



Condensed Interim Financial Statements

For the three and nine months ended September 30, 2018

September 30, 2018

Interim Statements of Financial Position

(Unaudited, Canadian dollars)

	Note	September 30, 2018	December 31, 2017
Assets			
Current assets			
Cash		\$ 375	\$ 822,010
Accounts receivable		1,757,869	1,991,332
Prepaid expenses and deposits		268,648	132,923
		2,026,892	2,946,265
Due from shareholder	17	-	268,525
Property, plant and equipment	5	57,599,797	57,720,471
		\$ 59,626,689	\$ 60,935,261
Liabilities			
Current liabilities			
Accounts payable and accrued liabilities		\$ 4,033,663	\$ 2,319,729
Risk management contracts	4	3,211,866	887,852
Bank loan	6	1,115,130	3,051,501
		8,360,659	6,259,082
Risk management contracts	4	606,251	634,994
Other long-term liabilities	11	11,759,195	11,506,151
		20,726,105	18,400,227
Shareholders' equity			
Shareholders' capital	12	53,189,854	53,189,854
Convertible debentures	7	4,016,100	-
Contributed surplus		7,433,494	6,153,693
Deficit		(25,738,864)	(16,808,513)
		38,900,584	42,535,034
		\$ 59,626,689	\$ 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 September 30,		Nine months ended September 30,	
		2018	2017	2018	2017
Revenues					
Petroleum and natural gas sales		\$ 4,714,800	\$ 5,059,543	\$ 12,992,630	\$ 15,854,338
Royalties		(836,777)	(864,378)	(2,410,408)	(2,735,399)
Revenue, net of royalties		3,878,023	4,195,165	10,582,222	13,118,939
Saskatchewan resource tax		(24,931)	(105,000)	(72,090)	(290,851)
Realized gain (loss) on risk management contracts	4	(1,216,524)	467,566	(2,443,616)	380,063
Other income		10,063	-	10,063	-
		2,646,631	4,557,731	8,076,579	13,208,151
Expenses					
Operating expenses		2,449,490	2,105,243	6,865,309	8,616,990
Transportation expenses		243,283	244,290	647,583	810,260
General and administrative expenses		327,136	801,827	1,363,929	2,200,315
Net finance expenses	10	98,721	88,684	288,897	240,498
Share-based compensation	12	386,850	488,506	1,069,950	1,455,966
Restructuring expenses	9	-	-	1,167,028	-
Depletion and depreciation		1,098,071	1,377,467	3,308,963	4,190,870
Unrealized (gain) loss on risk management contracts	4	(616,311)	1,085,351	2,295,271	(3,772,807)
		3,987,240	6,191,368	17,006,930	13,742,092
Earnings (loss) before income taxes		(1,340,609)	(1,633,637)	(8,930,351)	(533,941)
Income taxes					
Current tax expense		-	-	-	4,514
Deferred tax expense		-	-	-	-
		-	-	-	4,514
Net loss and comprehensive loss		\$ (1,340,609)	\$ (1,633,637)	\$ (8,930,351)	\$ (538,455)
Net loss per share					
Basic and diluted	13	\$ (0.03)	\$ (0.04)	\$ (0.20)	\$ (0.01)

