



**ANNUAL REPORT  
AS AT AND FOR THE YEAR ENDED  
DECEMBER 31, 2017**

[THIS PAGE IS INTENTIONALLY BLANK]

FINANCIAL AND OPERATIONAL HIGHLIGHTS (CA\$ thousands, except as otherwise indicated)	Three months ended December 31			Year ended December 31		
	2017	2016	%	2017	2016	%
<b>FINANCIAL</b>						
Petroleum and natural gas revenue, before royalties	80,838	55,737	45	257,557	184,613	40
Cash provided by operating activities	36,458	21,919	66	115,222	44,720	158
Adjusted funds from operations <sup>(1)</sup>	32,898	23,100	42	108,011	58,380	85
Basic (\$/ common share) <sup>(1)</sup>	0.18	0.13	38	0.61	0.34	79
Diluted (\$/ common share) <sup>(1)</sup>	0.18	0.13	38	0.61	0.34	79
Profit (loss) and comprehensive income (loss)	(5,389)	11,856	-145	(23,178)	(49,774)	-53
Basic (\$/ common share)	(0.03)	0.07	-143	(0.13)	(0.29)	-55
Diluted (\$/ common share)	(0.03)	0.07	-143	(0.13)	(0.29)	-55
Total capital expenditures, net of dispositions	55,778	36,339	53	127,977	98,268	30
Total assets	1,276,567	1,255,958	2	1,276,567	1,255,958	2
Bank debt, net of working capital <sup>(1)</sup>	136,729	138,042	-1	136,729	138,042	-1
Convertible debentures	74,517	70,978	5	74,517	70,978	5
Shareholders' equity	845,701	843,301	0	845,701	843,301	0
Weighted average shares outstanding (000s)						
Basic	178,220	175,275	2	176,466	173,076	2
Diluted	179,898	176,234	2	177,920	173,415	3
<b>OPERATIONS</b>						
Average daily production						
Oil (bbls/d)	7,902	4,746	66	6,634	5,070	31
NGLs (bbls/d)	3,379	2,502	35	2,608	2,709	-4
Gas (mcf/d)	82,689	75,084	10	77,330	79,009	-2
Combined (BOE/d)	25,063	19,762	27	22,130	20,947	6
Production per million common shares (BOE/d) <sup>(1)</sup>	141	113	25	125	121	3
Average realized prices, before financial instruments <sup>(1)</sup>						
Oil (\$/bbl)	65.13	58.23	12	59.10	47.84	24
NGLs (\$/bbl)	29.62	23.11	28	27.72	18.28	52
Gas (\$/mcf)	2.79	3.62	-23	3.01	2.69	12
Operating netbacks (\$/BOE) <sup>(1)</sup>						
Petroleum and natural gas revenue	35.06	30.66	14	31.89	24.08	32
Cost of purchases	(1.32)	-	-	(0.38)	-	-
Average realized price, before financial instruments <sup>(1)</sup>	33.74	30.66	10	31.51	24.08	31
Cash premiums on derivatives	-	0.11	-100	-	0.06	-100
Realized gain (loss) on financial instruments	(0.32)	(0.24)	33	(0.13)	(0.04)	225
Average realized price, after financial instruments <sup>(1)</sup>	33.42	30.53	9	31.38	24.10	30
Royalties	(3.12)	(2.86)	9	(2.92)	(2.08)	40
Production expense	(11.01)	(9.47)	16	(10.05)	(9.29)	8
Transportation expense	(3.11)	(3.12)	0	(3.13)	(2.86)	9
Operating netback <sup>(1)</sup>	16.18	15.08	7	15.28	9.87	55
Undeveloped land						
Gross acres	755,455	768,345	-2	755,455	768,345	-2
Net acres	637,823	647,770	-2	637,823	647,770	-2
Reserves – proved plus probable						
Crude oil (mbbls)	21,438	23,308	-8	21,438	23,308	-8
NGLs (mbbls)	80,350	48,585	65	80,350	48,585	65
Gas (mmcf)	802,875	733,037	10	802,875	733,037	10
Combined (mBOE)	235,601	194,066	21	235,601	194,066	21

(1) Refer to advisories regarding non-GAAP financial measures and other key performance indicators.

## MESSAGE TO SHAREHOLDERS

Kelt Exploration Ltd. ("Kelt" or the "Company") reports its financial and operating results to shareholders for the fourth quarter and year ended December 31, 2017.

Average production for the three months ended December 31, 2017 was a Company record high quarterly production of 25,063 BOE per day, up 27% compared to average production of 19,762 BOE per day during the fourth quarter of 2016. Daily average production in the fourth quarter of 2017 was 11% higher than average production of 22,510 BOE per day in the third quarter of 2017. In addition, Kelt achieved a record high calendar year average production in 2017. Average production for 2017 was 22,130 BOE per day, up 6% from average production of 20,947 BOE per day in 2016 and 2% higher than guidance whereby Kelt's forecasted target for average production in 2017 was 21,800 BOE per day. Production for 2017 was weighted 42% oil and NGLs and 58% gas.

Kelt's realized average oil price during the fourth quarter of 2017 was \$65.13 per barrel, up 22% from \$53.22 per barrel in the third quarter of 2017 and up 12% from \$58.23 per barrel in the fourth quarter of 2016. The realized average NGLs price during the fourth quarter of 2017 was \$29.62 per barrel, up 22% from \$24.34 per barrel in the third quarter of 2017 and up 28% from \$23.11 per barrel in the corresponding quarter of 2016. Kelt's realized average gas price during the fourth quarter of 2017 was \$2.79 per MCF, up 20% from \$2.33 per MCF in the third quarter of 2017 and down 23% from the realized average gas price of \$3.62 per MCF in the fourth quarter of the previous year.

Kelt's operating netback for the fourth quarter of 2017 was reported as \$16.18 per BOE and production expense was reported as \$11.01 per BOE. Subsequent to the Company's press release issued on February 8, 2018, Kelt was provided with notice by a third-party operator of a gas plant in the Pouce Coupe/Progress area that the operator had erroneously undercharged Kelt operating expenses related to Kelt gas volumes processed at the gas plant for 2016 and 2017. As a result, Kelt has recorded \$5.2 million of additional production expense (of which, \$2.3 million related to 2016 expenses) during the fourth quarter of 2017. This resulted in additional production expense of \$2.26 per BOE during the quarter. The pro-forma effect of recording the correct amounts in each calendar year is as follows:

2017 Production Expense		2016 Production Expense	
As Reported	Pro-Forma Actual	As Reported	Pro-Forma Actual
\$81.2 million	\$78.9 million	\$71.2 million	\$73.5 million
\$10.05 per BOE	\$9.77 per BOE	\$9.29 per BOE	\$9.58 per BOE

For the three months ended December 31, 2017, total revenue was \$80.8 million and adjusted funds from operations was \$32.9 million (\$0.18 per share, diluted), compared to \$55.7 million and \$23.1 million (\$0.13 per share, diluted) respectively, in the fourth quarter of 2016. At December 31, 2017, bank debt, net of working capital was \$136.7 million, down 1% from \$138.0 million at December 31, 2016.

Net capital expenditures incurred during the three months ended December 31, 2017 were \$55.8 million and for the year ended December 31, 2017, net capital expenditures were \$128.0 million. During 2017, the Company spent \$154.7 million on drill and complete operations, \$78.0 million on equipment, facilities and pipelines and \$11.1 million on land and seismic. During the year, Kelt realized proceeds of \$116.3 million from asset dispositions and incurred \$0.5 million on asset acquisitions.

As at December 31, 2017, Kelt's net working interest land holdings were 852,181 acres (1,332 sections) of which 637,823 net acres (997 sections) are undeveloped. Kelt is focused on long-term value creation by accumulating significant undeveloped land acreage on resource style plays, with a primary focus on Triassic Montney oil and liquids-rich gas plays. At December 31, 2017, Kelt's net Montney land holdings were 438,365 acres (685 sections).

In the fourth quarter of 2017, Kelt drilled seven horizontal wells that were not yet completed (DUCs) at year-end. Five wells were from a pad at Pouce Coupe in the Middle Montney (D2), the sixth well was drilled at Progress in the Middle Montney and the seventh well was drilled at Inga in the Upper Montney. These wells are all expected to be completed by the end of the first quarter in 2018. During the completion operations of the five-well pad at Pouce Coupe, the Company shut-in existing producing wells in the pool in order to mitigate damage while fracking. Kelt expects to bring the five-well pad and previously shut-in production at Pouce Coupe on-stream during March and April 2018.

The Progress Middle Montney well is expected to be put on production in July 2018 after tie-in pipeline construction is completed. In addition, Kelt has drilled two wells (at 56% working interest) in the Halfway oil play at Progress and expects to have these wells on-stream by early April 2018.

At Inga, Kelt is currently drilling a three-well pad targeting the Upper Montney, the IBZ Middle Montney and the Middle Montney formations. These wells are expected to be drilled by the end of the first quarter and are expected to be completed in the second quarter of 2018.

Kelt continues to delineate its recently acquired undeveloped Montney lands at Oak/Flatrock in British Columbia and at Wembley/Pipestone in Alberta. At Oak/Flatrock, the Company has drilled two delineation wells to date in 2018 and expects to have these wells completed by April 2018.

At Wembley/Pipestone, Kelt has drilled three delineation wells to date in 2018 and a fourth well is expected to be drilled prior to the end of the first quarter. The Company has entered into an agreement with Tidewater Midstream and Infrastructure Ltd. ("Tidewater") for firm processing of 25.0 MMcf per day of raw gas under a five year take-or-pay arrangement at Tidewater's proposed deep-cut natural gas processing plant that is expected to be constructed and on-stream by the third quarter of 2019. Kelt, at its sole discretion, has the option to convert a part of its take-or-pay arrangement into an ownership interest (up to 15%) in the proposed Tidewater gas plant. The Company currently owns a fractional interest in the Cenovus Wembley Gas Plant which has allowed Kelt to produce its first Montney well at Wembley/Pipestone. The ability to produce solution gas on this oil prone Montney play through deep-cut gas processing facilities further enhances the overall oil/NGLs weighting in the play. The first well at Wembley/Pipestone had an IP120 of 1,009 BOE per day (46% oil, 27% NGLs and 27% gas). During the 120 day period, NGL recoveries were 110 barrels per MMcf of raw gas (or 160 barrels per MMcf of sales gas).

Kelt has revised its previously reported financial guidance for 2018:

<i>(CA\$ millions, except as otherwise indicated)</i>	<b>2018 Guidance [March 6, 2018]</b>	2018 Guidance [November 8, 2017]	Change
Average Production			
Oil & NGLs (bbls/d)	<b>13,400 – 13,900</b>	13,400 – 13,900	
Gas (mmcf/d)	<b>90.6 – 93.6</b>	90.6 – 93.6	
Combined (BOE/d)	<b>28,500 – 29,500</b>	28,500 – 29,500	N/C
Forecast Average Commodity Prices			
WTI oil price (US\$/bbl)	<b>58.50</b>	52.00	13%
Canadian Light Sweet (\$/bbl)	<b>69.80</b>	61.52	13%
NYMEX natural gas price (US\$/MMBTU)	<b>3.05</b>	3.15	- 3%
AECO natural gas price (\$/GJ)	<b>1.96</b>	2.15	- 9%
Average Exchange Rate (US\$/CA\$)	<b>0.790</b>	0.794	- 1%
Capital Expenditures	<b>210.0</b>	210.0	N/C
Funds from operations	<b>200.0</b>	175.0	14%
Per common share, diluted	<b>1.10</b>	0.97	13%
Bank debt, net of working capital, at year-end <sup>(1)</sup>	<b>140.0</b>	155.0	- 10%
Net bank debt/Funds from operations ratio	<b>0.7 x</b>	0.9 x	- 22%

(1) In addition to bank debt, the Company has \$90.0 million principal amount of convertible debentures outstanding with a coupon of 5% per annum, maturing May 31, 2021.

Oil and NGL prices have exceeded the Company's estimates for January and February; however, gas prices to date have been lower than forecasted. The Company will re-evaluate its spending plans for the remainder of 2018 after the first quarter. With continued improvement in commodity prices, Kelt may consider increasing its capital program for the balance of 2018 at that time.

Management looks forward to updating shareholders with 2018 first quarter results on or about May 9, 2018.

On behalf of the Board of Directors,

*[signed]*

David J. Wilson  
President and Chief Executive Officer  
March 6, 2018

## **MANAGEMENT'S DISCUSSION & ANALYSIS**

### **INTRODUCTION**

Kelt Exploration Ltd. ("Kelt" or the "Company") is an oil and gas company based in Calgary, Alberta, focused on the exploration, development and production of crude oil and natural gas resources, primarily in northwestern Alberta and northeastern British Columbia ("BC"). The Company was incorporated under the *Business Corporations Act* (Alberta) on October 11, 2012 and was inactive until February 26, 2013. Kelt's land holdings are located in two core areas, namely: (a) Grande Prairie, Alberta (including Pouce Coupe, Progress and La Glace), held directly by Kelt; and (b) Fort St. John, BC (including Inga, Fireweed and Stoddart), held by the Company's wholly-owned subsidiary, Kelt Exploration (LNG) Ltd. ("Kelt LNG"). The head office of the Company is located at Suite 300, 311 - 6th Avenue S.W., Calgary, Alberta T2P 3H2. The Company's common shares and 5% convertible debentures are listed on the Toronto Stock Exchange ("TSX") under the symbol "KEL" and "KEL.DB", respectively.

Additional information relating to Kelt can be found on SEDAR at [www.sedar.com](http://www.sedar.com).

This Management's Discussion and Analysis ("MD&A") is dated March 6, 2018 and should be read in conjunction with the Company's audited consolidated annual financial statements and related notes as at and for the year ended December 31, 2017. The accompanying financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") as set out in the CPA Canada Handbook – Accounting ("CPA Handbook"). The CPA Handbook incorporates International Financial Reporting Standards ("IFRS") and publicly accountable enterprises, including Kelt, are required to apply such standards. The Company's Board of Directors approved and authorized the consolidated annual financial statements for issue on March 6, 2018.

### **ADVISORY REGARDING FORWARD-LOOKING STATEMENTS**

This MD&A contains forward-looking statements and forward-looking information within the meaning of applicable securities laws. The use of any of the words "expect", "anticipate", "continue", "estimate", "objective", "ongoing", "may", "will", "project", "should", "believe", "plans", "intends", "potentially" and similar expressions are intended to identify forward-looking information or statements. In particular, this MD&A contains forward-looking statements pertaining to the following: the anticipated improvement in Kelt's price realizations for its oil and butane sales following completion of the installation of blending facilities at the Company's three main oil terminals; Kelt's expectation that its gas pricing will realize a premium of approximately 33% to the average AECO price in 2018 as a result of its diversified gas market contracts; the expectation that the recent purchase of a major infrastructure package in northeastern BC (refer to additional information under the heading of "*Capital Expenditures*") will reduce the Company's production expenses in the future; the Company's ability to continue accumulating land at a low-cost in its core operating areas and potentially monetize non-core assets; positive indicators in the current economic environment that the Company believes will continue to support stronger oil and gas prices in 2018; and the Company's expected future financial position and operating results, as well as the amount and timing of future development capital expenditures. Statements relating to "reserves" or "resources" are deemed to be forward looking statements, as they involve the implied assessment, based on certain estimates and assumptions, that the reserves described exist in the quantities predicted or estimated and that the reserves can be profitably produced in the future. Actual reserves may be greater than or less than the estimates provided herein.

Although Kelt believes that the expectations and assumptions on which the forward-looking statements are based are reasonable, undue reliance should not be placed on the forward-looking statements because Kelt cannot give any assurance that they will prove to be correct. Since forward-looking statements address future events and conditions, by their very nature they involve inherent risks and uncertainties. Actual results could differ materially from those currently anticipated due to a number of factors and risks. These include, but are not limited to, the risks associated with the oil and gas industry in general (e.g., operational risks in development, exploration and production; delays or changes in plans with respect to exploration or development projects or capital expenditures; the uncertainty of reserve estimates; the uncertainty of estimates and projections relating to production, costs and expenses; failure to obtain necessary regulatory approvals for planned operations; health, safety and environmental risks; uncertainties resulting from potential delays or changes in plans with respect to exploration or development projects or capital expenditures; volatility of commodity prices, currency exchange rate fluctuations; imprecision of reserve estimates; and competition from other explorers) as well as general economic conditions, stock market volatility; and the ability

to access sufficient capital. We caution that the foregoing list of risks and uncertainties is not exhaustive.

In addition, the reader is cautioned that historical results are not necessarily indicative of future performance. The forward-looking statements contained herein are made as of the date hereof and the Company does not intend, and does not assume any obligation, to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise unless expressly required by applicable securities laws.

Certain information set out herein may be considered as “financial outlook” within the meaning of applicable securities laws. The purpose of this financial outlook is to provide readers with disclosure regarding Kelt’s reasonable expectations as to the anticipated results of its proposed business activities for the periods indicated. Readers are cautioned that the financial outlook may not be appropriate for other purposes.

## **OTHER MEASUREMENTS**

All dollar amounts are referenced in thousands of Canadian dollars, except when noted otherwise. This MD&A contains various references to the abbreviation BOE which means barrels of oil equivalent. Where amounts are expressed on a BOE basis, natural gas volumes have been converted to oil equivalence at six thousand cubic feet per barrel and sulphur volumes have been converted to oil equivalence at 0.6 long tons per barrel. The term BOE may be misleading, particularly if used in isolation. A BOE conversion ratio of six thousand cubic feet per barrel is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead and is significantly different than the value ratio based on the current price of crude oil and natural gas. This conversion factor is an industry accepted norm and is not based on either energy content or current prices. Such abbreviation may be misleading, particularly if used in isolation. References to “oil” in this MD&A include crude oil and field condensate. References to “natural gas liquids” or “NGLs” include pentane, butane, propane, and ethane. References to “liquids” include field condensate and NGLs. References to “gas” in this discussion include natural gas and sulphur.

## **NON-GAAP FINANCIAL MEASURES AND OTHER KEY PERFORMANCE INDICATORS**

This MD&A contains certain financial measures, as described below, which do not have standardized meanings prescribed by GAAP. In addition, this MD&A contains other key performance indicators (“KPI”), financial and non-financial, that do not have standardized meanings under the applicable securities legislation. As these non-GAAP financial measures and KPI are commonly used in the oil and gas industry, the Company believes that their inclusion is useful to investors. The reader is cautioned that these amounts may not be directly comparable to measures for other companies where similar terminology is used.

### *Non-GAAP financial measures*

“Operating income” is calculated by deducting royalties, production expenses and transportation expenses from petroleum and natural gas revenue, net of the cost of purchases and after realized gains or losses on associated financial instruments. The Company refers to operating income expressed per unit of production as an “operating netback”. “Adjusted funds from operations” is calculated as cash provided by operating activities before changes in non-cash operating working capital, and adding back (if applicable): transaction costs associated with acquisitions and dispositions, provisions for potential credit losses, and settlement of decommissioning obligations. Adjusted funds from operations per common share is calculated on a consistent basis with profit (loss) per common share, using basic and diluted weighted average common shares as determined in accordance with GAAP. Adjusted funds from operations and operating income or netbacks are used by Kelt as key measures of performance and are not intended to represent operating profits nor should they be viewed as an alternative to cash provided by operating activities, profit or other measures of financial performance calculated in accordance with GAAP.



The following table reconciles cash provided by operating activities to adjusted funds from operations:

(CA\$ thousands, except as otherwise indicated)	Three months ended December 31			Year ended December 31		
	2017	2016	%	2017	2016	%
<b>Cash provided by operating activities</b>	<b>36,458</b>	21,919	66	<b>115,222</b>	44,720	158
Change in non-cash working capital	(4,044)	776	-621	(8,723)	12,546	-170
<b>Funds from operations</b>	<b>32,414</b>	22,695	43	<b>106,499</b>	57,266	86
Transaction costs	-	4	-100	-	23	-100
Provision for potential credit losses	-	81	-100	-	309	-100
Settlement of decommissioning obligations	484	320	51	1,512	782	93
<b>Adjusted funds from operations</b>	<b>32,898</b>	23,100	42	<b>108,011</b>	58,380	85

The following table demonstrates the calculation of operating income derived from the individual financial statement line items in accordance with GAAP:

(CA\$ thousands, except as otherwise indicated)	Three months ended December 31			Year ended December 31		
	2017	2016	%	2017	2016	%
Petroleum and natural gas revenue <sup>(1)</sup>	80,838	55,737	45	257,557	184,613	40
Cost of purchases	(3,052)	-	100	(3,052)	-	100
Kelt Revenue <sup>(2)</sup> , before financial instruments	77,786	55,737	40	254,505	184,613	38
Cash premiums on financial instruments	-	205	-100	-	460	-100
Realized gain (loss) on financial instruments <sup>(4)</sup>	(720)	(428)	68	(1,060)	(315)	237
Kelt Revenue <sup>(2)</sup> , after financial instruments	77,066	55,514	39	253,445	184,758	37
Royalties	(7,185)	(5,203)	38	(23,557)	(15,911)	48
Production expenses	(25,385)	(17,231)	47	(81,201)	(71,204)	14
Transportation expenses	(7,172)	(5,677)	26	(25,301)	(21,943)	15
<b>Operating income</b>	<b>37,324</b>	27,403	36	<b>123,386</b>	75,700	63
Production (mBOE)	2,306	1,818	27	8,077	7,667	5
<b>Operating netback (\$/BOE)</b>	<b>16.18</b>	15.08	7	<b>15.28</b>	9.87	55
<b>Average realized prices <sup>(3)</sup></b>						
Before financial instruments (\$/BOE)	33.74	30.66	10	31.51	24.08	31
After financial instruments (\$/BOE)	33.42	30.53	9	31.38	24.10	30

(1) Petroleum and natural gas revenue (before royalties) as reported in the consolidated financial statements is referred to as "total revenue" throughout this MD&A.

(2) "Kelt Revenue" is a non-GAAP measure and includes petroleum and natural gas revenue (before royalties), net of the cost of the third party volumes purchased.

(3) Average realized prices are calculated based on Kelt Revenue (1) divided by total production and reflect the Company's realized sales prices plus the net benefit of oil blending/marketing activities.

(4) Includes realized gains (losses) on commodity price and foreign exchange derivatives. Excludes realized gains (losses) on interest rate swaps.

Throughout this MD&A, reference is made to "total revenue", "Kelt Revenue" and "average realized prices". "Total revenue" refers to petroleum and natural gas revenue (before royalties) as reported in the consolidated financial statements in accordance with GAAP, and is before realized gains or losses on financial instruments. "Kelt Revenue" is a non-GAAP measure and is calculated by deducting the cost of purchases from petroleum and natural gas revenue (before royalties). "Average realized prices" are calculated based on "Kelt Revenue" divided by production and reflect the Company's realized selling prices plus the net benefit of oil blending/marketing activities, which commenced during the fourth quarter of 2017. In addition to using its own production, the Company may purchase butane and crude oil from third parties for use in its blending operations, with the objective of selling the blended oil product at a premium. Marketing revenue from the sale of third party volumes is included in total petroleum and natural gas revenue as reported in the Consolidated Statement of Profit (Loss) and Comprehensive Income (Loss) in accordance with GAAP. Given the Company's per unit operating statistics disclosed throughout this MD&A are

calculated based on Kelt's production volumes, management believes that disclosing its average realized prices based on Kelt Revenue is more appropriate and useful, because the cost of third party volumes purchased to generate the incremental marketing revenue has been deducted.

"Average realized prices" referenced throughout this MD&A are before financial instruments, except as otherwise indicated as being after financial instruments.

The term "net bank debt" is used synonymously with, and is equal to, "bank debt, net of working capital". "Net bank debt" is calculated by adding the working capital deficiency to bank debt. The working capital deficiency is equal to total current assets net of total current liabilities. The Company uses a "net bank debt to trailing adjusted funds from operations ratio" as a benchmark on which management monitors the Company's capital structure and short-term financing requirements. Management believes that this ratio, which is a non-GAAP financial measure, provides investors with information to understand the Company's liquidity risk. The "net bank debt to trailing adjusted funds from operations ratio" is also indicative of the "debt to cash flow" calculation used to determine the applicable margin for a quarter under the Company's Credit Facility agreement (though the calculation may not always be a precise match, it is representative).

#### *Other KPI*

"Production per common share" is calculated by dividing total production by the basic weighted average number of common shares outstanding, as determined in accordance with GAAP.

"Finding, development and acquisition" ("FD&A") cost is the sum of capital expenditures incurred in the period and the change in future development capital ("FDC") required to develop reserves. FD&A cost per BOE is determined by dividing current period net reserve additions into the corresponding period's FD&A cost. Readers are cautioned that the aggregate of capital expenditures incurred in the year, comprised of exploration and development costs and acquisition costs, and the change in estimated FDC generally will not reflect total FD&A costs related to reserves additions in the year.

"Recycle ratio" is a measure for evaluating the effectiveness of a company's re-investment program. The ratio measures the efficiency of capital investment by comparing the operating netback per BOE to FD&A cost per BOE.

"Net asset value per common share" is calculated by adding the present value of petroleum and natural gas reserves, undeveloped land value and proceeds from exercise of stock options, less the present value of decommissioning obligations and bank debt, net of working capital, and dividing by the diluted number of common shares outstanding. The calculation of proceeds from exercise of stock options and the diluted number of common shares outstanding only include stock options that are "in-the-money" based on the closing price of KEL common shares as at the calculation date. The diluted number of common shares outstanding includes common shares issuable upon conversion of the convertible debentures that are "in-the-money" based on the closing price of KEL common shares as at the calculation date.

## **GROWTH STRATEGY**

The business plan of Kelt is to create sustainable and profitable growth as a participant in the oil and gas industry in Canada. Kelt implements a full cycle exploration program, resulting in exploration and development drilling based on opportunities generated internally. From time to time, Kelt may complement its exploration and development drilling program by acquiring strategic oil and gas properties in order to further enhance its opportunity base.

Kelt is opportunity driven and is confident that it can grow its production base by building on its current inventory of development projects and by adding new exploration prospects. Kelt will endeavor to maintain a high quality product stream that on a historical basis receives a superior price with reasonably low production and transportation costs. In addition, the Company will focus its exploration efforts in areas of multi-zone hydrocarbon potential, primarily in northwestern Alberta and northeastern British Columbia. Kelt will continue to seek optimization of its asset base by building on its core properties and monetizing non-core assets.

## **RESULTS OF OPERATIONS**

*On January 18, 2017, Kelt completed the disposition of the majority of its oil and gas assets in the Karr area of Alberta (the "Karr Property Disposition") for cash proceeds of \$103.1 million after closing adjustments. At the time of the disposition, the assets were producing approximately 1,300 BOE per day (50% oil and NGLs). The Company's operating results for the year ended December 31, 2017 include production and operating income from the assets disposed for the 17 day period prior to closing on January 18, 2017. Additional information regarding the Karr Property Disposition is provided under the heading of "Capital Expenditures" in this MD&A.*

- Kelt achieved record high average production during the fourth quarter and year ended December 31, 2017:
  - Production averaged 25,063 BOE per day (45% oil/NGLs) during the fourth quarter of 2017, up 11% from 22,510 BOE per day (42% oil/NGLs) in the third quarter of 2017, and up 27% from 19,762 BOE per day (37% oil/NGLs) in the fourth quarter of 2016.
  - Calendar year average production for 2017 was 22,130 BOE per day (42% oil/NGLs), up 6% from average production of 20,947 BOE per day (37% oil/NGLs) in 2016. Production per million shares was 125 BOE per day, up from 121 BOE per day in 2016.
- Kelt's oil production has increased significantly, averaging 7,902 barrels per day during the fourth quarter of 2017, up 15% from the third quarter of 2017 and up 66% from average oil production of 4,746 barrels per day in the fourth quarter of 2016.
- Total revenue for the three months ended December 31, 2017 was \$80.8 million, up 45% from \$55.7 million in the same quarter of 2016. Kelt's average realized price of \$33.74 per BOE during the fourth quarter of 2017 is 10% higher than the average price of \$30.66 per BOE realized in the fourth quarter of 2016, reflecting the significant increase in Kelt's corporate average oil production weighting, which more than offset the impact of lower gas prices on the Company's revenue during the fourth quarter of 2017.
- During the three months ended December 31, 2017, corporate royalty rates averaged 9.2%, production expense averaged \$11.01 per BOE, transportation expenses were \$3.11 per BOE, interest expense was \$0.93 per BOE and G&A expense was \$0.98 per BOE. In the comparative quarter of 2016, corporate royalty rates averaged 9.3%, production expense averaged \$9.47 per BOE, transportation expenses were \$3.12 per BOE, interest expense was \$1.38 per BOE and G&A expense was \$0.98 per BOE.
- Kelt's operating netback was \$16.18 per BOE for the quarter ended December 31, 2017, up 26% from \$12.86 per BOE during the quarter ended September 30, 2017 and up 7% from \$15.08 per BOE during the quarter ended December 31, 2016. The increase in operating netback is driven by Kelt's higher combined average realized price partly offset by higher per unit production expenses, which averaged \$11.01 per BOE during the fourth quarter of 2017. Production expense during the quarter included an adjustment relating to a third-party gas plant in the Pouce Coupe/Progress area that the operator had erroneously undercharged Kelt operating expenses related to Kelt gas volumes processed at the gas plant for 2016 and 2017. As a result, Kelt has recorded \$5.2 million of additional production expense (of which, \$2.3 million related to 2016 expenses) during the fourth quarter of 2017. This resulted in additional production expense of \$2.26 per BOE for the three month period ended December 31, 2017.
- Adjusted funds from operations of \$32.9 million (\$0.18 per share, diluted) during the fourth quarter of 2017 increased by 43% from \$23.0 million (\$0.13 per share, diluted) during the third quarter of 2017 and is also up by 42% compared to \$23.1 million (\$0.13 per share, diluted) in the fourth quarter of 2016. On an annual basis, adjusted funds from operations increased 85% in 2017 to \$108.0 million (\$0.61 per share, diluted, compared to \$58.4 million (\$0.34 per share, diluted) in 2016.
- Total capital expenditures, net of dispositions, were \$55.8 million during the fourth quarter and \$128.0 million for the year ended December 31 2017, up 30% compared to net capital expenditures of \$98.3 million in 2016. Total capital expenditures prior to acquisitions and dispositions were \$243.8 million during 2017, of which, Kelt spent \$154.7 million drilling and completing wells, \$78.0 million on facilities, pipelines and equipment, and \$11.1 million on land and seismic. Net capital expenditures during 2017 include \$0.5 million incurred on asset acquisitions and proceeds of \$116.3 million from property dispositions.
- In addition to the Karr Property Disposition on January 18, 2017, the Company completed several dispositions of non-core assets during 2017 for aggregate cash proceeds of \$13.3 million. Kelt realized a gain on sale of \$10.5

million from these strategic dispositions as the total net carrying value of the assets and associated decommissioning obligations disposed was \$2.8 million. Production was approximately 150 BOE per day (90% gas) at the time of the respective dispositions.

