received milestone payments which are recorded as a contract liability. This project was completed in Q1, 2020.

### ***ROBOTICS AS A SERVICE (RaaS)***

Kraken believes that certain customers would prefer to hire the company to provide product output (i.e. imaging and bathymetry data) to them using the Kraken's own equipment, rather than the customer buying the equipment and having to own and operate and maintain the equipment. This is the genesis of Kraken's RaaS offering. Kraken expects RaaS to become a growing part of its revenue mix over time. Kraken will provide RaaS services to customers using Kraken's KATFISH™ towed underwater vehicles and ThunderFish® AUV and innovative sensors like the SeaVision® 3D laser system.

While RaaS revenue remains small, Kraken is bidding on opportunities involving both shallow and deeper water surveys with the KATFISH™ and ThunderFish® as well as our SeaVision® 3D laser system. Kraken's relationship with Ocean Infinity as well as with similar operators could result in a significant increase in RaaS revenue over time. In addition, the Company's OceanVision™ project proposal to the Ocean Supercluster is focused on the development of a RaaS offering for underwater seabed imagery and mapping.

During Q3, 2019 Kraken was awarded RaaS contract from Husky Energy (Husky) for the development of a mooring chain laser inspection sensor, for use in offshore oil and gas applications. Under this 16-month project, a total of \$1.8 million of funding is being provided in cash and in-kind services from Husky (\$1.26M) and the Government of Newfoundland and Labrador, through the Innovation and Business Investment Corporation (\$0.54 million). The project cash component to be received by Kraken will be \$0.7 million.

### ***OCEANVISION™ PROJECT***

At the end of June 2019, Kraken announced it had been conditionally approved by the Ocean Supercluster to move forward with its OceanVision™ project. This follows more than a year of effort by Kraken to position this project as an attractive proposal for the Ocean Supercluster.

The OceanVision™ project was formally signed in January 2020 and is a three-year, \$18.8 million project focused on the development of new marine technologies and products to enable an underwater robotics data acquisition and data analytics as a service business. This will be a turnkey service solution for ultra-high definition seafloor imaging, mapping and analytics, including simultaneous acquisition of ocean environmental and marine habitat data. It will result in an end-to-end digitalization solution offering advanced sensors, robots and data analytics as a turnkey service solution for seafloor imaging and mapping. Rapid high-throughput data analytics will make it possible to significantly reduce the cost of obtaining high resolution seafloor imaging and mapping allowing end-users to make more informed operational decisions in real-time.

The new technologies Kraken will develop within the scope of the OceanVision™ project are currently unavailable in a fully matured and tightly integrated offering in the commercial industry. The combination of a hovering-capable AUV with the potential for subsea residency, and a cutting-edge suite of acoustic and optical sensors, is a powerful package. As Kraken is the manufacturer of all the major vehicle components (i.e., sensors, batteries, propulsion system and software), it is Kraken's belief that its robotics platforms and services can be provided at a much lower overall cost than competing systems.

The project began in Q3, 2019 and in late September, Kraken deployed its sensors and unmanned underwater platforms to conduct ultra-high definition seabed imaging and mapping on the Grand Banks of Newfoundland and other areas of Atlantic Canada as part of the initial phase of the OceanVision™ project.

To fund the project, Canada's Ocean Supercluster will provide an investment of \$6.3 million, while the balance of the project will be provided by government agencies, industry partners (Petroleum Research Newfoundland and Labrador, Ocean Choice International and Nunavut Fisheries Association) and Kraken. Kraken's commitment to the project is \$7.4 million, of which \$6.7 million remains outstanding at March 31, 2020. Kraken's commitment will be reduced as government and industry partners join the project in 2020.

### ***FINANCIAL CONTRIBUTIONS AWARDED***

At March 31, 2020, Kraken had \$1.7 million remaining in grant funding to drawn down against research and development activities. This excludes funding received under the OceanVision™ project.

Major components of this remaining funding are as follows:

In May 2018, the Company's German subsidiary, Kraken Robotik GmbH was awarded over \$0.9 million in contracts for two development initiatives for evaluation of SeaVision® sensors and AI control for software for autonomous underwater

vehicles. The two projects are called ARIM and RoboVaaS and are collaborative research activities funded by the German Federal Ministry for Economic Affairs and Energy as part of the MarTERA Horizon 2020 initiative of the European Commission.

