



## Condensed Interim Financial Statements

For the three and six months ended June 30, 2018

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**June 30, 2018**

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## Interim Statements of Financial Position

(Unaudited, Canadian dollars)

	Note	June 30, 2018	December 31, 2017
<b>Assets</b>			
Current assets			
Cash		\$ 102,136	\$ 822,010
Accounts receivable		1,717,906	1,991,332
Prepaid expenses and deposits		163,105	132,923
		<b>1,983,147</b>	2,946,265
Due from shareholder	17	-	268,525
Property, plant and equipment	5	57,725,615	57,720,471
		<b>\$ 59,708,762</b>	\$ 60,935,261
<b>Liabilities</b>			
Current liabilities			
Accounts payable and accrued liabilities		\$ 2,997,406	\$ 2,319,729
Risk management contracts	4	3,544,632	887,852
Bank loan	6	2,771,728	3,051,501
		<b>9,313,766</b>	6,259,082
Risk management contracts	4	889,796	634,994
Other long-term liabilities	11	11,708,630	11,506,151
		<b>21,912,192</b>	18,400,227
<b>Shareholders' equity</b>			
Shareholders' capital	12	53,189,854	53,189,854
Convertible debentures	7	2,016,100	-
Contributed surplus		6,988,871	6,153,693
Deficit		(24,398,255)	(16,808,513)
		<b>37,796,570</b>	42,535,034
		<b>\$ 59,708,762</b>	\$ 60,935,261

Commitments (note 16)

Subsequent events (note 18)

See accompanying notes to the unaudited interim financial statements.

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

(Unaudited, Canadian dollars, except per share amounts)

	Note	Three months ended June 30,		Six months ended June 30,	
		2018	2017	2018	2017
<b>Revenues</b>					
Petroleum and natural gas sales		\$ 4,512,651	\$ 5,797,615	\$ 8,277,830	\$ 10,794,795
Royalties		(845,899)	(952,966)	(1,573,631)	(1,871,020)
Revenue, net of royalties		3,666,752	4,844,649	6,704,199	8,923,775
Saskatchewan resource tax		8,915	(105,000)	(47,159)	(185,851)
Realized gain (loss) on risk management contracts	4	(1,179,615)	124,453	(1,227,092)	(87,503)
		<b>2,496,052</b>	<b>4,864,102</b>	<b>5,429,948</b>	<b>8,650,421</b>
<b>Expenses</b>					
Operating expenses		2,206,919	2,897,520	4,415,819	6,511,749
Transportation expenses		184,819	319,324	404,300	565,971
General and administrative expenses		423,361	701,263	1,036,793	1,398,488
Net finance expenses	10	97,381	94,516	190,176	151,815
Share-based compensation	12	211,363	485,695	683,100	967,460
Restructuring expenses	9	1,167,028	-	1,167,028	-
Depletion and depreciation		1,033,337	1,523,144	2,210,892	2,813,403
Unrealized (gain) loss on risk management contracts	4	1,245,872	(1,999,626)	2,911,582	(4,858,158)
		<b>6,570,080</b>	<b>4,021,836</b>	<b>13,019,690</b>	<b>7,550,728</b>
<b>Earnings (loss) before income taxes</b>		<b>(4,074,028)</b>	<b>842,266</b>	<b>(7,589,742)</b>	<b>1,099,693</b>
<b>Income taxes</b>					
Current tax expense (recovery)		-	-	-	(4,514)
Deferred tax expense		-	-	-	-
		-	-	-	(4,514)
<b>Net earnings (loss) and comprehensive earnings (loss)</b>		<b>\$ (4,074,028)</b>	<b>\$ 842,266</b>	<b>\$ (7,589,742)</b>	<b>\$ 1,095,179</b>
<b>Net earnings (loss) per share</b>					
Basic and diluted	13	\$ (0.09)	\$ 0.03	\$ (0.17)	\$ 0.03

See accompanying notes to the unaudited interim financial statements.

