



Annual Financial Statements

For the three and twelve month periods ended December 31, 2017

December 31, 2017

MANAGEMENT'S REPORT

To the Shareholders of Kaisen Energy Corp.

Management's Responsibility on Financial Statements

Management is responsible for the preparation of the annual Kaisen Energy Corp. financial statements. The financial statements have been prepared in accordance with the accounting policies detailed in the notes thereto. In Management's opinion, the financial statements are in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board and include certain estimates that reflect Management's best judgments.

Management is responsible for the integrity of the financial statements. Management has developed and maintains an adequate system of internal control over financial reporting which provides reasonable assurance that all transactions are recorded, that the financial statements realistically report the Company's operating and financial results, and that the Company's assets are safeguarded from loss or unauthorized use. Management believes that this system of internal controls has operated effectively for the year ended December 31, 2017. The Company has effective disclosure controls and procedures to ensure timely and accurate disclosure of material information relating to the Company which complies with the requirements of Canadian securities legislation.

The Board of Directors has approved the information contained in the financial statements. Their financial statement related responsibilities are fulfilled mainly through the Audit Committee which is composed entirely of independent directors, and includes at least one director with financial expertise. The Audit Committee meets regularly with management and the external auditors to discuss reporting issues and ensures each party is properly discharging its responsibilities. The Audit Committee also considers the independence of the external auditors and reviews their fees.

The financial statements have been audited by Ernst & Young LLP, Independent Registered Chartered Professional Accountants, in accordance with Canadian generally accepted auditing standards on behalf of the shareholders.

(Signed)

Cameron King
President and Chief Executive Officer

(Signed)

Jeff Holmgren
Senior Vice-President and Chief Financial Officer

April 9, 2018

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of Kaisen Energy Corp.:

We have audited the accompanying financial statements of Kaisen Energy Corp. (the "Company"), which comprise the statements of financial position as at December 31, 2017 and 2016, and the statements of earnings (loss) and comprehensive earnings (loss), cash flows and statements of changes in shareholders' equity for the years then ended and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management of the Company is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Kaisen Energy Corp. as at December 31, 2017 and 2016, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.



Chartered Professional Accountants

Calgary, Canada

April 9, 2018

Statements of Financial Position
As at December 31

<i>(Cdn\$)</i>	2017		2016	
Assets				
Cash	\$	822,010	\$	2,399,085
Accounts receivable <i>(Note 6)</i>		1,991,332		1,831,470
Prepaid expenses and deposits		132,923		609,842
Total current assets		2,946,265		4,840,397
Due from shareholder <i>(Note 18)</i>		268,525		259,275
Property, plant and equipment <i>(Note 8)</i>		57,720,471		53,347,150
Total assets	\$	60,935,261	\$	58,446,822
Liabilities				
Accounts payable and accrued liabilities	\$	2,319,729	\$	4,505,943
Risk management contracts <i>(Note 7)</i>		887,852		2,517,685
Bank debt <i>(Note 9)</i>		3,051,501		-
Total current liabilities		6,259,082		7,023,628
Risk management contracts <i>(Note 7)</i>		634,994		1,465,598
Asset retirement obligations <i>(Note 12)</i>		11,506,151		9,862,302
Deferred tax liability <i>(Note 15)</i>		-		-
Total non-current liabilities		12,141,145		11,327,900
Total liabilities		18,400,227		18,351,528
Equity				
Share capital <i>(Note 13)</i>		53,189,854		50,689,854
Contributed surplus <i>(Note 13)</i>		6,153,693		3,851,531
Retained earnings / (deficit)		(16,808,513)		(14,446,091)
Total equity		42,535,034		40,095,294
Total liabilities and equity	\$	60,935,261	\$	58,446,822
Commitments and contingencies <i>(Note 17)</i>				

See accompanying notes to the financial statements

Approved by the Board of Directors

(Signed)

Evan Hazell
Chairman
April 9, 2018

(Signed)

Cameron King
President, CEO and Director
April 9, 2018

Statements of Earnings (Loss) and Comprehensive Earnings (loss)

(Cdn\$)	Three months ended December 31, (Unaudited)		Twelve months ended December 31,	
	2017	2016	2017	2016
Petroleum and natural gas sales	\$ 5,578,173	\$ 4,587,979	\$ 21,432,511	\$ 11,155,536
Royalties	(975,978)	(908,606)	(3,711,376)	(1,951,060)
Revenue, net of royalties	4,602,195	3,679,373	17,721,135	9,204,476
Saskatchewan resource tax	(9,622)	(62,254)	(300,472)	(147,254)
Realized gain/(loss) on risk management contracts (Note 7)	(256,044)	(302,071)	124,018	(373,987)
Revenue, net of royalties and realized hedging gain/(loss)	4,336,529	3,315,048	17,544,681	8,683,235
Operating expenses	2,150,478	2,965,240	10,767,470	7,495,529
Transportation expenses	244,039	291,756	1,054,299	733,458
General and administrative expenses	448,916	709,050	2,649,231	2,658,155
Transaction expenses	-	-	-	290,049
Share-based compensation (Note 13)	481,263	491,515	1,937,229	1,801,751
Depletion and depreciation	1,441,199	1,323,042	5,632,069	3,783,685
Unrealized (gain)/loss on risk management contracts (Note 7)	1,312,370	2,145,162	(2,460,437)	3,983,283
Total expenses	6,078,265	7,925,765	19,579,861	20,745,910
Loss from operating activities	(1,741,736)	(4,610,717)	(2,035,180)	(12,062,675)
Finance charges (Note 10)	(82,229)	(51,250)	(322,728)	(209,316)
Earnings / (loss) before income taxes	(1,823,965)	(4,661,967)	(2,357,908)	(12,271,991)
Current income tax expense/(recovery)	-	(89,721)	4,514	(89,721)
Deferred income tax expense/(recovery)	-	-	-	(882,263)
Total Income tax expense/(recovery) (Note 15)	-	(89,721)	4,514	(971,984)
Net loss and comprehensive loss	\$ (1,823,965)	\$ (4,572,246)	\$ (2,362,422)	\$ (11,300,007)
Net loss per share (Note 13)				
Basic & diluted	(\$0.04)	(\$0.11)	(\$0.05)	(\$0.35)

See accompanying notes to the financial statements

Statements of Cash Flows

(Cdn\$)	Three months ended December 31, (Unaudited)		Twelve months ended December 31,	
	2017	2016	2017	2016
Cash provided by (used in)				
Operating activities				
Net loss for the period	\$ (1,823,965)	\$ (4,572,246)	\$ (2,362,422)	\$ (11,300,007)
Add (deduct) items not affecting cash:				
Depletion and depreciation expense	1,441,199	1,323,042	5,632,069	3,783,685
Accretion of asset retirement obligations (Note 12)	57,428	54,406	224,786	181,897
Deferred income tax expense/(recovery)	-	-	-	(882,263)
Share-based compensation (Note 13)	481,263	491,515	1,937,229	1,801,751
Abandonment costs incurred (Note 12)	(7,960)	-	(63,873)	-
Change in fair value of financial instruments (Note 7)	1,312,370	2,145,162	(2,460,437)	3,983,283
	1,460,335	(558,121)	2,907,352	(2,431,654)
Change in non-cash working capital (Note 14)	(1,570,828)	905,294	(1,912,426)	1,632,883
Cash flow from (used in) operating activities	(110,493)	347,173	994,926	(798,771)
Financing activities				
Increase / (decrease) in bank debt	1,702,195	-	3,051,501	-
Proceeds from issuance of shares	-	-	2,500,000	20,000,000
Share issue costs	-	(5,025)	-	(736,499)
Cash flow from financing activities	1,702,195	(5,025)	5,551,501	19,263,501
Investing activities				
Development of oil and gas properties	(310,770)	(1,424,243)	(8,157,521)	(3,467,580)
Corporate acquisitions	-	-	-	(15,579,774)
Change in non-cash working capital (Note 14)	(592,102)	-	34,019	-
Cash used in investing activities	(902,872)	(1,424,243)	(8,123,502)	(19,047,354)
Net change in cash during the period	688,830	(1,082,095)	(1,577,075)	(582,624)
Cash, beginning of the period	133,180	3,481,180	2,399,085	2,981,709
Cash, end of the period	\$ 822,012	\$ 2,399,085	\$ 822,010	\$ 2,399,085
Supplementary disclosure				
Cash interest paid	\$ 24,801	\$ -	\$ 97,942	\$ 27,419