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 September 30,		Nine months ended September 30,	
		2018	2017	2018	2017
Cash provided by (used in) the following activities:					
Operating activities					
Net earnings (loss) for the period		\$ (1,340,609)	\$ (1,633,637)	\$ (8,930,351)	\$ (538,455)
Add (deduct) items not affecting cash from operations:					
Depletion and depreciation expense		1,098,071	1,377,467	3,308,963	4,190,870
Accretion of decommissioning obligations	10	64,917	56,666	193,603	167,358
Restructuring expenses	9	-	-	257,162	-
Share-based compensation	12	386,850	488,506	1,069,950	1,455,966
Unrealized (gain) loss on risk management contracts	4	(616,311)	1,085,351	2,295,271	(3,772,807)
Other		(13,521)	-	(27,099)	-
Well abandonment costs incurred		-	(55,913)	-	(55,913)
		(420,603)	1,318,440	(1,832,501)	1,447,019
Change in non-cash working capital	14	1,002,383	569,046	1,906,922	(388,303)
Cash flow from (used in) operating activities		581,780	1,887,486	74,421	1,058,716
Financing activities					
Net (payments) advances of bank loan		(1,656,598)	(2,690,975)	(1,936,371)	1,349,306
Proceeds from issuance of shares		-	2,500,000	-	2,500,000
Issuance of convertible debentures, net of issue costs	7	2,000,000	-	4,016,100	-
Cash flow from financing activities		343,402	(190,975)	2,079,729	3,849,306
Investing activities					
Development of oil and gas properties		(914,481)	(2,966,536)	(2,938,030)	(7,846,752)
Change in non-cash working capital	14	(112,462)	1,309,045	(37,755)	672,825
Cash used in investing activities		(1,026,943)	(1,657,491)	(2,975,785)	(7,173,927)
Change in cash		(101,761)	39,020	(821,635)	(2,265,905)
Cash, beginning of the period		102,136	94,160	822,010	2,399,085
Cash, end of the period		\$ 375	\$ 133,180	\$ 375	\$ 133,180
Supplementary disclosure					
Cash interest paid		\$ 66,626	\$ 34,348	\$ 95,294	\$ 75,058
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		-	-	-	(8,930,351)	(8,930,351)
Convertible debentures issued	7	-	-	4,016,100	-	4,016,100
Share-based compensation	12	-	1,279,801	-	-	1,279,801
Balance as at September 30, 2018		\$ 53,189,854	\$ 7,433,494	\$ 4,016,100	\$ (25,738,864)	\$ 38,900,584

See accompanying notes to the unaudited interim financial statements.

Notes to the Interim Financial Statements (unaudited)

As at September 30, 2018 and for the three and nine months ended September 30, 2018 and 2017

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 November 30, 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

IFRS 16 Leases ("IFRS 16") replaces IAS 17 Leases and requires entities to recognize lease assets and lease obligations on the statement of financial position. For lessees, IFRS 16 removes the classification of leases as either operating leases or finance leases, effectively treating all leases as finance leases. Certain short-term leases (less than 12 months) and leases of low-value assets are exempt from the requirements and may continue to be treated as operating leases. Lessors will continue with a dual lease classification model. Classification will determine how and when a lessor will recognize lease revenue and what assets would be recorded. The standard will come into effect for annual periods beginning on or after January 1, 2019 and may be applied retrospectively or using a modified retrospective approach. The modified retrospective approach does not require restatement of prior period financial information as it recognizes the cumulative effect as an adjustment to opening retained earnings and applies the standard prospectively.

The Company has elected to adopt IFRS 16 on January 1, 2019 using the modified retrospective approach. As of September 30, 2018, the Company has performed an initial assessment of its lease contracts that will fall into scope of this standard. The Company is currently evaluating the financial impact of the standard on its financial statements in preparation for adoption. The Company anticipates that the standard will increase both assets and liabilities reported on the consolidated statement of financial position. Additionally, the Company expects impacts to the consolidated statement of comprehensive income (loss), likely with an increase in depreciation and net finance expenses and decreases in general and administrative expenses. As part of this review, the Company is also assessing potential changes to its financial reporting policies and internal controls.