## Interim Statements of Cash Flows

(Unaudited, Canadian dollars, except per share amounts)

	Note	Three months ended		Six months ended	
		2018	June 30, 2017	2018	June 30, 2017
<b>Cash provided by (used in) the following activities:</b>					
<b>Operating activities</b>					
Net earnings (loss) for the period		\$ (4,074,028)	\$ 842,266	\$ (7,589,742)	\$ 1,095,179
Add (deduct) items not affecting cash from operations:					
Depletion and depreciation expense		1,033,337	1,523,144	2,210,892	2,813,403
Accretion of decommissioning obligations	10	64,559	55,725	128,686	110,692
Restructuring expenses	9	257,162	-	257,162	-
Share-based compensation	12	211,363	485,695	683,100	967,460
Unrealized (gain) loss on risk management contracts	4	1,245,872	(1,999,626)	2,911,582	(4,858,158)
Other		(13,578)	-	(13,578)	-
		(1,275,313)	907,204	(1,411,898)	128,576
Change in non-cash working capital	14	(106,330)	(3,573,603)	904,539	(1,648,987)
Cash flow from (used in) operating activities		(1,381,643)	(2,666,399)	(507,359)	(1,520,411)
<b>Financing activities</b>					
Net (payments) advances of bank loan		(641,212)	3,390,281	(279,773)	4,040,281
Issuance of convertible debentures, net of issue costs	7	2,016,100	-	2,016,100	-
Cash flow from financing activities		1,374,888	3,390,281	1,736,327	4,040,281
<b>Investing activities</b>					
Development of oil and gas properties		(630,683)	(408,176)	(2,023,549)	(4,880,215)
Change in non-cash working capital	14	185,483	(558,539)	74,707	55,420
Cash used in investing activities		(445,200)	(966,715)	(1,948,842)	(4,824,795)
Change in cash		(451,955)	(242,833)	(719,874)	(2,304,925)
Cash, beginning of the period		554,091	336,993	822,010	2,399,085
<b>Cash, end of the period</b>		<b>\$ 102,136</b>	<b>\$ 94,160</b>	<b>\$ 102,136</b>	<b>\$ 94,160</b>
<b>Supplementary disclosure</b>					
Cash interest paid		\$ 32,822	\$ 36,097	\$ 61,490	\$ 40,710
Cash taxes paid		-	-	-	-

See accompanying notes to the unaudited interim financial statements.

## Statements of Changes in Shareholders' Equity

(Unaudited, Canadian dollars)

	Note	Share capital	Contributed surplus	Convertible debentures	Retained earnings (deficit)	Shareholders' equity
Balance as at December 31, 2016		\$ 50,689,854	\$ 3,851,531	\$ -	\$ (14,446,091)	\$ 40,095,294
Net loss		-	-	-	(2,362,422)	(2,362,422)
Common shares issued	12	2,500,000	-	-	-	2,500,000
Share-based compensation	12	-	2,302,162	-	-	2,302,162
Balance as at December 31, 2017		\$ 53,189,854	\$ 6,153,693	\$ -	\$ (16,808,513)	\$ 42,535,034
Net loss		-	-	-	(7,589,742)	(7,589,742)
Convertible debentures issued	7	-	-	2,016,000	-	2,016,100
Share-based compensation	12	-	835,178	-	-	835,178
<b>Balance as at June 30, 2018</b>		<b>\$ 53,189,854</b>	<b>\$ 6,988,871</b>	<b>\$ 2,016,000</b>	<b>\$ (24,398,255)</b>	<b>\$ 37,796,570</b>

See accompanying notes to the unaudited interim financial statements.

## Notes to the Interim Financial Statements (unaudited)

As at June 30, 2018 and for the three and six months ended June 30, 2018 and 2017

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### 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 400, 522 – 11th Avenue S.W. Calgary, Alberta, Canada, T2R 0C8.

### 2. Basis of Presentation and Statement of Compliance

These unaudited condensed interim financial statements (the "financial statements") have been prepared in accordance with International Accounting Standards ("IAS") 34 Interim Financial Reporting using accounting policies aligned with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"). These financial statements are condensed as they do not include all the information required by IFRS for annual financial statements and should be read in conjunction with the Company's audited financial statements for the year ended December 31, 2017. Unless otherwise stated, amounts presented in these financial statements, including tabular amounts, are stated Canadian dollars. The functional currency of the Company is the Canadian dollar.

These financial statements have been prepared on a historical cost basis, except as detailed in the accounting policies disclosed in Note 2 "Basis of presentation" of the Company's audited consolidated financial statements for the year ended December 31, 2017. All accounting policies, methods of computation, and the use of estimates or judgements, followed in the preparation of these financial statements are consistent with those of the previous financial year, except as noted in Note 3 "Changes to Accounting Policies".