See accompanying notes to the financial statements

Statement of Changes in Shareholders' Equity

<i>(Cdn\$)</i>	Share Capital <i>(Note 13)</i>	Contributed Surplus	Retained Earnings / (deficit)	Total Equity
Balance at December 31, 2015	\$ 31,228,855	\$ 1,732,881	\$ (3,146,084)	\$ 29,815,652
Net loss	-	-	(11,300,007)	(11,300,007)
Shares issued for cash	20,000,000	-	-	20,000,000
Share issue costs (net of tax of \$197,498)	(539,001)	-	-	(539,001)
Share-based compensation – stock options	-	2,118,650	-	2,118,650
Balance at December 31, 2016	\$ 50,689,854	\$ 3,851,531	\$ (14,446,091)	\$ 40,095,294
Net loss			(2,362,422)	(2,362,422)
Shares issued for cash	2,500,000		-	2,500,000
Share-based compensation – stock options	-	2,302,162	-	2,302,162
Balance at December 31, 2017	\$ 53,189,854	\$ 6,153,693	\$ (16,808,513)	\$ 42,535,034

See accompanying notes to the financial statements

Notes to the Annual Financial Statements

For the three and twelve month periods ended December 31, 2017 and 2016

1. Corporate information:

Kaisen Energy Corp. (the “Company” or “Kaisen”) is a Calgary based energy company primarily focused on heavy oil development and production in Saskatchewan. The Company was incorporated in Canada on November 6, 2012. The Company’s principal place of business is located at 400, 522 – 11th Avenue S.W. Calgary, Alberta, Canada, T2R 0C8.

2. Basis of presentation

(a) Statement of compliance

These financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”). The reporting and the measurement currency is the Canadian dollar. Management believes these financial statements present fairly the Company’s financial position, financial performance and cash flows for the periods reported herein. The financial statements were approved by the board of directors for release on April 9, 2018.

All three month periods presented in these financial statements are unaudited.

(b) Basis of Measurement

These financial statements have been prepared under the historical cost convention except for derivative financial instruments and share-based compensation transactions which are measured at fair value. The methods used to measure fair values are discussed in Note 6 – Financial Instruments and Risk Management.

(c) Use of Judgments, Estimates and Assumptions

The timely preparation of financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that impact the carrying amounts of assets and liabilities and disclosure of contingent assets and liabilities as at the date of the balance sheets as well as the reported amounts of revenue, expenses and cash flows during the periods presented. Such estimates relate primarily to unsettled transactions and events as of the date of the financial statements. Actual results could differ materially from estimated amounts.

Amounts recorded for depletion and depreciation expenses and amounts used for impairment test calculations are based on estimates of crude oil reserves and future costs required to develop those reserves. Estimates and assumptions by management are employed with respect to exploration and evaluation assets and cash-generating-units (“CGU’s”). Decommissioning liabilities are based on estimates of abandonment costs, timing of abandonment, forecast inflation and risk-free interest rates. Stock-based compensation is based upon the expected volatility, estimated forfeiture rate and option life estimates. The unrealized value of commodity price risk management contracts (if applicable) are based on valuations from third party providers and verified by management. These judgments, estimates and assumptions are subject to measurement uncertainty and changes to any of these items could materially impact the financial statements of future periods. These estimates and underlying assumptions are reviewed on an ongoing basis.

(i) Depletion, Depreciation and Reserve Estimates

Depletion is based on the proved plus probable reserves as evaluated in accordance with National Instrument 51-101, Standards of Disclosure for Oil and Gas Activities (“NI 51-101”) and incorporating the estimated future cost of development and production. The process of estimating reserves is complex. It requires significant judgments and decisions based on available geological, geophysical, engineering, and economic data. These estimates may change substantially as additional data from ongoing development activities and production performance becomes available and as economic conditions impacting oil and gas prices and costs change. The reserve estimates are based on current production forecasts, prices and economic conditions. As circumstances change and additional data becomes available, reserve estimates also change. Estimates made are reviewed and revised, either upward or downward, as warranted by new information. Revisions are often required due to changes in well performance, prices, economic conditions and government restrictions.

Although every reasonable effort is made to ensure that reserve estimates are accurate, reserve estimation is not an exact science. As a result, subjective decisions, new geological or production information and a changing environment may impact these estimates. Revisions to reserve estimates can arise from changes in year-end oil and gas prices and reservoir performance. Such revisions can be either positive or negative. Changes in reserve estimates impact the financial results of the Company as reserves and estimated future development costs are used to calculate depletion and are also used in measuring fair value less costs to sell of property, plant and equipment for impairment calculation.

(ii) Determination of Cash-Generating Units

The determination of CGUs requires judgment in defining a group of assets that generate cash inflows that are largely independent of the cash inflows from other assets or groups of assets. CGUs are determined by similar geological structure, shared infrastructure, geographical proximity, commodity type, similar exposure to market risks and materiality.

(iii) Decommissioning Liabilities

Decommissioning and restoration costs will be incurred by the Company at the end of the operating life of certain of its assets. The ultimate decommissioning and restoration costs are uncertain and cost estimates can vary in response to many factors including changes to relevant legal and regulatory requirements, the emergence of new restoration techniques or experience at other production sites. The expected timing

and amount of expenditure can also change in response to changes in reserves or changes in laws and regulations or their interpretation. As a result, there could be significant adjustments to the provisions established which would affect future financial results. In the Company's judgment, the most appropriate discount rate to use is a weighted average risk free rate. The Company re-measures the provision at the end of each reporting period to reflect the rates in effect at that time.

(iv) Impairment Indicators and Discount Rate

The recoverable amounts of CGUs and individual assets have been determined as the greater of an asset's or CGU's value-in-use and fair value less costs to sell. These calculations require the use of estimates and assumptions and are subject to changes as new information becomes available including information on future commodity prices, expected production volumes, quantity of reserves and discount rates as well as future development and operating costs. It is reasonably possible that the commodity price assumptions may change, which may impact the estimated life of the field and economical reserves recoverable and may require a material adjustment to the carrying value of oil and natural gas assets. The Company monitors internal and external indicators of impairment relating to its tangible assets.

(v) Stock Based Compensation

The Company measures the fair value of stock-based compensation based on grant dates using the Black- Scholes model using estimates for expected volatility, forfeiture rate, and option life. Actual stock-based compensation may differ from estimated amounts.