- As at December 31, 2017, the Company holds petroleum and natural gas rights in 637,823 net acres of undeveloped land (647,770 net acres at December 31, 2016). During 2017, Kelt increased its Montney land holdings by 5% in its core areas to 438,365 net acres (685 net sections).
- Kelt drilled 40 (31.2 net) wells during the year ended December 31, 2017. The number of net wells drilled by the Company is up 154% compared to 15 (12.3 net working interest) wells drilled during the previous year ended December 31, 2016. Seven wells drilled during the fourth quarter were uncompleted as at December 31, 2017. These wells are all expected to be completed by the end of the first quarter in 2018.
- The Company reported significant growth in reserves as at December 31, 2017:
  - Proved developed producing reserves increased 10% to 37.9 million BOE;
  - Total proved reserves increased 23% to 133.0 million BOE; and
  - Total proved plus probable reserves increased 21% to 235.6 million BOE.
- The Company's 2017 capital investment program resulted in net reserve additions that replaced 2017 production by a factor of 4.1 times on a proved basis and 6.2 times on a proved plus probable basis.
- Kelt's net asset value at December 31, 2017 was \$11.06 per common share, up 20% from \$9.20 per common share at December 31, 2016.
- The Company maintained a strong balance sheet and reduced net bank debt year-over-year while carrying out its robust \$243.8 million capital expenditure program during 2017. Kelt's net bank debt was 1.0 times trailing adjusted funds from operations as at December 31, 2017, down from 1.5 times as at December 31, 2016. In addition to the Company's continued focus on cost discipline, Kelt strengthened its liquidity and financial position by monetizing non-core assets and through the completion of strategic equity financings for net proceeds for \$20.3 million during October 2017, pursuant to which Kelt issued:
  - 2.0 million common shares on a flow-through private placement basis in respect of Canadian development expenses at a subscription price of \$7.75 per share for gross proceeds of \$15.6 million; and
  - 0.6 million common shares on a flow-through private placement basis in respect of Canadian exploration expenses at a subscription price of \$8.75 per share for gross proceeds of \$5.0 million.
- As at December 31, 2017, the Company had drawn \$91.5 million on its revolving bank credit facility with an authorized borrowing amount of \$185.0 million. The Company and its syndicate of lenders are reviewing the authorized borrowing amount to reflect the increase in Kelt's reserves and expect to complete the borrowing base redetermination prior to the end of the current revolving period in April 2018.
- The Company also has \$90.0 million principal amount of convertible debentures outstanding with a conversion price of \$5.50 per share and maturity date of May 31, 2021, if not converted or redeemed prior to maturity. As at December 31, 2017, the convertible debentures are "in-the-money" based on the closing price of Kelt common shares on the TSX of \$7.19 on December 29, 2017, being the last trading day in the year.

Kelt is well positioned to execute on its 2018 capital expenditure program and has sufficient financial flexibility to take advantage of opportunities as they arise.

## PRODUCTION

(CA\$ thousands, except as otherwise indicated)	Three months ended December 31			Year ended December 31		
	2017	2016	%	2017	2016	%
Average daily production:						
Oil (bbls/d)	7,902	4,746	66	6,634	5,070	31
NGLs (bbls/d)	3,379	2,502	35	2,608	2,709	-4
Gas (mcf/d)	82,689	75,084	10	77,330	79,009	-2
Combined (BOE/d) <sup>(1)</sup>	25,063	19,762	27	22,130	20,947	6

(1) Kelt completed the Karr Property Disposition on January 18, 2017. Average production reported for 2016 included approximately 1,700 BOE per day of production from the assets disposed at Karr, which were producing approximately 1,300 BOE per day (50% oil and NGLs) at the time of the disposition.

Average production for the three months ended December 31, 2017 was a Company record high quarterly production of 25,063 BOE per day, up 27% compared to average production of 19,762 BOE per day during the fourth quarter of 2016. Daily average production in the fourth quarter of 2017 was 11% higher than average production of 22,510 BOE per day in the third quarter of 2017. In addition, Kelt achieved a record high calendar year average production in 2017. Average production for 2017 was 22,130 BOE per day, up 6% from average production of 20,947 BOE per day in 2016.

The increase in production is driven by strong results from the Company's active development drilling program in its core areas in Alberta and BC, which targeted multiple zones of its Montney acreage. New production added as multi-well pads were brought on-stream during 2017 more than offset the impact of the Karr Property Disposition and corporate declines, and also contributed to the significant increase in oil production. Oil and NGLs production represented 45% of corporate average production during the fourth quarter of 2017 compared to 37% on average during 2016.

On October 6, 2017, Kelt elected to temporarily shut-in approximately 21.4 MMcf/d of dry gas production (3,770 BOE/d including associated NGLs) at its Grande Cache and West Pouce Coupe properties in Alberta. The Company elected to shut-in production at its dry gas properties due to the weakness in the AECO price primarily caused by transportation bottlenecks on the entire western Canadian pipeline transportation system. The production was brought back on-stream on November 1, 2017, as the Company's non-AECO based contracts came into effect.

## REVENUE

*All references to revenue in this discussion are before royalties. Petroleum and natural gas revenue (before royalties) as reported in the Consolidated Statement of Profit (Loss) and Comprehensive Income (Loss) has been abbreviated as "total revenue". "Kelt Revenue" includes total revenue, net of the cost of the third party volumes purchased and is before royalties – refer to additional information under the heading of "Non-GAAP Financial Measures and Other Key Performance Indicators".*

(CA\$ thousands, except as otherwise indicated)	Three months ended December 31			Year ended December 31		
	2017	2016	%	2017	2016	%
Revenue, before royalties and financial instruments:						
Oil	47,252	25,424	86	142,999	88,767	61
NGLs	9,208	5,320	73	26,382	18,124	46
Gas	21,227	24,993	-15	85,025	77,722	9
Revenue, before marketing	77,687	55,737	39	254,406	184,613	38
Marketing revenue <sup>(2)</sup>	3,151	-	-	3,151	-	-
Total revenue <sup>(1)</sup>	80,838	55,737	45	257,557	184,613	40
Cost of purchases <sup>(3)</sup>	(3,052)	-	-	(3,052)	-	-
Kelt Revenue <sup>(4)</sup>	77,786	55,737	40	254,505	184,613	38
Average realized prices <sup>(5)</sup>						
Oil (\$/bbl)	65.13	58.23	12	59.10	47.84	24
NGLs (\$/bbl)	29.62	23.11	28	27.72	18.28	52
Gas (\$/mcf)	2.79	3.62	-23	3.01	2.69	12
Combined (\$/BOE)	33.74	30.66	10	31.51	24.08	31

(1) Petroleum and natural gas revenue (before royalties) as reported in the consolidated financial statements is abbreviated as "total revenue".

(2) Sales of third party volumes related to the Company's oil blending operations.

(3) Cost of third party volumes purchased for use and resale in the Company's oil blending operations.

(4) "Kelt Revenue" is a non-GAAP measure and includes petroleum and natural gas revenue (before royalties), net of the cost of the third party volumes purchased.

(5) Average realized prices are calculated based on Kelt Revenue (note 3) and reflect Kelt's realized commodity prices plus the net benefit of oil blending/marketing activities (notes 1 and 2). Refer to additional information under the heading of "Non-GAAP Financial Measures and Other Key Performance Indicators".

Total revenue during 2017 was \$257.6 million, up 40% compared to \$184.6 million in 2016. For the three months ended December 31, 2017, total revenue was \$80.8 million, up 45% from \$55.7 million during the same three month period of 2016. The increase in revenue is driven by higher production volumes and higher combined average realized prices, which increased 31% to \$31.51 per BOE in 2017 compared to \$24.08 per BOE on average during 2016. The increase in Kelt's average realized price is primarily due to higher benchmark commodity prices and the significant increase in oil production compared to 2016. Oil and NGLs represented 42% of production volumes and 67% of revenue during 2017. In 2016, oil and NGLs represented 37% of production volumes and 58% of revenue.

Kelt's average realized price of \$33.74 per BOE during the fourth quarter of 2017 is 24% higher than the average price of \$27.24 per BOE realized in the third quarter of 2017 and 10% higher than the average price of \$30.66 per BOE realized in the fourth quarter of 2016, reflecting the further increase in Kelt's corporate average oil production weighting, which more than offset the impact of lower gas prices on the Company's revenue during the fourth quarter of 2017.

## OIL REVENUE

*References to "oil" in this discussion includes crude oil and field condensate (see "Other Measurements" for additional references). All references to "oil revenue" are before oil royalties.*

(CA\$ thousands, except as otherwise indicated)	Three months ended December 31			Year ended December 31		
	2017	2016	%	2017	2016	%
Oil production (average bbls per day)	<b>7,902</b>	4,746	66	<b>6,634</b>	5,070	31
Oil revenue, before marketing	<b>47,252</b>	25,424	86	<b>142,999</b>	88,767	61
Marketing revenue, net of cost of purchases <sup>(1)</sup>	<b>99</b>	-	-	<b>99</b>	-	-
Kelt Oil Revenue	<b>47,351</b>	25,424	86	<b>143,098</b>	88,767	61
Average realized oil prices (\$/bbl) <sup>(2)(3)</sup>						
Before financial instruments	<b>65.13</b>	58.23	12	<b>59.10</b>	47.84	24
Realized gain (loss) on financial instruments	-	-		-	-	
After financial instruments	<b>65.13</b>	58.23	12	<b>59.10</b>	47.84	24
Average realized price, percentage of CLS	<b>99%</b>	96%		<b>96%</b>	91%	
Benchmark oil prices:						
WTI Cushing Oklahoma (US\$/bbl) <sup>(4)</sup>	<b>55.40</b>	49.29	12	<b>50.95</b>	43.32	18
WTI Cushing Oklahoma (CA\$/bbl) <sup>(5)</sup>	<b>70.41</b>	65.78	7	<b>66.10</b>	57.24	15
Canadian Light Sweet ("CLS") (\$/bbl) <sup>(4)</sup>	<b>65.67</b>	60.76	8	<b>61.85</b>	52.79	17
CLS % of CA\$WTI	<b>93%</b>	92%		<b>94%</b>	92%	
Average exchange rate (CA\$/US\$) <sup>(4)</sup>	<b>1.2713</b>	1.3339	-5	<b>1.2986</b>	1.3256	-2

(1) Net marketing revenue related to the purchase and resale of third party volumes used in the Company's oil blending operations.

(2) Calculated based on Kelt Oil Revenue and reflects Kelt's realized oil price plus the net benefit of oil blending/marketing activities (note 1).

(3) The Company's realized oil price is discounted to benchmark oil prices as the base price paid by purchasers is adjusted for quality and is net of all applicable fees and deductions, including pipeline tariffs or location differentials. These tariffs and differentials vary depending on the delivery point, but do not fluctuate with oil prices. Pipeline tariffs are classified as transportation expenses when the Company has firm commitments or contractual arrangements on the pipeline. Refer to further discussion under the heading of "Transportation Expenses".

(4) Source: Bank of Canada

(5) Source: Sproule Associates Limited, Canadian dollar equivalent price WTI price ("CA\$WTI") is calculated based on the monthly average U.S. dollar WTI price and the monthly average CA\$/US\$ exchange rate.

Kelt realized an average oil price of \$59.10 per barrel during the year ended December 31, 2017, up 24% from \$47.84 per barrel during the year ended December 31, 2016. Global crude oil prices have recovered significantly compared to 2016 and continued to strengthen during the fourth quarter. During the three months ended December 31, 2017, WTI averaged US\$55.40 (CA\$70.41) per barrel, up 15% from US\$48.20 (CA\$60.38) per barrel in the third quarter of 2017 and up 12% compared to US\$49.29 (CA\$65.78) in the fourth quarter of 2016. The impact of

stronger U.S. dollar WTI oil prices is partly offset by appreciation of the Canadian dollar which reduces the equivalent price realized by Kelt in Canadian dollars.

Kelt's average realized oil price of \$65.13 per barrel during the fourth quarter of 2017 is 22% higher than the average price of \$53.22 per barrel realized during the third quarter of 2017. The increase in Kelt's realized oil price outperformed the increase in CLS reference price (up 15% quarter-over-quarter) due to improved contract pricing and a decrease in the Company's average quality discount during the quarter ended December 31, 2017. Kelt installed blending facilities at two of its main oil terminals in Alberta and commenced blending operations at La Glace and Progress during the fourth quarter of 2017. In addition to using its own production, the Company may purchase butane and crude oil from third parties for use in its blending operations, with the objective of selling the blended oil product at a premium. Kelt's average realized oil price reflects the benefit of oil blending activities on the higher price it received for the sale of its own oil production volumes as well as incremental marketing revenue from the purchase and resale of third party volumes.

The average discount of Kelt's realized oil price relative to the CLS reference price was \$0.54 per barrel (1% of CLS) during the fourth quarter and \$2.75 per barrel (4% of CLS) on average during 2017. The average discount was \$2.53 per barrel (4% of CLS) and \$4.95 per barrel (9% of CLS) on average during the comparative fourth quarter and year ended December 31, 2016, respectively.

## NGL REVENUE

*References to "NGLs" in this discussion includes pentanes (C5 and C5+), butane (C4), propane (C3) and ethane (C2) (see "Other Measurements" for additional references). All references to "NGLs revenue" are before NGLs royalties.*

(CA\$ thousands, except as otherwise indicated)	Three months ended December 31			Year ended December 31		
	2017	2016	%	2017	2016	%
NGLs production (average bbls per day)	3,379	2,502	35	2,608	2,709	-4
NGLs revenue	9,208	5,320	73	26,382	18,124	46
Average realized NGLs price (\$/bbl)						
Before financial instruments	29.62	23.11	28	27.72	18.28	52
Realized gain (loss) on financial instruments	(1.94)	-		(1.07)	-	
After financial instruments	27.68	23.11	20	26.65	18.28	46
Average realized price, percentage of CA\$WTI <sup>(1)</sup>	42%	35%		42%	32%	
Benchmark NGLs prices <sup>(2)</sup> (\$/bbl):						
Edmonton Pentane	73.71	64.88	14	67.21	55.71	21
% of CA\$WTI	105%	99%		102%	97%	
Edmonton Butane	53.19	42.35	26	44.08	34.32	28
% of CA\$WTI	76%	64%		67%	60%	
Edmonton Propane	40.29	25.08	61	28.74	13.60	111
% of CA\$WTI	57%	38%		43%	24%	
Edmonton Ethane	4.78	8.61	-44	6.11	6.04	1
% of CA\$WTI	7%	13%		9%	11%	

(1) Average realized NGLs price, before financial instruments, divided by the Canadian dollar equivalent WTI reference price for the period.

(2) Source: Sproule Associates Limited.

Kelt realized an average price for its NGL sales of \$27.72 per barrel (42% of CA\$WTI) during 2017, up 52% from \$18.28 per barrel (32% of CA\$WTI) during 2016. The increase in NGL prices is primarily attributed to the underlying recovery of WTI crude oil prices compared to 2016, as well as the dramatic recovery of propane prices. In addition, the Company's NGLs marketing contracts were renegotiated effective April 1, 2017 under favorable terms, including lower fixed deductions.

Kelt's average realized NGLs price of \$29.62 per barrel during the fourth quarter of 2017 is up 22% from \$24.34 in

the third quarter of 2017, driven by strong demand for pentane, butane and propane along with the increase in WTI crude oil prices. The decrease in ethane prices during the three months ended December 31, 2017 did not significantly impact Kelt's average realized NGLs price as ethane represents a small percentage of total corporate NGLs revenue.

Propane prices continued to strengthen during the fourth quarter of 2017. The OPIS-Conway propane price averaged US\$38.00 per barrel (69% of US\$WTI), up 24% from the average price of US\$30.64 per barrel (64% of US\$WTI) during the third quarter 2017. Propane sales represent approximately 30% of Kelt's total NGLs production. In January 2017, Kelt entered into a financial derivative contract to lock-in the recovery of propane prices by fixing the OPIS-Conway propane price at 50% of US\$WTI a notional 500 barrels per day, for the period from February 1 to December 31, 2017. As a result of stronger than expected OPIS-Conway pricing, Kelt realized a loss of under the contract of \$0.6 million during the fourth quarter and a cumulative loss of \$1.0 million over the contract term in 2017.

## GAS REVENUE

References to "gas" in this discussion includes natural gas and sulphur (see "Other Measurements" for additional references). All references to "gas revenue" are before gas royalties.

(CA\$ thousands, except as otherwise indicated)	Three months ended December 31			Year ended December 31		
	2017	2016	%	2017	2016	%
Gas production (MCF per day)	<b>82,689</b>	75,084	10	<b>77,330</b>	79,009	-2
Gas revenue	<b>21,227</b>	24,993	-15	<b>85,025</b>	77,722	9
Average realized gas price (\$/MCF)						
Before financial instruments	<b>2.79</b>	3.62	-23	<b>3.01</b>	2.69	12
Cash premium on financial instruments	-	0.03		-	0.02	
Realized gain (loss) on financial instruments	<b>(0.02)</b>	(0.06)		-	(0.01)	
After financial instruments	<b>2.77</b>	3.59	-23	<b>3.01</b>	2.70	11
Kelt average premium to AECO 5A <sup>(1)</sup>	<b>65%</b>	17%		<b>39%</b>	25%	
Benchmark gas prices:						
NYMEX Henry Hub (US\$/MMBtu) <sup>(2)</sup>	<b>2.91</b>	2.95	-1	<b>3.07</b>	2.43	26
Average exchange rate (CA\$/US\$) <sup>(3)</sup>	<b>1.2713</b>	1.3339	-5	<b>1.2986</b>	1.3256	-2
NYMEX Henry Hub (CA\$/MMBtu) <sup>(2)</sup>	<b>3.70</b>	3.94	-6	<b>3.98</b>	3.23	23
AECO 5A (CA\$/MMBtu) <sup>(4)</sup>	<b>1.69</b>	3.09	-45	<b>2.16</b>	2.16	0
Chicago-City Gate (CA\$/MMBtu) <sup>(5)</sup>	<b>3.60</b>	3.96	-9	<b>3.75</b>	3.27	15
Dawn (CA\$/MMBtu) <sup>(6)</sup>	<b>3.72</b>	n/a	-	<b>3.95</b>	n/a	-
Malin (CA\$/MMBtu) <sup>(7)</sup>	<b>3.43</b>	n/a	-	<b>3.67</b>	n/a	-
Sumas (CA\$/MMBtu) <sup>(8)</sup>	<b>3.45</b>	3.80	-9	<b>3.59</b>	2.89	24
Station 2 (CA\$/MMBtu) <sup>(9)</sup>	<b>0.56</b>	2.41	-77	<b>1.56</b>	1.73	-10

(1) Kelt's average realized price, before financial instruments, relative to AECO 5A (CA\$/MMBtu) assumes 1 MMBtu = 1 MCF.

(2) Source: Canadian Gas Price Reporter "Henry Hub 3-Day Average Close" (US\$/MMBtu). The Canadian dollar equivalent NYMEX price is calculated based on the monthly average US\$ price and the monthly average CA\$/US\$ exchange rate (3).

(3) Source: Bank of Canada

(4) Source: Canadian Gas Price Reporter "NGX AB-NIT Same Day Index 5A" (CA\$/GJ) converted to CA\$/MMBtu.

(5) Source: Platts "Alliance, into Interstates" Daily Midpoint Average (US\$/MMBtu). The Canadian dollar equivalent Chicago-City Gate price is calculated based on the monthly average US\$ price and the monthly average CA\$/US\$ exchange rate.

(6) Source: Canadian Gas Price Reporter "NGX Union-Dawn Spot Day Ahead Index" (CA\$/GJ) converted to CA\$/MMBtu.

(7) Source: Platts "P&G Malin" Monthly Bidweek Spot Gas Price (US\$/MMBtu). The Canadian dollar equivalent Malin price is calculated based on the monthly average US\$ price and the monthly average CA\$/US\$ exchange rate.

(8) Source: Platts "Northwest, Canadian Border (Sumas)" Monthly Bidweek Spot Gas Price (US\$/MMBtu). The Canadian dollar equivalent Sumas price is calculated based on the monthly average US\$ price and the monthly average CA\$/US\$ exchange rate.

(9) Source: Canadian Gas Price Reporter "NGX Spectra Station #2 Day Ahead Index" (CA\$/GJ) converted to CA\$/MMBtu.



While year-to-date average gas prices during 2017 have recovered from the lows during the first half of 2016, ongoing pipeline maintenance and egress issues in western Canada continue to impact the industry, with gas prices becoming increasingly volatile through the third and fourth quarters. The AECO 5A index price averaged \$0.70/GJ, \$2.19/GJ and \$1.92/GJ during the months of October, November, December 2017, respectively, resulting in an average price of \$1.60 per GJ (\$1.69 per MMBtu) during the three month period ended December 31, 2017. By comparison, Kelt realized an average price for its gas sales of \$2.79 per MCF during the quarter ended December 31, 2017, representing a 65% premium to the AECO 5A reference price<sup>(1)</sup> reflecting the Company's new gas marketing contracts that came into effect November 1, 2017 (refer to additional information under the heading of "Gas Marketing Arrangements").

Kelt receives a premium to the AECO 5A gas price due to the higher heat content of its gas production as well as various gas marketing arrangements that the Company has in place to diversify and gain exposure to alternative markets. During the first ten months of 2017, prior to the effective date of new gas marketing arrangements, gas sales under AECO based contracts represented 60-65% of the Company's total gas production and Kelt received Chicago-City Gate pricing on approximately 25-30% of its gas production. In addition, effective November 1, 2016, a portion of the Company's BC gas production which was previously sold at discounted Station 2 prices, received Sumas pricing less a fixed differential. As the AECO gas market weakened significantly during the second half of 2017, the discount to the Chicago City-Gate and Sumas markets widened, contributing to the increase in Kelt's average realized premium relative to AECO 5A compared to 2016. The impact of the higher realized gas price on Kelt's funds from operations is partially offset by higher tolls on the Alliance pipeline, which are included in transportation expenses.

#### Gas Marketing Arrangements

Kelt has entered into various natural gas marketing contracts in order to provide the Company with exposure to diversified gas price hubs and reduce exposure to a single market.

As of December 31, 2017, Kelt's gas market sales portfolio consists of the following firm contracts:

Market Term (Sales)	Firm Volume (MMBtu/d)	Percent <sup>(1)</sup> @ Dec 31/17	Market Price
Nov/1/17 – Oct/31/27	23,695	31%	<b>DAWN</b> USD Daily Index
Nov/1/17 – Oct/31/20	15,000	19%	<b>MALIN</b> USD NGI FOM Index less US\$0.70/MMBtu
Nov/1/17 – Oct/31/20	11,990	16%	<b>SUMAS</b> USD Monthly Index less US\$0.679/MMBtu
Nov/1/17 – Oct/31/18	3,000	4%	<b>SUMAS</b> USD Monthly Index less US\$0.76/MMBtu
Nov/1/17 – Oct/31/18 <sup>(2)</sup>	10,330	13%	<b>CHICAGO</b> City Gate USD Gas Daily Index
Dec/1/17 – Oct/31/20 <sup>(2)</sup>	2,000	2%	<b>CHICAGO</b> City Gate USD Gas Daily Index
Nov/1/17 – Oct/31/18	11,305	15%	<b>AECO</b> CAD Daily (5A) Index
<b>TOTAL (as of Dec31/17) <sup>(1)</sup></b>	<b>77,320</b>	<b>100%</b>	

(1) The percentage of total volumes is based on the Company's firm contracts in place as of December 31, 2017. To the extent that Kelt's actual gas production in future periods is greater than 77,320 MMBtu/d, being the total firm volume under contracts in place as of the date of this MD&A, the incremental gas production is expected to be sold primarily at the AECO or Chicago price hubs (see footnote 2).

(2) The Company also has access to priority interruptible transportation service ("PITS") equating to 25% (3,082 MMBtu/d) of its firm service volume on the Alliance pipeline system under which Kelt can increase the amount of gas sales from its properties into the Chicago market.

## ROYALTIES

(CA\$ thousands, unless otherwise indicated)	Three months ended December 31			Year ended December 31		
	2017	2016	%	2017	2016	%
Royalties	<b>7,185</b>	5,204	38	<b>23,557</b>	15,911	48
Average royalty rate <sup>(1)</sup>	<b>9.2%</b>	9.3%	-1	<b>9.3%</b>	8.6%	8
\$ per BOE	<b>3.12</b>	2.86	9	<b>2.92</b>	2.08	40

(1) Average royalty rate is calculated based on total royalties as a percentage of "Revenue, before marketing" which excludes revenue related to the sale of third party production volumes used in oil blending operations (see table under the heading of "Revenue").

Kelt's average royalty rate was 9.3% during 2017 compared to 8.6% on average during 2016, reflecting higher oil and gas prices on average during 2017. The impact of higher commodity prices on royalty rates is partially offset by lower royalties on new production that qualifies for various royalty incentives, including favorable treatment of oil wells under the Alberta Modernized Royalty Framework ("MRF") which came into effect January 1, 2017. Royalty incentives on new wells recently drilled and brought on production in Alberta and BC contributed to the decrease in Kelt's average royalty rate to 9.2% during the fourth quarter of 2017.

On a per unit basis, royalties averaged \$2.92 per BOE in 2017 compared to \$2.08 per BOE in 2016, with the increase driven by the significant increase in oil production and relative decrease in gas production weighting during 2017.

## PRODUCTION EXPENSES

(CA\$ thousands, unless otherwise indicated)	Three months ended December 31			Year ended December 31		
	2017	2016	%	2017	2016	%
Production expense	<b>25,385</b>	17,231	47	<b>81,201</b>	71,204	14
\$ per BOE	<b>11.01</b>	9.47	16	<b>10.05</b>	9.29	8

During 2017, production expenses averaged \$10.05 per BOE, up 14% compared to \$9.29 per BOE in 2016. The increase in total production expenses reflects the 6% increase in corporate average production during 2017 as well as a material increase in the oil weighting of Kelt's production. While oil production expenses are typically higher than gas production expenses on a barrel of oil equivalent basis, the Company has realized significantly higher revenues and operating netbacks from growing its oil production, which includes field condensate from its BC gas wells.

Kelt has reported average production expense of \$11.01 per BOE for the three months ended December 31, 2017, up significantly compared to \$9.67 per BOE reported for the first nine months of 2017. Production expenses for the fourth quarter of 2017 are \$8.2 million or 47% higher than the comparative quarter of 2016, of which \$5.2 million of the increase is due to an adjustment for third-party gas plant equalizations. Preliminary calculations for the equalizations, which relate to the calendar years 2016 and 2017, were received from the plant operator in late February 2018. As the information was received prior to issuing the annual financial statements as at and for the year ended December 31, 2017, the estimated amount of the equalizations was accrued with the full amount of \$5.2 million being recognized during the fourth quarter of 2017.

## TRANSPORTATION EXPENSES

(CA\$ thousands, unless otherwise indicated)	Three months ended December 31			Year ended December 31		
	2017	2016	%	2017	2016	%
Transportation expense <sup>(1)</sup>	<b>7,172</b>	5,677	26	<b>25,301</b>	21,943	15
\$ per BOE	<b>3.11</b>	3.12	0	<b>3.13</b>	2.86	9

(1) Pipeline tariffs are classified as transportation expenses when the Company has firm commitments or contractual arrangements on the pipeline. Pipeline tariffs may also be incurred indirectly by way of deduction from the base price paid by the purchasers of the Company's oil, NGLs and gas sales. In the latter case, and in the absence of a firm contractual obligation on the pipeline, the pipeline tariffs are presented as a reduction of revenue rather than as transportation expense.

Transportation expenses averaged \$3.11 per BOE during the fourth quarter of 2017, consistent with the comparative quarter of 2016 and in line with average transportation expenses of \$3.14 per BOE during the first nine months of

2017. The increase in average per unit transportation expenses compared to 2016 is primarily due to higher pipeline tolls under the various marketing arrangements that the Company has in place to diversify its gas sales markets.

## FINANCING EXPENSES

(CA\$ thousands, unless otherwise indicated)	Three months ended December 31			Year ended December 31		
	2017	2016	%	2017	2016	%
Interest and fees on bank debt	1,013	1,376	-26	3,310	7,308	-55
Interest on convertible debentures	1,134	1,134	0	4,500	2,983	51
Total interest expense	2,147	2,510	-14	7,810	10,291	-24
Accretion of convertible debentures	933	844	11	3,539	2,145	65
Accretion of decommissioning obligations	774	555	39	2,981	2,817	6
Total financing expense	3,854	3,909	-1	14,330	15,253	-6
Interest expense per BOE <sup>(1)</sup>	0.93	1.38	-33	0.97	1.34	-28
Average principal amount outstanding during period:						
Bank debt	89,758	119,160	-25	67,282	149,562	-55
Convertible debentures	90,000	90,000	0	90,000	59,754	51
Average total principal amount of debt outstanding	179,758	209,160	-14	157,282	209,316	-25
Average interest rates:						
Bank debt <sup>(2)</sup>	4.5%	4.6%	-2	4.9%	4.9%	-
Convertible debentures	5.0%	5.0%	-	5.0%	5.0%	-

(1) Interest expense used in the calculation of "Interest expense per BOE" includes interest and fees on bank debt and accrued cash interest on convertible debentures.

(2) Average interest rate inclusive of fees on bank debt.

The Company's total interest expense paid or payable in cash of \$2.1 million (\$0.93 per BOE) for the quarter ended December 31, 2017 is down 14% from the comparative quarter, and the total interest expenses for the year ended December 31, 2017 of \$7.8 million is down 24% from the year ended December 31, 2016. The reduction in interest expense is due to the significant decrease in average total debt outstanding following completion of the Karr Property Disposition in January 2017, and on higher average commodity prices in 2017 compared to 2016.

On May 3, 2016, Kelt reduced borrowings under its revolving bank credit facility using the net proceeds of the offering of \$90.0 million principal amount of convertible unsecured subordinated debentures (the "Debentures"). The Debentures mature on May 31, 2021 and bear interest at 5.0% per annum, payable semi-annually on May 31<sup>st</sup> and November 30<sup>th</sup>. Financing expense for the quarter ended December 31, 2017 includes \$1.1 million of accrued cash interest and \$0.9 million of non-cash accretion expense. The Debentures are convertible into common shares of the Company at a conversion price of \$5.50 per share. As at December 31, 2017, the Debentures are "in-the-money" based on the closing price of Kelt common shares on the TSX of \$7.19 on December 29, 2017, being the last trading day in the year.

The Company has a revolving committed term credit facility (the "Credit Facility") with a syndicate of financial institutions. Amounts drawn under the Credit Facility are primarily in the form of bankers' acceptances ("BAs"). Stamping fees on BAs fluctuate based on a pricing grid and range from 2.0% to 3.5%, depending upon the Company's quarter-end debt to cash flow ratio of between less than one and one tenth times to greater than three times. Kelt's average interest rate (inclusive of fees) on bank debt outstanding was 4.9% during 2017, unchanged from the average rate in 2016. The Company's debt to cash flow ratio improved significantly during 2017 reducing the applicable margin payable by Kelt under the Credit Facility compared to 2016. However, the impact is mostly offset by the 50 basis point increase in the prime rate in response to the Bank of Canada increasing its policy interest rate by the same amount during 2017.

Additional information regarding the Credit Facility and Debentures is provided under the heading of "Capital Resources and Liquidity".