These financial statements were authorized for issue by the Board of Directors on September 5, 2018.

### 3. Changes in Accounting Policies

#### (a) Adoption of IFRS 9 Financial Instruments

Effective January 1, 2018, the Company adopted IFRS 9 *Financial Instruments* ("IFRS 9"), which replaced IAS 39 *Financial Instruments: Recognition and Measurement*. The adoption of IFRS 9 did not result in any adjustments to the measurement of financial instruments, and no adjustment to retained earnings was required.

As a result of the adoption of IFRS 9, the Company has revised the description of its financial instrument accounting policies to reflect the new classification approach as follows:

#### *Financial Instruments:*

Financial assets and financial liabilities are measured at fair value on initial recognition. Measurement in subsequent periods depends on the financial instrument's classification, as described below.

- *Fair value through profit or loss:* Financial instruments designated at fair value through profit or loss are initially recognized and subsequently measured at fair value with changes in those fair values charged immediately to net earnings. Financial instruments under this classification include derivative assets and liabilities.
- *Fair value through other comprehensive income:* Financial instruments designated as fair value through other comprehensive income are initially recognized at fair value, net of directly attributable transaction costs, and are subsequently measured at fair value with changes in fair value recognized in other comprehensive income, net of tax.

Derivatives may be used by the Company to manage exposure to market risk relating to commodity prices, foreign exchange rates and interest rates. The Company does not designate its financial derivatives contracts as hedges. As a result, all financial derivative contracts are classified as fair value through profit or loss and are recorded and carried on the consolidated statement of financial position at fair value with actual amounts received or paid on the settlement of the financial derivative instrument recorded in net earnings. Forward crude oil derivative contracts are recorded at their estimated fair value based on the difference between the contracted price and the period end forward price, using quoted market prices.

#### *Impairment of Financial Assets:*

The Company recognizes loss allowances for expected credit losses on its financial assets measured at amortized cost. Expected credit losses exist if one or more loss events occur after initial recognition of the financial asset which has an impact on the estimated future cash flows of the financial asset and that impact can be reliably measured. The Company uses a combination of historical and forward-looking information to determine the appropriate expected credit loss. The carrying amount of the asset is reduced through the use of an allowance account, and the loss is recognized in general and administrative expenses.

#### (b) Adoption of IFRS 15 Revenue Recognition

Effective January 1, 2018, the Company adopted IFRS 15 *Revenue from Contracts with Customers* ("IFRS 15"). IFRS 15 establishes a comprehensive framework for determining whether, how much, and when revenue from contracts with customers is recognized.

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.

The Company adopted IFRS 15 using the modified retrospective approach. Under this transitional provision, the cumulative effect of initially applying IFRS 15 is recognized on the date of initial application as an adjustment through retained earnings. The adoption of IFRS 15 did not impact the timing or measurement of revenue, and no adjustment to retained earnings was required. As a result of the adoption of IFRS 15, the Company has revised the description of its accounting policy for revenue recognition as follows:

Revenue associated with the sale of crude oil, natural gas, or natural gas liquids is measured based on the consideration specified in contracts with customers. Revenue from contracts with customers is recognized when or as the Company satisfies a performance obligation by transferring a promised good or service to a customer. A good or service is transferred when the customer obtains control of that good or service. The transfer of control of crude oil, natural gas, or natural gas liquids coincides with title passing to the customer and the customer taking physical possession. Kaisen has expanded 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.

#### (c) Standards Issued but not yet adopted

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.

#### (d) Onerous Contracts

A provision for onerous contracts is recognized when the expected benefits to be derived by the Company from a contract are lower than the unavoidable cost of meeting its obligations under the contract. The provision is measured at the lower of the expected cost of terminating the contract and the expected net cost of continuing with the contract.