(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 September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
Realized gain (loss)	\$ (1,216,524)	\$ 467,566	\$ (2,443,616)	\$ 380,063
Unrealized gain (loss)	616,311	(1,085,351)	(2,295,271)	3,772,807
Total gain (loss) on risk management contracts	\$ (600,213)	\$ (617,785)	\$ (4,738,887)	\$ 4,152,870

For the three and nine months ended September 30, 2018, the Company recorded realized losses of \$1,216,524 and \$2,443,616, respectively (2017 – gains of \$467,566 and \$380,063) on contracts entered to manage commodity price risk. As at September 30, 2018, the fair value associated with these risk management contracts was a liability of \$3,818,117 (December 31, 2017 - \$1,522,846 liability), of which \$3,211,866 is reported as a current liability reflecting contracts which will settle by September 30, 2019, and \$606,251 reported as a long-term liability for contracts that will settle after September 30, 2019. The change in the fair value during the three and nine months ended September 30, 2018 produced an unrealized gain of \$616,311 and an unrealized loss \$2,295,271, respectively (2017 – loss of \$1,085,351 and gain of \$3,772,807).

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

Type	Period	Volume	Price/unit ⁽¹⁾	Index
Fixed WTI Swap	January 1, 2018 – December 31, 2018	200 bbl/d	CAD \$67.20	WTI-NYMEX
Fixed WTI Swap	July 1, 2018 – December 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 ⁽²⁾	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
Cost:			
Balance, January 1, 2017	\$ 67,678,798	\$ 181,003	\$ 67,859,801
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
Balance, December 31, 2017	\$ 77,669,337	\$ 195,854	\$ 77,865,191
Development expenditures	2,651,938	1,927	2,653,865
Additions to decommissioning obligations	40,408	-	40,408
Capitalized general and administrative costs	284,165	-	284,165
Capitalized share-based compensation	209,851	-	209,851
Balance, September 30, 2018	\$ 80,855,699	\$ 197,781	\$ 81,053,480
Accumulated depletion and depreciation:			
Balance, January 1, 2017	\$ 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
Depletion and depreciation	3,288,400	20,563	3,308,963
Balance, September 30, 2018	\$ 23,327,076	\$ 126,607	\$ 23,453,683
Net book value:			
Balance, December 31, 2017	\$ 57,630,661	\$ 89,810	\$ 57,720,471
Balance, September 30, 2018	57,528,623	71,174	57,599,797

During the three and nine months ended September 30, 2018, the Company capitalized general and administrative expenses in the amount of \$92,499 and \$284,165, respectively (2017 - \$97,500 and \$292,500) and capitalized share-based compensation expense in the amount of \$121,895 and \$209,851, respectively (2017 - \$91,773 and \$275,200), 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 September 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 September 30, 2018, no indicators of impairment were present.

6. Bank Loan

The Company's revolving operating facility limit of \$2.5 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 September 30, 2018, the Company was in breach of its lenders covenant as its working capital was 0.85:1.00. As a result, the lender can demand repayment of the bank loan in full which had a balance of \$1,115,130 owing at September 30, 2018 and is classified as a current liability on the statement of financial position. In response to the breach the Company issued an additional 1,000 convertible debentures for total proceeds of \$1,000,000 in November 2018 (see note 18b). Management plans to

address any future working capital deficiencies by accessing the remaining \$2,426,000 in funding that is available subsequent to the November 2018 convertible debentures issuance.

7. Convertible Debentures and Obligation Debentures

On May 28, 2018, the Company provided all shareholders and its Managing Director the opportunity to subscribe for an aggregate of \$7,502,000 in convertible debentures and the execution of an agreement for 5,426 committed convertible debentures ("Obligation Debentures"), as described in further detail in note 7b. During the third quarter of 2018, the Company issued an additional 2,000 convertible debentures for total gross and net proceeds of \$2,000,000. On a year to date basis, the Company has issued a total of 4,076 convertible debentures for total gross proceeds of \$4,076,000 (\$4,016,100 net of issue costs).

(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 September 30, 2018 and the convertible debentures were converted to common shares, 81,520,000 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 \$3,426,000 of cash. As at September 30, 2018, the total face value of the convertible debentures plus accrued undeclared interest was \$4,142,000.