## GENERAL AND ADMINISTRATIVE (“G&A”) EXPENSES

The following table summarizes significant components of the Company’s G&A expenses:

(CA\$ thousands, unless otherwise indicated)	Three months ended December 31			Year ended December 31		
	2017	2016	%	2017	2016	%
Salaries and benefits	2,067	1,783	16	8,247	6,757	22
Other G&A expenses	1,326	1,101	20	4,323	3,924	10
Gross G&A expenses	3,393	2,884	18	12,570	10,681	18
Overhead recoveries	(1,125)	(1,102)	2	(5,006)	(3,687)	36
G&A expense, net of recoveries	2,268	1,782	27	7,564	6,994	8
Gross G&A (\$ per BOE)	1.47	1.59	-8	1.56	1.39	12
Net G&A (\$ per BOE)	0.98	0.98	0	0.94	0.91	3

Kelt continues to incur below industry average G&A expenses as a result of management’s continued efforts to maintain a low cost structure. G&A expense averaged \$0.94 per BOE during 2017 compared to \$0.91 per BOE during 2016. Fourth quarter G&A expenses are typically above average due to various year-end reporting costs including audit and reserve engineering fees. G&A expense of \$0.98 per BOE reported for the three months ended December 31, 2017 is in-line with the comparative quarter of 2016.

The increase in gross G&A expenses (before recoveries) during 2017 is primarily driven by the increase in total salaries and benefits as Kelt has hired new employees and consultants to support the Company’s growth. Executive salaries continue to be below median levels in the industry.

G&A expenses are reported net of overhead recoveries, however, Kelt does not capitalize any direct G&A expenses. Total overhead recoveries are higher in 2017 in conjunction with the significant increase in capital expenditures compared to 2016.

## SHARE BASED COMPENSATION (“SBC”)

(CA\$ thousands, unless otherwise indicated)	Three months ended December 31			Year ended December 31		
	2017	2016	%	2017	2016	%
Stock options	1,180	1,108	6	3,867	4,099	-6
Restricted share units (“RSUs”)	386	415	-7	1,572	1,766	-11
Total SBC expense	1,566	1,523	3	5,439	5,865	-7
\$ per BOE	0.68	0.84	-19	0.67	0.77	-13

Share based compensation is expensed using graded amortization over the three year vesting period. The decrease in SBC expense during the year ended December 31, 2017 is primarily due to the decrease in the number of new stock options and RSUs granted compared to 2016. The impact is partly offset by an increase in the average fair value of new stock options and RSUs granted during 2017 driven by appreciation of Kelt’s share price compared to 2016, which contributed to the increase in total SBC expense during the fourth quarter.

SBC expense averaged \$0.67 per BOE during 2017, down 13% from \$0.77 per BOE in 2016 reflecting management’s efforts to provide long term incentives to employees while minimizing the dilutive impact to shareholders. As at December 31, 2017, stock options and RSUs outstanding represent 6% of total shares outstanding (5% of total shares outstanding at December 31, 2016).

## EXPLORATION AND EVALUATION (“E&E”) EXPENSES

(CA\$ thousands, unless otherwise indicated)	Three months ended December 31			Year ended December 31		
	2017	2016	%	2017	2016	%
Expired mineral leases	324	862	-62	1,311	4,260	-69
\$ per BOE	0.14	0.47	-70	0.16	0.56	-71

The Company expensed \$1.3 million of costs related to the expiry of non-core land holdings during the year ended December 31, 2017, down compared to lease expiries of \$4.3 million expensed in the previous year. The Company continues to focus on the development of its core areas and the majority of the mineral leases expired during 2017 and 2016 were acquired through corporate acquisitions.

The Company concluded there were no indicators of impairment of its E&E assets as at December 31, 2017.

## DEPLETION, DEPRECIATION AND IMPAIRMENT

(CA\$ thousands, unless otherwise indicated)	Three months ended December 31			Year ended December 31		
	2017	2016	%	2017	2016	%
Depletion of D&P assets	35,731	28,592	25	126,531	139,217	-9
Depreciation of corporate assets	219	226	-3	967	830	17
Total depletion and depreciation	35,950	28,818	25	127,498	140,047	-9
Impairment of PP&E (net of impairment reversals)	6,864	(26,141)	126	6,864	(26,141)	126
Total depletion, depreciation and impairment	42,814	2,677	1499	134,362	113,906	18
Depletion and depreciation (\$/BOE)	15.59	15.85	-2	15.78	18.27	-14
Impairment (reversal) loss (\$/BOE)	2.98	(14.38)	121	0.85	(3.41)	-125

The Company calculates depletion of development and production (“D&P”) assets based on production relative to total proved reserves, for each depletion unit. Total depletion and depreciation expense of \$127.5 million for the year ended December 31, 2017 is down by 9% from \$140.0 million in 2016, with the decrease in total expenses primarily attributed to the Karr Property Disposition. The decrease of depletion expense per BOE reflects the addition proved reserves at lower than cumulative historical finding and development capital costs.

As a result of the decrease in forecast oil and natural gas prices as at December 31, 2017 compared to forecast prices as at December 31, 2016, an indication of potential impairment was identified for certain cash generating units (“CGUs”) comprised of non-core properties located in Alberta. Notwithstanding the decrease in price forecasts, there is no indication of impairment for the Company’s British Columbia and Grande Prairie CGUs, which comprise approximately 95% of the carrying value of PP&E as at December 31, 2017.

Recoverable amounts were estimated based on fair value less cost of disposal (“FVLCD”) methodology for the CGUs in which impairment indicators were identified, namely: Grande Cache, Karr Non-Operated, and Leduc-Woodbend. The FVLCD was calculated using the present value of the CGUs’ expected future cash flows (after-tax). The cash flow information was derived from a report on the Company’s oil and gas reserves which was prepared by an independent qualified reserve evaluator, Sproule Associates Limited (“Sproule”) as of December 31, 2017. The projected cash flows used in the FVLCD calculation reflect market assessments of key assumptions as at December 31, 2017, including long-term forecasts of commodity prices, inflation rates, and foreign exchange rates (Level 3 fair value inputs). Cash flow forecasts are also based on past experience, historical trends and Sproule’s evaluation of the Company’s reserves and resources to determine production profiles and volumes, operating costs, maintenance and future development capital expenditures. Future cash flow estimates are discounted using after-tax risk-adjusted discount rates. The after-tax discount rates applied in the impairment calculation as at December 31, 2017 ranged from 9% to 12% depending on the risks specific to the assets in the CGUs.

Based on the FVLCD calculation, the carrying value of the Grande Cache CGU was in excess of the recoverable amount resulting in an impairment loss of \$6.9 million (before-tax) as at December 31, 2017. The Grande Cache CGU is comprised of mature, low-decline dry gas assets. Despite being a low-cost property, the decrease in forecast

gas prices had a pervasive impact on the recoverable amount calculated for the CGU, given that 99% of proved plus probable reserves of the Grande Cache property are natural gas. Compared to Sproule's prior forecast at December 31, 2016, forecast AECO-C gas prices fell by 13% for 2018 and by 5% on average based on Sproule's forecast at December 31, 2017.

The impairment test as at December 31, 2017 did not result in an impairment or reversal of previous impairment losses for the Karr Non-Operated or Leduc-Woodbend CGUs, which are both non-core oil weighted properties.

The recoverable amounts estimated pursuant to FVLCD calculations are sensitive to the discount rate and future commodity price assumptions. As at December 31, 2017, holding all other variables in the FVLCD calculation for each CGU constant: if the discount rate increased (decreased) by 1%, the impairment of the Grande Cache CGU would increase (decrease) by approximately \$1.6 million; and if the forecast combined average realized price decreased (increased) by 5%, the impairment of the Grande Cache CGU would increase (decrease) by approximately \$4.0 million. Given the relatively low value of the Karr Non-Operated and Leduc-Woodbend CGUs, the sensitivity analysis did not have a significant impact on the recoverable amounts or conclusions from the impairment calculation, being that, a 1% increase (decrease) in the discount rate or 5% decrease (increase) in the forecast combined average realized price would not trigger an impairment (reversal) for those CGUs as at December 31, 2017.

Forecast future prices used in the impairment evaluations as at December 31, 2017 and December 31, 2016, reflect the benchmark prices set-forth in the tables below, adjusted for basis differentials to determine local reference prices, transportation costs and tariffs, heat content and quality. In addition, the impairment loss calculation for Grande Cache is based on an external consultant average AECO forecast benchmark price.

<b>As at December 31, 2017</b>	<b>2018</b>	<b>2019</b>	<b>2020</b>	<b>2021</b>	<b>2022<sup>(1)</sup></b>
WTI Cushing Oklahoma (US\$/bbl)	55.00	65.00	70.00	73.00	74.46
Canadian Light Sweet 40 API (\$/bbl)	65.44	74.51	78.24	82.45	84.10
NYMEX Henry Hub (US\$/MMBtu)	3.25	3.50	4.00	4.08	4.16
AECO-C Spot (\$/MMBtu)	2.85	3.11	3.65	3.80	3.95
Exchange rate (CA\$/US\$)	1.2658	1.2195	1.1765	1.1765	1.1765

(1) Prices escalate at 2.0% thereafter

<b>As at December 31, 2016</b>	<b>2017</b>	<b>2018</b>	<b>2019</b>	<b>2020</b>	<b>2021<sup>(1)</sup></b>
WTI Cushing Oklahoma (US\$/bbl)	55.00	65.00	70.00	71.40	72.83
Canadian Light Sweet 40 API (\$/bbl)	65.58	74.51	78.24	80.64	82.25
NYMEX Henry Hub (US\$/MMBtu)	3.50	3.50	3.50	4.00	4.08
AECO-C Spot (\$/MMBtu)	3.44	3.27	3.22	3.91	4.00
Exchange rate (CA\$/US\$)	1.2821	1.2195	1.1765	1.1765	1.1765

(1) Prices escalate at 2.0% thereafter

During the previous year ended December 31, 2016, indicators of potential impairment were identified and recoverable amounts for each CGU were estimated based on after-tax discount rates between 9% to 12%. Based on the FVLCD calculation as at December 31, 2016, the carrying value of the Leduc-Woodbend CGU was in excess of the recoverable amount, resulting in an impairment loss of \$6.0 million. In addition, and as described in note 5 of the annual financial statements, the majority of the assets included in the Karr CGU were classified as held for sale as at December 31, 2016 and subsequently disposed of on January 18, 2017. As at December 31, 2016, the previous impairment of the Karr CGU of \$48.5 million was partially reversed by \$32.2 million to reflect the increase in carrying amount of the assets that has ultimately been recovered by proceeds of the Karr Property Disposition.

## GAIN ON SALE OF ASSETS

(CA\$ thousands, unless otherwise indicated)	Three months ended December 31			Year ended December 31		
	2017	2016	%	2017	2016	%
Gain on sale of assets	<b>8,850</b>	3,911	126	<b>10,436</b>	8,746	19

On January 18, 2017, Kelt completed the Karr Property Disposition for proceeds of \$103.1 million after estimated closing adjustments. Closing of the Karr Property Disposition had a minimal impact on the gain on sale of assets reported in 2017 because the assets and associated decommissioning obligations disposed were classified as held for sale at December 31, 2016. Kelt reported an impairment reversal of \$32.2 million during the fourth quarter ended December 31, 2016, based on the increase in fair value of the Karr property evidenced by the cash purchase price.

In addition, Kelt completed several minor non-core asset dispositions during the year ended December 31, 2017 for aggregate cash proceeds of \$13.3 million, after estimated closing adjustments. The assets and associated decommissioning obligations disposed had a net carrying value of approximately \$2.8 million resulting in a gain on sale of \$10.5 million during 2017.

Refer to additional information in respect of property dispositions under the heading of “*Capital Expenditures*”.

## DERIVATIVE FINANCIAL INSTRUMENTS

The Company may, from time to time, enter into fixed price contracts and derivative financial instruments with respect to commodity prices, currency exchange and interest rates in order to secure a certain amount of cash flow to protect a desired level of capital spending. Fair value accounting for derivative financial instruments may cause significant fluctuations in the reported amounts of derivative financial instrument assets and liabilities and the resultant magnitude of unrealized gains and losses.

The table below summarizes realized and unrealized gains (losses) on risk management contracts:

(CA\$ thousands, unless otherwise indicated)	Three months ended December 31			Year ended December 31		
	2017	2016	%	2017	2016	%
Realized gain (loss)	<b>(720)</b>	(439)	64	<b>(1,050)</b>	(350)	200
Unrealized gain (loss)	<b>726</b>	81	796	<b>599</b>	91	558
Gain (loss) on derivative financial instruments	<b>6</b>	(358)	-102	<b>(451)</b>	(259)	74
\$ per BOE	<b>-</b>	(0.20)	-100	<b>(0.06)</b>	(0.03)	100

### *Commodity price risk*

Inherent to the business of producing oil and gas, the Company's cash provided by operating activities is subject to commodity price risk. Commodity price risk is the risk that future cash flows will fluctuate as a result of changes in commodity prices. Commodity prices are impacted by world economic events that dictate the levels of supply and demand as well as the currency exchange rate relationship between the Canadian and U.S. dollar.

As at December 31, 2017, there are no commodity price risk management contracts outstanding.

### *Interest rate risk*

The Company is exposed to interest rate risk to the extent that changes in market interest rates will impact the Company's Credit Facility which is subject to a floating interest rate. Based on average bank debt outstanding of \$67.3 million during the year ended December 31, 2017, an increase (decrease) in the market rate of interest by 25 basis points would have increased (decreased) interest expense by \$0.2 million. As at December 31, 2017, there are no interest rate risk management contracts outstanding.

During the previous year ended December 31, 2016, Kelt had an interest rate swap fixing CDOR at 0.925% on a notional amount of \$100 million until June 30, 2017. In January 2017, in conjunction with the Karr Property Disposition and resulting reduction in bank debt, the interest rate swap was unwound and terminated for proceeds of \$10 thousand.

### Foreign exchange risk

Kelt is exposed to fluctuations of the Canadian to U.S. dollar exchange rate given realized pricing is directly influenced by U.S. dollar denominated benchmark pricing. In addition, the Company has natural gas marketing arrangements in place whereby Kelt receives revenue in U.S. dollars. The Company also has commitments for firm gas transportation service under contracts denominated in U.S. dollars as outlined under the heading of “Commitments and Contractual Obligations” in this MD&A. The Company may enter into derivative contracts to mitigate the impact of foreign currency fluctuations.

On July 11, 2016, the Company entered into a foreign exchange swaption contract and received a cash premium of \$0.255 million. The swaption was exercised by the counterparty resulting in a derivative contract that fixed the exchange rate at CA\$/US\$1.33 on a notional US\$1.0 million per month over the initial contract term of January to December 2017. On July 26, 2017, the Company unwound the foreign exchange swap for cash proceeds of \$0.4 million, extinguishing the contract for the remaining five month term from August to December 2017. Kelt realized a cumulative net cash gain of \$0.7 million under this contract, including the cash premium earned at inception.

In November 2016, Kelt received a cash premium of \$0.205 million for entering into a forward foreign exchange swaption contract, however the option was not exercised by the counterparty and the contract expired on March 31, 2017.

As at December 31, 2017, there are no foreign exchange risk management contracts outstanding.

### PREMIUM ON FLOW-THROUGH SHARES

(CA\$ thousands, unless otherwise indicated)	Three months ended December 31			Year ended December 31		
	2017	2016	%	2017	2016	%
Premium on flow-through shares	1,511	2,459	-39	2,309	3,305	-30

Management has employed a successful strategy of utilizing the Company’s strong tax position, which includes approximately \$1.0 billion of tax pools, to raise capital through equity private placements at a premium to market prices by issuing common shares on a “flow-through” basis. The premium received by the Company in excess of the fair value of its common shares at the time of the offering, is initially deferred and subsequently recognized in income as the premium is earned by incurring qualifying capital expenditures.

In October 2017, the Company completed non-brokered private placements of 2.6 million flow-through common shares (“FTS”) for aggregate gross proceeds of \$20.6 million, of which: 2.0 million FTS were issued in respect of Canadian development expenses at a price of \$7.75 per share for gross proceeds of \$15.6 million (the “CDE Private Placement”); and 0.6 million FTS were issued in respect of Canadian exploration expenses at a price of \$8.75 per share for gross proceeds of \$5.0 million (the “CEE Private Placement”). After estimated expenses related to the private placements, net proceeds to Kelt were approximately \$20.3 million and resulted in a total premium \$2.6 million relative to the fair value of Kelt’s common shares at the respective dates of announcement of each tranche of the private placement.

Proceeds from the CDE Private Placement were used to partially finance the Company’s development drilling and completion expenditures during the fourth quarter of 2017. Pursuant to the provisions in the *Income Tax Act* (Canada), Kelt incurred eligible Canadian development expenses of \$15.6 million after the respective closing dates of the CDE Private Placement and prior to December 31, 2017. The Company has fully satisfied all obligations related to CDE Private Placement and renounced the qualifying expenditures to the subscribers with an effective date of December 31, 2017. The deferred premium of \$1.5 million (\$0.75 per share) was recognized in income as expenditures were incurred during the fourth of 2017.

In respect of the CEE Private Placement, Kelt committed to incur eligible Canadian exploration expenses prior to December 31, 2018, in the aggregate amount of not less than the gross proceeds of \$5.0 million. The deferred premium of \$1.0 million (\$1.82 per share) is presented as a liability in Kelt’s Consolidated Statement of Financial Position as at December 31, 2017. The qualifying expenditures were incurred subsequent to year-end during the first two months of 2018, have been renounced to the subscribers of the flow-through common shares with an effective date of December 31, 2017, under the “look-back” provisions in the *Income Tax Act* (Canada).



On November 2, 2016, the Company issued 1.0 million FTS in respect of Canadian development expenses for gross proceeds of \$7.1 million. The FTS were issued at a price of \$7.10 per FTS, resulting in a premium of \$0.9 million or \$0.88 per FTS. As at December 31, 2016, Kelt had incurred \$5.8 million of qualifying expenditures and incurred the remaining commitment of \$1.3 million during the first quarter of 2017. The qualifying expenditures were renounced to subscribers with an effective date of March 31, 2017, in accordance with the subscription agreements.

On August 23, 2016, the Company raised gross proceeds of \$2.5 million by issuing 0.385 million FTS at a price of \$6.50 per FTS, resulting in a premium of \$0.6 million or \$1.66 per FTS. The commitment amount was renounced to the subscribers with an effective date of December 31, 2016 under the “look-back” provisions in the *Income Tax Act* (Canada). Kelt recognized the deferred premium in income as the qualifying CEE expenditures were incurred during the first half of 2017.

On April 7, 2016, the Company completed private placements of 4.7 million FTS at a price of \$4.70 per FTS, resulting in gross proceeds of \$22.1 million. The implied premium was determined to be \$2.6 million or \$0.55 per FTS, which were issued in respect of Canadian development expenses. As at December 31, 2016, Kelt had fully satisfied the commitment and renounced \$22.1 million of qualifying expenditures to the subscribers.

## INCOME TAXES

(CA\$ thousands, unless otherwise indicated)	Three months ended December 31			Year ended December 31		
	2017	2016	%	2017	2016	%
Deferred income tax expense (recovery)	<b>2,920</b>	10,944	-73	<b>(3,142)</b>	(9,489)	-67
Profit (loss) before taxes	<b>(2,469)</b>	22,800	-111	<b>(26,320)</b>	(59,263)	-56
Effective tax rate	<b>-118%</b>	48%	-346	<b>12%</b>	16%	-25

Kelt's consolidated combined federal and provincial statutory tax rate averaged 26.7% during the year ended December 31, 2017, compared to the consolidated average of 26.4% in 2016.

A detailed analysis of the provision for deferred income taxes is included in note 12 of the annual financial statements as at December 31, 2017, which includes a reconciliation of the difference between the deferred income tax recovery reported relative to expected recovery based on the statutory tax rate. The variance in Kelt's effective tax rate in the periods is primarily due to qualifying expenditures incurred and renounced in respect of the Company's flow-through share commitments, which reduce the effective rate of tax recovery or increase the effective rate of tax expense, notably in each of the fourth quarters of 2016 and 2017. Kelt incurred \$19.4 million of qualifying expenditures in total during 2017, of which \$15.6 million was incurred during the three months ended December 31, 2017 related to the CDE Private Placement in October 2017. During 2016, Kelt incurred a total of \$27.9 million of qualifying expenditures, of which, \$20.7 million was incurred during the fourth quarter contributing to the high effective rate of tax expense of 48% for the three months ended December 31, 2016.

Deferred tax expense of \$4.8 million was charged directly to equity in respect of the fair value allocated to the equity component of the convertible debentures issued on May 3, 2016. Deferred income tax recoveries in the amounts of \$0.1 million and \$0.1 million were charged directly to equity in respect of share issue costs incurred in 2016 and 2017, respectively.

Kelt was not required to pay income taxes in the current or prior year as the Company had sufficient income tax deductions available to shelter taxable income. The Company's consolidated tax pools are estimated to be approximately \$977.8 million as of December 31, 2017, compared to \$975.4 million at December 31, 2016. Proceeds from the Karr Property Disposition of \$100.0 million (before closing adjustments) reduced Kelt's COGPE and UCC tax pools by \$80 million and \$20 million, respectively, however the Company's total tax pools are substantially unchanged as the impact of the property disposition was primarily offset by exploration and development capital expenditures during 2017.

The table below summarizes the Company's estimated tax pool balances as at December 31, 2017 and the change compared to the previous year ended December 31, 2016:

<i>(CA\$ thousands, unless otherwise indicated)</i>	Rate	2017	2016	% change
Canadian oil and gas property expenses (COGPE)	10%	146,010	248,468	-41
Canadian development expenses (CDE)	30%	195,362	154,830	26
Canadian exploration expenses (CEE)	100%	102,708	94,597	9
Undepreciated capital cost <sup>(1)</sup> (UCC)	25%	187,426	177,487	6
Share and debt issue costs (SIC/DIC)	5 years	7,340	13,795	-47
Non-capital losses <sup>(2)</sup> (NCL)	100%	338,978	286,219	18
Estimated tax deductions available, end of period		977,824	975,396	0

(1) The majority of the Company's undepreciated capital cost deductions relate to Class 41 assets, which are deductible at a rate of 25% per year.

(2) The Company's non-capital losses expire in years 2023 to 2037.

## CASH PROVIDED BY OPERATING ACTIVITIES

The Company's cash provided by operating activities increased by 158% to \$115.2 million in 2017 compared to \$44.7 million in 2016. During the three months ended December 31, 2017, cash provided by operating activities was \$36.5 million, up 66% compared to \$21.9 million in the same three month period of 2016.

The following table reconciles cash provided by operating activities reported in accordance with GAAP to adjusted funds from operations, which is a non-GAAP financial measure used by Kelt as a key measures of performance:

<i>(CA\$ thousands, except as otherwise indicated)</i>	Three months ended December 31			Year ended December 31		
	2017	2016	%	2017	2016	%
<b>Cash provided by operating activities</b>	<b>36,458</b>	21,919	66	<b>115,222</b>	44,720	158
Change in non-cash working capital	(4,044)	776	-621	(8,723)	12,546	-170
<b>Funds from operations</b>	<b>32,414</b>	22,695	43	<b>106,499</b>	57,266	86
Transaction costs	-	4	-100	-	23	-100
Provision for potential credit losses	-	81	-100	-	309	-100
Settlement of decommissioning obligations	484	320	51	1,512	782	93
<b>Adjusted funds from operations</b>	<b>32,898</b>	23,100	42	<b>108,011</b>	58,380	85

For both the three month and annual periods ended December 31, 2017, cash provided by operating activities is higher the Company's funds from operations due to an increase in the non-cash working capital deficit. Specifically, the balance of accounts payable and accrued liabilities related to operating activities increased significantly as at December 31, 2017 compared to the balances outstanding at September 30, 2017 and December 31, 2016, primarily due to higher activity levels. In addition, the balance of accounts payable at December 31, 2017 includes a \$5.2 million accrual related to an adjustment for third-party plant equalizations (discussed further below). Increases in payables result in a positive change in non-cash working capital, and contributed to the increase in cash provided by operating activities compared to funds from operations. A detailed discussion of the Company's adjusted funds from operations is included below.

## ADJUSTED FUNDS FROM OPERATIONS

The following table provides a continuity of income and expenses included in the Company's calculation of operating income and adjusted funds from operations generated during the three month periods ended December 31, 2017 and 2016, respectively. Adjusted funds from operations and operating income or netbacks (\$ per BOE) are non-GAAP measures used by Kelt as key measures of performance and are not intended to represent operating profits nor should they be viewed as an alternative to cash provided by operating activities, profit or other measures of financial performance calculated in accordance with GAAP.

<b>THREE MONTHS ENDED DECEMBER 31<sup>ST</sup></b>	<b>2017</b>		<b>2016</b>		<b>% change</b>	
<i>(CA\$ thousands, unless otherwise indicated)</i>	<b>Amount</b>	<b>\$/BOE</b>	<b>Amount</b>	<b>\$/BOE</b>	<b>Amount</b>	<b>\$/BOE</b>
Petroleum and natural gas revenue	<b>80,838</b>	<b>35.06</b>	55,737	30.66	45	14
Cost of purchases	<b>(3,052)</b>	<b>(1.32)</b>	-	-	-	-
Cash premiums on financial instruments	-	-	205	0.11	-100	-100
Realized loss on financial instruments <sup>(1)</sup>	<b>(720)</b>	<b>(0.32)</b>	(428)	(0.24)	68	33
Royalties	<b>(7,185)</b>	<b>(3.12)</b>	(5,203)	(2.86)	38	9
Revenue, after royalties and financial instruments	<b>69,881</b>	<b>30.30</b>	50,311	27.67	39	10
Production expense	<b>(25,385)</b>	<b>(11.01)</b>	(17,231)	(9.47)	47	16
Transportation expense	<b>(7,172)</b>	<b>(3.11)</b>	(5,677)	(3.12)	26	0
<b>Operating income <sup>(2)</sup></b>	<b>37,324</b>	<b>16.18</b>	27,403	15.08	36	7
Financing expense <sup>(3)</sup>	<b>(2,147)</b>	<b>(0.93)</b>	(2,510)	(1.38)	-14	-33
G&A expense	<b>(2,268)</b>	<b>(0.98)</b>	(1,782)	(0.98)	27	0
Realized loss on foreign exchange	<b>(11)</b>	-	-	-	-	-
Realized gain (loss) on financial instruments <sup>(4)</sup>	-	-	(11)	(0.01)	-100	-100
<b>Adjusted funds from operations <sup>(5)</sup></b>	<b>32,898</b>	<b>14.27</b>	23,100	12.71	42	12
Basic (\$ per common share) <sup>(6)</sup>	<b>0.18</b>		0.13		38	
Diluted (\$ per common share) <sup>(6)</sup>	<b>0.18</b>		0.13		38	
Common shares outstanding (000s):						
Basic, weighted average	<b>178,220</b>		175,275		2	
Diluted, weighted average	<b>179,898</b>		176,234		2	

Refer to footnotes included under the table on following page.

During the three months ended December 31, 2017, adjusted funds from operations of \$32.9 million (\$0.18 per share, diluted) increased by 43% from \$23.0 million (\$0.13 per share, diluted) during the third quarter ended September 30, 2017. Compared to the fourth quarter of 2016, adjusted funds from operations increased by \$9.8 million and is 42% higher in the fourth quarter of 2017. The increase in adjusted funds from operations is primarily attributed to the increase in Kelt's revenues which are up 39% or \$19.6 million after royalties and financial instruments, driven by the 27% increase in average production and material shift in the oil weighting of Kelt's production, which mitigated the impact of lower gas prices in the fourth quarter of 2017.

Although adjusted funds from operations of \$14.27 per BOE for the quarter ended December 31, 2017 is up 12% from \$12.71 per BOE in the comparative quarter of 2016, the Company's results were negatively impacted by the significant increase in production expenses reported in the period.

Total production expenses for the fourth quarter of 2017 are \$8.2 million or 47% higher than the comparative period, of which \$5.2 million of the increase is due to an adjustment for third-party gas plant equalizations. Preliminary calculations for the equalizations, which relate to the calendar years 2016 and 2017, were received from the plant operator in late February 2018. As the information was received prior to issuing the annual financial statements as at and for the year ended December 31, 2017, the estimated amount of the equalizations was accrued with the full amount of \$5.2 million being recognized during the fourth quarter of 2017. This information was received by the Company subsequent to issuing its February 8, 2018 press release entitled "*Kelt Reports Significant Increase in Oil & Gas Reserves and Net Asset Value as at December 31, 2017*". As a result, certain non-GAAP measures and other key performance measures initially reported by the Company in the February 8, 2018 press release, namely: "Operating Netback", "Recycle Ratio", "Bank debt, net of working capital" and "Net asset value", have been updated in this MD&A to reflect the late adjustment for third-party equalizations.

The following table provides a continuity of income and expenses included in the Company's calculation of operating income and adjusted funds from operations for the years ended December 31, 2017 and 2016, as well as the annual average netback (\$ per BOE) for each component.

<b>YEAR ENDED DECEMBER 31<sup>ST</sup></b>	<b>2017</b>		<b>2016</b>		<b>% change</b>	
<i>(CA\$ thousands, unless otherwise indicated)</i>	<b>Amount</b>	<b>\$/BOE</b>	<b>Amount</b>	<b>\$/BOE</b>	<b>Amount</b>	<b>\$/BOE</b>
Petroleum and natural gas revenue	<b>257,557</b>	<b>31.89</b>	184,613	24.08	40	32
Cost of purchases	<b>(3,052)</b>	<b>(0.38)</b>	-	-	-	-
Cash premiums on financial instruments	-	-	460	0.06	-100	-100
Realized gain (loss) on financial instruments <sup>(1)</sup>	<b>(1,060)</b>	<b>(0.13)</b>	(315)	(0.04)	237	225
Royalties	<b>(23,557)</b>	<b>(2.92)</b>	(15,911)	(2.08)	48	40
Revenue, after royalties and financial instruments	<b>229,888</b>	<b>28.46</b>	168,847	22.02	36	29
Production expense	<b>(81,201)</b>	<b>(10.05)</b>	(71,204)	(9.29)	14	8
Transportation expense	<b>(25,301)</b>	<b>(3.13)</b>	(21,943)	(2.86)	15	9
<b>Operating income</b> <sup>(2)</sup>	<b>123,386</b>	<b>15.28</b>	75,700	9.87	63	55
Financing expense <sup>(3)</sup>	<b>(7,810)</b>	<b>(0.97)</b>	(10,291)	(1.34)	-24	-28
G&A expense	<b>(7,564)</b>	<b>(0.94)</b>	(6,994)	(0.91)	9	3
Realized loss on foreign exchange	<b>(11)</b>	-	-	-	-	-
Realized gain (loss) on financial instruments <sup>(4)</sup>	<b>10</b>	-	(35)	-	-129	-
<b>Adjusted funds from operations</b> <sup>(5)</sup>	<b>108,011</b>	<b>13.37</b>	58,380	7.62	85	76
Basic (\$ per common share) <sup>(6)</sup>	<b>0.61</b>		0.34		79	
Diluted (\$ per common share) <sup>(6)</sup>	<b>0.61</b>		0.34		79	
Common shares outstanding (000s):						
Basic, weighted average	<b>176,466</b>		173,076		2	
Diluted, weighted average	<b>177,920</b>		173,415		3	

(1) Includes realized gains (losses) on commodity price and foreign exchange derivatives. Excludes realized gains (losses) on interest rate swaps.