In December 2018, the Company was awarded a \$0.6 million contract with Public Works and Procurement Canada under the Defence Innovation Research Program (DIRP). Kraken will develop a low frequency, ultra-wideband Synthetic Aperture Sonar (SAS) for use in underwater operational environments.

In March 2019, the Company was awarded a \$1.0 million financial contribution from the Government of Newfoundland and Labrador under the Innovation and Business Development Funding (IBDF) program. The funding will be used for the initial phase of the OceanVision™ project as part of the Ocean Supercluster initiative.

In August 2019, the Company was awarded funding for the development of a mooring chain laser inspection sensor for use in offshore oil and gas applications. Under the project, a total of \$1.8 million funding is being provided in cash and in-kind services from Husky (\$1.26M) and the Government of Newfoundland and Labrador, through the Innovation and Business Investment Corporation (\$540,000). The project cash component received by Kraken will be \$720,000.

In September 2019, the Company was awarded \$0.750 funding from the National Research Council of Canada Industrial Research Assistance Program (NRC IRAP). This funding is being used to support research and development of Kraken's Thunderfish® XL Autonomous Underwater Vehicle (AUV) and is also part of Kraken's OceanVision™ project.

## RESULTS OF OPERATIONS

### Selected Annual Information

	Year Ended December 31, 2019 (\$)	Year Ended December 31, 2018 (\$)	Year Ended December 31, 2017 (\$)
<b>Statement of Comprehensive Loss</b>			
Total Revenues	15,145,976	6,707,956	3,533,605
Cost of Sales	8,441,506	3,902,538	1,936,463
Loss from operating activities	(3,208,728)	(3,982,668)	(3,006,573)
Net loss	(3,003,486)	(2,852,389)	(2,397,229)
Basic and diluted loss per share	(0.02)	(0.03)	(0.03)

	Year Ended December 31, 2019 (\$)	Year Ended December 31, 2018 (\$)	Year Ended December 31, 2017 (\$)
<b>Statement of Financial Position</b>			
Total Assets	18,090,876	14,028,465	5,258,148
Total Current Assets	13,498,657	9,738,966	3,458,421
Total Current Liabilities	6,262,178	4,815,590	4,722,736
Total Liabilities	8,427,558	5,731,030	4,722,736
Total Shareholders' Equity	9,663,318	8,297,435	535,412

The Company incurred a loss of \$3,003,486 for the year ended December 31, 2019, as compared with a loss of \$2,852,389 for the year ended December 31, 2018. Share-based payments of \$1,370,745 (2018 - \$342,600) were recorded upon the grant of incentive stock options pursuant to the Company's incentive stock option plan.

During 2019, the Company continued to execute its growth plan. Administrative expenses increased 32% with those of the prior year at \$5,313,419 (2018 - \$4,028,757). Research and Development costs, net of related government assistance

declined 20% to \$1,886,861 (2018 - \$2,369,455) due to increased government assistance including those related to the OceanVision project.

No cash dividends have been declared or paid since the date of incorporation and the Company has no present intention of paying dividends on its common shares. The Company anticipates that all available funds will be used to finance the growth of its business.

### Summary of Quarterly Information

Selected financial information for each of the eight most recently completed quarters are as follows:

	Revenue (\$)	Operating activity less share based payments (\$)	Share-based payments (\$)	Net income (loss) (\$)	Comprehensive income (loss) \$	Basic and diluted income (loss) per share (\$)
Q1 2020	6,390,675	1,882,739	235,358	727,937	1,005,882	0.00
Q4 2019	4,616,644	2,101,106	288,276	(247,364)	(683,013)	0.00
Q3 2019	7,822,452	2,585,027	999,469	95,242	317,253	0.00
Q2 2019	1,337,495	2,486,264	8,200	(1,988,914)	(1,944,881)	(0.01)
Q1 2019	1,369,385	1,708,275	74,800	(862,450)	(733,412)	(0.01)
Q4 2018	1,406,974	1,724,071	141,100	(567,534)	(457,407)	0.00
Q3 2018	1,574,335	2,115,154	90,100	(1,067,432)	(1,083,415)	(0.01)
Q2 2018	3,726,647	1,509,146	85,300	638,441	647,759	0.01