#### 4. Risk Management Contracts

	Three months ended June 30,		Six months ended June 30,	
	2018	2017	2018	2017
Realized gain (loss)	\$ (1,179,615)	\$ 124,453	\$ (1,227,092)	\$ (87,503)
Unrealized gain (loss)	(1,245,872)	1,999,626	(2,911,582)	4,858,158
<b>Total gain (loss) on risk management contracts</b>	<b>\$ (2,425,487)</b>	<b>\$ 2,124,079</b>	<b>\$ (4,138,674)</b>	<b>\$ 4,770,655</b>

For the three and six months ended June 30, 2018, the Company recorded realized losses of \$1,179,615 and \$1,227,092, respectively (2017 - \$124,453 gain and \$87,503 loss) on contracts entered to manage commodity price risk. As at June 30, 2018, the fair value associated with these risk management contracts was a liability of \$4,434,428 (December 31, 2017 - \$1,522,846 liability), of which \$3,544,632 is reported as a current liability reflecting contracts which will settle by June 30, 2019, and \$889,796 reported as a long-term liability for contracts that will settle after June 30, 2019. The change in the fair value during the three and six months ended June 30, 2018 produced unrealized losses of \$1,245,872 and \$2,911,582, respectively (2017 - gains of \$1,999,626 and \$4,858,158).

The following is a summary of all risk management contracts in place as at June 30, 2018:

Type	Period	Volume	Price/unit <sup>(1)</sup>	Index
Fixed WTI Swap	January 1, 2018 – December 31, 2018	200 bbl/d	CAD \$67.20	WTI-NYMEX
Fixed WTI Swap	July 1, 2018 – Dec 31, 2018	200 bbl/d	CAD \$75.50	WTI-NYMEX
Fixed WTI Swap	July 1, 2018 – December 31, 2018	200 bbl/d	CAD \$63.65	WTI-NYMEX
Call option <sup>(2)</sup>	January 1, 2019 – December 31, 2019	400 bbl/d	USD \$60.00	WTI-NYMEX

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

(2) 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.

5. **Property, Plant and Equipment**

	Oil and gas assets	Corporate assets	Total assets
<b>Cost:</b>			
<b>Balance, January 1, 2017</b>	<b>\$ 67,678,798</b>	<b>\$ 181,003</b>	<b>\$ 67,859,801</b>
Development expenditures	7,929,179	14,851	7,944,030
Additions to decommissioning obligations	1,306,427	-	1,306,427
Capitalized general and administrative costs	390,000	-	390,000
Capitalized share-based compensation	364,933	-	364,933
<b>Balance, December 31, 2017</b>	<b>\$ 77,669,337</b>	<b>\$ 195,854</b>	<b>\$ 77,865,191</b>
Development expenditures	1,829,956	1,927	1,831,883
Additions to decommissioning obligations	40,409	-	40,409
Capitalized general and administrative costs	191,666	-	191,666
Capitalized share-based compensation	152,078	-	152,078
<b>Balance, June 30, 2018</b>	<b>\$ 79,883,446</b>	<b>\$ 197,781</b>	<b>\$ 80,081,227</b>
<b>Accumulated depletion and depreciation:</b>			
<b>Balance, January 1, 2017</b>	<b>\$ 14,443,615</b>	<b>\$ 69,036</b>	<b>\$ 14,512,651</b>
Depletion and depreciation	5,595,061	37,008	5,632,069
<b>Balance, December 31, 2017</b>	<b>\$ 20,038,676</b>	<b>\$ 106,044</b>	<b>\$ 20,144,720</b>
Depletion and depreciation	2,196,696	14,196	2,210,892
<b>Balance, June 30, 2018</b>	<b>\$ 22,235,372</b>	<b>\$ 120,240</b>	<b>\$ 22,355,612</b>
<b>Net book value:</b>			
Balance, December 31, 2017	\$ 57,630,661	\$ 89,810	\$ 57,720,471
<b>Balance, June 30, 2018</b>	<b>57,648,074</b>	<b>77,541</b>	<b>57,725,615</b>

During the three and six months ended June 30, 2018, the Company capitalized general and administrative expenses in the amount of \$94,166 and \$191,666, respectively (2017 - \$97,500 and \$195,000) and capitalized share-based compensation expense in the amount of \$64,122 and \$152,078, respectively (2017 - \$92,646 and \$183,427), relating to development activities.

Future development costs associated with proved and probable undeveloped reserves of \$98,069,400 (December 31, 2017 - \$98,869,400) are included in the depletion calculation net of salvage values of \$2,580,000 as at June 30, 2018 (December 31, 2017 - \$2,580,000). No other costs have been included or excluded from property plant and equipment in the determination of depletion and depreciation expense. As at June 30, 2018, no indicators of impairment were present.