(2) "Operating income" is a non-GAAP financial measure which is calculated by deducting royalties, production expenses and transportation expenses from petroleum and natural gas revenue, after realized gains or losses on associated financial instruments.

(3) Excludes non-cash accretion of decommissioning obligations and convertible debentures.

(4) Includes realized gains (losses) on interest rate swaps.

(5) "Adjusted funds from operations" is a non-GAAP financial measure which is calculated as cash provided by operating activities before changes in non-cash operating working capital, and adding back (if applicable): transaction costs, provisions for potential credit losses, and settlement of decommissioning obligations.

(6) Adjusted funds from operations per common share is calculated on a consistent basis with profit (loss) per common share, using basic and diluted weighted average common shares as determined in accordance with GAAP.

Adjusted funds from operations for the year ended December 31, 2017 was \$108.0 million (\$0.61 per common share, diluted), up 85% from \$58.4 million (\$0.34 per common share, diluted) in 2016. The Company grew its production by 6% year-over-year and reported 63% growth in operating income. The increase in operating income is primarily attributed to the increase in Kelt's revenues which are up 36% after royalties and financial instruments, driven by the increase in oil weighting of Kelt's production in conjunction with higher average oil and gas prices during 2017, partly offset by higher production and transaction expenses. While the Company incurred higher transportation expenses during 2017, a portion of the increase related to oil and gas marketing arrangements and firm pipeline commitments contributed to the increase in Kelt's realized prices, partly mitigating the impact on operating netbacks.

The Company's operating netback averaged \$15.28 per BOE for the year ended December 31, 2017, up 55% compared to \$9.87 per BOE in 2016. The Company's low financing and G&A expenses result in the majority of operating income generated in the field contributing directly to Kelt's funds from operations, which averaged \$13.37 per BOE during 2017, an increase of 76% from \$7.62 per BOE in 2016.

## PROFIT (LOSS) AND COMPREHENSIVE INCOME (LOSS)

(CA\$ thousands, unless otherwise indicated)	Three months ended December 31			Year ended December 31		
	2017	2016	%	2017	2016	%
Profit (loss) and comprehensive income (loss)	(5,389)	11,856	-145	(23,178)	(49,774)	-53
Wtd avg. shares outstanding, basic (000s)	178,220	176,466	1	176,466	173,076	2
Wtd avg. shares outstanding, diluted (000s) <sup>(1)(2)</sup>	178,220	177,920	0	176,466	173,076	2
\$ per common share, basic	(0.03)	0.07	-143	(0.13)	(0.29)	-55
\$ per common share, diluted <sup>(1)(2)</sup>	(0.03)	0.07	-143	(0.13)	(0.29)	-55
\$ per BOE	(2.34)	6.52	-136	(2.87)	(6.49)	-56

(1) The Company uses the treasury stock method to determine the dilutive effect of stock options and RSUs. Under this method, only "in-the-money" dilutive instruments impact the calculation of diluted profit per common share. In computing the diluted loss per common share for both the fourth quarter and year ended December 31, 2017 and for the year ended December 31, 2016, the Company excluded the effect of stock options and RSUs as they were anti-dilutive. Therefore, the diluted weighted average is equal to the basic weighted average shares outstanding in those periods.

(2) The common shares potentially issuable on conversion of the Debentures are excluded from the calculation of diluted weighted average shares outstanding as they were anti-dilutive to the loss reported for all periods outstanding.

Kelt reported a loss of \$5.4 million (\$0.03 per common share, diluted) for the three months ended December 31, 2017, compared to a profit of \$11.9 million (\$0.07 per common share, diluted) in the same three month period of 2016. For the year ended December 31, 2017, the loss reported by Kelt is \$23.2 million (\$0.13 per common share, diluted), down \$26.6 million compared to the loss of \$49.8 million reported in 2016. The decrease in net loss was primarily driven by the \$47.7 million increase in Kelt's operating income, partly offset by depletion, depreciation and impairment expense which is higher in 2017 by \$20.4 million (2016 included a net reversal of PP&E impairment of \$26.1 million), and the decrease in deferred tax recovery by \$6.3 million corresponding to the change in net loss.

## CAPITAL RESOURCES AND LIQUIDITY

### MARKET CAPITALIZATION

The Company's total capitalization was \$1.7 billion as of December 31, 2017, up 6% from December 31, 2016. The market value of common shares, based on the closing share price on the TSX, represented 74% of the total capitalization.

The following table summarizes the Company's capitalization:

CAPITALIZATION (CA\$ thousands, except per share amounts)	As at December 31, 2017		As at December 31, 2016		% change
	Amount	% of total	Amount	% of total	
Common shares outstanding (000s)	178,858		175,672		2
Share price <sup>(1)</sup>	\$7.19		\$6.77		6
<b>Capitalization of common shares</b>	<b>1,285,989</b>	<b>74</b>	1,189,299	73	8
Convertible debentures outstanding	90,000		90,000		0
Market price of Debentures <sup>(1)</sup>	\$150.00		\$145.00		3
<b>Capitalization of convertible debentures</b>	<b>135,000</b>	<b>8</b>	130,500	8	3
<b>Market capitalization</b>	<b>1,420,989</b>	<b>82</b>	1,319,799	81	8
Bank debt, net of working capital	136,729	8	138,042	8	-1
Decommissioning obligations	135,343	8	126,597	8	7
Deferred income tax liability	39,131	2	42,351	3	-8
<b>Total capitalization</b>	<b>1,732,192</b>	<b>100</b>	1,626,789	100	6

(1) Last price traded at in the year.

As at December 31, 2017, the Company had \$91.5 million of bank debt outstanding on its \$185.0 million Credit Facility. Net bank debt was \$136.7 million at December 31, 2017, representing 1.3 times 2017 annual adjusted funds

from operations of \$108.0 million. By comparison, net bank debt of \$138.0 million at December 31, 2016 was 2.4 times 2016 annual adjusted funds from operations of \$58.4 million.

## LIQUIDITY

Kelt's capital management objective is to maintain a flexible capital structure and sufficient liquidity to allow the Company to execute on its capital investment program and strategic growth plan. The Company strives to actively manage its capital structure in response to changes in economic conditions and the risk characteristics of its underlying oil and natural gas assets. As at December 31, 2017, Kelt's capital structure was comprised of shareholders' capital, convertible debentures, bank debt and working capital.

During the year ended December 31, 2017, the Company's net capital expenditures of \$128.0 million were primarily funded by \$115.2 million of cash provided by operating activities and \$20.3 million of net proceeds from equity private placements completed in October 2017, supplemented by borrowings under Kelt's revolving bank credit facility. Future capital expenditures are expected to be funded through a combination of cash flow from operations and bank debt, supplemented with new equity or debt offerings if required. Refer to discussion under the heading of "*Premium on Flow-Through Shares*" in this MD&A for additional information regarding flow-through equity financings completed during 2016 and 2017.

Liquidity risk is the risk the Company will encounter difficulties in meeting its financial obligations. The Company's financial liabilities as at December 31, 2017 are comprised of accounts payable, bank debt and convertible debentures. A contractual maturity analysis of Kelt's financial liabilities is provided in note 13 to the consolidated annual financial statements as at December 31, 2017. The Company manages liquidity risk through prudent use of bank debt and an actively managed production and capital expenditure budgeting process. The Board of Directors approves an annual capital expenditure budget, which is regularly monitored and updated as necessary in response to changing capital requirements. Should circumstances affect cash flow in a detrimental way, the Company is capable of reducing capital investment levels. In addition, the Company utilizes a control system with respect to authorizations for expenditures on both operated and non-operated projects to further manage capital expenditures. Risk management contracts such as derivative financial instruments may also be used from time to time.

The Company monitors its capital structure and short-term financing requirements using a net bank debt to trailing adjusted funds from operations ratio, which is a non-GAAP financial measure. Kelt targets a net bank debt to trailing adjusted funds from operations ratio of less than 2.0 times.

	December 31, 2017	December 31, 2016
Bank debt	91,465	111,693
Working capital deficiency	45,264	26,349
Bank debt, net of working capital <sup>(1)</sup>	136,729	138,042
Trailing annualized adjusted funds from operations <sup>(2)(3)</sup>	131,592	92,400
Net bank debt to trailing adjusted funds from operations ratio <sup>(1)</sup>	1.0	1.5

(1) "Net bank debt" is equal to "Bank debt, net of working capital" determined in accordance with GAAP.

(2) Adjusted funds from operations is a non-GAAP financial measure which is calculated as cash provided by operating activities before changes in non-cash operating working capital, and adding back (if applicable): transaction costs, provisions for potential credit losses, and settlement of decommissioning obligations.

(3) Trailing adjusted funds from operations is annualized based on the most recent quarter's adjusted funds from operations.

The Company's net bank debt to trailing adjusted funds from operations ratio of 1.0 times as at December 31, 2017 is down compared to 1.5 times at December 31, 2016 as a result of the significant increase in funds from operations during the fourth quarter of 2017 compared to the fourth quarter of 2016.

## WORKING CAPITAL

The Company's working capital is comprised primarily of accounts receivable and accounts payable. The capital intensive nature of Kelt's operations may create a working capital deficiency position during periods with high levels of capital investment. Kelt's working capital deficiency increased at December 31, 2017 along with higher production and capital spending during the second half of 2017. The Company maintains sufficient unused bank credit lines to

satisfy such working capital deficiencies. As at December 31, 2017, the Company's working capital deficit of \$45.3 million combined with outstanding bank debt of \$91.5 million, represented 74% of the authorized borrowing amount available under the Credit Facility of \$185.0 million.

<b>WORKING CAPITAL SUMMARY</b> (CA\$ thousands)	<b>Balance Dec31/17</b>	Balance Sept30/17	Change QoQ <sup>(1)</sup>	Balance Dec31/16	Change YoY <sup>(2)</sup>
Accounts receivable and accrued revenue	<b>39,446</b>	24,957	14,489	30,406	9,040
Other current assets <sup>(3)</sup>	<b>5,700</b>	3,618	2,082	1,751	3,949
<b>Total current assets</b>	<b>45,146</b>	28,575	16,571	32,157	12,989
Accounts payable and accrued liabilities	<b>87,783</b>	67,952	19,831	55,659	32,124
Other current liabilities <sup>(4)</sup>	<b>2,627</b>	2,409	218	2,847	(220)
<b>Total current liabilities</b>	<b>90,410</b>	70,361	20,049	58,506	31,904
<b>Net working capital deficit</b>	<b>45,264</b>	41,786	3,478	26,349	18,915

(1) Change in working capital balances at December 31, 2017 compared to most recent quarter ended September 30, 2017 ("QoQ" change).

(2) Change in working capital balances at December 31, 2017 compared to previous year ended December 31, 2016 ("YoY" change).

(3) Includes cash and cash equivalents, prepaid expenses and deposits and derivative financial instrument assets (if any).

(4) Includes the current portion of decommissioning obligations, deferred premiums on flow-through shares, and derivative financial instrument liabilities (if any).

The Company's accounts receivable consists primarily of accrued revenue and joint venture receivables. The oil and gas industry has a pre-arranged monthly clearing day for payment of revenues from all buyers of oil and natural gas. This occurs on the 25th day following the month of sale and as a result, the Company's production revenues are collected in an orderly fashion. Kelt monitors its counterparty credit positions to mitigate any potential credit losses. To the extent that the Company has joint venture partners in its activities, it must collect the partners' share of capital expenditures and operating expenses on a monthly basis. Exceptions are in the event that the partners' share of a capital project is a significant amount. In this case, Kelt will collect such amounts from its partners in advance of expenditures taking place in accordance with standard industry operating procedures. Many oil and gas companies, including some of Kelt's partners, continue to face financial challenges through this period of volatile commodity prices. The Company has been diligent with respect to its credit risk management practices and 96% of accounts receivable outstanding at December 31, 2017 are current, an improvement from 94% at December 31, 2016. The balance of accounts receivable outstanding for more than 90 days is approximately \$1.0 million and relates primarily to receivables from joint venture partners. Management has reviewed past due accounts and expects the balances to be fully collectible, except for approximately \$0.7 million of accounts receivable which are provided for in the provision for expected credit losses. Detailed disclosures regarding the Company's provision for expected credit losses are included in note 13 of the consolidated annual financial statements as at December 31, 2017.

Accounts payable and accrued liabilities are \$87.8 million as at December 31, 2017, of which approximately \$20.1 million is payable and \$67.7 million is accrued. Accrued liabilities include approximately \$38.4 million of estimated capital expenditures related to the Company's capital program. Invoices are typically processed within 30 to 60 days, however, the Company takes advantage of prompt pay discounts offered by certain vendors.

## CREDIT FACILITY

The Company has a revolving committed term credit facility (the "Credit Facility") with a syndicate of financial institutions. As at December 31, 2017, the authorized borrowing amount available under the Credit Facility was \$185.0 million (unchanged from December 31, 2016). The Credit Facility is available for a revolving period of 364 days, maturing on April 28, 2018, and may be extended annually at Kelt's option and subject to lender approval, with a term-out to April 28, 2019 if not renewed. The Credit Facility is subject to semi-annual borrowing base reviews, occurring approximately in April and October of each year. In the event that the lenders reduced the borrowing base below the amount drawn at the time of the redetermination, the Company would have 60 days to eliminate any borrowing base shortfall by repaying the amount drawn in excess of the re-determined borrowing base or by providing additional security or other consideration satisfactory to the lenders. Repayments of principal are not required provided that the borrowings under the facility do not exceed the authorized borrowing amount and the Company is in compliance with all covenants, representations and warranties.

There are no financial covenants under the Credit Facility and Kelt is in compliance with all other covenants. Covenants include industry standard positive and negative covenants including reporting requirements, permitted indebtedness, permitted dispositions (to a maximum in each calendar year which are in the aggregate not more than 5% of the borrowing base then in effect), permitted risk management activities (as more particularly described in note 13 of the annual financial statements), permitted encumbrances and other standard business operating covenants. Security is provided for by a first fixed and floating charge debenture over all assets in the amount of \$800.0 million and general assignment of book debts.

## CONVERTIBLE DEBENTURES

On May 3, 2016, the Company issued \$90.0 million principal amount of convertible unsecured subordinated debentures (the “Debentures”) for net proceeds of \$86.4 million. The Debentures mature on May 31, 2021 (the “Maturity Date”) and bear interest at 5.0% per annum payable semi-annually on May 31<sup>st</sup> and November 30<sup>th</sup>, commencing November 30, 2016. At the holder’s option, the Debentures may be converted into common shares of the Company at any time prior to the close of business on the earlier of the business day immediately preceding (i) the Maturity Date, (ii) if called for redemption, the date fixed for redemption by the Company, or (iii) if called for repurchase in the event of a change of control, the payment date, at a conversion price of \$5.50 per share (the “Conversion Price”), being a conversion rate of approximately 181.8182 common shares per \$1,000 principal amount of Debentures, subject to adjustment in certain circumstances.

As at December 31, 2017, the Debentures are “in-the-money” based on the closing price of Kelt common shares on the TSX of \$7.19 on December 29, 2017, being the last trading day in the year. To date, there have been no conversions and the \$90.0 million principal amount is outstanding.

The Debentures are redeemable by the Company after May 31, 2019 and prior to May 31, 2020, in whole or in part, from time to time, on not more than 60 days and not less than 40 days prior notice at a redemption price equal to their principal amount plus accrued and unpaid interest, if any, up to but excluding the date set for redemption, provided that the volume weighted average trading price of the common shares on the TSX for the 20 consecutive trading days ending five trading days (the “Current Market Price”) prior to the date on which notice of redemption is provided is at least 125% of the Conversion Price. On or after May 31, 2020 and prior to the Maturity Date, the Debentures may be redeemed by the Company, in whole or in part, from time to time, on not more than 60 days and not less than 40 days prior notice at a redemption price equal to their principal amount plus accrued and unpaid interest, if any, up to but excluding the date set for redemption.

The Company may, at its option, elect to satisfy its obligation to repay all or any portion of the principal amount of the Debentures upon redemption or due at maturity, by issuing common shares instead of cash (subject to the receipt of any required regulatory approvals and provided that no event of default has occurred). The number of common shares to be issued would be obtained by dividing the principal amount of the Debentures by 95% of the Current Market Price on the date fixed for redemption or maturity, as applicable.

The Debentures trade on the TSX under the symbol “KEL.DB”. As at December 31, 2017, the fair value of the Debentures was \$135.0 million based on the closing market price of \$150.00 per Debenture, being the price at which the Debentures last traded in the fourth quarter. The fair value was \$130.5 million at December 31, 2016.

The following table outlines Kelt’s Debenture trading activity by quarter:

DEBENTURE TRADING ACTIVITY (KEL.DB)	Q1 2017	Q2 2017	Q3 2017	Q4 2017	YTD 2017
High (\$)	147.00	155.35	152.00	155.00	155.35
Low (\$)	139.00	140.00	133.51	141.00	133.51
Close (\$)	145.00	140.00	152.00	150.00	150.00
Volume traded (number of Debentures)	65,120	69,440	25,160	9,970	169,690
Value of Debentures traded (\$ thousands)	9,125	10,553	3,597	1,481	24,757
Weighted average trading price (\$)	140.13	151.98	142.97	148.59	145.89



	Q1 2016	Q2 2016	Q3 2016	Q4 2016	YTD 2016
High (\$)	-	126.00	133.00	150.02	150.02
Low (\$)	-	105.50	112.00	130.00	105.50
Close (\$)	-	114.17	131.25	145.00	145.00
Volume traded (number of Debentures)	-	20,053	10,242	3,782	34,077
Value of Debentures traded (\$ thousands)	-	21,846	12,429	5,300	39,574
Weighted average trading price (\$)	-	108.94	121.35	140.13	116.13

## SHARE INFORMATION

The Company is authorized to issue an unlimited number of common shares and an unlimited number of preferred shares. As at December 31, 2017 there were 178.9 million common shares issued and outstanding (as at March 6, 2018, there are 180.3 million common shares outstanding). There are no preferred shares issued or outstanding.

As at December 31, 2017, officers, directors, and employees have been granted options to purchase 9.9 million common shares of the Company at an average exercise price of \$6.51 per common share. In addition, there are 0.8 million RSUs outstanding. Options and RSUs outstanding at December 31, 2017 represented 6% of total common shares issued and outstanding. Additional information regarding the Company's stock options and RSUs is included in note 11 of the consolidated annual financial statements.

Subsequent to the end of the reporting period, during January 2018, 1.4 million stock options were exercised at an average exercise price of \$6.35 per share for proceeds to Kelt of approximately \$8.9 million.

The Company's common shares trade on the TSX under the symbol "KEL". During the period from January 1, 2017 to December 31, 2017, 192.3 million common shares traded on the TSX at a weighted average price of \$6.66 per common share, up from the volume weighted average trading price of \$4.93 per common share during the year ended December 31, 2016.

The following table outlines Kelt's common share trading activity by quarter:

<b>SHARE TRADING ACTIVITY (KEL)</b>	<b>Q1 2017</b>	<b>Q2 2017</b>	<b>Q3 2017</b>	<b>Q4 2017</b>	<b>YTD 2017</b>
High (\$)	7.49	7.70	7.21	7.56	7.70
Low (\$)	5.73	5.56	5.69	6.38	5.56
Close (\$)	6.68	6.28	7.13	7.19	7.19
Volume traded (thousands)	60,550	64,730	36,069	30,906	192,255
Value traded (\$ thousands)	391,024	443,203	230,140	216,986	1,281,353
Weighted average trading price (\$)	6.46	6.85	6.38	7.02	6.66

	Q1 2016	Q2 2016	Q3 2016	Q4 2016	YTD 2016
High (\$)	4.49	5.60	6.04	7.06	7.06
Low (\$)	2.51	3.42	4.22	5.43	2.51
Close (\$)	3.96	4.73	5.79	6.77	6.77
Volume traded (thousands)	82,117	98,723	99,941	96,819	377,600
Value traded (\$ thousands)	301,612	443,180	507,146	610,240	1,862,178
Weighted average trading price (\$)	3.67	4.49	5.07	6.30	4.93

## INVESTING ACTIVITIES

### CAPITAL EXPENDITURES

Kelt is committed to future growth through its strategy to implement a full-cycle exploration and development program. In previous years, the Company completed strategic acquisitions of oil and gas properties where it believes further exploitation, development and exploration opportunities exist. Kelt will continue to seek optimization of its asset base by building on its core properties and monetizing non-core assets.

The Company's total capital expenditures, including acquisitions and dispositions ("A&D"), are summarized in the following table:

(CA\$ thousands, unless otherwise indicated)	Three months ended December 31			Year ended December 31		
	2017	2016	%	2017	2016	%
Capital expenditures:						
Lease acquisition and retention	1,789	3,141	-43	9,185	9,127	1
Geological and geophysical	4	477	-99	1,925	638	202
Drilling and completion of wells	39,888	25,502	56	154,667	47,373	226
Facilities, pipeline and well equipment	23,592	7,143	230	77,199	27,873	177
Corporate assets	24	67	-64	793	636	25
Capital expenditures, before A&D	65,297	36,330	80	243,769	85,647	185
Property acquisitions	464	(349)	-233	531	18,512	-97
Property dispositions	(9,984)	358	-2889	(116,323)	(5,891)	1875
Total capital expenditures, net of dispositions	55,778	36,339	53	127,977	98,268	30

### LAND HOLDINGS

Kelt continues to focus on long-term value creation by accumulating significant undeveloped land acreage on resource style plays, with a primary focus on Triassic Montney oil and liquids-rich gas plays. As at December 31, 2017, Kelt's net working interest land holdings were 852,181 acres (1,332 net sections) of which 438,365 net acres (685 net sections) include Montney rights. This ranks Kelt as one of the top Montney land owners amongst publicly traded oil and gas companies.

During the energy industry downturn throughout 2015 and 2016, Kelt took advantage of its strong financial position and executed on its land acquisition strategy, which is focused on building a significant land base of high working interest, operated, internally generated prospects. In 2017, the Company expended approximately \$7.4 million at Crown land sales acquiring 37,638 net acres (59 net sections) of petroleum and natural gas rights at an average bonus cost of \$197 per acre. The average bonus cost is up 405% compared to \$39 per acre during the year ended December 31, 2016.

Kelt's land holdings are located in two core areas, namely: (a) Grande Prairie (including Pouce Coupe, Progress and La Glace), Alberta; and (b) Fort St. John (including Inga, Fireweed and Stoddart), British Columbia.

The following table summarizes the Company's land holdings:

LAND HOLDINGS (Acres)	As at December 31, 2017		As at December 31, 2016		Percentage Change	
	Gross	Net	Gross	Net	Gross	Net
Developed	392,936	214,358	389,280	208,984	1	3
Undeveloped	755,455	637,823	768,345	647,770	-2	-2
Total	1,148,391	852,181	1,157,625	856,754	-1	-1
Average working interest		74%		74%		-

As at December 31, 2017, the Company holds petroleum and natural gas rights in 637,823 net acres of undeveloped land. Based on an internal evaluation of the fair market value of the Company's land holdings at December 31, 2017,

Kelt estimates the fair market value of its undeveloped land at \$239.1 million. This implies an average fair value of \$375 per acre, up compared to the internally estimated market value of \$328 per acre at December 31, 2016.

## MONTNEY LAND EXPANSION

The table below sets-out Kelt's Montney land holdings as at December 31, 2017:

<b>MONTNEY RIGHTS</b>	<b>Net Acres</b>	<b>Net Sections</b>
British Columbia	<b>290,091</b>	453
Alberta	<b>148,274</b>	232
<b>Total</b>	<b>438,365</b>	685

In northeastern BC, Kelt has accumulated and currently holds 145,072 net acres (227 sections) of land with Montney rights in a new core exploration area at Oak/Flatrock, adjacent to its Inga/Fireweed assets. The Artek Acquisition completed on April 16, 2015 consolidated the majority of the Company's Inga/Fireweed Montney asset ownership to 100% and resulted in operational control of the large asset base. Kelt has drilled and successfully completed ten upper Montney wells and four middle Montney wells on its 204 section substantially contiguous land block at Inga/Fireweed, de-risking and delineating a large portion of the lands.

Kelt recently completed an Upper Montney well located at Fireweed 00/B-90-A/94-A-13 (surface location C-10-H/94-A-13). This well which is located the furthest north on the Company's contiguous land block at Inga/Fireweed had a similar high liquids rate as its other wells further south. The Company is pleased to see the high liquids rate this far north on its lands.

In addition, the Company has recently completed its first Middle IBZ Montney well located at Inga 03/14-24-087-23W6 (surface location C12-36-087-23W6). The well was completed with a 46-stage ball drop system. Due to its proximity to an existing Middle Montney well that had been on production for over a year, several fracs had to be reduced or skipped resulting in fewer stages and less sand being placed during the completion. The Company is drilling its second Middle IBZ Montney well from a three-well pad at Inga and plans to place the horizontal lateral in a position offsetting both the Upper and Middle Montney wells in a "W" pattern which should maximize drainage and prevent interference from the other zones. Kelt is pleased with the high liquids rate from its first Middle IBZ Montney well at Inga.

The Company has also been active in expanding its Montney land position in its core areas in northwestern Alberta. During the commodity price downturn, Kelt began acquiring and has now accumulated 69,008 net acres (108 net sections) of land with Montney rights in a new core exploration area at Wembley/Pipestone, Alberta, adjacent to its Valhalla/La Glace assets. Kelt established its original Montney core position at Valhalla/La Glace and Wembley/Pipestone through certain acquisitions completed in 2013 and 2014. Prior to the commodity price downturn, the Company held 38,513 net acres (60 net sections) of lands with Montney rights.

## DRILLING

Drilling and completion expenditures incurred during the year ended December 31, 2017 were focused on Montney wells in the Company's core areas at Pouce Coupe, Progress and La Glace in Alberta and at Inga and Fireweed in British Columbia. During the year ended December 31, 2017, the Company drilled 40 (31.2 net) wells. The Company's average working interest in wells drilled during 2017 was 78% (2016 – 82%). In 2016, Kelt's active horizontal drilling program resulted in an average measured depth of net wells drilled of 4,396 metres (2016 – 4,390 meters). The Company drilled a total of 137,309 net metres during the year ended December 31, 2017 (2016 – 56,237 net metres).

Kelt has recently moved to pad drilling as part of its future development plan for its vast corporate Montney acreage. The Company's first significant pad drilling program was carried out at Pouce Coupe, Alberta. The five-well pad located at 15-06-78-11W6 was completed and brought on production during the first quarter of 2017. Kelt drilled its second five-well pad at Pouce Coupe 16-07-78-11W6 during the second half of 2017, which the Company plans to complete in the first quarter of 2018. Kelt expects to realize significant improved capital efficiencies from pad drilling and began drilling a multi-well pad on its large Inga/Fireweed Montney land acreage during 2018.

DRILLING ACTIVITY 2017	Three months ended December 31, 2017		Year ended December 31, 2017	
	Gross	Net	Gross	Net
Oil	4	4.0	27	18.2
Gas	4	4.0	13	13.0
Service	-	-	-	-
Dry	-	-	-	-
Total wells	8	8.0	40	31.2

DRILLING ACTIVITY 2016	Three months ended December 31, 2016		Year ended December 31, 2016	
	Gross	Net	Gross	Net
Oil	5	5.0	10	7.3
Gas	2	2.0	5	5.0
Service	-	-	-	-
Dry	-	-	-	-
Total wells	7	7.0	15	12.3

## FACILITIES AND INFRASTRUCTURE EXPENDITURES

During 2017, Kelt spent \$77.2 million on facilities, pipelines and well equipment, up 177% from \$27.9 million in 2016. The Company further invested in the development of infrastructure in its core operating areas, including compressor stations, oil battery expansions, pipeline infrastructure and multiple drill-pad equipping projects.

On July 31, 2017, the Company completed the purchase of a major infrastructure package for \$12.5 million. The infrastructure package includes four 4,700 horse power gas compressors with aggregate capacity of 100 MMCF per day, two 50 MMCF per day gas dehydration units, a fuel gas conditioning skid, a high pressure flare system, four 750 barrel tanks, a vapor recovery unit, instrument air compressors, three electric power generators, a master control center building and several other buildings and associated equipment. After a new lease has been surveyed and built, this infrastructure package will be moved from its existing location in northeastern BC and installed on a new site at Inga, BC, in close proximity to the Company's existing Inga facility located at 15-03-088-23W6. The estimated cost of moving the equipment from the seller's location is included in the Company's capital commitments for 2018 (refer to "*Commitments and Contractual Obligations*"). This infrastructure purchase is expected to lower future production expenses regardless of whether the Company elects to construct its own gas plant at Inga, or alternatively, continues to process gas through third party facilities in BC.

During 2017, Kelt installed blending facilities at two of its main oil terminals in Alberta and commenced blending operations at La Glace and Progress during the fourth quarter of 2017. These facilities are now pipeline connected to oil sales and water injection. In addition to using its own production, the Company may purchase butane and crude oil from third parties for use in its blending operations, with the objective of selling the blended oil product at a premium. Kelt's average realized oil price reflects the benefit of oil blending activities on the higher price it received for the sale of its own oil production volumes as well as incremental marketing revenue from the purchase and resale of third party volumes. Kelt has also installed blending facilities at its main oil terminal located at Inga, British Columbia, which is expected to be operational in March 2018.

## PROPERTY ACQUISITIONS

During 2017 the Company completed acquisitions of undeveloped land for total cash consideration of \$0.5 million. The undeveloped acreage acquired adds to Kelt's inventory of exploration and development prospects.

On April 28, 2016, the Company closed an acquisition of oil and gas assets in its core area at Progress, Alberta, for cash consideration of \$18.5 million, after closing adjustments. The acquisition included approximately 600 BOE per day of production (60% light oil), 4,135 net acres of land, and infrastructure that is an integral part of Kelt's existing light oil play at Progress.

## PROPERTY DISPOSITIONS

### *Karr Property Disposition*

On January 18, 2017, Kelt completed the disposition of the majority of its oil and gas assets in the Karr area of Alberta (the "Karr Property Disposition"). The disposition had an effective date of January 1, 2017. Kelt received gross cash proceeds, prior to adjustments at closing and following the waiver of certain preferential rights, in the amount of \$100.0 million. Net proceeds were used, initially, to reduce indebtedness under the Company's Credit Facility. The syndicate of lenders confirmed that the authorized borrowing amount available under the Credit Facility remained unchanged at \$185.0 million.

The assets and associated decommissioning obligations disposed pursuant to the Karr Property Disposition were classified as held for sale as at December 31, 2016. Immediately prior to the initial classification as held for sale, the net carrying amount of PP&E was \$68.9 million, including accumulated impairment of \$46.2 million recognized during the year ended December 31, 2015. As at December 31, 2016, the impairment loss was partially reversed by \$32.2 million based on the estimated fair value of consideration in excess of the carrying amount.