*Note: Operating expenses are defined as administrative expenses, R&D costs and depreciation and amortization.*

Comparative balance sheet information for 2019 and 2018 is presented below:

	Total Assets (\$)	Total Current Assets (\$)	Total Current Liabilities (\$)	Total Liabilities (\$)
Q1 2020	19,248,329	14,224,596	5,983,912	8,293,155
Q4 2019	18,090,876	13,498,657	6,262,178	8,427,558
Q3 2019	17,273,370	12,492,410	4,776,548	7,116,466
Q2 2019	20,090,135	13,892,388	8,867,266	11,164,027
Q1 2019	18,726,179	12,266,678	5,718,495	8,000,358
Q4 2018	14,028,465	9,738,966	4,815,590	5,731,030
Q3 2018	9,401,124	5,299,390	5,790,272	7,114,072
Q2 2018	8,097,893	6,401,801	5,920,830	5,920,830

### Three Months Ended March 31, 2020

The Company recorded revenues of \$6,390,675 (2019 - \$1,369,385) from product sales and services, an increase of 467% compared to the same period a year ago due to the delivery of a KATFISH™, subsea batteries, the provision of software services and survey support work. The Company's revenue can fluctuate significantly on a quarterly basis mainly due to the timing of orders and lead times on parts purchases. At March 31, 2020, the Company had contract liabilities of \$977,662 (2019 - \$2,445,223), which represent customer advances on product orders.

Cost of sales were higher than that of the prior year at \$3,472,702 (2019 - \$780,628). The increase in cost of sales was due the cost associated with the manufacturing of a KATFISH™, subsea batteries and labour associated with providing service revenue. The Company realized gross profit of \$2,917,973 (2019 - \$588,757). Gross margin for the quarter was 46%, as compared to 43% gross margin in the prior first quarter. Our product gross margins generally range from 45%-75% while overall gross margin percentages are lower as labor costs get allocated to cost of sales.

Administrative expenses in the quarter increased 57% to \$1,520,759 compared to \$969,947 in the prior year due to both an increase in headcount and various administrative expenses such as rent and software subscriptions. At the end of March 31, 2020, Kraken employed 108 employees compared to 74 in the prior year. Other notable items in the Administrative expense category include Accounting and legal \$98,516 (2019 - \$86,751) travel related costs of \$89,798 (2019 - \$164,091), which decreased due to COVID related cancellations for business meetings, trade shows and conferences. Also included were rent of \$61,384 (2019 - \$38,477), and software subscriptions \$128,451 (2019 - \$48,939) due to the implementation of a new ERP system. During the quarter, the Company realized a foreign exchange loss of \$54,825 (2019 foreign exchange loss - \$4,128).

Depreciation in the quarter totalled \$185,462 (2019 - \$195,309), while amortization of intangible assets declined to \$72,357 (2019- \$290,805) declined due to the customers contract portion of intangible being fully amortized.

Research and development costs (“R&D”) costs in the quarter declined to \$104,161 (2019 - \$210,223), as a result of the timing of expenditures on various R&D programs as well as the timing of government assistance and reimbursements from the Ocean SuperCluster/funding partners which are netted against R&D.

During the three months ended March 31, 2020, the Company received government assistance, excluding the OceanVision project, in the amount of \$677,561 (2019 - \$868,955). Government Assistance has been classified as a reduction to Cost of Sales \$Nil (2019 - \$86,375) and Research & Development expense \$667,561 (2019 – \$782,580).

The financial statements reflect a cost reimbursement accrual made to recognize work under Kraken’s OceanVision project, including \$618,462 (2019 - \$Nil) in reimbursements from the Ocean SuperCluster and \$230,081 (2019 - \$Nil) in reimbursements by funding partners. Assistance related to the OceanVision project has been classified as a reduction to Research & Development expense \$314,903 (2019 – \$Nil), Administrative expense \$12,893 (2019 – \$Nil), Cost of sales \$14,352 (2019 – \$Nil) and Construction in progress of \$506,395 (2019 - \$Nil).

