



Kraken Robotics Inc.

Condensed Consolidated Interim Financial Statements

For the three and six months ended June 30, 2020 and 2019
(Expressed in Canadian Dollars)

(Unaudited)

Q2 Fiscal 2020



June 30, 2020

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

	June 30, 2020	December 31, 2019
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 3,371,879	\$ 2,097,199
Trade and other receivables (note 3)	3,478,395	5,083,740
Investment tax credits recoverable (note 4)	650,138	-
Inventory (note 5)	6,002,259	5,886,256
Prepayments (note 6)	663,563	431,462
	14,166,234	13,498,657
Property and equipment (note 7)	3,615,903	3,161,924
Intangible assets	989,997	1,082,945
Goodwill	364,547	347,350
TOTAL ASSETS	\$ 19,136,681	\$ 18,090,876
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities:		
Trade and other payables	3,720,987	\$ 3,620,443
Contract liability	1,356,576	2,445,223
Current tax payable	5,031	4,882
Current portion of lease liabilities	237,652	191,630
	5,320,246	6,262,178
Long-term obligations (note 10)	475,806	392,374
Lease liabilities	1,462,731	1,347,006
Deferred Taxes	448,258	426,000
Shareholders' equity:		
Share capital (note 11)	23,293,623	22,594,846
Contributed surplus	2,448,540	2,220,924
Accumulated other comprehensive loss	(122,315)	(363,031)
Deficit	(14,190,208)	(14,789,421)
	11,429,640	9,663,318
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 19,136,681	\$ 18,090,876

Commitments (note 15) Subsequent events (note 16)

On Behalf of the Board:

"Karl Kenny"

Director

"Shaun McEwan"

Director

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



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

	Three months ended		Six months ended	
	June 30, 2020	June 30, 2019	June 30, 2020	June 30, 2019
Product Revenue	\$ 2,198,615	\$ 1,085,453	\$ 7,172,028	\$ 2,197,521
Service Revenue	83,314	252,042	1,500,576	509,359
	2,281,929	1,337,495	8,672,604	2,706,880
Cost of sales (note 5)	1,139,299	708,837	4,612,001	1,489,465
	1,142,630	628,658	4,060,603	1,217,415
Administrative expenses	1,297,985	1,213,241	2,818,744	2,183,188
Research and development costs	139,844	789,198	244,005	999,421
Depreciation and Amortization	251,228	483,825	509,047	966,810
Share-based compensation (note 11(d))	220,420	8,200	455,778	83,000
Investment tax credits recoverable	(650,138)	-	(650,138)	(338,219)
	1,259,339	2,494,464	3,377,436	3,894,200
(Loss) income from operating activities	(116,709)	(1,865,806)	683,167	(2,676,785)
Foreign exchange (gain)/loss	(44,165)	77,639	(16,152)	81,767
Financing costs	56,180	45,469	100,106	92,812
Net (loss) income before taxes	\$ (128,724)	\$ (1,988,914)	\$ 599,213	\$ (2,851,364)
Deferred income tax recovery	-	-	-	-
Net (loss) income	\$ (128,724)	\$ (1,988,914)	\$ 599,213	\$ (2,851,364)
Net (loss) income attributed to:				
Shareholders of Kraken Robotics Inc.	(128,724)	(1,751,755)	\$ 599,213	\$ (2,526,987)
Non-controlling interests	-	(237,159)	-	(324,377)
	\$ (128,724)	\$ (1,988,914)	\$599,213	\$ (2,851,364)
Basic and diluted (loss) income per share	\$0.00	\$(0.01)	\$ 0.00	\$(0.02)
Basic and diluted weighted average number of shares outstanding	148,014,549	145,921,411	147,680,162	146,002,595