(CA\$ thousands)	December 31 2017	December 31 2016	Change in Estimates
Gross purchase price	100,000	100,000	-
Closing adjustments	3,054	2,926	128
<b>Fair value of consideration</b>	<b>103,054</b>	<b>102,926</b>	<b>128</b>
Exploration and evaluation assets	4,377	4,377	-
Property, plant and equipment, net <sup>(1)</sup>	101,264	101,081	183
Assets held for sale and disposed	105,641	105,458	183
Decommissioning obligations held for sale and disposed <sup>(2)</sup>	(2,532)	(2,532)	-
<b>Net assets held for sale and disposed</b>	<b>103,109</b>	<b>102,926</b>	<b>183</b>

(1) Cost of \$163.3 million, net of accumulated depletion and depreciation of \$48.1 million and accumulated impairment of \$14.0 million (net of impairment reversal).

(2) The carrying amount of the decommissioning obligations held for sale was estimated based on a risk-free rate of 2.3% and an inflation rate of 2.0% as at December 31, 2016. The undiscounted cash flows required to settle the obligations were estimated to be approximately \$2.7 million.

### Key Attributes of the Karr Property Disposition:

- At December 31, 2016, as evaluated by Sproule, proved reserves were 7.7 million BOE (\$71.3 million of FDC required to develop proved reserves) and proved plus probable reserves were 13.5 million BOE (\$105.3 million of FDC required to develop proved plus probable reserves) of which 26% were oil, 21% were NGLs and 53% were gas;
- Average production for December 2016 was approximately 1,300 BOE per day (34% oil, 16% NGLs and 50% gas);
- Land holdings include 16,480 gross acres (25.7 sections) and 16,400 net acres (25.6 sections) of which 9,920 gross acres (15.5 sections) and 9,840 net acres (15.4 sections) included Montney rights. Approximately 79% of net land holdings were classified as undeveloped by Kelt; and

- Tangible equipment includes a 100% interest in the Kelt Karr 10-21-65-3W6 oil battery and a 2.26% interest in the CNRL Karr 10-10-65-2W6 gas plant.

Kelt retained certain non-operated interests at Karr with current production of approximately 300 BOE per day and a 1.0% interest in the CNRL Karr 10-10-65-2W6 gas plant. The Company may endeavour to divest of these minor interests in the future.

#### *Non-core property dispositions*

On December 20, 2017 Kelt completed a disposition of certain non-core assets located at Gordondale, Alberta, for cash proceeds of \$5.6 million after estimated closing adjustments. The disposition included undeveloped land (E&E) with a carrying value of \$1.8 million and decommissioning obligations of \$1.1 million, resulting in a gain on sale of \$4.9 million. Production was approximately 6 BOE per day as the majority of the wells disposed were inactive and there were no developed reserves assigned.

On December 13, 2017 Kelt completed the disposition of certain petroleum and natural gas assets located at Spirit River, Alberta, for cash proceeds of \$1.6 million after estimated closing adjustments. The disposition resulted in a gain of \$1.7 million as the carrying value of decommissioning obligations relinquished of \$0.5 million exceeded the carrying value of undeveloped land (E&E) disposed of \$0.4 million. There were no reserves assigned to these assets as the majority of the wells were inactive.

On November 9, 2017, Kelt completed a disposition of undeveloped land located at Fireweed, BC, for cash proceeds of \$2.8 million. The lands disposed were previously acquired as part of a larger property acquisition and had a carrying value of \$0.5 million, resulting in a gain on sale of \$2.3 million.

On June 20, 2017, Kelt completed a disposition of certain non-core assets located near Grande Cache, Alberta, for cash proceeds of \$3.1 million after closing adjustments. The assets and associated decommissioning obligations disposed had a net carrying value of approximately \$1.5 million resulting in a gain on sale of \$1.6 million. At the time of disposition, production from the assets was approximately 140 BOE per day (90% gas).

On October 7, 2016, Kelt completed the disposition of certain non-core assets located at Stoddart, BC, for proceeds of one dollar, before closing adjustments. Kelt discharged liabilities for future abandonment and site restoration of approximately \$9.2 million (\$9.6 million undiscounted) as a result of the disposition. At the time of the disposition, production from the assets was approximately 11 BOE per day as the majority of wells were inactive and did not have reserves assigned.

On September 21, 2016, Kelt completed a disposition of certain non-producing assets located at Karr, Alberta, for cash consideration of \$5.0 million and recognized a gain of \$2.6 million. The assets disposed primarily consisted of undeveloped land with a carrying amount of \$2.5 million and decommissioning obligations of \$0.1 million.

On March 31, 2016, the Company disposed of certain non-core assets located at Boundary Lake in northwestern Alberta, for cash consideration of \$1.2 million, after closing adjustments, and reported a gain of \$2.0 million. The carrying amount of decommissioning obligations disposed was \$2.4 million, which exceeded the \$1.4 million combined carrying amount of the E&E and D&P assets. At the time of disposition, production from the assets was approximately 16 BOE per day.

## **RESERVES**

Kelt retained Sproule Associates Limited ("Sproule"), an independent qualified reserve evaluator to prepare a report on its oil and gas reserves (the "Sproule Report"). The Company has a Reserves Committee which oversees the selection, qualifications and reporting procedures of the independent engineering consultants. Reserves as at December 31, 2017 and at December 31, 2016 were determined using the guidelines and definitions set out under National Instrument 51-101 ("NI 51-101"). The Sproule Report is dated February 1, 2018 and is effective as of December 31, 2017.

At December 31, 2017, Kelt's proved plus probable reserves were 235.6 million BOE, up 21% from 194.1 million BOE at December 31, 2016. The Company's net present value of proved plus probable reserves at December 31, 2017, discounted at 10% before tax, was \$2.1 billion, an increase of 22% from \$1.7 billion at December 31, 2016. This increase was achieved despite lower forecasted oil and gas prices for the future years in the December 31, 2017

evaluation (see “Future Commodity Price Forecast” table below). Sproule’s forecasted commodity prices for 2017 used to determine the present value of the Company’s reserves at December 31, 2017, are US\$55.00 per barrel for WTI oil and \$2.70 per GJ for AECO-C gas.

At December 31, 2017, the weighting of proved plus probable reserves was 43% oil/NGLs and 57% natural gas. At December 31, 2016, the weighting of proved plus probable reserves was 37% oil/NGLs and 63% gas.

The following table outlines a summary of the Company’s reserves volumes at December 31, 2017:

<b>SUMMARY OF RESERVE VOLUMES</b>	Crude Oil (mbbls)	Liquids <sup>(1)</sup> (mbbls)	Natural Gas (mmcf)	Combined (mBOE)	FDC Costs (\$ thousands)
Proved developed producing	6,605	8,104	138,891	37,858	429
Proved developed non-producing	463	801	9,412	2,833	6,577
Proved undeveloped	5,442	33,571	319,621	92,282	768,994
<b>Total Proved</b>	<b>12,510</b>	<b>42,476</b>	<b>467,924</b>	<b>132,973</b>	<b>776,000</b>
Probable additional	8,928	37,874	334,951	102,628	387,592
<b>Total Proved plus Probable</b>	<b>21,438</b>	<b>80,350</b>	<b>802,875</b>	<b>235,601</b>	<b>1,163,592</b>

(1) “Liquids” include field condensate and NGLs.

Proved developed producing reserves at December 31, 2017 were 37.9 million BOE, an increase of 10% from 34.5 million BOE at December 31, 2016. Total proved reserves at December 31, 2017 were 133.0 million BOE, up 23% from 108.2 million BOE at December 31, 2016. Proved plus probable reserves at December 31, 2017 were 235.6 million BOE, an increase of 21% from 194.1 million BOE at December 31, 2016.

<b>CHANGE IN RESERVES – YEAR OVER YEAR</b> (mBOE)	<b>December 31 2017</b>	December 31 2016	Change
Proved developed producing	<b>37,858</b>	34,467	+ 10%
Proved developed non-producing	<b>2,833</b>	1,393	+ 103%
Proved undeveloped	<b>92,282</b>	72,333	+ 28%
<b>Total Proved</b>	<b>132,973</b>	108,193	+ 23%
Probable additional	<b>102,628</b>	85,873	+ 20%
<b>Total Proved plus Probable</b>	<b>235,601</b>	194,066	+ 21%

The following tables reconcile the change in total proved (“1P”) reserves and the change in total proved plus probable (“2P”) reserves during the year:

<b>RESERVES RECONCILIATION – 1P</b>	Crude Oil	Liquids <sup>(1)</sup>	Natural Gas	Combined
<b>TOTAL PROVED</b>	(mbbls)	(mbbls)	(mmcf)	(mBOE)
Balance, December 31, 2016	12,782	25,146	421,592	108,193
Extensions	1,026	12,773	62,538	24,222
Infill drilling	2,137	2,418	23,167	8,416
Technical revisions	501	5,183	13,965	8,012
Economic factors	28	76	412	173
Acquisitions	6	6	256	55
Dispositions	(2,101)	(1,623)	(25,899)	(8,041)
<b>Net additions</b>	<b>1,597</b>	<b>18,833</b>	<b>74,439</b>	<b>32,837</b>
2017 Production <sup>(2)</sup>	(1,869)	(1,503)	(28,107)	(8,057)
<b>Balance, December 31, 2017 <sup>(2)</sup></b>	<b>12,510</b>	<b>42,476</b>	<b>467,924</b>	<b>132,973</b>

(1) “Liquids” include field condensate and NGLs.

(2) Sulphur production of 20 MBOE and 1P sulphur reserves of 9 MBOE have been excluded in the above table.

<b>RESERVES RECONCILIATION – 2P</b>	Crude Oil	Liquids <sup>(1)</sup>	Natural Gas	Combined
<b>TOTAL PROVED PLUS PROBABLE</b>	(mbbls)	(mbbls)	(mmcf)	(mBOE)
Balance, December 31, 2016	23,308	48,585	733,037	194,066
Extensions	1,826	26,432	127,399	49,491
Infill drilling	2,595	222	13,821	5,121
Technical revisions	(809)	9,314	521	8,592
Economic factors	70	145	664	326
Acquisitions	7	13	617	123
Dispositions	(3,690)	(2,858)	(45,077)	(14,061)
Net additions	<b>(1)</b>	<b>33,268</b>	<b>97,945</b>	<b>49,592</b>
2017 Production <sup>(2)</sup>	(1,869)	(1,503)	(28,107)	(8,057)
<b>Balance, December 31, 2017 <sup>(2)</sup></b>	<b>21,438</b>	<b>80,350</b>	<b>802,875</b>	<b>235,601</b>

(1) "Liquids" include field condensate and NGLs.

(2) Sulphur production of 20 MBOE and 2P sulphur reserves of 24 MBOE have been excluded in the above table.

Future development capital ("FDC") expenditures of \$776 million are included in the reserve evaluation for total proved reserves and are expected to be spent as follows: \$118 million in 2018, \$153 million in 2019, \$135 million in 2020, \$92 million in 2021, \$73 million in 2022, and \$205 million thereafter. FDC expenditures of \$1,164 million are included for proved plus probable reserves and are expected to be spent as follows: \$139 million in 2018, \$210 million in 2019, \$199 million in 2020, \$185 million in 2021, \$130 million in 2022 and \$301 million thereafter.

The following table outlines FDC expenditures and future wells to be drilled by province, included in the December 31, 2017 and 2016 reserve evaluations for proved plus probable reserves:

<b>FDC EXPENDITURES</b>	<b>Year ended December 31, 2017</b>		<b>Year ended December 31, 2016</b>	
<b>TOTAL PROVED PLUS PROBABLE</b>	<b>FDC (\$M)</b>	<b>Net Wells</b>	<b>FDC (\$M)</b>	<b>Net Wells</b>
Alberta Montney HZ Wells	<b>175,728</b>	<b>37.3</b>	260,716	49.3
B.C. Montney HZ Wells	<b>638,203</b>	<b>102.5</b>	312,482	51.0
<b>Total Montney HZ Wells</b>	<b>813,931</b>	<b>139.8</b>	573,198	100.3
Other formations HZ wells	<b>342,441</b>	<b>74.5</b>	347,556	76.7
Other expenditures	<b>7,220</b>	<b>n/a</b>	26,862	n/a
<b>Total FDC Expenditures</b>	<b>1,163,592</b>	<b>214.3</b>	947,616	177.0

The WTI oil price during the three years from 2015 to 2017 averaged US\$47.69 per barrel, after a precipitous decline from US\$93.00 in 2014. Sproule is forecasting an average WTI oil price of US\$55.00 per barrel in 2018. Natural gas prices during the 2015 to 2017 period at AECO-C averaged \$2.24 per GJ. Sproule is forecasting an average AECO-C gas price of \$2.70 per GJ in 2018.

The following table outlines forecasted future prices that Sproule has used in their evaluation of the Company's reserves at December 31, 2017:

<b>FUTURE COMMODITY PRICE FORECAST</b>	WTI Cushing	Canadian	NYMEX	AECO-C	USD/CAD
	Oklahoma	Light Sweet	Henry Hub	Spot	Exchange
	US\$/bbl	CA\$/bbl	US\$/MMBtu	CA\$/GJ	US\$/CA\$
2018	55.00	65.44	3.25	2.70	0.79
2019	65.00	74.51	3.50	2.95	0.82
2020	70.00	78.24	4.00	3.46	0.85
2021	73.00	82.45	4.08	3.60	0.85
2022	74.46	84.10	4.16	3.75	0.85
<b>Five year average</b>	<b>67.49</b>	<b>76.95</b>	<b>3.80</b>	<b>3.29</b>	<b>0.83</b>



The Company's net present value of proved plus probable reserves, discounted at 10% before tax, was \$2.1 billion as at December 31, 2017, up 22% from \$1.7 billion as of December 31, 2016. The undiscounted future net cash flow, before tax, was \$4.4 billion as of December 31, 2017, an increase of 14% from \$3.9 billion as of December 31, 2016.

The following table summarizes the net present value of the Company's reserves (before tax) as at December 31, 2017:

<b>NET PRESENT VALUE (BEFORE TAX)</b>				
<i>(CA\$ millions)</i>	Undiscounted	NPV 5% BT	NPV 8% BT	NPV 10% BT
Proved developed producing	555.1	482.3	444.9	422.9
Proved developed non-producing	34.1	28.3	25.4	23.6
Proved undeveloped	1,531.2	957.7	747.9	646.7
<b>Total Proved</b>	<b>2,120.4</b>	<b>1,468.3</b>	<b>1,218.2</b>	<b>1,093.2</b>
Probable additional	2,317.6	1,456.5	1,160.2	1,018.4
<b>Total Proved plus Probable</b>	<b>4,438.0</b>	<b>2,924.8</b>	<b>2,378.4</b>	<b>2,111.6</b>

The Company's net present value of proved plus probable reserves, discounted at 10% after tax, was \$1.7 billion as of December 31, 2017, up 20% from \$1.4 billion as of December 31, 2016. The undiscounted future net cash flow, after tax, was \$3.5 billion as of December 31, 2017, an increase of 12% from \$3.1 billion as of December 31, 2016.

The following table summarizes the net present value of the Company's reserves (after tax) as at December 31, 2017:

<b>NET PRESENT VALUE (AFTER TAX)</b>				
<i>(CA\$ millions)</i>	Undiscounted	NPV 5% AT	NPV 8% AT	NPV 10% AT
Proved developed producing	555.1	482.3	444.9	422.9
Proved developed non-producing	34.1	28.3	25.4	23.6
Proved undeveloped	1,216.0	765.5	600.0	519.8
<b>Total Proved</b>	<b>1,805.2</b>	<b>1,276.1</b>	<b>1,070.3</b>	<b>966.3</b>
Probable additional	1,692.2	1,058.2	840.5	736.6
<b>Total Proved plus Probable</b>	<b>3,497.4</b>	<b>2,334.3</b>	<b>1,910.8</b>	<b>1,702.9</b>

During 2017, the Company's capital expenditures, net of dispositions, resulted in proved plus probable reserve additions of 49.6 million BOE, resulting in 2P FD&A costs of \$6.94 per BOE, including FDC expenditures. Proved reserve additions in 2017 were 32.8 million BOE, resulting in 1P FD&A costs of \$9.61 per BOE, including FDC expenditures. Despite a significant disposition in 2017, Kelt was able to show significant reserve additions from new wells and from certain existing wells that have produced at rates that have exceeded previous estimates. Capital expenditures in 2017 were \$128.0 million, up 30% from \$98.3 million in 2016. The Company considers the calculated FD&A costs in 2017 to be a good result considering it also increased its undeveloped land acreage in its core areas including the newer Montney plays located at Oak/Flatrock in BC and at Wembley/Pipestone in Alberta, and made a significant infrastructure purchase in 2017.

"FD&A cost per BOE" is a key performance indicator commonly used in the oil and gas industry. Readers are cautioned that these amounts may not be directly comparable to other companies, as the term "FD&A cost" does not have a standardized meaning under GAAP or NI 51-101 (refer to advisories under the heading of "Non-GAAP Financial Measures and Other Key Performance Indicators").

The recycle ratio is a measure for evaluating the effectiveness of a company's re-investment program. The ratio measures the efficiency of capital investment. It accomplishes this by comparing the operating netback per BOE to the same period's reserve FD&A cost per BOE. With the purchase and construction of facilities and infrastructure in 2016 and 2017, along with land and asset acquisitions during the year, Kelt has positioned itself to achieve high efficiencies in production additions and finding and development costs over the upcoming years, as it continues to transition to development/pad drilling.

The following table outlines the calculation of the Company's 1P FD&A costs and 1P recycle ratio:

<b>FINDING, DEVELOPMENT &amp; ACQUISITION COSTS – 1P</b> (CA\$ thousands, except as otherwise noted)	Year ended December 31	
	<b>2017</b>	2016
<b>Proved (1P) reserves:</b>		
Total capital expenditures, net of dispositions <sup>(1)</sup>	<b>127,977</b>	98,268
Change in FDC costs required to develop 1P reserves	<b>187,459</b>	57,241
Total capital costs	<b>315,436</b>	155,509
1P Reserve additions, net (mBOE)	<b>32,837</b>	32,010
FD&A cost, before FDC (\$/BOE)	<b>3.90</b>	3.07
<b>1P FD&amp;A cost, including FDC (\$/BOE)</b>	<b>9.61</b>	4.86
Operating netback (\$/BOE) <sup>(2)</sup>	<b>15.28</b>	9.87
<b>1P Recycle ratio</b>	<b>1.6 x</b>	2.0 x

(1) Comprised of the Company's total exploration and development capital expenditures, as well as acquisitions, net of proceeds from dispositions. Refer to "Capital Expenditures" table in this MD&A.

(2) Kelt's "Operating netback" calculation is provided under the heading of "Non-GAAP Financial Measures and Other Key Performance Indicators".

The following table outlines the calculation of the Company's 2P FD&A costs and 2P recycle ratio:

<b>FINDING, DEVELOPMENT &amp; ACQUISITION COSTS – 2P</b> (CA\$ thousands, except as otherwise noted)	Year ended December 31	
	<b>2017</b>	2016
<b>Proved plus probable (2P) reserves:</b>		
Total capital expenditures, net of dispositions <sup>(1)</sup>	<b>127,977</b>	98,268
Change in FDC costs required to develop 2P reserves	<b>215,976</b>	79,416
Total capital costs	<b>343,953</b>	177,684
2P Reserve additions, net (mBOE)	<b>49,592</b>	51,211
FD&A cost, before FDC (\$/BOE)	<b>2.58</b>	1.92
<b>2P FD&amp;A cost, including FDC (\$/BOE)</b>	<b>6.94</b>	3.47
Operating netback (\$/BOE) <sup>(2)</sup>	<b>15.28</b>	9.87
<b>2P Recycle ratio</b>	<b>2.2 x</b>	2.8 x

(1) Comprised of the Company's total exploration and development capital expenditures, as well as acquisitions, net of proceeds from dispositions. Refer to "Capital Expenditures" table in this MD&A.

(2) Kelt's "Operating netback" calculation is provided under the heading of "Non-GAAP Financial Measures and Other Key Performance Indicators".

Kelt's 2017 capital investment program resulted in net reserve additions that replaced 2017 production by a factor of 4.1 times on a proved basis (2016 – 4.2 times) and 6.2 times on a proved plus probable basis (2016 – 6.7 times).

The tables below summarize production replacement for 2017:

<b>PRODUCTION REPLACEMENT</b>	Crude Oil	Liquids <sup>(1)</sup>	Natural Gas	Combined
<b>TOTAL PROVED RESERVES</b>	(mbbls)	(mbbls)	(mmcf)	(mBOE)
Reserve additions, including revisions	1,597	18,833	74,439	32,837
2017 Production <sup>(2)</sup>	1,869	1,503	28,107	8,057
<b>Production replacement ratio – 1P</b>	<b>0.9 x</b>	<b>12.5 x</b>	<b>2.6 x</b>	<b>4.1 x</b>

(1) "Liquids" include field condensate and NGLs.

(2) Sulphur production of 20 MBOE has been excluded in the above tables.

<b>PRODUCTION REPLACEMENT</b>	Crude Oil	Liquids <sup>(1)</sup>	Natural Gas	Combined
<b>TOTAL PROVED PLUS PROBABLE RESERVES</b>	(mbbls)	(mbbls)	(mmcf)	(mBOE)
Reserve additions, including revisions	(1)	33,268	97,945	49,592
2017 Production <sup>(2)</sup>	1,869	1,503	28,107	8,057
<b>Production replacement ratio – 2P</b>	<b>-</b>	<b>22.1 x</b>	<b>3.5 x</b>	<b>6.2 x</b>

(1) "Liquids" include field condensate and NGLs.

(2) Sulphur production of 20 MBOE has been excluded in the above tables.

## NET ASSET VALUE

The Company estimates its net asset value to be \$2.3 billion or \$11.06 per common share as at December 31, 2017. The components of Kelt's net asset value calculation are set-forth in the table below. The reader is cautioned that these amounts may not be directly comparable to other companies, as the term "net asset value" does not have a standardized meaning under GAAP or NI 51-101. The present value of petroleum and natural gas ("P&NG") reserves was determined by Sproule in their year-end evaluation reports, based on a discount rate of 10% before-tax. Undeveloped land at December 31, 2017 was internally valued at an average price of \$375 per acre (2016 – \$328 per acre). The Company's total decommissioning obligations, as determined in accordance with GAAP and as reported in the consolidated financial statements as of the calculation dates, were revalued using a discount rate of 10% to match the discount rate applied to value P&NG reserves. The present value of decommissioning obligations reported in the table below is the amount incremental to abandonment and reclamation costs assigned for existing locations by Sproule, which are already reflected in the present value of P&NG reserves.

## NET ASSET VALUE

<i>(CA\$ thousands, except per share amounts)</i>	<b>December 31, 2017</b>	December 31, 2016
Present value of 2P P&NG reserves, discounted at 10% before tax	<b>2,111,574</b>	1,730,690
Undeveloped land	<b>239,118</b>	212,528
Present value of decommissioning obligations	<b>(12,815)</b>	(9,462)
Bank debt, net of working capital	<b>(136,729)</b>	(138,044)
Proceeds from exercise of stock options <sup>(1)</sup>	<b>60,361</b>	29,683
Net asset value	<b>2,261,509</b>	1,825,395
Fully diluted common shares outstanding (000s) <sup>(1)(2)(3)</sup>	<b>204,410</b>	198,504
<b>Net asset value (\$ per common share)</b>	<b>11.06</b>	9.20

(1) The calculation of proceeds from exercise of stock options and the fully diluted number of common shares outstanding only includes stock options that are "in-the-money" based on the closing price of Kelt common shares of \$7.19 and \$6.77 as at December 31, 2017 and 2016, respectively.

(2) For purposes of the net asset value calculation, the Company does not apply the treasury stock-method prescribed by GAAP. Rather, the fully diluted number of common shares outstanding is determined by adding the total number of outstanding RSUs and "in-the-money" stock options (1) to the number of common shares outstanding at the calculation date.

(3) The 5% convertible debentures that mature on May 31, 2021 are convertible to common shares at \$5.50 per share. At the December 31, 2017 closing price of Kelt common shares of \$7.19, the convertible debentures are "in-the-money" and 16.4 million shares issuable upon conversion are included in diluted common shares outstanding.

## COMMITMENTS AND CONTRACTUAL OBLIGATIONS

As of December 31, 2017, the Company is committed to future payments under the following agreements:

(CA\$ thousands)	2018	2019	2020	2021	2022	Thereafter
Operating lease - office buildings	589	900	968	987	1,006	335
Operating lease - vehicles	366	262	112	13	-	-
Capital commitments <sup>(1)</sup>	5,568	-	-	-	-	-
Firm processing commitments	6,490	1,528	1,566	1,605	1,365	-
Firm transportation commitments <sup>(2)</sup>	28,106	16,448	13,650	10,974	10,374	36,586
<b>Total annual commitments</b>	<b>41,119</b>	<b>19,138</b>	<b>16,296</b>	<b>13,579</b>	<b>12,745</b>	<b>36,921</b>

(1) Refer to additional information under the heading of *Capital Expenditures*.

(2) A portion of Kelt's commitments on the Alliance pipeline are denominated in US dollars. The volumes committed vary over the term of the contracts, which are effective until October 31, 2018 and October 31, 2020, respectively. However, the maximum US denominated commitment in a given month does not exceed US\$0.2 million. Amounts are translated to Canadian dollars at the spot rate on December 31, 2017 of CA\$/US\$1.2545.

Payments under the office building operating leases relate to the Company's head office in Calgary, Alberta, and field offices in Grande Prairie, Alberta and Fort St. John, British Columbia. The leases expire on April 30, 2023, February 28, 2020, and November 30, 2018, respectively, if not extended.

The Company has firm commitments for oil and gas transportation on major pipelines in Alberta and British Columbia. For periods subsequent to 2020, Kelt has an average annual commitment of \$7.4 million for gas transportation until October 31, 2027 and an average annual commitment of \$0.9 million for oil transportation until December 31, 2027.

## RELATED PARTY TRANSACTIONS

A director of the Company is also a partner at a law firm which Kelt has engaged to provide legal services. During the year ended December 31, 2017, the Company incurred \$0.3 million (2016 – \$0.6 million) in legal fees and disbursements. The Company expects to continue using the services of this law firm from time to time.

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Company. The following table summarizes compensation paid or payable to officers and directors of the Company:

	Year ended December 31	
	2017	2016
Salaries, bonuses and other benefits	1,752	1,437
Share based compensation	2,185	2,521
<b>Total compensation</b>	<b>3,937</b>	<b>3,958</b>

During the year ended December 31, 2017, key management personnel were granted 89,000 RSUs and 984,000 stock options with an exercise price of \$6.09 per share. During the previous year ended December 31, 2016, key management personnel were granted 146,210 RSUs and 988,000 stock options with an exercise price of \$4.52 per share.

## OFF-BALANCE SHEET TRANSACTIONS

The Company did not engage in any off-balance sheet transactions during the periods ended December 31, 2017 and 2016.

## SUMMARY OF QUARTERLY RESULTS

The following tables summarize the Company's financial and operating results over the past eight quarters:

<i>(CA\$ thousands, except as otherwise indicated)</i>	<b>Q4 2017</b>	Q3 2017	Q2 2017	Q1 2017
Petroleum and natural gas revenue, before royalties	<b>80,838</b>	56,422	60,072	60,225
Cash provided by operating activities	<b>36,458</b>	24,394	28,480	25,890
Adjusted funds from operations <sup>(1)</sup>	<b>32,898</b>	22,957	25,333	26,823
Per share – basic (\$/common share)	<b>0.18</b>	0.13	0.14	0.15
Per share – diluted (\$/common share)	<b>0.18</b>	0.13	0.14	0.15
Profit (loss) and comprehensive income (loss)	<b>(5,389)</b>	(10,653)	(4,869)	(2,267)
Per share – basic (\$/common share)	<b>(0.03)</b>	(0.06)	(0.03)	(0.01)
Per share – diluted (\$/common share)	<b>(0.03)</b>	(0.06)	(0.03)	(0.01)
Total capital expenditures, net of dispositions	<b>55,778</b>	75,933	31,630	(35,364)
Total assets	<b>1,276,567</b>	1,227,962	1,203,174	1,193,644
Bank debt, net of working capital <sup>(1)</sup>	<b>136,729</b>	134,759	80,618	75,765
Convertible debentures	<b>74,517</b>	73,584	72,685	71,810
Shareholders' equity	<b>845,701</b>	830,344	839,485	842,351
Average daily production (BOE/d)	<b>25,063</b>	22,510	20,684	20,204
Average realized price (\$/BOE) <sup>(1)(2)</sup>	<b>33.42</b>	27.26	31.70	33.13
Operating netback (\$/BOE) <sup>(1)</sup>	<b>16.18</b>	12.86	15.49	16.63
Operating netback % of average realized price <sup>(2)</sup>	<b>48%</b>	47%	49%	50%

  

	Q4 2016	Q3 2016	Q2 2016	Q1 2016
Petroleum and natural gas revenue, before royalties	55,737	47,760	40,718	40,398
Cash provided (used in) by operating activities	21,919	15,152	7,776	(127)
Adjusted funds from operations <sup>(1)</sup>	23,100	17,658	11,671	5,951
Per share – basic (\$/common share)	0.13	0.10	0.07	0.04
Per share – diluted (\$/common share)	0.13	0.10	0.07	0.04
Profit (loss) and comprehensive income (loss)	11,856	(15,299)	(20,413)	(25,918)
Per share – basic (\$/common share)	0.07	(0.09)	(0.12)	(0.15)
Per share – diluted (\$/common share) <sup>1</sup>	0.07	(0.09)	(0.12)	(0.15)
Total capital expenditures, net of dispositions	36,339	12,616	25,908	23,405
Total assets	1,255,958	1,232,147	1,260,245	1,268,268
Bank debt, net of working capital <sup>(1)</sup>	138,042	132,471	139,080	230,290
Convertible debentures	70,978	70,134	69,320	-
Shareholders' equity	843,301	823,887	835,241	822,229
Average daily production (BOE/d)	19,762	20,542	20,208	23,295
Average realized price (\$/BOE) <sup>(1)(2)</sup>	30.53	25.47	22.13	19.06
Operating netback (\$/BOE) <sup>(1)</sup>	15.08	11.73	8.72	4.76
Operating netback as a % of average realized price <sup>(2)</sup>	49%	46%	39%	25%

(1) Refer to advisories regarding non-GAAP financial measures and other key performance indicators.

(2) In this table, average realized prices are after financial instruments.

Less than five years since commencing active operations on February 26, 2013 with initial production of approximately 3,500 BOE per day, Kelt achieved corporate record average production of 25,063 BOE per day during the fourth quarter of 2017. The Company's previous record high quarterly average production was 23,295 BOE per day in the first quarter of 2016. Production was lower in subsequent quarters of 2016 and in the first half of 2017 primarily due to normal declines in conjunction with significantly lower capital expenditures in 2016 compared to 2015. Kelt's production was also impacted by various plant/facility outages as well as ongoing pipeline maintenance

and egress issues which continue to impose challenges on the industry. Natural gas infrastructure and capacity constraints have discounted realized natural gas prices in domestic western Canadian markets relative to other North American markets. Kelt has taken measures to diversify its gas sales markets with new contracts that came into effect November 1, 2017, helping to mitigate the effect of low prices in Alberta and British Columbia.