Share-based compensation of \$235,358 was recorded, representing the fair value of the options that vested during the three months ended March 31, 2020. During the same period of the prior year, the Company recorded share-based compensation of \$74,800. The increase over the prior year is attributable options granted to Board, management, and employees in 2019.

On December 31, 2019 Kraken acquired the remaining 25% of Kraken Power not currently owned for €350,000, consisting of €250,000 (\$367,450) in cash and the issuance of 236,258 common shares of the Company at \$0.62 per share (\$146,480). As a result, no non-controlling interest was recorded during the quarter.

The Company recorded net income of \$727,937 and comprehensive income of \$1,005,882 for the quarter, as compared to a loss of \$862,450 and comprehensive loss of \$782,344 for the same period of prior year

## **LIQUIDITY AND CAPITAL RESOURCES**

At March 31, 2020, the Company had working capital of \$8,240,684 (December 31, 2019 – \$7,236,479). Cash and cash equivalents as at March 31, 2020 was \$2,118,426, as compared with \$2,097,199 at December 31, 2019.

During the three months ended March 31, 2020, the Company received proceeds of \$50,616 (December 31, 2019 - \$157,620) upon the exercise of 200,000 stock options.

During the three months ended March 31, 2020, the Company experienced cash inflows of \$359,651 (2019 – (\$1,984,928)) from operating activities. Cash outflows from investing activities were \$402,974 versus \$961,875 for 2019. Financing activities realized outflows of \$39,793 (2019 – \$2,999,466) and included proceeds of \$50,616 received upon option exercises.

Overall, excluding the foreign exchange impact on cash, cash decreased by \$83,116 as compared to an increase of \$52,662 during the prior year.

## **RISKS AND UNCERTAINTIES**

The Company is a relatively new company with limited operating history and, in addition to facing all of the competitive risks in the underwater sonar and robotics sector it will face all the risks inherent in developing a business including: access to capital, ability to attract and retain qualified employees, ability to attract and maintain customers and the ability to put in place appropriate operating and control procedures.

Industry specific risks include, but are not limited to:

- *Competitive risk* – the sonar industry in which the Company operates is highly competitive. The competitors of the Company range from small single product companies to diversified corporations in the military, sonar and marine imaging industry. Some of the competitors of the Company may have more extensive or more specialized engineering, manufacturing, and marketing capabilities;
- *Technology risk* – The future success of the Company will depend on its ability to develop new technologies that achieve market acceptance. The sonar market is characterized by rapidly-changing technologies and evolving industry standards;
- *Protection of Intellectual Property*: The Company may be unable to adequately protect its intellectual property rights, which could affect its ability to compete. Protecting the Company's intellectual property rights is critical to its ability to compete and succeed as a company. The Company currently has trademark registrations and relies on a combination of copyright, trademark, and trade secret laws, confidentiality procedures, contractual provisions and other measures to protect its proprietary information. However, all of these measures afford only limited protection;
- *Outside suppliers*: The Company's operations depend on component availability and the manufacture and delivery by key suppliers of certain products and services. Further, the Company's operations are dependent on the timely delivery of materials by outside suppliers. The Company cannot be sure that materials, components, and subsystems will be available in the quantities required, if at all;
- *Government contracts*: The Company will depend, in part, on government contracts, which may only be partially funded, subject to termination, heavily regulated, and audited. The termination of one or more of these contracts could have a negative impact on the operations of the Company; and
- *Competitive bidding*: The Company will derive significant revenue from contracts awarded through a competitive bidding process, which can impose substantial costs upon it, and the Company could fail to maintain its current and projected revenue if it fails to compete effectively.

An investment in the Company's common shares is highly speculative and subject to a number of risks and uncertainties. Only those persons who can bear the risk of the entire loss of their investment should participate. An investor should carefully consider the risks described above and the other information filed with the Canadian securities regulators before investing in the Company's common shares. The risks described above are not the only ones faced. Additional risks that the Company currently believes are immaterial may become important factors that affect the Company's business. If any of these risks occur, or if others occur, the Company's business, operating results and financial condition could be seriously harmed and investors may lose all of their investment.

## **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 long-term note payable. 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.