(b) Obligation Debentures

Concurrent with the initial convertible debenture issuance, on May 28, 2018 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. In the third quarter of 2018, the Company called on the subscriber to purchase an additional 2,000 Obligation Debentures resulting in the issuance of \$2,000,000 in convertible debentures by the Company. In November 2018 an additional 1,000 Obligation Debentures were called resulting in the issuance of \$1,000,000 in convertible debentures. Subsequent to the November 2018 issuance a total of 2,426 Obligation Debentures remain, which represent an additional \$2,426,000 in funding available to the Company.

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 to understand its position relative to industry peers but 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. As discussed in note 6, the Company was in breach of its lenders working capital covenant at September 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 over the next twelve months, Kaisen's current capital resources (cash on hand, equity proceeds and available borrowing capacity) are sufficient to fund ongoing corporate obligations through to September 30, 2019. 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 adjusting its operations and capital expenditure programs.

9. Restructuring Expenses

Kaisen underwent a restructuring in the second quarter of 2018 resulting in a reduction to the Company's employee base and office space requirements. During the nine months ended September 30, 2018, the Company recorded \$1,167,028 in restructuring expenses (2017 - \$nil). Cash based restructuring expenses for the nine months ended September 30, 2018 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. Restructuring expenses for the three months ended September 30, 2018 and the prior year comparative quarter were \$nil.

10. Net Finance Expenses

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

	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
Interest expense on bank loan	\$ 33,804	\$ 32,018	\$ 95,294	\$ 73,140
Accretion of decommissioning obligations	64,917	56,666	193,603	167,358
Net finance expenses	\$ 98,721	\$ 88,684	\$ 288,897	\$ 240,498

11. Other Long-Term Liabilities

	September 30, 2018	December 31, 2017
Decommissioning obligations	\$ 11,740,162	\$ 11,506,151
Onerous lease	19,033	-
Total other long-term liabilities	\$ 11,759,195	\$ 11,506,151

(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 September 30, 2018 is \$13.8 million which will be incurred over the next 10-15 years with the majority of costs incurred between 2020 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:

	September 30, 2018	December 31, 2017
Balance, beginning of period	\$ 11,506,151	\$ 9,862,302
Liabilities incurred	40,408	296,726
Accretion	193,603	224,786
Change in estimate	-	1,186,210
Decommissioning expenditures incurred	-	(68,873)
Balance, end of period	\$ 11,740,162	\$ 11,501,151

(b) Onerous Leases

The Company records 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. As at September 30, 2018, the undiscounted amount of estimated future cash flows to settle the obligations was \$77,008. 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 September 30, 2018, the balance of the provision was \$75,371, of which \$56,338 is classified as accounts payable and accrued liabilities. Charges of \$102,470 related to the original recognition of the onerous lease were recorded as restructuring costs in the second quarter of 2018 (see note 9).

	September 30, 2018	December 31, 2017
Balance, beginning of period	\$ -	\$ -
Additions	102,470	-
Amortization of onerous lease	(27,099)	-
Balance, end of period	\$ 75,371	\$ -
Current	56,338	-
Non-current	19,033	-
Total	\$ 75,371	\$ -

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
Balance, December 31, 2017 and September 30, 2018	45,420,029	\$ 53,189,854

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

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. Pursuant to the 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 Company's current share-based compensation plans consist of share options, executive incentive options, and performance warrants.

The following table summarizes the Company's outstanding equity compensation units:

	September 30, 2018			December 31, 2017		
	Number of units outstanding	Weighted average exercise price (\$ per share)	Weighted average remaining life (years)	Number of units outstanding	Weighted average exercise price (\$ per share)	Weighted average remaining life (years)
Incentive share options	4,500,000	0.05	2.8	-	-	-
Share options	10,931,000	0.11	4.7	1,448,000	1.46	0.9
Performance warrants	34,240,999	0.53	4.3	10,780,999	1.78	3.2
Units outstanding	49,671,999	0.39	4.2	12,228,999	1.74	2.9

On July 18, 2018, the Company granted 4,500,000 executive incentive options ("Incentive Options"), 10,650,000 share options and 26,625,000 performance warrants to directors, employees and contractors serving in capacity of employees of the Company. The weighted average fair value of Incentive Options, share options, and performance warrants granted during the nine months ended September 30, 2018 was \$0.05, \$0.02, and \$0.01 per unit, respectively, as estimated on the date of grant using the Black-Scholes option pricing model.