6. **Bank Loan**

The Company's revolving operating facility limit of \$4.0 million (December 31, 2017 - \$5.5 million) 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 Bank loan is presented as a current liability on the Interim Statement of Financial Position. Prime-based loans are available through the revolving operating facility at the Canadian prime rate plus 1.25% per annum. A demand debenture on all the assets of the Company has been provided as collateral for the facility.

The Bank loan is subject to a financial covenant wherein the working capital ratio shall not 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). As at June 30, 2018, the Company was compliant with its lenders working capital covenant limit at 1.07:1.00.

Subsequent to the quarter, the mid-year borrowing base review was completed resulting in a borrowing base reduction from \$4.0 million to \$2.5 million.

7. **Convertible Debentures and Obligation Debentures**

During the second quarter of 2018, the Company provided all shareholders and its Managing Director an opportunity to subscribe for an aggregate of \$7,502,000 in convertible debentures. The offer was fully subscribed by its May 28, 2018 closing date, through (a) the issuance of 2,076 convertible debentures for total gross proceeds of \$2,076,000 (\$2,016,100 net of issue costs) and (b) the execution of an agreement for 5,426 committed, but as yet uncalled, convertible debentures ("Obligation Debentures", as described in further detail in note 7b, which represent an additional \$5,426,000 in funding available to the Company.

#### **(a) Convertible Debentures**

The key terms of the convertible debentures are as follows:

- issuable only in denominations of \$1,000 or multiples thereof
- mature on the occurrence of a liquidity event, with a qualifying liquidity event including, but not limited to:
  - (i) an amalgamation, arrangement, merger, or other similar transaction wherein all issued and outstanding common shares are sold for cash and/or securities, or which results in all of the Company's common shares being listed on a stock exchange
  - (ii) a sale of all or substantially all of the property and assets of the Company for consideration consisting of cash and/or securities and the subsequent distribution of all of such consideration to all common shareholders, on a pro rata basis;
  - (iii) the liquidation, dissolution or winding up of the Company;
  - (iv) a public offering; and
  - (v) any combination of the events or circumstances described in subsections (i), (ii), (iii) or (iv) above.
- the debentures bear interest at a fixed rate of 8.00% per annum compounded quarterly and payable in arrears on the occurrence of a liquidity event,
- upon the occurrence of a liquidity event, the Company shall:
  - (i) satisfy its obligation to pay all accrued and unpaid Interest through a cash payment; and
  - (ii) at the election of the holder of each convertible debenture, repay all or any portion of the face value of the convertible debenture by cash payment and/or by issuing and delivering common shares at a deemed price of \$0.05 per common share;

The convertible debentures represent the Company's obligation to deliver a variable number of its own equity instruments upon a liquidity event. The Company has determined that the liquidity event is a contingent settlement provision for which the Company has control over. As such, the convertible debentures have been classified as equity net of issue costs. If a liquidity event occurred on June 30, 2018 and the convertible debentures were converted to common shares, 41,520,000 additional shares of the Company would have been issued. Furthermore, had the Company issued the entire subscription of convertible debentures (\$7,502,000 in aggregate) in the current quarter and converted then to common shares, a total of 150,040,000 additional shares of the Company would have been issued and Kaisen would have received an additional \$5,426,000 of cash. As at June 30, 2018, the total face value of the convertible debentures plus accrued interest was \$2,089,840.

#### **(b) Obligation Debentures**

The Company entered into an agreement with the subscriber for 5,426 committed, but as yet uncalled Obligation Debentures, which require the subscriber to subscribe for and purchase, and for the Company to issue and sell, the remaining \$5,426,000 in convertible debentures, two years from the date of issuance or at the Company's discretion. Subsequent to the quarter, the Company called on the subscriber to purchase an additional 2,000 in obligation debentures resulting in the issuance of \$2,000,000 in Convertible debentures by the Company (see note 18).

### **8. Capital Management**

The Company's policy is to maintain a strong capital base 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 the exception of the single covenant in place with the Company's lender (refer to note 6). There have been no material changes in the Company's approach to capital management during the three and six months ended June 30, 2018. Management closely monitors debt leverage to ensure the Company maintains financial flexibility and balance sheet strength sufficient to manage unforeseen events and/or opportunities as they arise.