(vi) Income Taxes

The Company recognizes a deferred tax liability based on estimates of temporary differences between the book and tax value of its assets. An estimate is also used for both the timing and tax rate upon reversal of the temporary differences. Actual differences and the timing of reversals may differ from estimates, impacting the future income tax balance and net income.

Tax interpretations, regulations and legislation are subject to change. As such, income taxes are subject to measurement uncertainty. Deferred tax assets are assessed by management at the end of each reporting period to determine the likelihood that they will be realized from future taxable earnings.

3. Business Combinations

In the prior year, on July 14, 2016, the Company closed the acquisition of Hawk Exploration Ltd. ("Hawk"), a public oil and gas company with properties in west central Saskatchewan and east central Alberta, by acquiring all of the issued and outstanding shares. Total consideration for Hawk's 45.6 million common shares outstanding was approximately \$3.6 million along with debt assumption totaling \$11.9 million for a total acquisition cost of \$15.6 million. Pursuant to the closing, Hawk's debt was repaid and terminated. The acquisition was funded through a private equity offering on July 12, 2016 of 20.0 million common shares of the Company to Azimuth Capital Management ("Azimuth") for total gross proceeds of \$20.0 million. Prior to the equity offering, Azimuth held approximately 51% of the voting shares of Kaisen, subsequent to the offering Azimuth increased its ownership to approximately 70% of the voting shares of the Company.

The Hawk acquisition was accounted for as a business combination using the acquisition method of accounting, whereby the assets acquired and the liabilities assumed were recorded at the estimated fair value on the closing date of July 14, 2016. Determination of the fair value of property, plant and equipment acquired in a business combination requires management to make assumptions and estimates about future events. The fair value of crude oil and natural gas properties was estimated with reference to the discounted cash flows expected to be derived from the crude oil and natural gas production. These assumptions and estimates generally require judgement and include estimates of reserves acquired, liabilities assumed, forecasted benchmark commodity prices, and discount rates. Changes in any of the assumptions or estimates used in determining the fair value of acquired assets and liabilities could impact the amounts assigned to the net assets acquired.

The following table summarizes the acquisition date fair value of the consideration paid and the allocation of the purchase price:

Cost of acquisition	
Cash for Hawk common shares	\$ 3,646,076
Cash for debt elimination	11,933,698
Total consideration	\$ 15,579,774
Allocated at estimated fair values	
Accounts receivable	295,691
Prepays & deposits	40,683
Accounts payable	(799,177)
Deferred income tax asset	1,195,313
Property and equipment	17,728,895
Asset retirement obligations	(2,881,631)
	\$ 15,579,774

As part of the acquisition, Kaisen acquired tax pools that would have resulted in a deferred tax asset of which only the portion equally offsetting the Company's deferred tax liability as at December 31, 2016 was recognized with the remaining deferred tax asset not recognized due to the uncertainty of future recoverability. The comparative (prior year) financial statements incorporate the results of operations of the acquired properties from July 14, 2016 to December 31, 2016 with crude oil, natural gas and natural gas liquids sales of \$4,439,014 and net earnings of

\$1,352,918. If the transaction had taken place on January 1, 2016, it is estimated that the assets acquired would have contributed prior year sales of crude oil, natural gas and natural gas liquids of \$7.2 million and net earnings of \$1.1 million.

In conjunction with the acquisition, Kaisen incurred \$290,049 of transaction costs including amounts relating to legal fees, accounting fees and other related acquisition costs. This amount were reported as transaction costs in the comparative year of the Statements of Earnings/(Loss).

4. Summary of Significant Accounting Policies

The accounting policies set out below have been applied consistently in these financial statements.

(a) Business Combinations

Business combinations are accounted for using the acquisition method. The cost of an acquisition is measured as the aggregate of the consideration transferred at acquisition date fair value. Acquisition costs incurred are expensed. When the Company acquires a business, it assesses the financial assets and liabilities assumed for appropriate classification and designation in accordance with the contractual terms, economic circumstances and pertinent conditions as at the acquisition date. Contingent consideration to be transferred by the Company is recognized at fair value at the acquisition date. Subsequent changes to the fair value of contingent consideration recorded as a financial asset or liability are recognized in accordance with IAS 39 *Financial Instruments: Recognition and Measurement* in net earnings (loss).

(b) Property, Plant and Equipment

Property, plant and equipment is stated at cost, less accumulated depreciation and accumulated impairment losses and are not depreciated until proved or probable reserves can be determined or until management determines that these costs have been impaired.

The initial cost of an asset comprises its purchase price or construction cost, any costs directly attributable to bringing the asset into operation, the initial estimate of the decommissioning obligation, and for qualifying assets, borrowing costs.

Expenditure on the construction, installation or completion of infrastructure facilities, pipelines and the drilling of development wells, including unsuccessful development or delineation wells, is capitalized within property, plant and equipment. The purchase price or construction cost is the aggregate amount paid and the fair value of any other consideration given to acquire the asset. The capitalized value of a finance lease is also included within property, plant and equipment. The Company does not capitalize interest expense.

A gain or loss arising on the disposal or retirement of fixed assets is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognized in the Statement of Earnings (Loss) for the relevant period.

Expenditure on major turnarounds comprises the cost of replacement assets or parts of assets and inspection and overhaul costs. Where an asset or part of an asset is replaced and it is probable that future economic benefits will flow to the Company from the replacement, the expenditure is capitalized and the replaced part is derecognized. Inspection and overhaul costs relating to turnarounds and all other repairs and maintenance costs are expensed when incurred.

Well workover costs incurred to stimulate depleted wells are charged as an expense when incurred. Certain stimulation costs which increase production and reserves, extending beyond one year, are capitalized in property, plant and equipment and depleted over the economic life of the asset.

The Company assesses at each reporting date whether there is an indication that property, plant and equipment may be impaired. If any indication exists, the Company estimates the asset's recoverable amount using the methodology described below.

(c) Impairment of Assets

Property, Plant and Equipment and Exploration and Evaluation Assets

The Company tests property, plant and equipment assets for possible impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable, for example, changes in assumptions relating to future prices, future costs and reserves. Individual assets are grouped for impairment assessment purposes at the lowest level at which there are identifiable cash flows that are largely independent of the cash flows of other groups of assets, known as a cash-generating unit. If any such indications of impairment exist, an estimate of its recoverable amount is made. A CGU's recoverable amount is the higher of its fair value less costs to sell and its value in use.

Exploration and evaluation assets are tested for impairment using the same methodology.

A previously recognized impairment loss is reversed only if there has been a change in the estimates or assumptions used to determine the asset's recoverable amount since the last impairment loss was recognized. If that is the case, the carrying amount of the CGU is increased to its recoverable amount, not to exceed the carrying amount of what would have been determined, net of depreciation, had no impairment loss been recognized for the CGU in prior years. Such a reversal is recognized in net earnings (loss), following which the depreciation charge is adjusted in future periods to allocate the CGU's revised carrying amount, less any residual value, over its remaining useful life.

(d) Depletion and Depreciation

Oil and gas properties are depleted on a unit-of-production basis over the proved and probable reserves of the CGU. The unit-of-production rate for the amortization of field development costs takes into account expenditures incurred to date, together with estimated future development expenditures.

Corporate assets are generally depreciated on a straight-line basis over their estimated useful lives.

(e) Decommissioning Liability

Decommissioning liabilities are recognized when the Company has a statutory, contractual or legal obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation and a reliable estimate of the amount of the obligation can be made. A corresponding amount equivalent to the liability is recognized as part of the cost of the related property, plant and equipment.