In the second half of 2014, global crude oil prices began a precipitous decline that subsequently resulted in massive cutbacks in capital spending on energy projects worldwide. After averaging US\$93.00 per barrel in 2014, WTI oil prices averaged US\$48.80 per barrel in 2015 and bottomed with a low average price of US\$33.45 per barrel during the first quarter of 2016. In November 2016, OPEC and certain non-OPEC countries agreed to cut oil production supplies, resulting in a recovery of oil prices starting in the fourth quarter of 2016. The positive momentum for global crude oil prices has continued and WTI rebounded to its highest level in the past eight consecutive quarters, averaging US\$55.40 per barrel in the fourth quarter of 2017.

The recovery of oil prices and stronger realized gas pricing under new contracts, taken together with higher average production, drove the significant increase in revenues, cash provided by operating activities, and operating netbacks during the fourth quarter of 2017.

With the improvement of commodity prices, Kelt expanded its capital expenditure program during 2017 focusing on the development of its core areas in located near Fort St. John in northeastern British Columbia and in the Grande Prairie area of Alberta. The Company continued to optimize its asset base by monetizing non-core assets, completing the Karr Property Disposition on January 18, 2017 for proceeds of \$103.1 million, as well as several other minor property dispositions during 2017 for total proceeds of \$13.3 million (of which, \$10.0 million was received during the fourth quarter). In addition to cash provided by operating activities, the Company's capital expenditures (net of proceeds from dispositions) were funded primarily through equity financings, supplemented by bank debt and the issuance of \$90 million principal amount of 5% convertible debentures on May 3, 2016.

Refer to the "Results of Operations" section of this MD&A for further discussion. Additional information relating to Kelt, including the Company's MD&A for previous quarters, is filed on SEDAR and can be viewed at [www.sedar.com](http://www.sedar.com).

## SELECTED ANNUAL INFORMATION

The following table summarizes key annual financial and operating information over the three most recently completed financial years.

<i>(CA\$ thousands, except as otherwise indicated)</i>	2017	2016	2015
Petroleum and natural gas revenue, before royalties	257,557	184,613	179,326
Cash provided by operating activities	115,222	44,720	63,010
Adjusted funds from operations <sup>(1)</sup>	108,011	58,380	56,517
Per share – basic (\$/common share)	0.61	0.34	0.37
Per share – diluted (\$/common share)	0.61	0.34	0.36
Profit (loss) and comprehensive income (loss)	(23,178)	(49,774)	(141,039)
Per share – basic (\$/common share)	(0.13)	(0.29)	(0.91)
Per share – diluted (\$/common share)	(0.13)	(0.29)	(0.91)
Total capital expenditures, net of dispositions	127,977	98,268	497,273
Total assets	1,276,567	1,255,958	1,279,475
Bank debt, net of working capital <sup>(1)</sup>	136,729	138,042	212,959
Convertible debentures	74,517	70,978	-
Shareholders' equity	845,701	843,301	846,754
Average daily production (BOE/d)	22,130	20,947	18,577
Average realized price (\$/BOE) <sup>(1)(2)</sup>	31.38	24.10	26.33
Operating netback (\$/BOE) <sup>(1)</sup>	15.28	9.87	10.09
Operating netback as a % of average realized price <sup>(2)</sup>	49%	41%	38%

(1) Refer to advisories regarding non-GAAP financial measures and other key performance indicators.

(2) In this table, average realized prices are after financial instruments.

## CHANGES IN ACCOUNTING POLICIES

As of January 1, 2017, the Company adopted all of the requirements of IFRS 9 *Financial Instruments*, as amended in July 2014 ("IFRS 9").

IFRS 9 uses a single approach to determine whether a financial asset is classified and measured at amortized cost or fair value, replacing the multiple rules in IAS 39. The approach in IFRS 9 is based on how an entity manages its financial instruments and the contractual cash flow characteristics of the financial assets. Most of the requirements in IAS 39 for classification and measurement of financial liabilities were carried forward in IFRS 9, and IFRS 9 has introduced a single expected credit loss impairment model, which is based on changes in credit quality since initial recognition. The adoption of the expected credit loss impairment model did not have a significant impact on the financial statements of the Company, however there are additional required disclosures which have been included in note 13 of the consolidated annual financial statements.

IFRS 9 also contains a new hedge accounting model, however the Company did not apply hedge accounting to any of its commodity price risk management contracts in 2017. In addition, IFRS 9 includes amended guidance for the classification and measurement of financial assets by introducing a fair value through other comprehensive income category for certain debt instruments. The Company did not have any investments in debt instruments in 2017 for which this guidance applies to.

The early adoption of IFRS 9 has been applied retrospectively and did not result in a change in the carrying value of any of Kelt's financial instruments on the transition date.

## UPDATE ON ACCOUNTING STANDARDS ISSUED BUT NOT YET EFFECTIVE

IFRS 15 *Revenue from Contracts with Customers* will be adopted by the Company effective January 1, 2018, and will replace IAS 18 *Revenue*, IAS 11 *Construction Contracts*, and related interpretations. IFRS 15 provides clarification on how and when an entity will recognize revenue and provides a single, principles-based, five-step model that will be applied to all contracts with customers. The Company has performed an initial assessment of IFRS 15 and plans to adopt the standard under the modified retrospective approach on January 1, 2018. Under this method, comparative figures are not restated and the cumulative effect of initially applying the standard (if any) would be recognized at the date of adoption. The Company will be required to disclose additional information regarding the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers, including a disaggregation of revenue by product type. The Company's initial assessment that adoption of IFRS 15 will not have a material impact on the Company's Consolidated Statement of Profit (Loss) and Comprehensive Income (Loss) is made as of the date of these annual financial statements and may change as new publications or interpretations of the new standard become available. The evaluation of all potential measurement and disclosure impacts is ongoing.

IFRS 16 *Leases*, is intended to replace IAS 17 and will bring fundamental changes for all companies, including Kelt, who lease assets. The new standard is effective for annual reporting periods beginning on or after January 1, 2019, with early application permitted. The most significant financial reporting impacts of the changes include: all leases will be on the balance sheet of lessees, except those that meet the limited exception criteria; the measurement and presentation of expenses will be significantly impacted as rent expense is removed and replaced by the recording of depreciation and financing expenses; the amount of profit (loss) recognized in a period will likely change as the timing of expenses is accelerated when applying the new standard which uses a finance lease model compared to a straight line operating lease expense; and key ratios may be impacted with the introduction of lease assets and liabilities on the balance sheet and changes to the timing of expenses. Management is currently implementing corporate processes to ensure contract completeness required to identify impacted leases, and will continue to evaluate the potential impact of IFRS 16 on the consolidated financial statements.

## SIGNIFICANT JUDGMENTS AND ESTIMATES

The significant accounting policies applied by the Company are disclosed in note 3 of the consolidated annual financial statements as at and for the year ended December 31, 2017. The timely preparation of the financial statements requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amount of assets, liabilities, income and expenses. Actual results may differ materially from these estimates. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are reviewed and for any future years

affected. The significant judgments, estimates and assumptions made by management in the consolidated financial statements as at and for the year ended December 31, 2017 are discussed below.

#### *Depletion, depreciation and reserves*

The Company calculates depletion based on total proved reserves as determined in accordance with the Canadian Oil and Gas Evaluation Handbook ("COGEH"). The process of determining reserves is complex. Significant judgments are based on available geological, geophysical, engineering, and economic data. These judgments are based on estimates and assumptions that 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 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 the new information. Revisions are often required due to changes in well performance, prices, economic conditions and governmental restrictions.

Although every reasonable effort is made to ensure that reserve estimates are accurate, reserve estimation can be impacted by subjective decisions, new geological or production information and a changing environment. In addition, revisions to reserve estimates can arise from changes in forecast 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. Reserves are used in measuring the fair value less costs of disposal ("FVLCD") of property, plant and equipment for impairment calculations and for determining the fair value of PP&E acquired in a business combination. Reserves also impact the Company's assessment of the commercial viability and technical feasibility of an exploration project and the decision to transfer exploration and evaluation assets to PP&E.

#### *Exploration and evaluation assets*

Judgment is required to determine the level at which E&E is assessed for impairment. For Kelt, the carrying value of E&E assets is assessed for overall impairment at the operating segment level and on a specific identification basis prior to transferring E&E assets to PP&E. The decision to transfer assets from E&E to PP&E requires judgment as it is based on estimated proved reserves, which are used, in part, to determine a project's technical feasibility and commercial viability.

#### *Determination of Cash Generating Units ("CGUs")*

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. As at December 31, 2017, the Company has one CGU for its assets located in the province of British Columbia and four CGUs for its assets located in the province of Alberta. The Company's CGUs are unchanged from the previous year ended December 31, 2016.

#### *Impairment of non-financial assets*

Significant judgment is required to assess the Company's non-financial assets, namely E&E and PP&E, for impairment. Management must first determine whether indicators of impairment exist that suggest the carrying value may not be recoverable through the asset's continued use or sale. As a result of a decrease in forecast oil and natural gas prices, an indication of potential impairment was identified for certain CGUs comprised of non-core properties located in Alberta. An impairment test was performed for these CGUs as at December 31, 2017. Although forecast commodity prices have decreased compared to the previous year, there is no indication of impairment for the Company's British Columbia and Grande Prairie CGUs, which comprise approximately 95% of the carrying value of PP&E as at December 31, 2017. The Company concluded there is no indication of impairment for its E&E assets at the operating segment level.

Significant judgment and estimates are required to calculate the recoverable amount of PP&E and goodwill in an impairment test. Management calculated the recoverable amount of each CGU based on its FVLCD, using an after-tax discounted cash flow analysis derived from proved plus probable reserves. Reserve estimates and expected



future cash flows from production of reserves are subject to measurement uncertainty as discussed above and are subject to variability due to changes in forecasted commodity prices. In addition, the present value of forecast future cash flows is highly sensitive to the discount rate. Judgment is required to determine an appropriate discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Refer to information under the heading of “*Depletion, depreciation and impairment*” in this MD&A (and in note 7 of the consolidated annual financial statements) for a discussion of the specific estimates and assumptions applied in the calculation of the recoverable amount.

#### *Business combinations*

Business combinations are accounted for using the acquisition method of accounting. The determination of fair value often requires management to make assumptions and estimates about future events. The assumptions and estimates with respect to determining the fair value of exploration and evaluation assets and property, plant and equipment acquired generally require the most judgment and include estimates of reserves acquired, forecast benchmark commodity prices and discount rates. Assumptions are also required to determine the fair value of decommissioning obligations associated with the properties. Changes in any of these assumptions or estimates used in determining the fair value of acquired assets and liabilities could impact the amounts assigned to assets, liabilities and goodwill (or gain from a bargain purchase) in the acquisition equation. Future profit (loss) can be affected as a result of changes in future depletion and depreciation or impairment. Refer to additional information regarding business combinations completed during the years ended December 31, 2017 and 2016 under the heading of “*Capital expenditures*” of this MD&A and in note 4 of the consolidated annual financial statements.

#### *Decommissioning obligations*

The Company estimates the decommissioning obligations for oil and gas wells and their associated production facilities and infrastructure. In most instances, dismantling of assets and remediation occurs many years into the future. The value of the ultimate decommissioning obligation can fluctuate in response to many factors including changes to relevant legal requirements, the emergence of new restoration techniques, experience at other production sites, and changes to the risk-free discount rate. The expected timing and amount of expenditure can also change, for example, in response to changes in reserves or changes in laws and regulations or their interpretation. Judgments include the most appropriate discount rate to use, which management has determined to be a risk-free rate. Key assumptions are disclosed in note 10 of the consolidated annual financial statements.

Kelt estimates abandonment and reclamation costs based on a combination of publically available industry benchmarks and internal site specific information. For producing wells and facilities, the expected timing of settlement is estimated based on the proved plus probable period to abandonment for each field, as per the independent reserve report. For non-producing wells, the expected timing of settlement is estimated to be half of the period applied to producing wells in that field, unless the timing to abandon and reclaim a specific well site or facility is known based on budgeted expenditures.

#### *Deferred income taxes*

The Company follows the liability method for calculating deferred income taxes. Tax interpretations, regulations and legislation in the jurisdictions in which the Company operates are subject to change. As such, deferred income taxes are subject to measurement uncertainty. The provision for deferred income taxes also includes the following significant judgments of management:

- Deferred income tax assets are assessed by management at the end of the reporting period to determine the likelihood that they will be realized from future taxable earnings. As at December 31, 2017, the Company has a consolidated deferred income tax liability of \$39.1 million. The deferred tax liability reported in the Consolidated Statement of Financial Position is presented net of offsetting deferred income tax assets, most notably, a deferred income tax asset in the amount of \$90.3 million related to non-capital losses which are estimated to be approximately \$339.0 million at December 31, 2017. The Company’s non-capital losses expire in years 2023 to 2037. Management believes that Kelt and Kelt LNG will have sufficient taxable income in the future in order to utilize the non-capital losses and has concluded that recognition of the associated deferred income tax assets is appropriate;
- Classification of intangible drilling and completion costs as Canadian exploration expenses (“CEE”) or Canadian development expenses (“CDE”) – CEE is deductible at a rate of 100% per year, whereas CDE may be deducted on a

declining basis at 30% per year. Accordingly, the allocation of resource deductions will impact the period in which Kelt may become taxable in the future. In addition, the designation of certain expenditures as CEE and/or CDE impacts the Company's ability to satisfy its flow-through share obligations; and

- Recognition of unrecognized deferred income tax asset – per IAS 12, deferred income taxes are not initially recognized on transactions that are not business combinations. The Company did not initially recognize a deferred income tax asset of \$14.4 million that arose on the spin-out certain assets from Celtic Exploration Ltd. (“Celtic”) at Kelt's inception on February 26, 2013. The initially unrecognized deferred tax asset is now being amortized at a rate of 3.3% per quarter, which management believes is a reasonable estimate as it reflects the weighted average depletion rate of the properties at the time of the spin-out and is aligned with Kelt's corporate average depletion rate.

#### *Share based compensation*

The Company uses the fair value method of accounting for its long-term incentive plans, which include an Incentive Stock Option Plan and a Restricted Share Unit Plan. Judgments include which valuation model is most appropriate for the grant of the award to estimate its fair value. Estimates and assumptions are then used in the valuation model to determine fair value.

For stock options, the Company uses the Black-Scholes option pricing model which requires that management make assumptions for the expected life of the option, the anticipated volatility of the share price over the life of the option, the risk-free interest rate for the life of the option, and the number of options that will ultimately vest. The assumptions used by the Company are discussed in note 11 of the consolidated annual financial statements.

The fair value of restricted share units is estimated based on the volume weighted average trading price (“VWAP”) on the TSX over three trading days immediately prior to the date of grant. Judgment is also required to estimate the number of restricted share units that will ultimately vest, in other words, the rate of forfeiture. The assumptions used by the Company are discussed in note 11 of the consolidated annual financial statements.

#### *Flow-through shares*

There is no IFRS guidance that specifically addresses accounting for flow-through shares, therefore the Company is required to develop an accounting policy. Consistent with prior years, and as set-forth in note 3 of the consolidated annual financial statements, the Company has applied the residual method. Under this method, judgement is required to determine of the fair value of ordinary shares. Typically, it is based on the share price at the time the parties agree to the transaction. In situations where flow-through shares are issued concurrent with an ordinary common share offering, the difference in subscription prices is used to value the premium. Otherwise, the Company uses the VWAP of KEL common shares for the five trading days immediately preceding the date of the binding agreement, to value the ordinary common shares.

Judgment is also required to determine when the Company has fulfilled its obligation to pass on the tax deduction to investors, at which time, the premium on flow-through shares is recognized in income. The Company deems the obligation to have been fulfilled in the period that eligible expenditures are incurred, regardless of the period in which the tax deductions are legally renounced. This is based on the view that the renunciation is perfunctory and that the accounting should be reflected when the expenditure is made.

### **DISCLOSURE CONTROLS AND PROCEDURES**

The Chief Executive Officer (“CEO”) and the Chief Financial Officer (“CFO”) have designed, or caused to be designed under their supervision, disclosure controls and procedures as defined in National Instrument 52-109 of the Canadian Securities Administrators, to provide reasonable assurance that: (i) material information relating to the Company is made known to the CEO and the CFO by others, particularly during the period in which the annual and interim filings are being prepared; and (ii) information required to be disclosed by the Company in its annual filings, interim filings or other reports filed or submitted by it under securities legislation is recorded, processed, summarized and reported within the time periods specified in securities legislation.

The CEO and the CFO have evaluated the effectiveness of Kelt's disclosure controls and procedures as at December 31, 2017 and have concluded that such disclosure controls and procedures are effective. The assessment was based on the framework in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

## INTERNAL CONTROLS OVER FINANCIAL REPORTING

The CEO and the CFO have designed, or caused to be designed under their supervision, internal controls over financial reporting as defined in National Instrument 52-109 of the Canadian Securities Administrators, in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS.

There were no material changes to the Company's internal controls over financial reporting during the interim period from October 1, 2017 to December 31, 2017. The CEO and the CFO have evaluated the effectiveness of Kelt's internal controls over financial reporting as at December 31, 2017 and have concluded that such internal controls over financial reporting are effective. The assessment was based on the framework in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

Due to its inherent limitations, internal controls over financial reporting may not prevent or detect misstatements. In addition, projections of any evaluation relating to the effectiveness in future periods are subject to the risk that controls may become inadequate as a result of changes in conditions, or that the degree of compliance with policies and procedures may deteriorate.

## **BUSINESS RISKS**

The business of exploring for, developing and producing oil and natural gas reserves is inherently risky. The following information is a summary only of certain risk factors relating to the Company and should be read in conjunction with the Company's Annual Information Form as at December 31, 2017, dated March 7, 2018 which can be found at [www.sedar.com](http://www.sedar.com). Prospective investors should carefully consider the risk factors set out below and consider all other information contained in this MD&A and in the Company's other public filings before making an investment decision. The risks set out below are not an exhaustive list, nor should be taken as a complete summary or description of all the risks associated with the Company's business and the oil and natural gas business generally.

### *Weakness in the Oil and Gas Industry*

Recent market events and conditions, including global excess oil and natural gas supply, actions taken by the Organization of the Petroleum Exporting Countries ("OPEC") and non-OPEC member countries' decisions on production growth, slowing growth in emerging economies, market volatility and disruptions in Asia, and sovereign debt levels in various countries, have caused significant weakness and volatility in commodity prices. North American crude oil price differentials are also expected to continue to be volatile throughout 2018 which will have an impact on crude oil prices for Canadian producers. These events and conditions have caused a significant decrease in the valuation of oil and gas companies and a decrease in confidence in the oil and gas industry. These difficulties have been exacerbated in Canada by the recent changes in government at the federal level and, in the case of Alberta, at the provincial level and the resultant uncertainty surrounding regulatory, tax and royalty changes that may be implemented by the new governments. In addition, the inability to get the necessary approvals or other delays to build pipelines and other facilities to provide better access to markets for the oil and gas industry in western Canada has led to additional uncertainty and reduced confidence in the oil and gas industry in western Canada. Lower commodity prices may also affect the volume and value of the Company's reserves especially as certain reserves become uneconomic. In addition, lower commodity prices have reduced, and are anticipated to continue to reduce the Company's cash flow which could result in a reduced capital expenditure budget. As a result, the Company may not be able to replace its production with additional reserves and both the Company's production and reserves could be reduced on a year over year basis. Any decrease in value of the Company's reserves may reduce the borrowing base under the Credit Facility, which, depending on the level of the Company's indebtedness, could result in the Company having to repay a portion of its indebtedness. Given the current market conditions and the lack of confidence in the Canadian oil and gas industry, the Company may have difficulty raising additional funds in the future or if it is able to do it may be on unfavourable and highly dilutive terms.

### *Credit Facility*

The amount authorized under the Company's Amended and Restated Credit Agreement, as amended, is dependent on the borrowing base determined by its lenders. The lenders under the Amended and Restated Credit Agreement use the Company's reserves, commodity prices, and other factors, to periodically determine the Company's borrowing base. There remains a substantial amount of uncertainty as to when and if commodity prices will recover.

Continued depressed commodity prices or further reductions in commodity prices could result in a reduction to the Company's borrowing base, reducing the funds available to the Company under the Credit Facility. This could result in the requirement to repay a portion, or all, of the Company's indebtedness.

#### *Prices, Markets and Marketing of Crude Oil and Natural Gas*

Oil and natural gas are commodities whose prices are determined based on world demand, supply and other factors, all of which are beyond the control of Kelt. World prices for oil and natural gas have fluctuated widely in recent years. Any material decline in prices will result in a reduction of net production revenue. Oil and natural gas prices have varied greatly over the last two years and are expected to remain volatile in the near future in response to a variety of factors beyond the Company's control, including but not limited to: (i) global energy supply, production and policies, including the ability of OPEC to set and maintain production levels in order to influence prices for oil; (ii) political conditions, instability and hostilities; (iii) global and domestic economic conditions, including currency fluctuations; (iv) the level of consumer demand, including demand for different qualities and types of crude oil and liquids and the availability and pricing of alternative fuel sources; (v) the production and storage levels of North American natural gas and crude oil and the supply and price of imported oil and liquefied natural gas; (vi) weather conditions; (vii) the proximity of reserves and resources to, and capacity of, transportation facilities and the availability of refining and fractionation capacity; (viii) the ability, considering regulation and market demand, to export oil and liquefied natural gas and NGLs from North America; (ix) the effect of world-wide energy conservation and greenhouse gas reduction measures and the price and availability of alternative fuels; and (x) government regulations. Certain wells or other projects may become uneconomic as a result of a decline in world oil prices and natural gas prices, leading to a reduction in the future volume of Kelt's oil and gas production. Kelt might also elect not to produce from certain wells at lower prices. All these factors could result in a material decrease in Kelt's future net production revenue, causing a reduction in its oil and gas acquisition and development activities. In addition, bank borrowings available to Kelt will be in part determined by the borrowing base of Kelt. A sustained material decline in prices from historical average prices could reduce Kelt's future borrowing base, therefore reducing the bank credit available to Kelt, and could require that a portion of any existing bank debt of Kelt be repaid.

In addition to establishing markets for its oil and natural gas, Kelt must also successfully market its oil and natural gas to prospective buyers. The marketability and price of oil and natural gas which may be acquired or discovered by Kelt will be affected by numerous factors beyond its control. Kelt will be affected by the differential between the price paid by refiners for light quality oil and the grades of oil produced by Kelt. The ability of Kelt to market natural gas may depend upon its ability to acquire space on pipelines which deliver natural gas to commercial markets. Kelt will also likely be affected by deliverability uncertainties related to the proximity of its reserves to pipelines and processing facilities and related to operational problems with such pipelines and facilities and extensive government regulation relating to price, taxes, royalties, land tenure, allowable production, the export of oil and natural gas and the management of other aspects of the oil and natural gas business. Kelt has limited direct experience in the marketing of oil and natural gas.

#### *Exploration, Development and Production Risks*

Oil and natural gas operations involve many risks that even a combination of experience, knowledge and careful evaluation may not be able to overcome. There is no assurance that expenditures made on exploration by the Company will result in new discoveries of oil or natural gas in commercial quantities. It is difficult to project the costs of implementing an exploratory drilling program due to the inherent uncertainties of drilling in unknown formations, the costs associated with encountering various drilling conditions such as over pressured zones and tools lost in the hole, and changes in drilling plans and locations as a result of prior exploratory wells or additional seismic data and interpretations thereof. The long-term commercial success of the Company depends on its ability to find, acquire, develop and commercially produce oil and natural gas reserves. Without the continual addition of new reserves, the Company's existing reserves, and the production from them, will decline over time as the Company produces from such reserves. A future increase in the Company's reserves will depend on both the ability of the Company to explore and develop its existing properties and on its ability to select and acquire suitable producing properties or prospects. There is no assurance that the Company will be able continue to find satisfactory properties to acquire or participate in. Moreover, management of the Company may determine that current markets, terms of acquisition, participation or pricing conditions make potential acquisitions or participations uneconomic. There is also no assurance that the Company will discover or acquire further commercial quantities of oil and natural gas.

Future oil and gas exploration may involve unprofitable efforts, not only from dry wells but from wells that are productive but do not produce sufficient net revenues to return a profit after drilling, completing, operating and other costs. Completion of a well does not assure a profit on the investment or recovery of drilling, completion and operating costs.

Drilling hazards or environmental damage could greatly increase the cost of operations and various field operating conditions may adversely affect the production from successful wells. These conditions include, but are not limited to, delays in obtaining governmental approvals or consents, shut-ins of connected wells resulting from extreme weather conditions, insufficient storage or transportation capacity or other geological and mechanical conditions. While diligent well supervision and effective maintenance operations can contribute to maximizing production rates over time, it is not possible to eliminate production delays and declines from normal field operating conditions, which can negatively affect revenue and cash flow levels to varying degrees.

Oil and natural gas exploration, development and production operations are subject to all the risks and hazards typically associated with such operations, including, but not limited to, fire, explosion, blowouts, cratering and spills or other environmental hazards. These typical risks and hazards could result in substantial damage to oil and natural gas wells, production facilities, other property, the environment and personal injury.

Oil and natural gas production operations are also subject to all the risks typically associated with such operations, including encountering unexpected formations or pressures, premature decline of reservoirs and the invasion of water into producing formations. Losses resulting from the occurrence of any of these risks may have a material adverse effect on the Company's business, financial condition, results of operations and prospects.

As is standard industry practice, the Company is not fully insured against all risks, nor are all risks insurable. Although the Company maintains liability insurance in an amount that it considers consistent with industry practice, liabilities associated with certain risks could exceed policy limits or not be covered. In either event the Company could incur significant costs. See *"Business Risks – Insurance"*.

#### *Possible Failure to Realize Anticipated Benefits of Acquisitions and Dispositions*

As part of its ongoing strategy, the Company may complete acquisitions of assets or other entities in the future. Achieving the benefits of completed and future acquisitions depends in part on successfully consolidating functions and integrating operations, procedures and personnel in a timely and efficient manner, as well as the Company's ability to realize the anticipated growth opportunities and synergies from combining the acquired businesses and operations with those of the Company. The integration of acquired businesses and entities requires the dedication of substantial management effort, time and resources which may divert management's focus and resources from other strategic opportunities and from operational matters during this process. The integration process may result in the loss of key employees and the disruption of ongoing business, customer and employee relationships that may adversely affect the Company's ability to achieve the anticipated benefits of any acquisitions. In addition, non-core assets may be periodically disposed of so the Company can focus its efforts and resources more efficiently. Depending on the state of the market for such non-core assets, certain non-core assets of the Company, if disposed of, may realize less than their carrying value on the financial statements of the Company.

#### *Capital Markets*

Kelt, along with all other oil and gas entities, may have restricted access to capital, bank debt and equity. The lending capacity of all financial institutions has diminished and risk premiums have increased. As future capital expenditures will be financed out of funds generated from operations, non-core property dispositions, borrowings and possible future equity sales, Kelt's ability to do so is dependent on, among other factors, the overall state of capital markets and investor appetite for investments in the energy industry and Kelt's securities in particular.

To the extent that external sources of capital become limited or unavailable or available on onerous terms, Kelt's ability to make capital investments and maintain existing assets may be impaired, and its assets, liabilities, business, financial condition and results of operations may be materially and adversely affected as a result.

Based on current funds available and expected funds generated from operations, Kelt believes it has sufficient funds available to fund its projected capital expenditures. However, if funds generated from operations are lower than expected or capital costs for these projects exceed current estimates, or if Kelt incurs major unanticipated expense related to development or maintenance of its existing properties, it may be required to seek additional capital to

maintain its capital expenditures at planned levels. Failure to obtain any financing necessary for Kelt's capital expenditure plans may result in a delay in development or production on Kelt's properties.

#### *Impact of Future Financings on Market Price*

In order to finance future operations or acquisitions opportunities, the Company may raise funds through the issuance of common shares or the issuance of debt instruments or securities convertible into common shares. The Company cannot predict the size of future issuances of common shares or the issuance of debt instruments or other securities convertible into common shares or the effect, if any, that future issuances and sales of the Company's securities will have on the market price of the common shares.

#### *Regulatory*

Various levels of governments impose extensive controls and regulations on oil and natural gas operations (exploration, production, pricing, marketing and transportation). Governments may regulate or intervene with respect to exploration and production activities, prices, taxes, royalties and the exportation of oil and natural gas. Amendments to these controls and regulations may occur from time to time in response to economic or political conditions. The implementation of new regulations or the modification of existing regulations affecting the oil and natural gas industry could reduce demand for crude oil and natural gas and increase the Company's costs, either of which may have a material adverse effect on the Company's business, financial condition, results of operations and prospects.

In addition to regulatory requirements pertaining to the production, marketing and sale of oil and natural gas mentioned above, the Company's business and financial condition could be influenced by federal legislation affecting, in particular, foreign investment, through legislation such as the *Competition Act* (Canada) and the *Investment Canada Act* (Canada).

#### *Royalty Regimes*

There can be no assurance that the federal government and the provincial governments of the western provinces will not adopt a new or modify the royalty regime which may have an impact on the economics of the Company's projects. An increase in royalties would reduce the Company's earnings and could make future capital investments, or the Company's operations, less economic.

#### *Insurance*

Kelt's involvement in the exploration for and development of oil and gas properties may result in Kelt becoming subject to liability for pollution, blow-outs, property damage, personal injury and other hazards. Although Kelt has obtained insurance in accordance with industry standards to address such risks, such insurance has limitations on liability that may not be sufficient to cover the full extent of such liabilities. In addition, such risks may not, in all circumstances be insurable or, in certain circumstances, Kelt may elect not to obtain insurance to deal with specific risks due to the high premiums associated with such insurance or for other reasons. The payment of such uninsured liabilities would reduce the funds available to Kelt. The occurrence of a significant event that Kelt is not fully insured against, or the insolvency of the insurer of such event, could have a material adverse effect on Kelt's financial position, results of operations or prospects.

#### *Operational Dependence*

Other companies operate some of the assets in which Kelt has an interest. As a result, Kelt will have limited ability to exercise influence over the operation of those assets or their associated costs, which could adversely affect Kelt's financial performance. Kelt's return on assets operated by others will therefore depend upon a number of factors that may be outside of Kelt's control, including the timing and amount of capital expenditures, the operator's expertise and financial resources, the approval of other participants, the selection of technology and risk management practices.

In addition, due to the current low and volatile commodity prices, many companies, including companies that may operate some of the assets in which Kelt has an interest, may be in financial difficulty, which could impact their ability to fund and pursue capital expenditures, carry out their operations in a safe and effective manner and satisfy regulatory requirements with respect to abandonment and reclamation obligations. If companies that operate some of the assets in which Kelt has an interest fail to satisfy regulatory requirements with respect to abandonment and reclamation obligations, Kelt may be required to satisfy such obligations and to seek recourse from such companies.

To the extent that any of such companies go bankrupt, become insolvent or make a proposal or institute any proceedings relating to bankruptcy or insolvency, it could result in such assets being shut-in, Kelt potentially becoming subject to additional liabilities relating to such assets and Kelt having difficulty collecting revenue due from such operators. Any of these factors could materially adversely affect Kelt's financial and operational results.