Based on currently forecasted commodity prices through 2018, Kaisen's current capital resources (cash on hand, equity proceeds and available borrowing capacity) are sufficient to fund ongoing corporate obligations through 2018. However, if the current economic circumstances affecting the Company 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 by making adjustments to its operations and capital expenditure programs.

### **9. Restructuring Expenses**

In the second quarter of 2018, the Company's employee base and office space requirements were significantly reduced resulting in the Company recording \$1,167,028 in restructuring expenses (2017 - \$nil). Cash based restructuring expenses comprised of severance payments of \$720,000, legal fees of \$55,888 and other costs of \$133,978. Non-cash expenses contain onerous lease charges of \$102,470 and \$154,692 relating to the impairment of the due from shareholder loan (see note 17). The Company still intends on actively pursuing re-payment in full for this amount.

**10. Net Finance Expenses**

The following table summarizes net finance expenses recorded during the three and six months ended June 30, 2018 and 2017:

	Three months ended June 30,		Six months ended June 30,	
	2018	2017	2018	2017
Interest expense on bank loan	\$ 32,822	\$ 38,791	\$ 61,490	\$ 41,123
Accretion of decommissioning obligations	64,559	55,725	128,686	110,692
<b>Net finance expenses</b>	<b>\$ 97,381</b>	<b>\$ 94,516</b>	<b>\$ 190,176</b>	<b>\$ 151,815</b>

**11. Other Long-Term Liabilities**

	June 30, 2018	December 31, 2017
Decommissioning obligations	\$ 11,675,247	\$ 11,506,151
Onerous lease	33,383	-
<b>Total other long-term liabilities</b>	<b>\$ 11,708,630</b>	<b>\$ 11,506,151</b>

**(a) Decommissioning Obligations**

The total future asset retirement obligations were estimated by management based on the expected cost to reclaim and abandon 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. The Company has estimated that the total undiscounted amount of cash flows required to settle its asset retirement obligations at June 30, 2018 is \$13.8 million which will be incurred over the next 10-15 years with the majority of costs incurred between 2019 and 2025. An annual inflation rate of 2.0% has been used to estimate future costs to abandon the wells. A reconciliation of the changes to the asset retirement obligations during the periods were as follows:

	June 30, 2018	December 31, 2017
<b>Balance, beginning of period</b>	<b>\$ 11,506,151</b>	<b>\$ 9,862,302</b>
Liabilities incurred	40,410	296,726
Accretion	128,686	224,786
Change in estimate	-	1,186,210
Decommissioning expenditures incurred	-	(68,873)
<b>Balance, end of period</b>	<b>\$ 11,675,247</b>	<b>\$ 11,501,151</b>

**(b) Onerous Leases**

During the three month and six months ended June 30, 2018, the Company recorded a provision related to the unused portion of its office lease which have been determined to be an onerous contract. The provision represents the present value of the unused portion relating to the minimum future lease payments that the Company is obligated to make under a non-cancellable operating lease contract. The undiscounted amount of estimated future cash flows to settle the obligations was \$104,247. These cashflows have been discounted using an interest rate of 1.8%. The onerous contract provision is estimated to be settled in the periods up to the year 2020.

As at June 30, 2018, the balance of the provision was \$88,891, of which \$55,508 is classified as accounts payable and accrued liabilities. Charges of \$102,470 related to the original recognition of the onerous lease have been recorded as restructuring expenses for the current quarter (see note 9).

	June 30, 2018	December 31, 2017
<b>Balance, beginning of period</b>	<b>\$ -</b>	<b>\$ -</b>
Additions	102,470	-
Amortization of onerous lease	(13,579)	-
<b>Balance, end of period</b>	<b>\$ 88,891</b>	<b>\$ -</b>
Current	55,508	-
Non-current	33,383	-
<b>Total</b>	<b>\$ 88,891</b>	<b>\$ -</b>

## 12. Share Capital

### (a) Issued and Outstanding Common Shares

The Company is authorized to issue an unlimited number of voting common shares and an unlimited amount of special voting shares. The following table is a continuity schedule of the Company's common shares outstanding and shareholders' capital:

	Number of Shares	Amount
Balance, January 1, 2017	43,420,029	\$ 50,689,854
Issued for cash	2,000,000	2,500,000
<b>Balance, December 31, 2017 and June 30, 2018</b>	<b>45,420,029</b>	<b>\$ 53,189,854</b>

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 held 6.0 million Special Voting Shares representing a remaining \$7.5 million of equity available to Kaisen to fund future growth opportunities. On November 12, 2017, the 6,000,000 special voting shares were cancelled and the attached put and call obligations expired.