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



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

	Three months ended		Six months ended	
	June 30, 2020	June 30, 2019	June 30, 2020	June 30, 2019
(Loss) income for the period	\$ (128,724)	\$ (1,988,914)	\$ 599,213	\$ (2,851,364)
Other comprehensive (loss) income				
<i>Items that may be reclassified to profit or loss</i>				
Currency translation adjustment	(37,229)	44,033	240,716	173,071
Other comprehensive (loss) income for the period	(37,229)	44,033	240,716	173,071
Comprehensive (loss) income for the period	\$ (165,953)	\$ (1,944,881)	\$ 839,929	\$ (2,678,293)
Comprehensive (loss) income attributed to:				
Shareholders of Kraken Robotics Inc.	\$ (165,953)	\$ (1,718,731)	\$ 839,929	\$ (2,397,184)
Non-controlling interests	-	(226,150)	-	(281,109)
Comprehensive (loss) income for the period	\$ (165,953)	\$ (1,944,881)	\$ 839,929	\$ (2,678,293)



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

2020	Number of Shares	Share capital (note 11)	Contributed Surplus	Accumulated other comprehensive loss	Non-Controlling Interest	Deficit	Total
Balance at January 1, 2020	147,177,186	\$ 22,594,846	\$ 2,220,924	\$ (363,031)	-	\$ (14,789,421)	9,663,318
Net income	-	-	-	-	-	599,213	599,213
Other comprehensive income	-	-	-	240,716	-	-	240,716
Transactions with shareholders, recorded directly in equity:							
Issue of common shares on stock option exercises	2,200,000	698,777	(228,162)	-	-	-	470,615
Issue of common shares on warrant exercises	-	-	-	-	-	-	-
Share issue costs (note 11(a))	-	-	-	-	-	-	-
Share-based compensation	-	-	455,778	-	-	-	455,778
Shareholders' equity as at June 30, 2020	149,377,186	\$ 23,293,623	\$ 2,448,540	\$ (122,315)	-	\$ (14,190,208)	11,429,640
2019	Number of Shares	Share capital (note 11)	Contributed Surplus	Accumulated other comprehensive loss*	Non-Controlling Interest*	Deficit	Total*
Balance at January 1, 2019	137,025,820	\$ 18,166,572	\$ 1,774,264	\$ (322,464)	331,395	\$ (11,652,332)	8,297,435
IFRS 16 Adjustment *	-	-	-	-	-	48,932	48,932
Net loss	-	-	-	-	(324,377)	(2,526,987)	(2,851,364)
Other comprehensive income *	-	-	-	129,803	43,268	-	173,071
Transactions with shareholders, recorded directly in equity:							
Issue of common shares on stock option exercises	87,333	15,119	-	-	-	-	15,119
Issue of common shares on warrant exercises	8,889,442	4,052,807	(811,374)	-	-	-	3,241,433
Share issue costs (note 11(a))	-	(41,344)	-	-	-	-	(41,344)
Share-based compensation	-	-	83,000	-	-	-	83,000
Shareholders' equity as at June 30, 2019*	146,002,595	\$ 22,193,154	\$ 1,045,890	\$ (192,661)	\$ 50,286	\$ (14,130,387)	8,966,282

*Prior year amounts have been corrected from amounts presented in the Q2 2019 interim financial statements



**Condensed Consolidated Interim Statements of Cash Flows
(Unaudited)
For the Six Months Ended June 30, 2020 and 2019
(Expressed in Canadian Dollars)**

	June 30, 2020	June 30, 2019
Cash flows used in operating activities		
Net Income/(loss)	\$ 599,213	\$ (2,851,364)
Adjustments for items not involving cash:		
Depreciation	362,272	383,265
Amortization of intangible assets	146,775	582,647
Share-based payments	455,778	83,000
Investment Tax Credit	(650,138)	(338,219)
Interest on lease liability	100,635	88,956
Changes in non-cash working capital	509,667	473,921
Net cash flows used in operating activities	1,524,202	(1,577,794)
Cash flows from (used in) investing activities		
Purchase of property, plant and equipment	(555,541)	(1,190,343)
	(555,541)	(1,190,343)
Cash flows from (used in) financing activities		
Proceeds from option exercise	470,615	15,119
Proceeds from exercise of warrants	-	3,241,433
Share issue costs	-	(41,344)
Payment of lease liability	(184,679)	(60,852)
Increase in long-term obligations	64,005	-
	349,941	3,154,356
Net increase in cash	1,318,602	386,219
Effect of foreign exchange on cash	(43,922)	82,160
Cash at beginning of period	2,097,199	4,929,865
Cash at end of period	\$ 3,371,879	\$ 5,398,244



**Notes to the Condensed Consolidated Interim Financial Statements
(Unaudited)
For the Six Months Ended June 30, 2020 and 2019**

1. Corporate Information:

Kraken Robotics Inc. (“Kraken” or the “Company”) 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’s principal business is the design, manufacture and sale of software-centric sensors, batteries, and underwater robotic systems.