#### *Project Risks*

Kelt manages a variety of small and large projects in the conduct of its business. Project delays may delay expected revenues from operations. Significant project cost over-runs could make a project uneconomic. Kelt's ability to execute projects and market oil and natural gas will depend upon numerous factors beyond Kelt's control, including: the availability of processing capacity; the availability and proximity of pipeline capacity; the availability of storage capacity; the supply of and demand for oil and natural gas; the availability of alternative fuel sources; the effects of inclement weather; the availability of drilling and related equipment; unexpected cost increases; accidental events; currency fluctuations; changes in regulations; the availability and productivity of skilled labour; and the regulation of the oil and natural gas industry by various levels of government and governmental agencies. Because of these factors, Kelt could be unable to execute projects on time, on budget or at all, and may not be able to effectively market the oil and natural gas that it produces.

#### *Gathering and Processing Facilities and Pipeline Systems*

The Company delivers its products through gathering, processing and pipeline systems some of which it does not own. The amount of oil and natural gas that the Company can produce and sell is subject to the accessibility, availability, proximity and capacity of these gathering, processing and pipeline systems. The lack of availability of capacity in any of the gathering, processing and pipeline systems, and in particular the processing facilities, could result in the Company's inability to realize the full economic potential of its production or in a reduction of the price offered for the Company's production. Although pipeline expansions are ongoing, the lack of firm pipeline capacity continues to affect the oil and natural gas industry and limit the ability to produce and to market oil and natural gas production. In addition, the pro-rationing of capacity on inter-provincial pipeline systems also continues to affect the ability to export oil and natural gas. Unexpected shut downs or curtailment of capacity of pipelines for maintenance or integrity work because of actions taken by regulators could also affect the Company's production, operations and financial results. Furthermore, producers are increasingly turning to rail as an alternative means of transportation. In recent years, the volume of crude oil shipped by rail in North America has increased dramatically. Any significant change in market factors or other conditions affecting these infrastructure systems and facilities, as well as any delays in constructing new infrastructure systems and facilities could harm the Company's business and, in turn, the Company's financial condition, results of operations and cash flows.

Following major accidents in Lac-Mégantic, Quebec and North Dakota, the Transportation Safety Board of Canada and the U.S. National Transportation Board have recommended additional regulations for railway tank cars carrying crude oil. In June 2015, as a result of these recommendations, the Government of Canada passed the *Safe and Accountable Rail Act* which increased insurance obligations on the shipment of crude oil by rail and imposed a per tonne levy of \$1.65 on crude oil shipped by rail to compensate victims and for environmental cleanup in the event of a railway accident. In addition to this legislation, new regulations have implemented the TC-117 standard for all rail tank cars carrying flammable liquids which formalized the commitment to retrofit, and eventually phase out DOT-111 tank cars carrying crude oil. The increased regulation of rail transportation may reduce the ability of railway lines to alleviate pipeline capacity issues and add additional costs to the transportation of crude oil by rail. On July 13, 2016, the Minister of Transport (Canada) issued Protective Direction No. 38, which directed that the shipping of crude oil on D07-111 tank cars end by November 1, 2016. Tank cars entering Canada from the United States will be monitored to ensure that they are compliant with Protective Direction No. 38.

A portion of the Company's production may, from time to time, be processed through facilities owned by third parties and over which the Company does not have control. From time to time these facilities may discontinue or decrease operations either as a result of normal servicing requirements or as a result of unexpected events. A discontinuation or decrease of operations could materially adversely affect the Company's ability to process its production and to deliver the same for sale.

#### *Variations in Foreign Exchange Rates and Insurance Rates*

World oil and gas prices are quoted in United States dollars and the price received by Canadian producers is therefore affected by the Canadian/U.S. dollar exchange rate, which will fluctuate over time. In recent years, the Canadian dollar increased materially in value against the United States dollar. More recently, the Canadian dollar has seen a material decrease in value against the United States dollar. Any material increases in the value of the Canadian dollar may negatively impacted Kelt's operating entities production revenues. Any increase in the future Canadian/United States exchange rates could accordingly impact the future value of Kelt's reserves as determined by independent evaluators.

To the extent that Kelt engages in risk management activities related to foreign exchange rates, there is a credit risk associated with counterparties with which Kelt may contract. An increase in interest rates could result in a significant increase in the amount Kelt pays to service debt, which could negatively impact the market price of the common shares.

#### *Substantial Capital Requirements; Liquidity*

Kelt anticipates that it will make substantial capital expenditures for the acquisition, exploration development and production of oil and natural gas reserves in the future. If Kelt's future revenues or reserves decline, Kelt may have limited ability to expend the capital necessary to undertake or complete future drilling programs. There can be no assurance that debt or equity financing, or cash generated by operations will be available or sufficient to meet these requirements or for other corporate purposes or, if debt or equity financing is available, that it will be on terms acceptable to Kelt. Moreover, future activities may require Kelt to alter its capitalization significantly. The inability of Kelt to access sufficient capital for its operations could have a material adverse effect on Kelt's financial condition, results of operations or prospects.

#### *Additional Funding Requirements*

Kelt's cash flow from its reserves may not be sufficient to fund its ongoing activities at all times. From time to time, Kelt may require additional financing in order to carry out its oil and gas acquisition, exploration and development activities. Failure to obtain such financing on a timely basis could cause Kelt to forfeit its interest in certain properties, miss certain acquisition opportunities and reduce or terminate its operations. If Kelt's revenues from its reserves decrease as a result of lower oil and natural gas prices or otherwise, it will affect Kelt's ability to expend the necessary capital to replace its reserves or to maintain its production. If Kelt's cash flow from operations is not sufficient to satisfy its capital expenditure requirements, there can be no assurance that additional debt or equity financing will be available to meet these requirements or be available on favourable terms. Any equity financing may result in a change of control of Kelt or holders of common shares suffering further dilution. Continued uncertainty in domestic and international credit markets could materially affect Kelt's ability to access sufficient capital for its capital expenditures and acquisitions, and as a result, may have a material adverse effect on Kelt's ability to execute its business strategy and on its business, financial condition, results of operations and prospects.

#### *Issuance of Debt*

From time to time Kelt may enter into transactions to acquire assets or the shares of other corporations. These transactions may be financed partially or wholly with debt, which may increase Kelt's debt levels above industry standards. Neither Kelt's articles nor its bylaws limit the amount of indebtedness that Kelt may incur. The level of Kelt's indebtedness from time to time could impair Kelt's ability to obtain additional financing in the future on a timely basis to take advantage of business opportunities that may arise. Kelt's ability to meet its debt service obligations will depend on Kelt's future operations which are subject to prevailing industry conditions and other factors, many of which are beyond the control of Kelt. As certain of the indebtedness of Kelt bears interest at rates which fluctuate with prevailing interest rates, increases in such rates would increase Kelt's interest payment obligations and could have a material adverse effect on Kelt's financial condition and results of operations. Further, Kelt's indebtedness is secured by substantially all of Kelt's assets. In the event of a violation by Kelt of any of its loan covenants or any other default by Kelt on its obligations relating to its indebtedness, the lender could declare such indebtedness to be immediately due and payable and, in certain cases, foreclose on Kelt's assets.



### *Hedging*

From time to time Kelt may enter into agreements to receive fixed prices on its oil and natural gas production to offset risk of revenue losses if commodity prices decline; however, if commodity prices increase beyond the levels set in such agreements, Kelt will not benefit from such increases. Similarly, from time to time Kelt may enter into agreements to fix the exchange rate of Canadian to United States dollars in order to offset the risk of revenue losses if the Canadian dollar increases in value compared to the United States dollar, however, if the Canadian dollar declines in value compared to the United States dollar, Kelt will not benefit from its fluctuating exchange rate. In addition, from time to time, Kelt may enter into agreements to fix the interest rate on its debt to offset the risk of higher interest expenses during a period of rising borrowing costs, however, if borrowing costs decline, Kelt will not be able to benefit from such declines.

### *Competition*

The oil and gas industry is highly competitive. Kelt actively competes for reserve acquisitions, exploration leases, licences and concessions and skilled industry personnel with a substantial number of other oil and gas entities, many of which have significantly greater financial resources, staff and facilities than Kelt. Kelt's competitors include integrated oil and natural gas companies and numerous other independent oil and natural gas companies and individual producers and operators. Certain of Kelt's customers and potential customers may themselves explore for oil and natural gas and the results of such exploration efforts could affect Kelt's ability to sell or supply oil or gas to these customers in the future. Kelt's ability to successfully bid on and acquire additional property rights, to discover reserves to participate in drilling opportunities and to identify and enter into commercial arrangements with customers will be dependent upon developing and maintaining close working relationships with its future industry partners and joint operators and its ability to select and evaluate suitable properties and to consummate transactions in a highly competitive environment. Competitive factors in the distribution and marketing of oil and natural gas include price and methods and reliability of delivery and storage. Competition may also be presented by alternate fuel sources.

### *Cost of New Technologies*

The oil industry is characterized by rapid and significant technological advancements and introductions of new products and services utilizing new technologies. Other oil and gas companies may have greater financial, technical and personnel resources that allow them to enjoy technological advantages and may in the future allow them to implement new technologies before the Company. There can be no assurance that the Company will be able to respond to such competitive pressures and implement such technologies on a timely basis or at an acceptable cost. One or more of the technologies currently utilized by the Company or implemented in the future may become obsolete. In such case, the Company's business, financial condition and results of operations could be materially adversely affected. If the Company is unable to utilize the most advanced commercially available technology, its business, financial condition and results of operations could be materially adversely affected.

### *Alternatives to and Changing Demand for Petroleum Products*

Fuel conservation measures, alternative fuel requirements, increasing consumer demand for alternatives to oil and natural gas, and technological advances in fuel economy and energy generation devices could reduce the demand for crude oil and other liquid hydrocarbons. Kelt cannot predict the impact of changing demand for oil and natural gas products, and any major changes may have a material adverse effect on Kelt's business, financial condition, results of operations and cash flows.

### *Title*

Title to oil and natural gas interests is often not capable of conclusive determination without incurring substantial expense. In accordance with industry practice, Kelt will conduct such title reviews in connection with its principal properties as it believes are commensurate with the value of such properties. However, no absolute assurances can be given that title defects do not exist. If title defects do exist, it is possible that Kelt may lose all or a portion of its right title and interest in and to the properties to which the title defects relate.

### *Environmental Risks*

All phases of the oil and natural gas business present environmental risks and hazards and are subject to environmental regulation pursuant to a variety of international conventions and federal, provincial and municipal laws

and regulations. Environmental legislation provides for, among other things, restrictions and prohibitions on spills, releases or emissions of various substances produced in association with oil and gas operations. The legislation also requires that wells and facility sites be operated, maintained, abandoned and reclaimed to the satisfaction of applicable regulatory authorities. Compliance with such legislation can require significant expenditures and a breach may result in the imposition of fines and penalties, some of which may be material. Environmental legislation is evolving in a manner expected to result in stricter standards and enforcement, larger fines and liability and potentially increased capital expenditures and operating costs. The discharge of oil, natural gas or other pollutants into the air, soil or water may give rise to liabilities to foreign governments and third parties and may require Kelt to incur costs to remedy such discharge. No assurance can be given that the application of environmental laws to the business and operations of Kelt will not result in a curtailment of production or a material increase in the costs of production, development or exploration activities or otherwise adversely affect Kelt's financial condition, results of operations or prospects.

#### *Climate Change*

Climate change policy is evolving at regional, national and international levels, and political and economic events may significantly affect the scope and timing of climate change measures that are ultimately put in place. The federal and certain provincial governments have implemented legislation aimed at incentivizing the use of alternative fuels and in turn reducing carbon emissions. The taxes placed on carbon emissions may have the effect of decreasing the demand for oil and natural gas products and at the same time, increasing the Company's operating expenses, each of which may have a material adverse effect on the Company's profitability and financial condition. Further, the imposition of carbon taxes puts us at a disadvantage with the Company's counterparts who operate in jurisdictions where there are less costly carbon regulations.

Adverse impacts to the Company's business as a result of comprehensive carbon emission legislation or regulation applied to the Company's business in Alberta or any jurisdiction in which the Company operates, may include, but are not limited to: (i) increased compliance costs; (ii) permitting delays; (iii) substantial costs to generate or purchase emission credits or allowances adding costs to the products the Company produces; and (iv) reduced demand for crude oil and certain refined products. Emission allowances or offset credits may not be available for acquisition or may not be available on an economic basis. Required emission reductions may not be technically or economically feasible to implement, in whole or in part, and failure to meet such emission reduction requirements or other compliance mechanisms may have a material adverse effect on the Company's business resulting in, among other things, fines, permitting delays, penalties and the suspensions of operations.

#### *Reserve Estimates*

There are numerous uncertainties inherent in estimating quantities of oil, natural gas and NGL reserves and cash flows to be derived therefrom, including many factors beyond Kelt's control. The information concerning reserves and associated cash flow set forth in this MD&A represents estimates only. In general, estimates of economically recoverable oil and natural gas reserves and the future net cash flows therefrom are based upon a number of variable factors and assumptions, such as historical production from the properties, production rates, ultimate reserve recovery, timing and amount of capital expenditures, marketability of oil and natural gas, royalty rates, the assumed effects of regulation by governmental agencies and future operating costs, all of which may vary from actual results. For those reasons, estimates of the economically recoverable oil and natural gas reserves attributable to any particular group of properties, classification of such reserves based on risk of recovery and estimates of future net revenues expected therefrom prepared by different engineers, or by the same engineers at different times, may vary. Kelt's actual production, revenues, taxes and development and operating expenditures with respect to its reserves will vary from estimates thereof and such variations could be material. Further, the evaluations are based, in part, on the assumed success of the exploitation activities intended to be undertaken in future years. The reserves and estimated cash flows to be derived therefrom contained in such evaluations will be reduced to the extent that such exploitation activities do not achieve the level of success assumed in the evaluation.

In accordance with applicable securities laws, Sproule has used forecast price and cost estimates in calculating reserve quantities. Actual future net cash flows will be affected by other factors such as actual production levels, supply and demand for oil and natural gas, curtailments or increases in consumption by oil and natural gas purchasers, changes in governmental regulation or taxation and the impact of inflation on costs. Actual production and cash flows derived therefrom will vary from the estimates contained in the Sproule Report, and such variations

could be material. The Sproule Report is based in part on the assumed success of activities Kelt intends to undertake in future years. The reserves and estimated cash flows to be derived therefrom contained in the Sproule Report will be reduced to the extent that such activities do not achieve the level of success assumed in the Sproule Report.

The Sproule Report is effective as of a specific effective date and has not been updated and thus does not reflect changes in Kelt's reserves since that date.

#### *Reserve Replacement*

Kelt's future oil and natural gas reserves, production, and cash flows to be derived therefrom are highly dependent on Kelt successfully acquiring or discovering new reserves. Without the continual addition of new reserves, any existing reserves Kelt may have at any particular time and the production therefrom will decline over time as such existing reserves are exploited. A future increase in Kelt's reserves will depend not only on Kelt's ability to develop any properties it may have from time to time, but also on its ability to select and acquire suitable producing properties or prospects. There can be no assurance that Kelt's future exploration and development efforts will result in the discovery and development of additional commercial accumulations of oil and natural gas.

#### *Reliance on Key Personnel*

Kelt's future success depends in large measure on certain key personnel. The exploration for, and the development and production of, oil and natural gas with respect to its assets requires experienced executive and management personnel and operational employees and contractors with expertise in a wide range of areas. There can be no assurance that all of the required employees and contractors with the necessary expertise will be available. Further, the loss of any key personnel may have a material adverse effect on Kelt's business, financial condition, results of operations and prospects. Kelt currently does not have any "key man" insurance in place.

Any inability on the part of Kelt to attract and retain qualified personnel may delay or interrupt the exploration for, and development and production of, oil and natural gas with respect to Kelt's assets. Sustained delays or interruptions could have a material adverse effect on the financial condition and performance of Kelt. In addition, rising personnel costs would adversely impact the costs associated with the exploration for, and development and production of, oil and natural gas in respect of Kelt's assets, which could be significant and material.

#### *Management of Growth*

Kelt may be subject to growth-related risks including capacity constraints and pressure on its internal systems and controls. The ability of Kelt to manage growth effectively will require it to continue to implement and improve its operations and financial systems and to expand, train and manage its employee base. The inability of Kelt to deal with this growth could have a material adverse impact on its business, operations and prospects.

#### *Permits and Licenses*

The operations of Kelt may require licenses and permits from various governmental authorities. There can be no assurance that Kelt will be able to obtain all necessary licenses and permits that may be required to carry out exploration and development at its projects. Further, if the Company or the holder of the licence or lease fails to meet the specific requirement of a licence or lease, the licence or lease may terminate or expire. There can be no assurance that any of the obligations required to maintain each licence or lease will be met. The termination or expiration of the Company's licenses or leases or the working interests relating to a licence or lease may have a material adverse effect on the Company's business, financial condition, results of operations and prospects.

#### *Liability Management*

Alberta and British Columbia have developed liability management programs designed to prevent taxpayers from incurring costs associated with suspension, abandonment, remediation and reclamation of wells, facilities and pipelines in the event that a licensee or permit holder becomes defunct. These programs generally involve an assessment of the ratio of a licensee's deemed assets to deemed liabilities. If a licensee's deemed liabilities exceed its deemed assets, a security deposit is required. Changes of the ratio of Kelt's deemed assets to deemed liabilities or changes to the requirements of liability management programs may result in significant increases to the security that must be posted. In addition, the liability management system may prevent or interfere with Kelt's ability to acquire or dispose of assets as both the vendor and the purchaser of oil and gas assets must be in compliance with the

liability management programs (both before and after the transfer of the assets) for the applicable regulatory agency to allow for the transfer of such assets.

#### *Availability of Drilling Equipment and Access Restrictions*

Oil and natural gas exploration and development activities are dependent on the availability of drilling and related equipment in the particular areas where such activities will be conducted. Demand for such limited equipment or access restrictions may affect the availability of such equipment to Kelt and may delay exploration and development activities.

#### *Aboriginal Claims*

Aboriginal peoples have claimed aboriginal title and rights to portions of western Canada. Kelt is not aware that any claims have been made in respect of its property and assets; however, if a claim arose and was successful this could have an adverse effect on Kelt and its operations.

#### *Global Financial Markets*

Market events and conditions, including disruptions in the international credit markets and other financial systems, and the deterioration of global economic conditions caused significant volatility to commodity prices over the last few years. These conditions have resulted in a loss of confidence in the broader U.S. and global credit and financial markets and resulting in the collapse of, and government intervention in, major banks, financial institutions and insurers and creating a climate of greater volatility, less liquidity, widening of credit spreads, a lack of price transparency, increased credit losses and tighter credit conditions. Notwithstanding various actions by governments, concerns about the general condition of the capital markets, financial instruments, banks, investment banks, insurers and other financial institutions caused the broader credit markets to further deteriorate and stock markets to decline substantially. These factors have negatively impacted company valuations and may continue to impact the performance of the global economy going forward.

If the economic climate in the U.S. or the world generally deteriorates further, demand for petroleum products could diminish further and prices for oil and natural gas could decrease further, which could adversely impact Kelt's results of operations, liquidity and financial condition.

#### *Seasonality*

The level of activity in the Canadian oil and gas industry is influenced by seasonal weather patterns. Wet weather and spring thaw may make the ground unstable. Consequently, municipalities and provincial transportation departments enforce road bans that restrict the movement of rigs and other heavy equipment, thereby reducing activity levels. Also, certain oil and gas producing areas are located in areas that are inaccessible other than during the winter months because the ground surrounding the sites in these areas consists of swampy terrain. There can be no assurance that these seasonal factors will not adversely affect the timing and scope of Kelt's exploration and development activities, which could in turn have a material adverse impact on Kelt's business, operations and prospects.

#### *Third Party Credit Risk*

Kelt is, or may be exposed to, third party credit risk through its contractual arrangements with its current or future joint venture partners, marketers of its petroleum and natural gas production and other parties. In the event such entities fail to meet their contractual obligations to Kelt, such failures could have a material adverse effect on Kelt and its cash flow from operations. In addition, poor credit conditions in the industry and of joint venture partners may impact a joint venture partner's willingness to participate in Kelt's ongoing capital program, potentially delaying the program and the results of such program until Kelt finds a suitable alternative partner.

#### *Hydraulic Fracturing*

Concern has been expressed over the potential environmental impact of hydraulic fracturing operations, including water aquifer contamination and other qualitative and quantitative effects on water resources as large quantities of water are used and injected fluids either remain underground or flow back to the surface to be collected, treated and disposed of. Regulatory authorities in certain jurisdictions have announced initiatives in response to such concerns. Federal, provincial and local legislative and regulatory initiatives relating to hydraulic fracturing, as well as

governmental reviews of such activities could result in increased costs, additional operating restrictions or delays, and adversely affect Kelt's production. Public perception of environmental risks associated with hydraulic fracturing can further increase pressure to adopt new laws, regulation or permitting requirements or lead to regulatory delays, legal proceedings and/or reputational impacts. Any new laws, regulations or permitting requirements regarding hydraulic fracturing could lead to operational delay, increased operating costs, and third-party or governmental claims. They could also increase Kelt's costs of compliance and doing business as well as delay the development of hydrocarbon (natural gas and oil) resources from shale formations, which may not be commercial without the use of hydraulic fracturing. Restrictions on hydraulic fracturing could also reduce the amount of oil and natural gas that Kelt is ultimately able to produce from its reserves.

In the event federal, provincial, local, or municipal legal restrictions are adopted in areas where Kelt is currently conducting, or in the future plan to conduct operations, Kelt may incur additional costs to comply with such requirements that may be significant in nature, experience delays or curtailment in the pursuit of exploration, development, or production activities, and perhaps even be precluded from the drilling of wells. In addition, if hydraulic fracturing becomes more regulated, Kelt's fracturing activities could become subject to additional permitting requirements and result in permitting delays as well as potential increases in costs. Restrictions on hydraulic fracturing could also reduce the amount of oil and natural gas that Kelt is ultimately able to produce from its reserves.

#### *Political Uncertainty*

In the last several years, the United States and certain European countries have experienced significant political events that have cast uncertainty on global financial and economic markets. The United States has withdrawn from the Trans-Pacific Partnership and the current U.S. administration has indicated its intention to renegotiate or withdraw from the North American Free Trade Agreement ("NAFTA"), the imposition of a tax on the importation of goods into the United States, reduction of regulation and taxation in the United States, and introduction of laws to reduce immigration and restrict access into the United States for citizens of certain countries. It is presently unclear exactly what actions the new administration in the United States will implement, and if implemented, how these actions may impact Canada and in particular the oil and gas industry. Any actions taken by the new United States administration may have a negative impact on the Canadian economy and on the businesses, financial conditions, results of operations and the valuation of Canadian oil and natural gas companies, including the Company.

In addition to the political disruption in the United States, the citizens of the United Kingdom voted to withdraw from the European Union and the Government of the United Kingdom has started taking steps to implement such withdrawal. Some European countries have also experienced the rise of antiestablishment political parties and public protests held against open-door immigration policies, trade and globalization. To the extent that certain political actions taken in North America, Europe and elsewhere in the world result in a marked decrease in free trade, access to personnel and freedom of movement it could have an adverse effect on the Company's ability to market its products internationally, increase costs for goods and services required for third party lessees' operations, reduce their access to skilled labour and as a result, negatively impact the Company's business, operations, financial conditions and the market value of the common shares.

#### *Geo-Political Risks*

The marketability and price of oil and natural gas that may be acquired or discovered by Kelt is and will continue to be affected by political events throughout the world that cause disruptions in the supply of oil. Conflicts, or conversely peaceful developments, arising in the Middle East, and other areas of the world, have a significant impact on the price of oil and natural gas. Any particular event could result in a material decline in prices and therefore result in a reduction of Kelt's net production revenue.

In addition, Kelt's expected oil and natural gas properties, wells and facilities could be subject to a terrorist attack. As the oil and gas industry in Canada is a key supplier of energy to the United States, certain terrorist groups may target Canadian oil and gas properties, wells and facilities in an effort to choke the United States economy. If any of Kelt's properties, wells or facilities are the subject of terrorist attack it could have a material adverse effect on Kelt. Kelt does not have insurance to protect against the risk from terrorism.

### *Tax Horizon*

It is expected, based upon current legislation, the projections contained in the Sproule Report and various other assumptions that no cash income taxes are to be paid by Kelt in the near future. If a lower level of capital expenditures than those contained in the Sproule Report is incurred or, should the assumptions used by Kelt prove to be inaccurate, Kelt may be required to pay cash income taxes sooner than anticipated, which will reduce cash flow available to Kelt.

### *Potential Conflicts of Interest*

There may be circumstances in which the interests of Kelt and its affiliates will conflict with those of shareholders. Kelt and its affiliates may acquire oil and natural gas properties on their own behalf or on behalf of persons other than the shareholders. Neither Kelt, nor its management, will carry on their full time activity on behalf of shareholders and, when acting on their own behalf or on behalf of others, may at times act in competition with the interests of shareholders.

In the event of such conflicts, decisions will be made on a basis consistent with the provisions of any relevant contractual arrangements and objectives and financial resources of each group of interested parties. Kelt will use all reasonable efforts to resolve such conflicts of interest in a manner which will treat Kelt, and the other interested party, fairly taking into account all of the circumstances of Kelt and such interested party and to act honestly and in good faith in resolving such matters.

Circumstances may arise where members of the Board of Directors are directors or officers of corporations which are in competition to the interests of Kelt. No assurances can be given that opportunities identified by such board members will be provided to Kelt.

Certain directors of Kelt are also directors of other oil and gas companies and as such may, in certain circumstances, have a conflict of interest requiring them to abstain from certain decisions. Conflicts, if any, will be subject to the procedures and remedies of the *Business Corporations Act* (Alberta).

### *Internal Controls*

Effective internal controls are necessary for Kelt to provide reliable financial reports and to help prevent fraud. Although Kelt will undertake a number of procedures in order to help ensure the reliability of its financial reports, including those imposed on it under Canadian securities laws, Kelt cannot be certain that such measures will ensure that Kelt will maintain adequate control over financial processes and reporting.

Failure to implement required new or improved controls, or difficulties encountered in their implementation, could harm Kelt's results of operations or cause it to fail to meet its reporting obligations. If Kelt or its independent auditors discover a material weakness, the disclosure of that fact, even if quickly remedied, could reduce the market's confidence in Kelt financial statements and harm the trading price of the common shares.

### *Dividends*

To date, Kelt has not paid any dividends on its common shares and does not anticipate the payment of any dividends on its common shares for the foreseeable future, though it is a possibility that the Company may pay dividends in the future if it has started generating sufficient positive cash flow. Any future determination to pay dividends will be at the discretion of the Board and will depend on the financial condition, business environment, operating results, capital requirements, any contractual restrictions on the payment of dividends and any other factors that the Board deems relevant.

### *Dilution*

Kelt may make future acquisitions or enter into financings or other transactions involving the issuance of securities of Kelt which may be dilutive. common shares, including rights, warrants, special warrants, subscription receipts and other securities to purchase, to convert into or to exchange into common shares, may be created, issued, sold and delivered on such terms and conditions and at such times as the Board of Directors may determine. In addition, the Company may issue additional common shares from time to time pursuant to the Company's stock option plan or restricted share unit plan. The issuance of these common shares would result in dilution to holders of common shares.

### *Litigation*

In the normal course of the Company's operations, it may become involved in, named as a party to, or be the subject of, various legal proceedings, including regulatory proceedings, tax proceedings and legal actions, related to personal injuries, property damage, property tax, land rights, the environment and contract disputes. The outcome of outstanding, pending or future proceedings cannot be predicted with certainty and may be determined adversely to the Company and as a result, could have a material adverse effect on the Company's assets, liabilities, business, financial condition and results of operations.

### *Breach of Confidentiality*

While discussing potential business relationships or other transactions with third parties, the Company may disclose confidential information relating to the business, operations or affairs of the Company. Although confidentiality agreements are signed by third parties prior to the disclosure of any confidential information, a breach could put the Company at competitive risk and may cause significant damage to its business. The harm to the Company's business from a breach of confidentiality cannot presently be quantified, but may be material and may not be compensable in damages. There is no assurance that, in the event of a breach of confidentiality, the Company will be able to obtain equitable remedies, such as injunctive relief, from a court of competent jurisdiction in a timely manner, if at all, in order to prevent or mitigate any damage to its business that such a breach of confidentiality may cause.

### *Volatility of Market Price of common shares*

The market price of the common shares may be volatile. The volatility may affect the ability of holders to sell the common shares at an advantageous price. Market price fluctuations in the common shares may be due to the Company's operating results failing to meet the expectations of securities analysts or investors in any quarter, downward revision in securities analysts' estimates, governmental regulatory action, adverse change in general market conditions or economic trends, acquisitions, dispositions or other material public announcements by the Company or its competitors, along with a variety of additional factors, including, without limitation, those set forth under the heading of "Advisory Regarding Forward-Looking Statements" in this MD&A. In addition, the market price for securities in the stock markets, including the TSX, has recently experienced significant price and trading fluctuations. These fluctuations have resulted in volatility in the market prices of securities that are often unrelated or disproportionate to changes in operating performance. These broad market fluctuations may adversely affect the market prices of the common shares.

### *Information Technology Systems and Cyber-Security*

The Company relies heavily on information technology, such as computer hardware and software systems, in order to properly operate its business. In the event the Company is unable to regularly deploy software and hardware, effectively upgrade systems and network infrastructure, and take other steps to maintain or improve the efficiency and efficacy of systems, the operation of such systems could be interrupted or result in the loss, corruption, or release of data, compromise confidential customer or employee information, result in the disruption of business, theft or extortion of funds, regulatory infractions, loss of competitive advantage and reputational damage. In addition, information systems could be damaged or interrupted by natural disasters, force majeure events, telecommunications failures, power loss, acts of war or terrorism, computer viruses, malicious code, physical or electronic security breaches, intentional or inadvertent user misuse or error, or similar events or disruptions. Any of these or other events could cause interruptions, delays, loss of critical and/or sensitive data or similar effects, which could have a material adverse impact on the protection of intellectual property, and confidential and proprietary information, and on the Company's business, financial condition, results of operations and cash flows.

In the ordinary course of business, the Company collects, uses and stores sensitive data, including intellectual property, proprietary business information and personal information of the Company's employees and third parties. Despite the Company's security measures, its information systems, technology and infrastructure may be vulnerable to attacks by hackers and/or cyberterrorists or breaches due to employee error, malfeasance or other disruptions. Any such breach could compromise information used or stored on the Company's systems and/or networks and, as a result, the information could be accessed, publicly disclosed, lost or stolen.

To date the Company has not experienced any material losses relating to cyber-attacks or other information security breaches. However, there can be no assurance that the Company will not incur such losses in the future. Any such

access, disclosure or other loss of information could result in legal claims or proceedings, liability under laws that protect the privacy of personal information, regulatory penalties or other negative consequences, including disruption to the Company's operations and damage to its reputation, which could have a material adverse effect on the Company's business, financial condition, results of operations and cash flows. Although the Company maintains a risk management program, which includes an insurance component that may provide coverage for the operational impacts from an attack to, or breach of, Kelt's information technology and infrastructure, including process control systems, the Company does not maintain stand-alone cyber insurance. Furthermore, not all cyber risks are insurable. As a result, Kelt's existing insurance may not provide adequate coverage for losses stemming from a cyber-attack to, or breach of, its information technology and infrastructure.