Estimated decommissioning liabilities are carried on the Statement of Financial Position at present value, calculated using a weighted average risk free rate, accreted over time for the change in present value, with this accretion expense included in finance costs on the Statement of Earnings (Loss). Actual expenditures incurred are charged against the accumulated obligation. Any difference between the recorded decommissioning liability and the actual retirement costs incurred is recorded as a gain or loss when the field is abandoned.

The resulting increase in capitalized costs due to the inclusion of the decommissioning liability is amortized to income on a basis consistent with depletion and depreciation of the underlying assets. Subsequent changes in the estimated decommissioning liabilities are capitalized and amortized over the remaining useful life of the underlying asset.

Liabilities for environmental costs are recognized when an obligation exists and the associated costs can be reliably estimated. Generally, the timing of recognition of these liabilities coincides with the commitment to a formal plan of action or, if earlier, on divestment or on closure of inactive sites. The amount recognized is the best estimate of the expenditure required. Where the liability will not be settled for a number of years, the amount recognized is the present value of the estimated future expenditure. These estimates are included in decommissioning liabilities.

(f) Cash and Cash Equivalents

Cash and cash equivalents include cash on deposit with banks and short-term investments with a maturity of 90 days or less. Cash and cash equivalents are stated at cost, which approximates market value. When material and applicable, restricted cash is reported separately on the statement of financial position.

(g) Accounts Receivable

Accounts receivable are recorded based on the Company's revenue recognition policy. The allowance for doubtful accounts is management's best estimate of accounts receivable balances that may not be collectible, and is reviewed at each interim period.

(h) Inventory

Inventory is valued at the lower of cost and net realizable value. Cost comprises direct purchase costs (including transportation), production costs and taxes. Net realizable value is the estimated selling price in the ordinary course of business, less applicable expected variable selling expenses.

(i) Financing Income and Charges

Finance income comprises interest earned on cash and cash equivalents and other income. Finance charges include interest and other costs that the Company incurs in connection with the borrowing of funds, as well as accretion expense relating to the Company's decommissioning liabilities and impairment losses recognized on financial assets.

(j) Financial Instruments

Financial instruments are measured at fair value on initial recognition of the instrument, into one of the following five categories: held-for-trading, loans and receivables, held-to-maturity investments, available-for-sale financial assets or other financial liabilities. All financial assets and liabilities are recognized on the Statement of Financial Position when the Company becomes a party to the contractual requirements of the instrument. All financial instruments are measured at fair value on initial recognition. Transactions costs are included in the initial carrying amount of financial instruments except for held-for-trading items, in which case they are expensed as incurred.

Subsequent measurement of financial instruments is based on their initial classification. Held-for-trading financial assets are measured at fair value and changes in fair value are recognized in net earnings (loss). Available-for-sale financial instruments are measured at fair value with changes in fair value recorded in other comprehensive income (loss) until the instrument is derecognized or impaired. The remaining categories of financial instruments are recognized at amortized cost using the effective interest rate method.

Accounts receivable and loan receivable from related parties are classified as loans and receivables, which are measured at amortized cost. Accounts payable and accrued liabilities and obligations under finance lease are classified as other financial liabilities, which are measured at amortized cost.

For financial instruments that are not classified as held-for-trading, the transaction costs that are directly attributable to the acquisition or issue of a financial instrument are adjusted to the fair value initially recognized for that financial instrument. These costs are expensed using the effective interest rate method and are recorded within interest expense.

The Company has not entered into any financial derivative contracts, does not enter into these contracts for speculative purposes, and has not recorded any assets or liabilities as a result of embedded derivatives.

(k) Taxes

The Company is a taxable entity under the Income Tax Act (Canada). Income tax expense is comprised of current and deferred taxes. Current tax and deferred tax are recognized in profit or loss, except to the extent that it relates to items recognized directly in equity or in other comprehensive income, or as part of a purchase option.

Current tax is the expected tax payable or receivable, calculated on the taxable income or loss for the period, using tax rates enacted or substantively enacted at the reporting date. Current tax assets and liabilities are offset if there is a legally enforceable right to offset and the amounts can be settled on a net basis.

Deferred tax is recognized using the liability method for temporary differences at the reporting date between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognized for:

- Temporary differences on the initial recognition of assets and liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit or loss;
- Temporary differences related to investments in subsidiaries and jointly controlled entities to the extent that they will not reverse in the foreseeable future; and
- Taxable temporary differences arising on the initial recognition of goodwill, deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

Deferred tax assets are recognized to the extent that it is probable future taxable profits will be available for their utilization.

(l) Revenue Recognition

Petroleum and natural gas sales are recognized as the Company's share of the fair value of the consideration received or receivable when the significant risks and rewards of ownership have been transferred, which is when title passes from the Company to the customer. Royalty payments to the Government and other mineral interest owners, transportation expenses and all taxes collected from customers that are remitted to the Government are reported separately.

(m) Share-Based Payments

The Company accounts for share-based compensation using the fair-value method of accounting for stock-options and performance warrants (collectively referred to as "Rights") granted to directors, officers, employees and consultants using the Black-Scholes option-pricing model. Share-based compensation expense is recorded over the vesting period with a corresponding amount reflected in reserve for share-based compensation. Share-based compensation expense is calculated as the estimated fair value for the related Rights at the time of grant, amortized over their vesting period. When Rights are exercised, the associated amounts previously recorded as reserve for share-based compensation are reclassified to common share capital.

(n) Per Share Information

Basic net earnings (loss) per share is calculated by dividing the income or loss attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the period. Diluted net earnings (loss) per share is determined by adjusting the income or loss attributable to common shareholders and the weighted average number of common shares outstanding for the effects of dilutive instruments such as options granted to employees, except when the effect would be anti-dilutive.

(o) Accounting Standards and Interpretations Issued but not yet effective

There are ongoing IFRS standards and interpretation developments which may apply to future periods. These IFRS developments may result in future changes to our existing accounting policies and other note disclosures. Management is currently assessing the impact of adopting these standards, however the impact of these changes is not expected to be material to the Company's financial statements and therefore no further disclosure of IFRS developments have been made herein.

(p) Flow-through shares

Resource expenditures for income tax purposes related to exploration and development activities funded by flow-through share arrangements are renounced to investors in accordance with income tax legislation. A deferred liability is recognized for the difference between the value ascribed to the flow-through shares issued and the value that would have been received for common shares at the date of announcement of the flow-through shares. The deferred liability is drawn down as the Company incurs qualifying expenditures. Any difference between the deferred liability set up for the premium on the flow-through shares and the tax effect on the renounced expenditures is recognized in profit or loss as a deferred tax expense.

5. New Accounting Policies**Changes in Accounting Policies**

There were no material new or amended accounting standards adopted during the year ended December 31, 2017.