2. 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, 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.

These consolidated financial statements were approved by the Board of Directors on August 24, 2020.

(b) Basis of measurement and reclassification of comparative figures

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

These condensed consolidated interim financial statements are presented in Canadian dollars, which is the Company’s functional and presentation currency.

(c) Business Combinations

These condensed consolidated financial statements incorporate the financial statements of the Company and entities controlled by the Company (its wholly owned subsidiaries), Kraken Robotic Systems Inc., Ocean Discovery Inc., Kraken Robotics US Inc., Kraken Robotik GmbH, Kraken Power GmbH. All intercompany balances and revenue and expense transactions have been eliminated on consolidation.

(d) Accounting estimates and judgments:

The preparation of condensed 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 condensed 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:

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.



**Notes to the Condensed Consolidated Interim Financial Statements
(Unaudited)
For the Six Months Ended June 30, 2020 and 2019**

2. Basis of presentation (continued):

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).

iii) 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.

iv) Business Combinations

The Company recognizes the consideration paid, assets acquired and liabilities assumed at their acquisition date fair values, recognizing any goodwill acquired or gain on purchase. The purchase price allocation requires significant judgements in the identification of the acquired assets and assumed liabilities. To determine the fair values of the identified assets and liabilities the Company will use the discounted cash flow method and other accepted valuation techniques that require assumptions about business strategies, growth rates, operating costs, discount rates and other economic factors.

The Company's assessment that it has control over an entity when it owns less than 50% of ownership interest requires significant judgement and consideration of 'de-facto' control. De-facto control exists when the size of the Company's own voting rights relative to the size and dispersion of other vote holders give the Company the ability to direct the relevant activities of the entity. In other cases, the assessment of control may be more complex and require more than one factor to be considered, for example when power results from one or more contractual arrangements. An investor with the current ability to direct the relevant activities has power even if its rights to direct have yet to be exercised. Evidence that the investor has been directing relevant activities can help determine whether the investor has power, but such evidence is not, in itself, conclusive in determining whether the investor has power over an investee.

For business combinations, the acquisition date is generally the date on which the acquirer legally transfers the consideration, acquires the assets and assumes the liabilities of the acquiree. However, acquisition date may differ from this date if the Company obtains control on a date that is either earlier or later than this date. For example, the acquisition date precedes the closing date if a written agreement provides that the Company obtains control of the acquiree on a date before the closing date. The Company considers all pertinent facts and circumstances in identifying the acquisition date.



**Notes to the Condensed Consolidated Interim Financial Statements
(Unaudited)
For the Six Months Ended June 30, 2020 and 2019**

2. Basis of presentation (continued):

- v) Goodwill and intangible assets

The Company conducts impairment testing on its goodwill and intangible assets annually in the fourth quarter and whenever events or changes in circumstances indicate that the carrying value may not be recoverable. The Company determines the fair value of each cash-generating unit to which goodwill and intangible assets are allocated using the value in-use-method, which estimates fair value using a discounted five-year forecasted cash flow estimate with a terminal value. The determination of the recoverable amount involves estimates and assumptions of future revenues, product margins, market conditions, and appropriate discount rates.

3. Trade and other receivables:

Trade and other receivables consist of the following:

	June 30, 2020	December 31, 2019
Trade receivables	\$ 2,040,812	\$ 3,236,207
Unbilled accounts receivables	202,843	272,832
Government assistance receivable and other	1,234,740	1,574,701
	\$ 3,478,395	\$ 5,083,740

4. Investment tax credit receivable

At June 30, 2020, the Company had filed its Scientific Research and Experimental Development (SR&ED) Expenditures Claim for the year ended December 31, 2019 and is entitled to a refundable Provincial Investment Tax Credit of \$650,138 (December 31, 2018 - \$338,219) from the Canada Revenue Agency (CRA).