## **FINANCIAL INSTRUMENTS AND RISK MANAGEMENT**

As at March 31, 2020, the Company's risk exposures and the impact of the Company's financial instruments are summarized below:

### ***Credit Risk:***

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

	March 31, 2020	December 31, 2019
Cash and cash equivalents	\$ 2,118,426	\$ 2,097,199
Trade and other receivables	5,718,525	5,083,740
	<u>\$ 7,836,951</u>	<u>\$ 7,180,939</u>

At March 31, 2020, 69% of the trade receivables balance was owing from 2 customers (2019 – 76% of the trade receivables was owing from 2 customers). At March 31, 2020, the Company had recorded contract liabilities of \$977,662 (2019–\$2,445,223).

**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 March 31, 2020, the Company had a cash balance of \$2,118,426 (December 31, 2019 - \$2,097,199) to settle current liabilities of \$5,983,912 (December 31, 2019 - \$6,262,178).

**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 March 31, 2020, the Company has cash balances of \$2,118,426 and has drawn \$Nil against its line of credit. The Company’s subsidiary, Kraken Power, has a €400,000 loan with a German regional economic development organization due March 31, 2023. The loan currently bears interest at 8.5% and is unsecured.

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, GBP and EUR, certain purchases of inventory in USD, GBP and EUR. The Company does not use any form of hedging against fluctuations in foreign exchange.

**Fair Value:**

During the twelve months ended March 31, 2020, 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:

March 31, 2020	Level 1	Level 2	Level 3
Financial assets classified as loans and receivables:			
Cash and cash equivalents	\$ 2,118,426	\$ -	\$ -
Trade and other receivables	-	5,718,525	-
Financial liabilities at amortized cost:			
Trade and other payables	-	4,786,180	-
Long-term note payable	-	419,307	-

## USE OF ESTIMATES AND JUDGMENTS

The preparation of financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from those estimates. Estimates are reviewed on an ongoing basis based on historical experience and other factors that are considered to be relevant under the circumstances. Revisions to estimates on the resulting effects of the carrying amounts of the Company's assets and liabilities are accounted for prospectively.

All of the Company's significant accounting policies and estimates and judgments are included in Notes 3 and 4 of its audited consolidated financial statements for the year ended December 31, 2019, as well as Notes 2 and 3 to the interim financial statements.

## SUBSEQUENT EVENTS

Subsequent to March 31, 2020, the Company:

- (a) granted 75,000 stock options to an employee on May 1, 2020 at an exercise price of \$0.44.
- (b) renewed and increased our credit facilities on our revolving demand facility from \$1.0 million to \$1.5 million.

## ADOPTION OF NEW ACCOUNTING PRONOUNCEMENTS

### *IFRS 16, Leases:*

The Company has adopted the following new accounting policies upon implementation of IFRS 16 on January 1, 2019:

#### *Right-of-use assets*

The Company recognizes right-of-use assets at the commencement date of the lease (i.e. the date the underlying asset is available for use). Right-of-use assets are measured at cost, less any accumulated depreciation and impairment losses, and adjusted for any re-measurement of lease liabilities. The cost of right-of-use assets includes the amount of lease liabilities recognized, initial direct cost incurred, and lease payments made at or before the commencement date less any lease incentives received. The right-of-use assets are depreciated on a straight-line basis over its lease term. Right-of-use assets are subject to evaluation of potential impairment.

#### *Lease liabilities*

At the commencement date of the lease, the Company recognizes lease liabilities measured at the present value of lease payments to be made over the lease term. The lease payment included fixed payments (including in-substance fixed payments). The lease payments also include the exercise price of purchase options, if any, reasonably certain to be exercised by the Company and payments of penalties for terminating a lease, if the lease term reflects the Company exercising the option to terminate. The variable lease payment that do not depend on an index or a rate are recognized as expense in the period on which the event or condition that triggers the payment occurs.

In calculating the present value of lease payments, the Company uses the incremental borrowing rate at the lease commencement date if the interest rate implicit in the lease is not readily determinable. After the commencement date, the amount of lease liabilities is increased to reflect the accretion of interest and reduced for the lease payments made. In addition, the carrying amount of lease liabilities is re-measured if there is a modification, a change in the lease term or a change in the in-substance fixed lease payments.