Future Accounting Policy Changes

In April 2016, the IASB issued its final amendments to IFRS 15 Revenue from Contracts with Customers which replaces IAS 18 Revenue and IAS 11 Construction Contracts. The standard requires an entity to recognize revenue to reflect the transfer of goods and services for the amount it expects to receive, when control is transferred to the purchaser. Disclosure requirements have also been expanded. The standard is required to be adopted either retrospectively or using the modified transition approach for fiscal years beginning on or after January 1, 2018, with early adoption permitted. The Company primarily enters into non-complex and routine revenue contracts with customers that require daily physical delivery of produced volumes priced at the current daily or monthly average spot price. Performance obligations are met upon delivery of the volumes at the processing facility and the transaction price is established based on the date of delivery. Kaisen will retrospectively adopt IFRS 15 on January 1, 2018. The Company has completed reviewing its various revenue streams and underlying contracts with customers. It has been concluded that the adoption of IFRS 15 will not have a material impact on the Company's net income and financial position. Kaisen will expand the disclosures in the notes to its financial statements as prescribed by IFRS 15, including disclosing the Company's disaggregated revenue streams by product type.

In July 2014, the IASB completed the final elements of IFRS 9 Financial Instruments. The standard supersedes earlier versions of IFRS 9 and completes the IASB's project to replace IAS 39 Financial Instruments: Recognition and Measurement. IFRS 9 introduces a single approach to determine whether a financial asset is measured at amortized cost or fair value and replaces the multiple rules in IAS 39. The approach is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of the financial assets. For financial liabilities, IFRS 9 retains most of the requirements of IAS 39; however, where the fair value option is applied to financial liabilities, any change in fair value resulting from an entity's own credit risk is recorded in OCI rather than the statement of income. Kaisen has determined that the adoption of IFRS 9 will not have a material impact on the measurement and carrying values of the Company's financial assets or liabilities.

In addition, IFRS 9 introduces a new expected credit loss model for calculating impairment of financial assets, replacing the incurred loss impairment model required by IAS 39. Kaisen has determined that the new impairment model will not result in material changes to the valuation of its financial assets on adoption of IFRS 9. IFRS 9 also contains a new model to be applied for hedge accounting. The Company does not currently apply hedge accounting to its risk management contracts and does not currently intend to apply hedge accounting to any of its existing risk management contracts on adoption of IFRS 9. The standard will come into effect for annual periods beginning on or after January 1, 2018, with earlier adoption permitted. IFRS 9, as well as consequential amendments to IFRS.

In January 2016 the IASB issued IFRS 16 Leases which requires lessees to recognize assets and liabilities for most leases. This standard replaces IAS 17 Leases and will be effective for annual periods beginning on or after January 1, 2019, with earlier adoption permitted if IFRS 15 Revenue from Contracts with Customers is also adopted. Under IFRS 16, lessees are required to recognize a lease liability reflecting future lease payments and a "right-to-use asset" for essentially all lease contracts. The Company is currently evaluating the effect of this standard.

6. Financial Instruments and Risk Management

(a) Classification and Measurement

Kaisen's financial instruments on the Balance Sheet are carried at amortized cost with the exception of cash and risk management contracts, which are carried at fair value. As at December 31, 2017 and 2016, no significant differences existed between the carrying value of financial instruments and their estimated fair values.

All of Kaisen's cash and risk management contracts are transacted in active markets. Kaisen classifies the fair value of these transactions according to the following hierarchy based on the amount of observable inputs used to value the instrument.

- Level 1 – Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions occur in sufficient frequency and volume to provide pricing information on an ongoing basis.
- Level 2 – Pricing inputs are other than quoted prices in active markets included in Level 1. Prices in Level 2 are either directly or indirectly observable as of the reporting date. Level 2 valuations are based on inputs, including quoted forward prices for commodities, time value and volatility factors, which can be substantially observed or corroborated in the marketplace.
- Level 3 – Valuations in this level are those with inputs for the asset or liability that are not based on observable market data.

Kaisen's cash (and cash equivalents if any), and risk management contracts have been assessed on the fair value hierarchy described above. Kaisen's cash is classified as Level 1 and risk management contracts as Level 2. Assessment of the significance of a particular input to the fair value measurement requires judgment and may affect the placement within the fair value hierarchy level.

(b) Risks Associated with Financial Assets and Liabilities

The Company has exposure to the following risks from its use of financial instruments:

- Credit risk
- Liquidity risk
- Market risk

This note presents information about the Company's exposure to each of the above risks.

Credit risk

Credit risk is the risk of financial loss to the Company if a counterparty to a financial instrument fails to meet its contractual obligations. The carrying amounts of cash and accounts receivable represent the maximum credit exposure to the Company.

All of the Company's crude oil and natural gas production is sold, as determined by market based prices adjusted for quality differentials, to midstream companies and intermediate producers. Receivables from customers are normally collected approximately 25 days following the month of production. As at December 31, 2017, approximately 95% of the Company's accounts receivables were with three crude oil marketing counterparts to whom the Company sells its production. The Company has not experienced any collection issues with its crude oil sales and therefore has not recorded an allowance for doubtful accounts as at December 31, 2017.

Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due. Kaisen's financial liabilities on the statement of financial position consist of accounts payable and accrued liabilities and bank debt. With consideration to currently low commodity prices, the Company believes it currently has adequate cash flows and working capital to discharge its current financial obligations and to service its bank debt.

Market risk

Market risk is the risk that fluctuations in commodity prices, interest rates and foreign currency rates will affect the Company's net earnings (loss) and comprehensive income (loss) or the value of its financial assets and liabilities.

(a) *Commodity price risk*

The price Kaisen receives for its oil production fluctuates continuously and, for the most part, is beyond the Company's control. A \$1.00 change in the US denominated WTI price or the US denominated Western Canadian Select heavy oil price, would impact the Company's revenues (utilizing the December 2017 production average of 1,185 barrels per day) by approximately \$46,000 per month.

(b) *Interest rate risk*

The only liability on the Company's balance sheet exposed to fluctuations in interest rates is the bank debt. Based upon the Company's bank debt at December 31, 2017, a fluctuation of one percent in interest rates would result in a change in monthly net income (before taxes) of approximately \$2,500.

(c) *Foreign currency risk*

Foreign currency risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate as a result of changes in foreign currency exchange rates. The Company is exposed to foreign currency fluctuations as crude oil prices are denominated in US dollars. A \$0.01 change in the US dollar to Canadian dollar exchange rate would impact the Company's revenues (utilizing the December 2017 production average of 1,185 barrels per day) by approximately \$21,000 per month. The Company had no foreign exchange forward rate contracts in place as at or during the period ended December 31, 2017.

7. Risk Management Contracts

The following is a summary of all risk management contracts in place as at December 31, 2017:

Type	Period	Volume	Price/unit ⁽¹⁾	Index
Swap	January 1, 2018 – December 31, 2018	200 bbl/d	CAD \$67.20	WTI-NYMEX
Swap	January 1, 2018 – June 30, 2018	100 bbl/d	CAD \$68.50	WTI-NYMEX
Swap	January 1, 2018 – June 30, 2018	200 bbl/d	CAD \$60.00	WTI-NYMEX
Swap	July 1, 2018 – December 31, 2018	200 bbl/d	CAD \$63.65	WTI-NYMEX
Call option ⁽³⁾	January 1, 2019 – December 31, 2019	400 bbl/d	USD \$60.00	WTI-NYMEX
Fixed WCS Basis Swap	January 1, 2018 – March 31, 2018	500 bbl/d	CAD -\$16.50	WCS-Net Energy

(1) Based on the weighted average price/bbl for the duration of the contract

(2) Contract acquired with acquisition of Hawk Exploration Ltd. on July 14, 2016, per above note on Asset Acquisition

(3) The Call Option contract provides ATB with an option (at only their election) to exercise the contract terms (on a month to month basis) throughout the term of the contract.