5. Inventory

Included in the cost of sales for the three months and six months ended June 30, 2020 is inventory of \$704,363 (2019 - \$672,104) and \$2,605,926 (2019 - \$1,048,732) respectively.

6. Prepayments

As at June 30, 2020, the Company had made prepayments of \$510,574 (2019 - \$130,415) towards inventory, of which 62% of the total represents 2 vendors.



**Notes to the Condensed Consolidated Interim Financial Statements
(Unaudited)
For the Six Months Ended June 30, 2020 and 2019**

7. Property and equipment

	Furniture and Equipment	Computer equipment	ROU Asset	Construction in progress	Leasehold improvements	AUV Vehicle	Total
Cost							
Balance at January 1, 2019	\$ 531,810	\$ 168,229	\$ 1,518,040		\$ 115,677	\$ 1,489,175	\$ 3,822,931
Additions	513,313	120,027	90,695	91,318	918,407	-	1,733,760
Disposal and transfer to inventory	(631)					(1,489,175)	(1,489,806)
Foreign exchange	(21,946)	(1,107)					(23,053)
Balance at December 31, 2019	\$ 1,022,546	\$ 287,149	\$ 1,608,735	\$ 91,318	\$ 1,034,084	\$ -	\$ 4,043,832
Additions	152,620	31,434	245,791	350,613	20,874		801,332
Foreign Exchange	13,451	1,468					14,919
Balance at June 30, 2020	\$ 1,188,617	\$ 320,051	\$ 1,854,526	\$ 441,931	\$ 1,054,958	\$ -	\$ 4,860,083
Accumulated depreciation							
Balance at January 1, 2019	\$ 79,804	\$ 68,787	\$ -		\$ 75,061	\$ 263,398	\$ 487,050
Depreciation	180,739	64,352	247,157		166,351	108,586	767,185
Disposal and transfer to inventory	(343)					(371,984)	(372,327)
Balance at December 31, 2019	\$ 260,200	\$ 133,139	\$ 247,157	\$ -	\$ 241,412	\$ -	\$ 881,908
Depreciation	99,279	38,682	138,774		85,537		362,272
Balance at June 30, 2020	\$ 359,479	\$ 171,821	\$ 385,931	\$ -	\$ 326,949	\$ -	\$ 1,244,180
Carrying amounts							
At December 31, 2019	\$ 762,346	\$ 154,010	\$ 1,361,578	\$ 91,318	\$ 792,672	\$ -	\$ 3,161,924
At June 30, 2020	\$ 829,138	\$ 148,230	\$ 1,468,595	\$ 441,931	\$ 728,009	\$ -	\$ 3,615,903

8. Financial instruments:

Credit Risk:

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

	June 30, 2020	December 31, 2019
Cash and cash equivalents	\$ 3,371,879	\$ 2,097,199
Trade and other receivables	3,478,395	5,083,740
	\$ 6,850,274	\$ 7,180,939



**Notes to the Condensed Consolidated Interim Financial Statements
(Unaudited)
For the Six Months Ended June 30, 2020 and 2019**

8. Financial instruments (continued):

At June 30, 2020, 67% of the trade receivables balance was owing from 2 customers (2019 – 65% of the trade receivables was owing from 2 customers). At June 30, 2020, the Company had recorded contract liabilities of \$ 1,356,576 (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 June 30, 2020, the Company had a cash balance of \$3,371,879 (December 31, 2019 - \$2,097,199) to settle current liabilities of \$5,320,246 (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 June 30, 2020, the Company has cash balances of \$3,371,879 and has drawn \$Nil 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, 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.