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. The Share options were granted at a strike price of \$0.05 per share, vest evenly over a three-year period and expire five years from the anniversary of the grant. The performance warrants vest upon a qualifying liquidity event, expire in 5 years and have exercise prices ranging from \$0.10 to \$0.25. Total equity compensation units outstanding as at September 30, 2018 was 49,671,999. A total of 3,165,000 performance warrants and 1,167,000 in share options expired or forfeited during the nine months ended September 30, 2018.

The following table summarizes the Company's exercisable equity compensation units:

	September 30, 2018			December 31, 2017		
	Number of units outstanding	Weighted average exercise price (\$ per share)	Weighted average remaining life (years)	Number of units outstanding	Weighted average exercise price (\$ per share)	Weighted average remaining life (years)
Incentive share options	1,125,000	0.05	2.8	-	-	-
Share options	281,000	2.25	0.9	1,448,000	1.48	0.9
Performance warrants	-	-	-	-	-	-
Units outstanding	1,406,000	0.49	2.4	1,448,000	1.48	0.9

During the three and nine months ended September 30, 2018, the Company recorded share-based compensation expenses of \$386,850 and \$1,069,950, respectively (2017 - \$488,506 and \$1,455,966).

13. Net Loss per Common share

	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
Net loss	\$ (1,340,609)	\$ (1,633,637)	\$ (8,930,351)	\$ (538,455)
Weighted number of average common shares outstanding:	45,420,029	45,180,899	45,420,029	43,942,485
Basic and diluted loss per share	\$ (0.03)	\$ (0.04)	\$ (0.20)	\$ (0.01)

For the purpose of calculating net loss per diluted share for the three and nine months ended September 30, 2018 and 2017, none of the outstanding options, performance warrants, or convertible debentures are included as these instruments are anti-dilutive.

14. Supplemental Cash Flow Information

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

	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
Accounts receivable and due from shareholder	\$ (39,963)	\$ 80,988	\$ 347,296	\$ (646,801)
Prepaid expenses and deposits	(105,543)	5,973	(135,725)	313,442
Accounts payable and accrued liabilities	1,035,427	1,791,130	1,657,596	617,881
Change in non-cash working capital	889,921	1,878,091	1,869,167	284,522
Related to operating activities	1,002,383	569,046	1,906,923	(388,303)
Related to investing activities	\$ (112,462)	\$ 1,309,045	\$ (37,755)	\$ 672,825

15. Major Customers

The majority of the Company's credit exposure on accounts receivable at September 30, 2018 pertains to accrued revenue for September 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 September 30, 2018 were received in October 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 September 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 September 30, 2018:

<i>(\$ thousands)</i>	Total	2018	2019	2020	2021	2022
Office leases	231	41	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. In the second quarter of 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 September 30, 2018, \$167,159 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 September 30, 2018, \$nil in related party amounts were included in accounts payable and accrued liabilities.

18. Subsequent Events

(a) Risk management contracts

Subsequent to September 30, 2018, the Company amended the terms of its 2019 400bbl/d call option with its banker at no cost to the Company. The new contract period runs from January 1, 2020 to December 31, 2020, has a volume of 500 bbl/d and retains its fixed price of US\$60.00 per unit.

(b) Convertible Debenture Issuance

The Company issued an additional 1,000 convertible debentures for total proceeds of \$1,000,000 in November of 2018. This leaves the Company with an additional \$2,426,000 of funding available under the original subscription dated May 28, 2018.