As at December 31, 2017, the fair value associated with Kaisen's risk management contracts was a liability of \$1,522,846 (\$3,983,283 at December 31, 2016), of which \$887,852 is a current liability reflecting contracts which will settle in 2018 with the remainder settling in 2019. The Company recorded a realized loss of \$256,044 for the Quarter and a gain of \$124,018 for the Year (losses of \$302,071 and \$373,987 respectively in the prior year.) The change in fair value during the Quarter produced an unrealized loss of \$1,312,370 (\$2,145,162 loss in same quarter in the prior year) and a gain of \$2,460,437 for the Year (\$3,983,283 loss in the prior year).

8. Property, plant and equipment

Cost	Oil and Gas Assets	Corporate Assets	Total Assets
Development expenditures	\$ 2,976,202	116,548	3,092,750
Corporate acquisition	17,728,895	-	17,728,895
Capitalized general and administrative costs	374,832	-	374,832
Capitalized stock based compensation	316,899	-	316,899
Balance, December 31, 2016	\$ 67,678,798	181,003	67,859,801
Development expenditures	7,929,179	14,851	7,944,030
Additions to asset retirement obligations	1,306,427	-	1,306,427
Capitalized general and administrative costs	390,000	-	390,000
Capitalized stock based compensation	364,933	-	364,933
Balance, December 31, 2017	77,669,337	195,854	77,865,191
Accumulated depletion and depreciation			
Balance, December 31, 2015	\$ (10,694,648)	\$ (34,318)	\$ (10,728,966)
Depletion and depreciation	(3,748,967)	(34,718)	(3,783,685)
Balance, December 31, 2016	\$ (14,443,615)	(69,036)	(14,512,651)
Depletion and depreciation	(5,595,061)	(37,008)	(5,632,069)
Balance, December 31, 2017	(20,038,676)	(106,044)	(20,144,720)
Net book value			
Balance, December 31, 2016	\$ 53,235,183	\$ 111,967	\$ 53,347,150
Balance, December 31, 2017	\$ 57,630,661	\$ 89,810	\$ 57,720,471

During the Quarter and Year ended December 31, 2017, the Company capitalized general and administrative expenses in the amount of \$97,500 and \$390,000 respectively (\$96,180 and \$374,832 respectively in the prior year) and capitalized share based compensation expense in the amount of \$89,733 and \$364,933 respectively (\$92,620 and \$316,899 respectively in prior year), relating to development activities.

Future development costs associated with proved and probable undeveloped reserves of \$98,869,400 (\$80,219,700 in the prior year) are included in the depletion calculation net of salvage values of \$2,580,000 (\$2,474,000 in the prior year) for the year. No other costs have been included or excluded from property plant and equipment in the determination of depletion and depreciation expense.

As a result of declining commodity prices for crude oil, an impairment test was carried out at December 31, 2017 on Kaisen's CGU's. The estimated recoverable amounts were based on fair value less costs of disposal calculations using a discount rate determined based on an estimated industry weighted cost of capital, and the following forward commodity price estimates:

Year	WTI Cushing Ok (US\$/bbl)	Western Canadian Select (Cad\$/bbl)	Canadian\$/US\$ Exchange rates
2018	55.00	51.05	0.790
2019	65.00	59.61	0.820
2020	70.00	64.94	0.850
2021	73.00	68.43	0.850
2022	74.46	69.80	0.850
2023	75.95	71.20	0.850
2024	77.47	72.62	0.850
2025	79.02	74.07	0.850
2026	80.60	75.55	0.850
2027	82.21	77.06	0.850
2028	83.85	78.61	0.850

Escalation rate of 1.5% thereafter

A sensitivity analysis for impairment has not been calculated due to the absence of any reasonable changes in assumptions that could be material to the outcome.

For the years ended December 31, 2017 and 2016, no impairment was recorded. The recoverable amount of the Company's CGU's at December 31, 2017 was \$148.4 million (\$145.0 million in 2016), determined using a discount rate of 10% before tax. The fair value less cost to dispose value used to determine the recoverable amount of the CGU's are classified as Level 3 fair value measurements. Refer to Note 4 for information on fair value hierarchy classifications.

9. Bank Debt

At December 31, 2017, the Company had a revolving bank operating credit facility of \$5,500,000.

The revolving operating facility is payable in full on demand by the lender, and the lender may terminate the availability thereof (including any undrawn portion) at any time without notice, therefore the loan facility (if applicable) would be classified by the Company as a current liability on the statement of financial position. Prime-based loans are available through the operating facility at prime plus 1.25% per annum.

The operating facility is subject to two financial covenants wherein 1) the working capital ratio at no time shall fall below 1.00:1.00 where working capital is defined under the lending agreement to include current assets plus any undrawn availability under the operating facility, less current liabilities less any amount currently drawn under the facility (if applicable), and 2) the net debt to trailing cashflow ratio shall not exceed 2.00:1.00 where net debt is defined as current liabilities and long-term debt less current assets (excluding unrealized financial contracts), and where trailing cashflow is defined as cashflow from the most recently completed financial quarter, annualized. As at December 31, 2017, the working capital ratio was 2.3:1 and the net debt to trailing cashflow ratio was 0.42:1.00, as such, the Company was compliant with both financial covenants. A demand debenture on all the assets of the Company has been provided as collateral for the facility.

Subsequent to the year end on January 15, 2018, the mid-year borrowing base review was completed resulting in a borrowing base reduction from \$5.5 million to \$4.0 million and the elimination of the net debt to trailing cashflow ratio covenant. The annual borrowing base review has been scheduled for April 30, 2018.

10. Finance Charges

	Three months ended		Year ended	
	December 31,		December 31,	
	2017	2016	2017	2016
Interest and financing charges on bank debt	\$ 24,801	\$ (3,156)	\$ 97,942	\$ 27,419
Accretion of asset retirement obligations	57,428	54,406	224,786	181,897
Finance charges	\$ 82,229	\$ 51,250	\$ 322,728	\$ 209,316

11. Capital Management

The Company's policy is to maintain a strong capital base in order to provide flexibility in the future development of the business and to maintain the confidence of investors and lenders.

The Company periodically reviews certain quantitative measures of its capital structure in order to understand its position relative to industry peers. The Company does not set certain limits or ranges with respect to these quantitative measures. The Company is not subject to any external restrictions on its capital structure with exception to covenants in place with the Company's lender (refer to note 7). There have been no material changes in the Company's approach to capital management during the year ended December 31, 2017.

Kaisen has a secured operating credit facility with a Canadian bank. Management closely monitors debt leverage against internally imposed borrowing limits to ensure the Company maintains financial flexibility and balance sheet strength sufficient to manage unforeseen events and/or opportunities as they arise.

As at December 31, 2017, the Company had bank debt of \$3,051,501 (nil in the prior year) and a net working capital surplus (current assets net of current liabilities excluding risk management contracts) of \$626,536 (\$334,454 net surplus in the prior year) for total net debt of \$2,424,965, with an available \$2,448,499 (\$5,500,000 in the prior year) of remaining borrowing capacity under the Company's credit facility with its lender. Subsequent to the year end on January 15, 2018, the Company's borrowing base was reduced from \$5.5 million to \$4.0 million thereby reducing the remaining borrowing capacity from \$2,448,499 to \$948,499.