Market Risk

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

	June 30, 2020	December 31, 2019
Financial liabilities denominated in foreign currency:		
Trade and other payables USD	\$ 339,598	\$ 62,577
Trade and other payables GBP	4,100	3,900
Trade and other payables EUR	661,416	814,618
Long-term debt EUR	310,883	269,063
Financial assets denominated in a foreign currency:		
Trade and other receivables USD	1,204,541	2,027,589
Trade and other receivables GBP	-	-
Trade and other receivables EUR	145,227	397,646

For the six months ended June 30, 2020 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 (\$9,390) respectively (2019 - \$471,430).



**Notes to the Condensed Consolidated Interim Financial Statements
(Unaudited)
For the Six Months Ended June 30, 2020 and 2019**

8. Financial instruments (continued):

Fair Value:

During the six months ended June 30, 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:

June 30, 2020	Level 1	Level 2	Level 3
Financial assets classified as loans and receivables:			
Cash and cash equivalents	\$ 3,371,879	\$ -	\$ -
Trade and other receivables	-	3,478,395	-
Financial liabilities at amortized cost:			
Trade and other payables	-	3,720,987	-
Long-term obligations	-	475,806	-
December 31, 2019	Level 1	Level 2	Level 3
Financial assets at amortized cost:			
Cash and cash equivalents	\$ 2,097,199	\$ -	\$ -
Trade and other receivables	-	5,083,740	-
Financial liabilities at amortized cost:			
Trade and other payables	-	3,620,443	-
Long-term obligations	-	392,374	-

9. Bank indebtedness:

At June 30, 2020, the Company had a \$1,500,000 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 June 30, 2020, a total of \$Nil (December 31, 2019 - \$Nil) was drawn against this facility.

10. Long-term obligations:

	June 30, 2020	December 31, 2019
Long-term note payable in the amount of €400,000 loan with a German regional economic development organization due March 31, 2023, unsecured and bearing interest at 8.5%.	\$ 411,801	\$ 392,374
Loan, secured by equipment, bearing interest at 1.4956%, in the amount of €41,820 for the initial deposit on the equipment. Upon delivery of equipment the final amount financed will be €94,032 repayable in equal installments over 72 months.	64,005	-
	\$ 475,806	\$ 392,374



**Notes to the Condensed Consolidated Interim Financial Statements
(Unaudited)
For the Six Months Ended June 30, 2020 and 2019**

10. Long-term obligations (continued):

The long-term note payable has a profit participation feature whereby if Kraken Power is profitable, the lender will receive 1.5% of the profits up to an annual cap of €6,000. Completion of the Kraken Power 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 in 2020, which is included in trade and other payables.

11. Share capital:

Authorized: Unlimited number of common shares

See the condensed consolidated statements of changes in shareholders' equity for a summary of changes in Share capital and Contributed surplus for the periods ended June 30, 2020 and 2019.

In February 2019, 1,050,000 warrants were exercised at a price of \$0.30.

In March 2019, 5,760,000 warrants held by Ocean Infinity were exercised at a price of \$0.40 and 1,510,000 warrants were exercised at a price of \$0.30.

In April 2019, 557,776 warrants were exercised at a price of \$0.30.

Share purchase warrant transactions are summarized for the periods ending June 30, 2020 and December 31, 2019:

	Six months ended June 30, 2020		Year ended December 31, 2019	
	Number of Warrants	Weighted Average Exercise Price	Number of Warrants	Weighted Average Exercise Price
Opening balance	550,000	\$ 0.60	9,427,776	\$ 0.38
Warrants exercised	-	-	(8,877,776)	0.365
Ending Balance	550,000	\$ 0.60	550,000	\$ 0.60
Warrants exercisable	550,000	\$ 0.60	550,000	\$ 0.60

In April 2019, 11,666 finder's warrants were exercised as a price of \$0.18, there were no remaining finder's warrants to expire during the period.

At June 30, 2020 and December 31, 2019, the following share purchase warrants were outstanding:

Expiry Date	Exercise Price	June 30, 2020	December 31, 2019	Weighted Average Remaining Contractual Life
December 20, 2020	\$0.60	550,000	550,000	.47 years
	\$0.60	550,000	550,000	.47 years

(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.