#### *Short-term leases and leases of low-value assets*

The Company applies the short-term lease recognition exemption to its short-term leases of properties (i.e., those leases that have a lease term of 12 months or less from the commencement date and do not contain a purchase option). It also applies the lease of low-value assets recognition exemption to leases of office equipment that are considered of low value (i.e., below \$5,000). Lease payments on short-term leases and leases of low-value assets are recognized as expense on a straight-line basis over the lease term.

**IFRIC 23, Uncertainty over Income Tax Treatments:**

The Interpretation provides guidance on the accounting for current and deferred tax liabilities 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. There was no impact to the financial statement as a result of adopting this interpretation effective January 1, 2019.

**FUTURE ACCOUNTING STANDARDS AND INTERPRETATIONS**

The Company has adopted the following new accounting policies:

*IAS 1 – Presentation of Financial Statements and IAS 8 – Accounting Policies, Changes in Estimates and Errors*

On October 31, 2018, the IASB issued amendments to IAS 1 Presentation of Financial Statements and IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors. These amendments clarify the definition of ‘material’ and aligns the definition used within the IFRS Standards. The effective date of the amendment is for annual periods beginning on or after January 1, 2020 and is to be applied prospectively. The application of this amendment did not have a material impact to the Company.

*IFRS 3 – Business Combinations*

On October 22, 2018 the IASB issued an amendment to IFRS 3 Business Combinations to narrow the definition of a business and introduce a screening test, which eliminates the requirement for a detailed assessment of the definition, when met. The effective date of the amendment is for annual periods beginning on or after January 1, 2020 and is to be applied prospectively. The application of this amendment did not have a material impact to the Company.

**OUTSTANDING SHARE DATA AS AT May 29, 2020:**

(a) Authorized and issued share capital:

Class	Par Value	Authorized	Issued Number
Common	No par value	Unlimited	147,377,186

(b) Summary of options outstanding:

Security	Number	Number Exercisable	Exercise Price	Expiry Date
Options	2,000,000	2,000,000	0.21	June 1, 2020
Options	350,000	350,000	0.17	September 20, 2020
Options	300,000	300,000	0.18	October 4, 2020
Options	1,571,834	1,474,334	0.18	December 18, 2020
Options	450,000	450,000	0.185	February 20, 2021
Options	200,000	133,333	0.21	June 21, 2021
Options	833,333	475,000	0.26	July 18, 2021
Options	500,000	166,667	0.70	March 5, 2022
Options	75,000	25,000	0.44	May 1, 2022
Options	1,500,000	500,000	0.63	July 14, 2022
Options	400,000	200,000	0.63	July 14, 2022
Options	2,746,667	910,000	0.53	September 8, 2022
Options	1,000,000	250,000	0.63	July 14, 2024
	11,851,834	7,234,334		

(c) Summary of warrants outstanding:

<b>Security</b>	<b>Number</b>	<b>Exercise Price</b>	<b>Expiry Date</b>
Warrants	550,000	0.60	December 20, 2020

#### **DISCLOSURE CONTROLS AND PROCEDURES AND INTERNAL CONTROLS OVER FINANCIAL REPORTING**

Disclosure controls and procedures (“DC&P”) are intended to provide reasonable assurance that material information is gathered and reported to senior management to permit timely decisions regarding public disclosure. Internal controls over financial reporting (“ICFR”) are intended to provide reasonable assurance regarding the reliability of financial reporting and the preparation of consolidated financial statements for external purposes in accordance with IFRS accounting principles.

TSX Venture-listed companies are not required to provide representations in their annual and interim filings relating to the establishment and maintenance of DC&P and ICFR, as defined in Multinational Instrument MI 52-109. In particular, the CEO and CFO certifying officers do not make any representations relating to the establishment and maintenance of (a) controls and other procedures designed to provide reasonable assurance that information required to be disclosed by the issuer in its annual filings, interim filings or other reports filed or submitted under securities legislation is recorded, processed, summarized and reported within the time periods specified in securities legislation, and (b) processes to provide reasonable assurance regarding the reliability of financial reporting and the preparation of consolidated financial statements for external purposes in accordance with the issuer’s GAAP.

#### **OTHER INFORMATION**

Additional information regarding the Company is available on SEDAR at [www.sedar.com](http://www.sedar.com) and on the Company’s website at [www.krakenrobotics.com](http://www.krakenrobotics.com).