Based on currently forecasted commodity prices through 2018, Kaisen's current capital resources (cash on hand and currently available borrowing capacity) are sufficient to fund ongoing corporate obligations through 2018. However, if the current economic circumstances affecting our business are to materially change, Kaisen maintains optionality to adjust its capital structure through such means as the issuance of new equity, and/or the issuance of new debt instruments in various forms tailored to the Company's specific needs, and/or by making adjustments to its operations and/or capital expenditure programs to the extent that capital expenditures are not committed.

12. Asset Retirement Obligations

The total future asset retirement obligations were estimated by management based on the expected cost to abandon and restore its net ownership interest in well sites and facilities and the estimated timing of the costs to be incurred in future periods. Asset retirement obligations acquired as part of an acquisition are initially measured at fair value using a credit-adjusted risk-free rate. During the year, the Company undertook a detailed review of its well abandonment inventory and estimated abandonment and reclamation costs, resulting in an increase to the Company's abandonment liability of \$1,186,210. The Company has estimated that the total undiscounted amount of cash flows required to settle its asset retirement obligations at December 31, 2017 was \$13.7 million (\$11.9 million in the prior year) which will be incurred over the next 10-15 years with the majority of costs incurred between 2019 and 2025. A rate of 2.0% has been used to inflate the estimated future costs to abandon the wells. A reconciliation of the changes to the asset retirement obligations during the periods were as follows:

	Year ended December 31, 2017	Year ended December 31, 2016
Balance, beginning of period	\$ 9,862,302	\$ 6,798,773
Liabilities incurred	296,726	-
Liabilities acquired	-	2,881,632
Accretion	224,786	181,897
Change in estimate	1,186,210	-
Abandonment expenditures incurred	(63,873)	-
Balance, end of period	\$ 11,506,151	\$ 9,862,302

13. Share Capital

(a) Authorized

The Company is authorized to issue an unlimited number of voting common shares, and;

The Company is authorized to issue an unlimited number of special voting shares

(b) Common shares, issued and outstanding

	Year ended December 31, 2017		Year ended December 31, 2016	
	Shares	Amount	Shares	Amount
Balance, beginning of period	43,420,029	\$ 50,689,854	23,420,029	\$ 31,228,855
Issued for cash ^(a)	2,000,000	\$ 2,500,000	20,000,000	\$ 20,000,000
Share issue costs (net of tax of \$197,498)	-	-	-	(539,001)
Balance, end of period	45,420,029	\$ 53,189,854	43,420,029	\$ 50,689,854

- a) On July 11, 2017, the Azimuth Capital Management converted 2,000,000 Special Voting Shares into Common Shares for net proceeds to the Company of \$2,500,000 (nil share issuance costs). Subsequent to the conversion, Azimuth holds 6.0 million Special Voting Shares representing a remaining \$7.5 million of equity available to Kaisen to fund future growth opportunities.

On July 12, 2016, the Company closed a private placement equity offering to Azimuth Capital Management for an aggregate of 20,000,000 Common Shares for total gross proceeds of \$20,000,000 (\$19,263,501 net of share issuance costs.)

On November 12, 2015, the Company closed a private placement equity offering to Azimuth Capital Management for an aggregate of 8,000,000 Common Shares, 8,000,000 put and call obligations ("Put and Call Obligations") and 8,000,000 special voting shares ("Special Voting Shares"), for total gross proceeds of \$10,000,000 (\$9,087,659 net of share issuance costs.)

- each Put and Call Obligation sets forth the rights of the Company to cause the holder ("Azimuth") thereof to subscribe for, or the right of the holder thereof to cause the Company to issue and sell, one Common Share at an issue price of \$1.25 per share pursuant to the terms of the put and call obligation agreement on or prior to the expiry time set forth therein;
- each Special Voting Share entitles Azimuth to notice of and to attend and vote at all meetings of shareholders of the Company but not providing any rights in respect of liquidation, dissolution or winding up or any entitlement to dividends; and
- For every Common Share of the Company issued in accordance with the terms of the Put and Call Obligations, an equal number of Special Voting Shares will be cancelled.

(c) Share Based Compensation

i. Stock Option Plan

The following table summarizes Kaisen's stock option plan and activity during the year ended December 31, 2017.

	Year ended December 31, 2017		Year ended December 31, 2016	
	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
Balance, beginning and end of period	1,448,000	\$1.46	1,448,000	\$1.46

	Outstanding stock options			Exercisable stock options	
Exercise price (\$/share)	Number of options outstanding	Weighted average remaining contractual life	Weighted average exercise price (\$/share)	Number of options exercisable	Weighted average exercise price (\$/share)
\$1.00	893,000	0.6	\$1.00	893,000	\$1.00
\$2.00	85,000	0.7	\$2.00	85,000	\$2.00
\$2.25	470,000	1.7	\$2.25	470,000	\$2.25
	1,448,000	0.9	\$1.46	1,448,000	\$1.48

ii. Performance Warrants

The following table summarizes Kaisen's performance warrants plan and activity during the year ended December 31, 2017.

	Year ended December 31, 2016		Year ended December 31, 2015	
	Number of warrants	Weighted Average Exercise Price	Number of warrants	Weighted Average Exercise Price
Balance, beginning of period	5,780,999	\$1.78	5,780,999	\$1.91
Granted	-	-	5,000,000	\$1.63
Balance, December 31, 2017	10,780,999	\$1.78	10,780,999	\$1.78

On July 12, 2016 and concurrent with the private equity issuance of common shares to Azimuth Capital Management, the Company granted 5,000,000 performance warrants to employees, directors and contractors serving in the capacity of employees of the Company. On November 12, 2015 and in connection with the Company's initial private equity offering to Azimuth Capital Management, the Company granted 4,000,000 performance warrants to employees, directors and contractors serving in the capacity of employees of the Company. These performance warrants vest upon a qualifying liquidity event, expire in 5 years and have exercise prices as follows:

Performance warrants granted	#	Exercise price	Grant Date
Series 1	1,000,000	\$1.50	November 12, 2015
Series 2	1,000,000	\$1.75	November 12, 2015
Series 3	2,780,999	\$2.00	November 12, 2015
Series 4	1,000,000	\$2.25	November 12, 2015
Series 5	1,250,000	\$1.25	July 12, 2016
Series 6	1,250,000	\$1.50	July 12, 2016
Series 7	1,250,000	\$1.75	July 12, 2016
Series 8	1,250,000	\$2.00	July 12, 2016
Total	10,780,999	\$1.74	

Concurrent with the November 12, 2015 grant of performance warrants, the Company approved the cancellation of the then outstanding 1,780,999 performance warrants and re-issued the same number of performance warrants under the new performance warrants plan, retaining the same exercise price (\$2.00) with revised vesting and expiry terms consistent with the terms of the new performance warrants granted. The cancellation of these warrants and the re-granting of the same number of performance warrants under revised terms, was accounted for as a modification of incentive units in accordance with IFRS 2. The incremental expense attributed to the modified performance warrants is being amortized to share based compensation expense over the expiry period of the new performance warrants granted.

Outstanding performance warrants				Exercisable performance warrants	
Exercise price (\$/share)	Number of perf. warrants outstanding	Weighted average remaining contractual life	Weighted average exercise price (\$/share)	Number of perf. warrants exercisable	Weighted average exercise price (\$/share)
\$1.25	1,250,000	3.5	\$1.25		
\$1.50	2,250,000	3.2	\$1.50	-	-
\$1.75	2,250,000	3.2	\$1.75	-	-
\$2.00	4,030,999	3.1	\$2.00	-	-
\$2.25	1,000,000	2.9	\$2.25	-	-
	10,780,999	3.2	\$1.78	-	-

(d) Per share information

The following table summarizes the weighted average shares used in calculating net earnings per share:

	Three months ended December 31,		Year ended December 31,	
	2017	2016	2017	2016
Basic	45,420,029	43,420,029	44,367,974	32,709,647
Diluted	45,420,029	43,420,029	44,367,974	32,709,647

For the purpose of calculation net loss per diluted share for the three and twelve month periods ended December 31, 2017 and 2016, none of the outstanding options and performance warrants are included as these instruments were anti-dilutive.