**Notes to the Condensed Consolidated Interim Financial Statements
(Unaudited)
For the Six Months Ended June 30, 2020 and 2019**

11. Share capital (continued):

The following options were outstanding as at June 30, 2020 and December 31, 2019:

	June 30, 2020		December 31, 2019	
	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
Opening balance	12,051,834	\$ 0.402	6,940,834	\$ 0.197
Granted	75,000	0.44	6,155,000	0.59
Exercised	(2,200,000)	0.21	(1,025,666)	0.154
Expired	-	-	(18,334)	0.18
Ending balance	9,926,834	\$ 0.44	12,051,834	\$ 0.402
Options exercisable	5,690,167	\$ 0.395	7,331,834	\$ 0.376

Weighted Average Exercise Price	Expiry Date	Number Outstanding	Number Exercisable	Weighted Average Remaining Contractual Life
0.17	September 8, 2020	350,000	350,000	0.19 years
0.18	October 4, 2020	300,000	300,000	0.26 years
0.18	December 15, 2020	1,571,834	1,571,834	0.46 years
0.185	February 20, 2021	450,000	450,000	0.64 years
0.21	June 21, 2021	200,000	200,000	0.98 years
0.26	July 18, 2021	833,333	500,000	1.05 years
0.70	March 5, 2022	500,000	333,333	1.68 years
0.63	July 14, 2022	1,500,000	500,000	2.04 years
0.63	July 14, 2022	400,000	300,000	2.04 years
0.53	September 8, 2022	2,746,667	910,000	2.19 years
0.44	May 1, 2023	75,000	25,000	2.84 years
0.63	July 14, 2024	1,000,000	250,000	4.04 years
\$ 0.395		9,926,834	5,690,167	1.53 years

(d) Share-based compensation

During the three month and six month period ended June 30, 2020 the Company recorded share-based compensation totaling \$220,420 and \$ 455,778 (2019 - \$8,200 and \$83,000), 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.

During the three month period ended June 30, 2020, the Company granted 75,000 options to an employee. The fair values of the options granted were estimated using the Black-Scholes option pricing model with the following assumptions:



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11. Share capital (continued):

	Six Months ended June 30, 2020	Six Months ended June 30, 2019
Risk-free interest rate	0.29%	1.74%
Expected life of options	3 years	3 years
Expected volatility	115.13%	103.81%
Weighted average fair value per option	\$0.19 - \$0.30	\$0.44
Dividend yield	Nil	Nil

12. 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 or sell assets to reduce debt.

13. Government assistance:

During the three months and six months ended June 30, 2020, the Company received government assistance, excluding the OceanVision project, in the amount of \$1,045,296 and \$1,712,702 respectively (2019 - \$237,295 and \$1,106,250). Government Assistance for the three months and six months ended June 30, 2020 has been classified as a reduction to Cost of Sales \$75,378 (2019 - \$106,925) and \$75,378 (2019 - \$193,300) respectively, Research & Development expense \$787,337 (2019 - \$130,370) and \$1,454,744 (2019 - \$912,950) respectively and Administrative expense \$182,581 (2019 - nil) and \$182,581 (2019 - nil) respectively.

The financial statements reflect a cost reimbursement accrual made to recognize work under Kraken's OceanVision project during the three months and six months ended June 30, 2020, including \$832,309 (2019 - nil) and \$1,450,771 (2019 - nil) respectively in reimbursements from the Ocean SuperCluster and \$189,264 (2019 - nil) and \$419,345 (2019 - nil) respectively in reimbursements by funding partners. Assistance related to the OceanVision project has been classified as a reduction to Research & Development expense \$857,505 (2019 - nil) and \$1,172,408 (2019 - nil) respectively, Administrative expense \$nil (2019 - nil) and \$12,893 (2019 - nil) respectively, Cost of sales \$11,944 (2019 - nil) and \$26,296 (2019 - nil) respectively and Construction in progress of \$152,124 (2019 - nil) and \$658,519 (2019 - nil) respectively.

14. Segmented information:

With the acquisition of Kraken Power in fiscal 2018, the Company now operates in two reportable operating segments, being: 1) "Sensors and Platforms" which is the design, manufacture and sale and provision of services for underwater sonar and laser scanner sensor equipment and underwater vehicle platforms; 2) "Power" which is the design, manufacture and sale of subsea power equipment such as drives, thrusters, and batteries.