### (b) Share Based Compensation

#### i. Share Options

The Company has a share option plan pursuant to which options to purchase common shares of the Company may be granted by the Board of Directors to directors, officers, employees and consultants of the Company. The share option plan was amended on July 19, 2018 (see note 18). Pursuant to the amended plan, the exercise price of each option may shall be fixed by the Board of Directors when such option is granted, provided that from and after the date that the common shares are listed on a stock exchange (the "Exchange"), such price shall not be less than the price permitted by such Exchange. Compensation expense is recognized as options vest. Unless otherwise determined by the Board of Directors, vesting typically occurs one third on each of the next three anniversaries of the date of the grant as recipients render continuous serve to the Company, and the share options typically expire five years from the date of the grant. The maximum number of common shares issuable on the exercise of outstanding share option sat any time is limited to 10% of the issued and outstanding common shares. The following table summarizes the share options outstanding at the end of the respective periods:

	Number of options	Weighted average exercise price
<b>Outstanding, January 1, 2017 and December 31, 2017</b>	<b>1,448,000</b>	<b>\$ 1.46</b>
Forfeited	(699,000)	1.34
<b>Outstanding, June 30, 2018</b>	<b>749,000</b>	<b>\$ 1.58</b>

Exercise price (\$ per share)	Outstanding share options			Exercisable share options	
	Number of options outstanding	Weighted average remaining contractual life	Weighted average exercise price (\$ per share)	Number of options exercisable	Weighted average exercise price (\$ per share)
1.00	383,000	0.1	1.00	383,000	1.00
2.00	85,000	0.2	2.00	85,000	2.00
2.25	281,000	1.2	2.25	281,000	2.25
	749,000	0.4	1.58	749,000	1.58

#### ii. Performance Warrants

The following table summarizes Kaisen's performance warrants activity during the following periods:

	Number of options	Weighted average exercise price
<b>Outstanding, January 1, 2017 and December 31, 2017</b>	<b>10,780,999</b>	<b>\$ 1.78</b>
Forfeited	(3,165,000)	1.83
<b>Outstanding, June 30, 2018</b>	<b>7,615,999</b>	<b>\$ 1.76</b>

Exercise price (\$/share)	Number of perf. warrants outstanding	Outstanding performance warrants		Exercisable performance warrants	
		Weighted average remaining contractual life	Weighted average exercise price (\$/share)	Number of perf. warrants exercisable	Weighted average exercise price (\$/share)
1.25	985,000	3.0	1.25	-	-
1.50	1,725,000	2.7	1.50	-	-
1.75	1,655,000	2.7	1.75	-	-
2.00	2,580,999	2.6	2.00	-	-
2.25	670,000	2.4	2.25	-	-
1.76	7,615,999	2.7	1.76	-	-

During the three and six months ended June 30, 2018, the Company recorded share-based compensation expenses of \$211,363 and \$683,100, respectively (2017 - \$485,695 and \$967,460). Share-based compensation expense decreased from the prior year comparative quarter as unvested shares options were forfeited based on departures during the quarter, which resulted in a recovery of the related unvested share-based compensation expense initially recognized.

### 13. Net Earnings (Loss) per Common share

	Three months ended June 30,		Six months ended June 30,	
	2018	2017	2018	2017
Net earnings (loss)	\$ (4,074,028)	\$ 842,266	\$ (7,589,742)	\$ (1,095,179)
Weighted number of average common shares outstanding:	45,420,029	43,420,029	45,420,029	43,420,029
<b>Basic and diluted loss per share</b>	<b>\$ (0.09)</b>	<b>\$ 0.03</b>	<b>\$ (0.17)</b>	<b>\$ 0.03</b>

For the purpose of calculating net loss per diluted share for the three and six months ended June 30, 2018, none of the outstanding options, performance warrants, or convertible debentures are included as these instruments are anti-dilutive. In the prior year, the Company estimated that none of the outstanding options or warrants were "in-the-money" and therefore diluted outstanding shares equaled basic outstanding shares.