(e) Contributed Surplus

	Three months ended December 31,		Year ended December 31,	
	2017	2016	2017	2016
Balance, beginning of period	\$ 5,582,697	\$ 3,267,396	\$ 3,851,531	\$ 1,732,881
Share based compensation	570,996	584,135	2,302,162	2,118,650
Balance, end of period	\$ 6,153,693	\$ 3,851,531	\$ 6,153,693	\$ 3,851,531

Share based compensation recorded to contributed surplus differs from Share based compensation expense due to the inclusion of capitalized share based compensation for the Quarter and Year of \$89,733 and \$364,933 respectively (\$92,620 and \$316,899 respectively in the prior year).

14. Change in Non-Cash Working Capital

The net change in working capital is comprised of:

	Three months ended December 31,		Year ended December 31,	
	2017	2016	2017	2016
Non-cash working capital				
Accounts receivable	\$ 417,537	\$ (366,314)	\$ (169,112)	\$ (1,244,272)
Prepaid expenses and deposits	163,477	247,030	476,919	(144,853)
Accounts payable and accrued liabilities	(2,743,944)	1,024,578	(2,186,214)	3,022,008
Change in non-cash working capital	(2,162,930)	905,294	(1,878,407)	1,632,883
Related to operating activities	(1,570,828)	905,294	(1,912,426)	1,632,883
Related to investing activities	(592,102)	-	34,019	-

15. Income Taxes

The tax provision differs from the amount computed by applying the combined Canadian federal and provincial statutory income tax rates to earnings before tax expense as follows:

	December 31,	
	2017	2016
Earnings/(loss) before income taxes	\$ (2,357,908)	\$ (12,271,991)
Canadian statutory tax rate	27.0%	27.0%
Expected income tax/(recovery) at statutory rates	(636,635)	(3,313,437)
Effect on income tax of:		
Stock based compensation	523,052	486,473
Difference between book and tax values of acquired assets	-	(1,195,313)
Other	6,105	(69,960)
Deferred Tax assets not recognized	111,992	3,120,253
Total current and deferred income tax expense/(recovery)	\$ 4,514	\$ (971,984)

	December 31,	
	2017	2016
Deferred tax assets:		
Non-capital losses	\$ 7,120,516	6,956,947
Decommissioning liability	3,106,661	2,662,821
Other	223,810	125,293
Share issuance costs	284,284	424,640
Deferred tax assets not recognized	(6,695,320)	(6,583,327)
Deferred tax liabilities:		
Capital assets in excess of tax value	(4,039,951)	(3,586,374)
Net deferred tax liability	\$ -	-

As part of the Hawk acquisition (July 2016), Kaisen acquired tax pools that would have resulted in a deferred tax asset of which only the portion equally offsetting the Company's deferred tax liability as at December 31, 2017 has been recognized with the remaining deferred tax asset not recognized due to the uncertainty of future recoverability.

The Company's estimated tax pools are as follows:

	December 31,	
	2017	2016
Canadian oil and gas property expense	\$ 10,021,741	\$ 9,420,522
Canadian exploration expense	5,888,912	5,888,912
Canadian development expense	16,417,432	13,364,938
Capital cost allowance	10,429,607	11,389,911
Non-capital losses	26,372,280	25,766,470
Other	1,053,654	1,573,547
	\$ 70,183,626	\$ 67,404,300

All of Kaisen's assets have an approximate tax basis of \$70.2 million (\$67.4 million in 2016) available for future use as deductions from taxable income. Included in this tax basis are estimated non-capital loss carry forwards that begin to expire in 2030.

16. Major Customers

The majority of the credit exposure on accounts receivable at December 31, 2017 pertains to accrued revenue for December 2017 production volumes. Kaisen typically sells its heavy oil production to four separate oil and natural gas marketing companies. These marketing companies remit amounts to Kaisen typically on or about the 25th day of the month following the production month. All accrued revenues at December 31, 2017 were received in January 2018. Kaisen did not have any other customers from which it had outstanding accounts receivable greater than 10 per of the total outstanding balance at December 31, 2017. As at December 31, 2017, the Company is confident in the collectability of its' receivables and therefore has not recorded an allowance for doubtful accounts.

17. Commitments and Contingencies

Following is a summary of Kaisen's contractual obligations and commitments as at December 31, 2016:

(\$ thousands)	Total	2018	2019	2020	2021	2022
Office leases	340	161	153	26	-	-

18. Related Party Transactions

The corporate secretary (and small shareholder) of the Company is a partner of the Company's legal counsel, Burnet, Duckworth & Palmer LLP ("BDP"). For the Year, \$78,000 (\$363,978 in the prior year) was invoiced from BDP for general corporate purposes, all of which was payable at the year end. Costs incurred in the prior year pertain to the acquisition of Hawk Exploration Ltd. and share issuance expenses in connection with the concurrent private placement share offering which closed on July 12, 2016, in addition to general corporate purposes.

On December 23, 2015, the Company provided a loan in the amount of \$250,000 to a shareholder on competitive commercial interest bearing terms with a maturity period of 5 years. Accrued interest is payable on the maturity date. The loan has been recorded as a long term receivable on the statement of financial position.

19. Subsequent events

On January 15, 2018, the Company amended the revolving operating credit facility with its lender resulting in a reduction of the Company's borrowing base from \$5.5 million to \$4.0 million and the elimination of the net debt to trailing cashflow ratio covenant. The annual renewal date for the credit facility is April 30, 2018.

Subsequent to December 31, 2017, the Company entered into the following fixed price contracts:

Type	Period	Volume (bbl/d)	Currency	Price/unit ⁽¹⁾	Index
Fixed WTI Swap	Feb 1, 2018 – June 30, 2018	150 bbl/d	CAD	\$78.15	WTI-NYMEX
Fixed WTI Swap	July 1, 2018 – Dec 31, 2018	200 bbl/d	CAD	\$75.50	WTI-NYMEX

Corporate Information

Directors

Evan Hazell, P.Eng., MBA
Calgary, Alberta
Chairman

Cameron King, P.I.Eng., MBA
President & CEO

Ed Chwyl
Victoria, British Columbia

Chris Hooper, CFA
Calgary, Alberta

Lowell E. Jackson, P.Eng.
Calgary, Alberta

Dave Pearce, P.Eng.
Calgary, Alberta

Richard Ramsay, P.Eng.
Calgary, Alberta

Officers

Cameron King, P.I.Eng., MBA
President & CEO

Jeffrey Holmgren, CA
Senior Vice President & CFO

Chris McGinnis, P.Eng., MBA
Vice President, Engineering

Andy Kramchynski, P.Geol
Vice President, Geology

James Kidd, LL.B
Corporate Secretary

Auditors

Ernst & Young LLP

Evaluation Engineers

Sproule Petroleum Consultants

Bankers

ATB Financial

Legal Counsel

Burnet, Duckworth and Palmer LLP

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