The following tables present the operations of the Company's reportable segments as at and for the six months ending June 30, 2020 and comparatives for June 30, 2019:



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14. Segmented information (continued):

June 30, 2020	Sensors and Platforms	Power	Eliminations	Consolidated
Revenue	\$ 8,663,204	\$ 2,814,467	\$ (2,805,067)	\$ 8,672,604
Expenses	\$ 7,864,073	\$ 2,319,763	\$ (2,110,445)	\$ 8,073,391
Segment profit (loss)	\$ 799,131	\$ 494,705	\$ (694,623)	\$ 599,213
Segment assets	\$ 15,998,134	\$ 5,580,770	\$ (2,442,223)	\$ 19,136,681
Segment liabilities	\$ 7,554,629	\$ 2,873,330	\$ (2,720,918)	\$ 7,707,041
Segment capital expenditures	\$ 760,572	\$ 40,760	\$ -	\$ 801,332
June 30, 2019	Sensors and Platforms	Power	Eliminations	Consolidated
Revenue	\$ 2,775,258	\$ 212,804	\$ (281,182)	\$ 2,706,880
Expenses	\$ 4,681,269	\$ 1,198,143	\$ (321,168)	\$ 5,558,244
Segment profit (loss)	\$ (1,906,011)	\$ (985,339)	\$ 39,986	\$ (2,851,364)
Segment assets	\$ 21,200,073	\$ 6,307,953	\$ (7,417,891)	\$ 20,090,135
Segment liabilities	\$ 12,548,775	\$ 8,086,715	\$ (9,471,463)	\$ 11,164,027
Segment capital expenditures	\$ 1,014,191	\$ 176,152	\$ -	\$ 1,190,343

The following table sets forth external revenue by geographic areas based on the location of the contracting customers:

	Three months ended June 30, 2020	Six months ended June 30, 2020	Three months ended June 30, 2019	Six months ended June 30, 2019
Total revenues:				
Canada	121,862	223,002	13,920	133,150
United States	1,881,490	6,590,642	505,462	505,462
Europe	278,577	1,846,436	816,767	1,996,811
Other	-	12,524	1,346	71,457
	\$2,281,929	\$8,672,604	\$1,337,495	\$2,706,880

15. Commitments:

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 contractually committed to grant research and development projects to Fraunhofer of €300,000 per year for a period of two more years (2020-2021), these projects will be awarded to Fraunhofer as various statement of works are agreed upon and purchase orders issued. The remaining commitment balance at June 30, 2020 is €600,00 and these projects will be expensed as incurred.



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15. Commitments (continued):

To fund the OceanVision 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 project is \$7.4 million, of which \$6.0 million remains outstanding at June 30, 2020. Kraken's commitment will be reduced as government and industry partners join the project in 2020.

With the adoption of IFRS 16 for Leases, the Company applies the short-term lease recognition exemption to its short-term leases (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. The total value of these short-term lease commitments for 2020 is \$115,197.

16. Subsequent events:

Subsequent to June 30, 2020, the Company:

- (a) Received notification that the complaint process regarding the Royal Danish Navy's mine hunting upgrade program has been finalized. The total contract value is expected to be between C\$35-\$40 million, with the majority of that received over a 2-year equipment acquisition phase. We expect to finalize matters with the Royal Danish Navy during Q3,2020.
- (b) Announced that NSP Maritime Link Inc (NSPML), a wholly owned subsidiary of Emera Inc, has joined Kraken's OceanVision™ project. NSPML will contribute over \$500,000 during the term of the project.
- (c) Kraken Power has obtained a €500,000 line of credit for general operating purposes (the "operating line"). The operating line bears interest at 3.95%, payable monthly.
- (d) Granted 1,500,000 stock options to certain Directors at an exercise price of \$0.57.
- (e) Granted 300,000 stock options to a Director at an exercise price of \$0.51.
- (f) Received an additional order under the FCT program for delivery in Q4, 2020.