### 14. Supplemental Cash Flow Information

The net change in non-cash working capital is comprised of:

	Three months ended June 30,		Six months ended June 30,	
	2018	2017	2018	2017
Accounts receivable and due from shareholder	\$ (157,410)	\$ 15,071	\$ 387,259	\$ (727,789)
Prepaid expenses and deposits	(87,840)	79,679	(30,182)	307,468
Accounts payable and accrued liabilities	324,403	(4,226,892)	622,169	(1,173,246)
Change in non-cash working capital	79,153	(4,132,142)	979,246	(1,593,567)
Related to operating activities	(106,330)	(3,573,603)	904,539	(1,648,987)
Related to investing activities	\$ 185,483	\$ (558,539)	\$ 74,707	\$ 55,420

### 15. Major Customers

The majority of credit exposure on accounts receivable at June 30, 2018 pertains to accrued revenue for June 2018 production volumes in addition to amounts receivable from joint operating partners. 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 June 30, 2018 were received in July 2018. For joint operating partners, Kaisen bills these partners typically 2 months after the month of activity with receipt 30 days thereafter. Kaisen did not have any other counterparties from which it had outstanding accounts receivable greater than 10 per of the total outstanding balance at June 30, 2018. The Company is confident in the collectability of its' receivables and therefore has not recorded an allowance for doubtful accounts.

### 16. Commitments and Contingencies

The following is a summary of the Company's contractual obligations and commitments as at June 30, 2018:

(\$ thousands)	Total	2018	2019	2020	2021	2022
Office leases	272	82	175	15	-	-

## 17. Related Party Transactions

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. During the three months ended June 30, 2018, a portion of the individual's severance was applied against the loan and the Company impaired the remaining balance of \$154,692 to restructuring expenses. The individual is still personally liable to Kaisen for the remaining balance and the Company will continue to seek repayment in full.

The corporate secretary of the Company is a partner of the Company's legal counsel, Burnet, Duckworth & Palmer LLP ("BDP"). As at June 30, 2018, \$152,159 in related party amounts were included in accounts payable and accrued liabilities (December 31, 2017 – \$68,213). The Managing Director of Kaisen is the President and Chief Executive Officer of a transloading company that Kaisen engages for emulsion treating of a portion of its production volumes. As at June 30, 2018, \$20,938 in related party amounts were included in accounts payable and accrued liabilities.

## 18. Subsequent Events

### (a) Bank Loan

In August of 2018, the Company's lender amended the revolving operating credit facility resulting in a reduction of the Company's borrowing base from \$4.0 million to \$2.5 million.

### (b) Convertible Debenture Issuance

The Company issued an additional 2,000 convertible debentures for total proceeds of \$2,000,000 in September of 2018. This leaves the Company with an additional \$3,426,000 of funding available under the original subscription dated May 28, 2018.

### (c) Share Option Plan Amendment

On July 18, 2018, the Company amended its share option plan. Pursuant to this amendment, the Company granted options and performance warrants to directors, employees and contractors serving in capacity of employees of the Company. A summary of the equity compensation grants is listed below:

#### *Executive Incentive Options ("Incentive Options")*

The Company granted 4,500,000 Incentive Options, a quarter of which vest immediately, and the remainder which vest on October 1, 2018, January 1, 2019, and April 1, 2019. The Incentive Options expire three years from the anniversary of the grant and each Incentive Option entitles the holder to receive one common share of the Company without the payment of an exercise price.

#### *Share Options*

The Company granted 11,550,000 share options at a strike price of \$0.05 per share. The options vest a third each year over a three-year period and expire five years from the anniversary of the grant.

#### *Performance Warrants*

The Company granted 28,875,000 performance warrants to directors, employees and contractors serving in capacity of employees of the Company. The performance warrants vest upon a qualifying liquidity event, expire in 5 years and have the following exercise prices:

Series	Grant date	Number of performance warrants granted	Exercise price
1	July 19, 2018	7,218,750	0.10
2	July 19, 2018	7,218,750	0.15
3	July 19, 2018	7,218,750	0.20
4	July 19, 2018	7,218,750	0.25
		28,875,000	0.18