#### *Reputation Risk*

The Company relies on its reputation to build and maintain positive relationships with stakeholders, to recruit and retain staff, and to be a credible trusted company. Any actions that Kelt takes that causes a negative public opinion has the potential to negatively impact the Company's reputation which may adversely impact its share price, development plans or its ability to continue operations.

#### *Forward-Looking Statements and Information May Prove Inaccurate*

Shareholders and prospective investors are cautioned not to place undue reliance on the Company's forward-looking statements and information. By its nature, forward-looking statements and information involve numerous assumptions, known and unknown risk and uncertainties, of both a general and specific nature, that could cause actual results to differ materially from those suggested by the forward-looking information or contribute to the possibility that predictions, forecasts or projections will prove to be materially inaccurate. Additional information on the risks, assumptions and uncertainties related to forward-looking statements and information are found under the heading "Advisory Regarding Forward-Looking Statements" in this MD&A.

## **BUSINESS OUTLOOK**

### **ADVISORY REGARDING FORWARD-LOOKING STATEMENTS**

Certain information with respect to Kelt contained herein, including management's assessment of future plans and operations, contains forward-looking statements. These forward-looking statements are based on assumptions and are subject to numerous risks and uncertainties, certain of which are beyond Kelt's control, including the impact of general economic conditions, industry conditions, volatility of commodity prices, currency exchange rate fluctuations, imprecision of reserve estimates, environmental risks, competition from other explorers, stock market volatility and ability to access sufficient capital. As a result, Kelt's actual results, performance or achievement could differ materially from those expressed in, or implied by, these forward-looking statements and, accordingly, no assurance can be given that any events anticipated by the forward-looking statements will transpire or occur.

In addition, the reader is cautioned that historical results are not necessarily indicative of future performance. The forward-looking statements contained herein are made as of the date hereof and the Company does not intend, and does not assume any obligation, to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise unless expressly required by applicable securities laws.

Certain information set out herein may be considered as "financial outlook" within the meaning of applicable securities laws. The purpose of this financial outlook is to provide readers with disclosure regarding Kelt's reasonable expectations as to the anticipated results of its proposed business activities for the periods indicated. Readers are cautioned that the financial outlook may not be appropriate for other purposes.



## CURRENT ECONOMIC ENVIRONMENT

The current economic environment in the energy industry remains volatile, however, positive indicators have started to appear:

- U.S. crude oil inventories continue to decline;
- U.S. natural gas exports (to Mexico and LNG) continue to grow; and
- U.S. natural gas storage is currently below the comparative period of the previous year, and also substantially below the five-year average.

Natural gas infrastructure and capacity constraints have continued to impact realized natural gas prices in domestic western Canadian markets relative to other North American markets. Kelt has taken measures to diversify its gas sales markets in order to mitigate the effect of low prices in Alberta and British Columbia.

In the current business environment, Kelt continues to focus on maintaining a strong balance sheet, giving the Company the ability to take advantage of opportunities as they arise. The Company's capital expenditure program is also flexible, with the ability to defer expenditures into the future if the current economic environment deteriorates rapidly. Kelt continues to be optimistic about the long-term outlook for oil and gas commodity prices.

## OUTLOOK AND GUIDANCE

During the period of low oil and gas prices experienced by the energy industry, Kelt was well positioned to take advantage of opportunities to add value at a reasonable cost. The cost to acquire land at Crown sales in the Company's core operating areas had dropped significantly and service related costs to drill and complete wells had also declined substantially. Kelt has transitioned to development pad drilling in order to take advantage of lower oilfield related service costs and will continue to test newly acquired exploration lands.

### 2018 GUIDANCE

WTI crude oil prices are forecasted to average US\$58.50 per barrel in 2018, up 15% from the average price of US\$50.95 per barrel in 2017. AECO natural gas prices are forecasted to average \$1.96 per GJ in 2018, down 4% from the average price of \$2.04 per GJ in 2017. Kelt is expected to realize a premium (prior to adjusting for heat content) of approximately 33% to the average forecasted AECO price in 2018 as a result of its diversified gas market contracts.

The Company's Board of Directors previously approved a capital expenditure budget of \$210.0 million for 2018 and this approved, budgeted amount is not being changed at this time. Kelt expects to drill 21 gross (20.1 net) wells in 2018, however the Company expects to complete 28 gross (27.1 net) wells in 2018 as there were 7 gross (7.0 net) drilled but un-completed ("DUC") wells carried over into the 2018 program from 2017.

Forecasted average production in 2018 is estimated to be in the range from 28,500 BOE per day to 29,500 BOE per day, representing a 29% to 33% increase from average production of 22,130 BOE per day in 2017. It is estimated that this 2018 forecasted average production will be weighted 47% to oil/NGLs and 53% to gas. However, based on the Company's forecasted commodity prices for 2018, 89% of forecasted operating income in 2018 is expected to be generated from oil and NGLs versus 11% from gas.

Oil and NGL prices have exceeded the Company's estimates for January and February; however, gas prices to date have been lower than forecasted. The Company will re-evaluate its spending plans for the remainder of 2018 after the first quarter. With continued improvement in commodity prices, Kelt may consider increasing its capital program for the balance of 2018 at that time.

After giving effect to the aforementioned production estimates, commodity price assumptions and estimated expenses, funds from operations for 2018 is forecasted to be approximately \$200.0 million or \$1.10 per common share, diluted. Kelt estimates that the Company's bank debt, net of working capital, will be approximately \$140.0 million as at December 31, 2018 (0.7 times forecasted 2018 funds from operations). Royalties are expected to average 10.8% of revenue in 2018. On average during 2018, combined production and transportation expense is estimated to be \$12.86 per BOE (\$9.54 per BOE and \$3.32 per BOE respectively), G&A expense is estimated to be \$0.76 per BOE and interest expense is forecasted at \$0.85 per BOE.

The table below outlines the Company's forecasted financial and operating guidance for 2018 and the comparative to previously announced 2018 guidance included in Kelt's press release dated November 9, 2017:

<i>(CA\$ millions, except as otherwise indicated)</i>	<b>Current 2018 Guidance</b>	Previous 2018 Guidance	Percent Change
Average Production			
Oil & NGLs (bbls/d)	<b>13,400 – 13,900</b>	13,400 - 13,900	N/C
Gas (mmcf/d)	<b>90.6 – 93.6</b>	90.6 - 93.6	N/C
Combined (BOE/d)	<b>28,500 – 29,500</b>	28,500 - 29,500	N/C
Production per million common shares (BOE/d)	<b>158 – 164</b>	159 - 165	
Forecasted Average Commodity Prices			
WTI oil price (US\$/bbl)	<b>58.50</b>	52.00	13%
Canadian Light Sweet (\$/bbl)	<b>69.80</b>	61.52	13%
NYMEX natural gas price (US\$/MMBTU)	<b>3.05</b>	3.15	- 3%
AECO natural gas price (\$/GJ)	<b>1.96</b>	2.15	- 9%
Average Exchange Rate (US\$/CA\$)	<b>0.790</b>	0.794	- 1%
Capital Expenditures			
Drilling & completions	<b>135.0</b>	135.0	N/C
Facilities, pipeline & well equipment	<b>65.0</b>	65.0	N/C
Land, seismic & property acquisitions	<b>10.0</b>	10.0	N/C
Net Capital Expenditures	<b>210.0</b>	210.0	N/C
Funds from operations	<b>200.0</b>	175.0	14%
Per common share, diluted	<b>1.10</b>	0.97	13%
Bank debt, net of working capital, at year-end <sup>(1)</sup>	<b>140.0</b>	155.0	- 10%
Net bank debt to trailing annual funds from operations ratio	<b>0.7 x</b>	0.9 x	- 22%
Weighted average common shares outstanding (millions)	<b>180.0</b>	179.0	1%

(1) In addition to bank debt, the Company has \$90.0 million principal amount of convertible debentures outstanding with a coupon of 5% per annum, maturing May 31, 2021.

Kelt is currently unhedged in 2018. As a result, a 10% increase (decrease) in the Company's forecasted average oil/NGLs price for 2018 would increase (decrease) forecasted funds from operations by approximately \$24.5 million (\$24.7 million). A 10% increase (decrease) in the Company's average gas price forecasted for 2018 would increase (decrease) funds from operations by approximately \$10.4 million (\$10.1 million). An increase (decrease) in the forecasted average exchange rate by CA\$/US\$0.05 would increase (decrease) funds from operations by approximately \$13.5 million (\$13.6 million).

The table below outlines the Company's revised forecasted financial guidance for 2018 compared to actual results for 2017:

<i>(CA\$ millions, except as otherwise indicated)</i>	<b>2018 Guidance</b>	2017 Actual	Change
Average Production			
Oil & NGLs (bbls/d)	<b>13,400 – 13,900</b>	9,242	45% - 50%
Gas (mmcf/d)	<b>90.6 – 93.6</b>	77.3	17% - 21%
Combined (BOE/d)	<b>28,500 – 29,500</b>	22,130	29% - 33%
Production per million common shares (BOE/d)	<b>158 – 164</b>	125	26% - 31%

<i>(CA\$ millions, except as otherwise indicated)</i>	<b>2018 Guidance</b>	2017 Actual	Change
Forecasted Average Commodity Prices			
WTI oil price (US\$/bbl)	<b>58.50</b>	50.95	15%
Canadian Light Sweet (\$/bbl)	<b>69.80</b>	61.85	13%
NYMEX natural gas price (US\$/MMBTU)	<b>3.05</b>	3.07	- 1%
AECO natural gas price (\$/GJ)	<b>1.96</b>	2.04	- 4%
Average Exchange Rate (US\$/CA\$)	<b>0.790</b>	0.770	3%
Capital Expenditures			
Drilling & completions	<b>135.0</b>	154.7	- 13%
Facilities, pipeline & well equipment	<b>65.0</b>	78.0	- 17%
Land, seismic & property acquisitions	<b>10.0</b>	11.6	- 14%
Property dispositions	-	(116.3)	N/A
Net Capital Expenditures	<b>210.0</b>	128.0	64%
Adjusted funds from operations	<b>200.0</b>	108.0	85%
Per common share, diluted	<b>1.10</b>	0.61	80%
Bank debt, net of working capital, at year-end <sup>(1)</sup>	<b>140.0</b>	136.7	2%
Net bank debt to trailing annual funds from operations ratio	<b>0.7 x</b>	1.3 x	- 46%
Weighted average common shares outstanding (millions)	<b>180.0</b>	176.5	2%

(1) In addition to bank debt, the Company has \$90.0 million principal amount of convertible debentures outstanding with a coupon of 5% per annum, maturing May 31, 2021.

Changes in forecasted commodity prices and variances in production estimates can have a significant impact on estimated funds from operations and profit. Please refer to the advisories regarding forward-looking statements and to the cautionary statement below.

The information set out herein is “financial outlook” within the meaning of applicable securities laws. The purpose of this financial outlook is to provide readers with disclosure regarding Kelt’s reasonable expectations as to the anticipated results of its proposed business activities for the calendar year 2018. Readers are cautioned that this financial outlook may not be appropriate for other purposes.

### **ADDITIONAL INFORMATION**

Additional information relating to Kelt, including the Company’s Annual Information Form (“AIF”) dated March 7, 2018 is filed on SEDAR and can be viewed on their website at [www.sedar.com](http://www.sedar.com). Copies of the AIF can also be obtained by contacting Sadiq H. Lalani, Vice President and Chief Financial Officer at Kelt Exploration Ltd., Suite 300, 311 Sixth Avenue SW, Calgary, Alberta, Canada, T2P 3H2. Further information relating to Kelt is also available on its website at [www.keltexploration.com](http://www.keltexploration.com).

On behalf of the Board of Directors,

*[signed]*

David J. Wilson  
President and Chief Executive Officer  
March 6, 2018



## **MANAGEMENT'S REPORT**

The accompanying financial statements of Kelt Exploration Ltd. (the "Company") are the responsibility of management. The financial statements have been prepared by management in Canadian dollars in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") and include certain estimates that reflect management's best judgments. When alternative accounting methods exist, management has chosen those it deems most appropriate in the circumstances.

Management has the overall responsibility for internal controls and maintains a system of internal controls over financial reporting that provides reasonable assurance that the financial information is relevant, reliable and accurate and that the Company's assets are properly accounted for and adequately safeguarded.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal control. The Board exercises this responsibility with the assistance of the Audit Committee. This Committee, consisting of non-management directors, meets with management and independent auditors to ensure that each group is properly discharging its responsibilities and to discuss adequacy of internal controls, accounting policies and financial reporting matters. The Audit Committee has reviewed the financial statements and has reported thereon to the Board of Directors. The Board of Directors has approved the financial statements and authorized them for issuance to shareholders.

PricewaterhouseCoopers LLP, an independent firm of Chartered Professional Accountants, has been engaged, as approved by the shareholders of the Company, to provide an independent audit opinion on the Company's financial statements. Their report, contained herein, outlines the nature of their audit and expresses an unqualified opinion on the financial statements.

*[signed]*

David J. Wilson  
President and Chief Executive Officer  
March 6, 2018

*[signed]*

Sadiq H. Lalani  
Vice President and Chief Financial Officer  
March 6, 2018



## **INDEPENDENT AUDITOR'S REPORT**

**To the Shareholders of Kelt Exploration Ltd.**

We have audited the accompanying financial statements of Kelt Exploration Ltd., which comprise the consolidated statements of financial position as at December 31, 2017 and December 31, 2016 and the consolidated statements of profit (loss) and comprehensive income (loss), changes in shareholders' equity and cash flows for the years then ended, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

### **Management's responsibility for the financial statements**

Management 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 Kelt Exploration Ltd. as at December 31, 2017 and December 31, 2016 and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board.

*PricewaterhouseCoopers LLP*

**Chartered Professional Accountants**

Calgary, Alberta

March 6, 2018

---

*PricewaterhouseCoopers LLP*  
111 5<sup>th</sup> Avenue SW, Suite 3100, Calgary, Alberta, Canada T2P 5L3  
T: +1 403 509 7500, F: +1 403 781 1825, [www.pwc.com/ca](http://www.pwc.com/ca)

"PwC" refers to PricewaterhouseCoopers LLP, an Ontario limited liability partnership.

**KELT EXPLORATION LTD.**  
**CONSOLIDATED STATEMENT OF FINANCIAL POSITION**  
**AS AT DECEMBER 31, 2017 AND DECEMBER 31, 2016**

<i>(CA\$ thousands)</i>	<i>[Notes]</i>	<b>December 31, 2017</b>	<b>December 31, 2016</b>
<b>ASSETS</b>			
<b>Current assets</b>			
Cash and cash equivalents		<b>3,695</b>	560
Accounts receivable and accrued revenue	[13]	<b>39,446</b>	30,406
Prepaid expenses and deposits		<b>2,005</b>	1,191
<b>Total current assets</b>		<b>45,146</b>	32,157
Assets held for sale	[5]	-	105,458
Exploration and evaluation assets	[6]	<b>123,349</b>	120,166
Property, plant and equipment	[7]	<b>1,108,072</b>	998,177
<b>Total assets</b>		<b>1,276,567</b>	1,255,958
<b>LIABILITIES</b>			
<b>Current liabilities</b>			
Accounts payable and accrued liabilities		<b>87,783</b>	55,659
Derivative financial instruments	[13]	-	599
Deferred premium on flow-through shares	[11]	<b>1,042</b>	798
Decommissioning obligations	[10]	<b>1,585</b>	1,450
<b>Total current liabilities</b>		<b>90,410</b>	58,506
Decommissioning obligations held for sale	[5]	-	2,532
Bank debt	[8]	<b>91,465</b>	111,693
Convertible debentures	[9]	<b>74,517</b>	70,978
Decommissioning obligations	[10]	<b>135,343</b>	126,597
Deferred income tax liability	[12]	<b>39,131</b>	42,351
<b>Total liabilities</b>		<b>430,866</b>	412,657
<b>SHAREHOLDERS' EQUITY</b>			
Shareholders' capital	[11]	<b>1,078,773</b>	1,055,959
Reserve from common control transaction		<b>(57,668)</b>	(57,668)
Equity component of convertible debentures	[9]	<b>12,856</b>	12,856
Contributed surplus		<b>20,218</b>	17,454
Retained earnings (deficit)		<b>(208,478)</b>	(185,300)
<b>Total shareholders' equity</b>		<b>845,701</b>	843,301
<b>Total liabilities and shareholders' equity</b>		<b>1,276,567</b>	1,255,958

**Commitments** [16]

*The accompanying notes form an integral part of these consolidated annual financial statements.*

On behalf of the Board of Directors:

*[signed]*

David J. Wilson, Director

*[signed]*

Neil G. Sinclair, Director

**KELT EXPLORATION LTD.**  
**CONSOLIDATED STATEMENT OF PROFIT (LOSS) AND COMPREHENSIVE INCOME (LOSS)**  
**FOR THE YEARS ENDED DECEMBER 31, 2017 AND DECEMBER 31, 2016**

		Year ended December 31	
(CA\$ thousands, except per share amounts)	[Notes]	2017	2016
<b>Revenue</b>			
Petroleum and natural gas revenue		257,557	184,613
Royalties		(23,557)	(15,911)
		<b>234,000</b>	168,702
<b>Expenses</b>			
Production		81,201	71,204
Transportation		25,301	21,943
Cost of purchases		3,052	-
Financing	[14]	14,330	15,253
General and administrative	[15]	7,564	6,994
Provision for potential credit losses	[13]	-	309
Share based compensation	[11]	5,439	5,865
Exploration and evaluation	[6]	1,311	4,260
Depletion, depreciation and impairment	[7]	134,362	113,906
		<b>272,560</b>	239,734
Loss on derivative financial instruments	[13]	(451)	(259)
Foreign exchange loss		(54)	-
Premium on flow-through shares	[11]	2,309	3,305
Gain on sale of assets	[5]	10,436	8,746
Transaction costs		-	(23)
<b>Loss before taxes</b>		<b>(26,320)</b>	(59,263)
Deferred income tax recovery	[12]	(3,142)	(9,489)
<b>Loss and comprehensive loss</b>		<b>(23,178)</b>	(49,774)
<b>Loss per common share</b>			
Basic	[11]	(0.13)	(0.29)
Diluted	[11]	(0.13)	(0.29)

*The accompanying notes form an integral part of these consolidated financial statements.*

**KELT EXPLORATION LTD.**  
**CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY**  
**AS AT AND FOR THE YEARS ENDED DECEMBER 31, 2017 AND DECEMBER 31, 2016**

(CA\$ thousands)	[Notes]	Shareholders' capital		Reserve	Convertible debentures – equity portion	Contributed surplus	Retained earnings (deficit)	Total shareholders' equity
		Number of Shares (000s)	Amount (\$ thousands)					
Balance at December 31, 2016		175,672	1,055,959	(57,668)	12,856	17,454	(185,300)	843,301
Loss and comprehensive loss		-	-	-	-	-	(23,178)	(23,178)
Common shares issued, net of costs:								
Private placements	[11]	2,585	20,605	-	-	-	-	20,605
Premium on flow-through shares	[11]	-	(2,553)	-	-	-	-	(2,553)
Share issue costs, net of tax	[11]	-	(212)	-	-	-	-	(212)
Exercise of stock options	[11]	415	3,234	-	-	(935)	-	2,299
Vesting of restricted share units	[11]	186	1,740	-	-	(1,740)	-	-
Share based compensation	[11]	-	-	-	-	5,439	-	5,439
<b>Balance at December 31, 2017</b>		<b>178,858</b>	<b>1,078,773</b>	<b>(57,668)</b>	<b>12,856</b>	<b>20,218</b>	<b>(208,478)</b>	<b>845,701</b>

  

Balance at December 31, 2015		168,668	1,022,115	(57,668)	-	17,833	(135,526)	846,754
Loss and comprehensive loss		-	-	-	-	-	(49,774)	(49,774)
Common shares issued, net of costs:								
Private placements	[11]	6,085	31,690	-	-	-	-	31,690
Premium on flow-through shares	[11]	-	(4,103)	-	-	-	-	(4,103)
Share issue costs, net of tax	[11]	-	(280)	-	-	-	-	(280)
Issuance of convertible debentures	[9]	-	-	-	12,856	-	-	12,856
Exercise of stock options	[11]	67	384	-	-	(91)	-	293
Vesting of restricted share units	[11]	852	6,153	-	-	(6,153)	-	-
Share based compensation	[11]	-	-	-	-	5,865	-	5,865
<b>Balance at December 31, 2016</b>		<b>175,672</b>	<b>1,055,959</b>	<b>(57,668)</b>	<b>12,856</b>	<b>17,454</b>	<b>(185,300)</b>	<b>843,301</b>

*The accompanying notes form an integral part of these consolidated financial statements.*



**KELT EXPLORATION LTD.**  
**CONSOLIDATED STATEMENT OF CASH FLOWS**  
**FOR THE YEARS ENDED DECEMBER 31, 2017 AND DECEMBER 31, 2016**

		Year ended December 31	
(CA\$ thousands)	[Notes]	2017	2016
<b>Operating activities</b>			
Loss and comprehensive loss		(23,178)	(49,774)
Items not affecting cash:			
Accretion of convertible debentures	[9,14]	3,539	2,145
Accretion of decommissioning obligations	[10,14]	2,981	2,817
Share based compensation		5,439	5,865
Exploration and evaluation		1,311	4,260
Depletion, depreciation and impairment		134,362	113,906
Unrealized gain on derivative financial instruments	[13]	(599)	(91)
Unrealized loss on foreign exchange		43	-
Premium on flow-through shares		(2,309)	(3,305)
Gain on sale of assets		(10,436)	(8,746)
Deferred income tax recovery		(3,142)	(9,489)
Cash premiums on derivatives		-	460
Settlement of decommissioning obligations	[10]	(1,512)	(782)
Change in non-cash operating working capital	[17]	8,723	(12,546)
<b>Cash provided by operating activities</b>		<b>115,222</b>	<b>44,720</b>
<b>Financing activities</b>			
Decrease in bank debt	[8]	(20,228)	(65,877)
Issue of common shares, net of costs	[11]	20,315	31,307
Proceeds on exercise of stock options	[11]	2,299	293
Issue of convertible debentures, net of costs	[9]	-	86,443
<b>Cash provided by financing activities</b>		<b>2,386</b>	<b>52,166</b>
<b>Investing activities</b>			
Exploration and evaluation assets		(42,627)	(35,575)
Property, plant and equipment		(201,142)	(50,072)
Property acquisitions	[4]	(531)	(18,512)
Property dispositions	[5]	116,323	5,891
Change in non-cash investing working capital	[17]	13,547	1,072
<b>Cash used in investing activities</b>		<b>(114,430)</b>	<b>(97,196)</b>
<b>Foreign exchange on cash and cash equivalents</b>		<b>(43)</b>	<b>-</b>
<b>Net change in cash and cash equivalents</b>		<b>3,178</b>	<b>(310)</b>
<b>Cash and cash equivalents, beginning of period</b>		<b>560</b>	<b>870</b>
<b>Cash and cash equivalents, end of period</b>		<b>3,695</b>	<b>560</b>

*The accompanying notes form an integral part of these consolidated financial statements.*

**KELT EXPLORATION LTD.  
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
AS AT AND FOR THE YEARS ENDED DECEMBER 31, 2017 AND 2016**

*(All tabular amounts in thousands of Canadian dollars, except as otherwise indicated)*

**1. DESCRIPTION OF THE BUSINESS**

Kelt Exploration Ltd. ("Kelt" or the "Company") is an oil and gas company based in Calgary, Alberta, focused on the exploration, development and production of crude oil and natural gas resources, primarily in northwestern Alberta and northeastern British Columbia. The Company was incorporated under the *Business Corporations Act* (Alberta) on October 11, 2012 and was inactive until February 26, 2013. Kelt's land holdings are located in two core areas, namely: (a) Grande Prairie, Alberta (including Pouce Coupe, Progress and La Glace), held directly by Kelt; and (b) Fort St. John, British Columbia (including Inga, Fireweed and Stoddart), held by the Company's wholly-owned subsidiary, Kelt Exploration (LNG) Ltd. ("Kelt LNG"). The Company's common shares and 5% convertible debentures are listed on the Toronto Stock Exchange ("TSX") under the symbol "KEL" and "KEL.DB", respectively.

The head office of the Company is located at Suite 300, 311 - 6th Avenue S.W., Calgary, Alberta T2P 3H2. Additional information relating to Kelt can be found on SEDAR at [www.sedar.com](http://www.sedar.com).

**2. BASIS OF PRESENTATION**

The Company's Board of Directors approved and authorized these consolidated annual financial statements for issue on March 6, 2018.

**a) Statement of compliance**

The Company prepares its financial statements in accordance with Canadian generally accepted accounting principles ("GAAP") as set out in the *CPA Canada Handbook - Accounting*. These consolidated annual financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"), as issued by the International Accounting Standards Board ("IASB"), applicable to the preparation of annual financial statements.

**b) Basis of measurement**

All references to dollar amounts in these financial statements and related notes are thousands of Canadian dollars, unless otherwise indicated.

The financial statements have been prepared on a historical cost basis, except for certain financial instruments which are recorded at fair value. The methods used to measure fair values are described in note 13 of these financial statements.

**c) Significant judgments and estimates**

The timely preparation of the financial statements requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amount of assets, liabilities, income and expenses. Actual results may differ materially from these estimates. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are reviewed and for any future years affected. Significant judgments, estimates and assumptions made by management in these financial statements are discussed below.

*Depletion, depreciation and reserves*

The Company calculates depletion based on total proved reserves as determined in accordance with the Canadian Oil and Gas Evaluation Handbook ("COGEH"). The process of determining reserves is complex. Significant judgments are based on available geological, geophysical, engineering, and economic data. These judgments are based on estimates and assumptions that 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 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 the new information. Revisions are often required due to changes in well performance, prices, economic conditions and governmental restrictions.

Although every reasonable effort is made to ensure that reserve estimates are accurate, reserve estimation can be impacted by subjective decisions, new geological or production information and a changing environment. In addition, revisions to reserve estimates can arise from changes in forecast 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. Reserves are used in measuring the fair value less costs of disposal ("FVLCD") of property, plant and equipment for impairment calculations and for determining the fair value of PP&E acquired in a business combination. Reserves also impact the Company's assessment of the commercial viability and technical feasibility of an exploration project and the decision to transfer exploration and evaluation assets to PP&E.

#### *Exploration and evaluation assets*

Judgment is required to determine the level at which E&E is assessed for impairment. For Kelt, the carrying value of E&E assets is assessed for overall impairment at the operating segment level and on a specific identification basis prior to transferring E&E assets to PP&E. The decision to transfer assets from E&E to PP&E requires judgment as it is based on estimated proved reserves, which are used, in part, to determine a project's technical feasibility and commercial viability.

#### *Determination of Cash Generating Units ("CGUs")*

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. As at December 31, 2017, the Company has one CGU for its assets located in the province of British Columbia and four CGUs for its assets located in the province of Alberta. The Company's CGUs are unchanged from the previous year ended December 31, 2016.

#### *Impairment of non-financial assets*

Significant judgment is required to assess the Company's non-financial assets, namely E&E and PP&E, for impairment or potential reversals of previously recorded impairment. Management must first determine whether indicators of impairment exist that suggest the carrying value may not be recoverable through the asset's continued use or sale. In addition, judgment is required to assess whether a previously recognized impairment for an asset (other than goodwill) no longer exists or has decreased.

As a result of a decrease in forecast oil and natural gas prices as at December 31, 2017, an indication of potential impairment was identified for certain CGUs comprised of non-core properties located in Alberta. An impairment test was performed for these CGUs as at December 31, 2017, and the results of the calculation are provided in note 7. Although forecast commodity prices have decreased compared to the previous year, there is no indication of impairment for the Company's British Columbia and Grande Prairie CGUs, which comprise approximately 95% of the carrying value of PP&E as at December 31, 2017. The Company concluded there is no indication of impairment for its E&E assets at the operating segment level.

Significant judgment and estimates are required to calculate the recoverable amount of PP&E and goodwill in an impairment test. Management calculated the recoverable amount of each CGU based on its FVLCD, using an after-tax discounted cash flow analysis derived from proved plus probable reserves. Reserve estimates and expected future cash flows from production of reserves are subject to measurement uncertainty as discussed above and are subject to variability due to changes in forecasted commodity prices. In addition, the present value of forecast future cash flows is highly sensitive to the discount rate. Judgment is required to determine an appropriate discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Refer to note 7 of the consolidated annual financial statements for a discussion of the specific estimates and assumptions applied in the calculation of the recoverable amount.

### *Business combinations*

Business combinations are accounted for using the acquisition method of accounting. The determination of fair value often requires management to make assumptions and estimates about future events. The assumptions and estimates with respect to determining the fair value of exploration and evaluation assets and property, plant and equipment acquired generally require the most judgment and include estimates of reserves acquired, forecast benchmark commodity prices and discount rates. Assumptions are also required to determine the fair value of decommissioning obligations associated with the properties. Changes in any of these assumptions or estimates used in determining the fair value of acquired assets and liabilities could impact the amounts assigned to assets, liabilities and goodwill (or gain from a bargain purchase) in the acquisition equation. Future profit (loss) can be affected as a result of changes in future depletion and depreciation or impairment. Refer to additional information regarding business combinations in note 4 of these financial statements.

### *Decommissioning obligations*

The Company estimates the decommissioning obligations for oil and gas wells and their associated production facilities and infrastructure. In most instances, dismantling of assets and remediation occurs many years into the future. The value of the ultimate decommissioning obligation can fluctuate in response to many factors including changes to relevant legal requirements, the emergence of new restoration techniques, experience at other production sites, and changes to the risk-free discount rate. The expected timing and amount of expenditure can also change, for example, in response to changes in reserves or changes in laws and regulations or their interpretation. Judgments include the most appropriate discount rate to use, which management has determined to be a risk-free rate. Key assumptions are disclosed in note 10 of these financial statements.

Kelt estimates abandonment and reclamation costs based on a combination of publically available industry benchmarks and internal site specific information. For producing wells and facilities, the expected timing of settlement is estimated based on the proved plus probable period to abandonment for each field, as per the independent reserve report. For non-producing wells, the expected timing of settlement is estimated to be half of the period applied to producing wells in that field, unless the timing to abandon and reclaim a specific well site or facility is known based on budgeted expenditures.

### *Deferred income taxes*

The Company follows the liability method for calculating deferred income taxes. Tax interpretations, regulations and legislation in the jurisdictions in which the Company operates are subject to change. As such, deferred income taxes are subject to measurement uncertainty. The provision for deferred income taxes also includes the following significant judgments of management:

- Deferred income tax assets are assessed by management at the end of the reporting period to determine the likelihood that they will be realized from future taxable earnings. As at December 31, 2017, the Company has a consolidated deferred income tax liability of \$39.1 million. The deferred tax liability reported in the Consolidated Statement of Financial Position is presented net of offsetting deferred income tax assets, most notably, a deferred income tax asset in the amount of \$90.3 million related to non-capital losses which are estimated to be approximately \$339.0 million at December 31, 2017. The Company's non-capital losses expire in years 2023 to 2037. Management believes that Kelt and Kelt LNG will have sufficient taxable income in the future in order to utilize the non-capital losses and has concluded that recognition of the associated deferred income tax assets is appropriate;
- Classification of intangible drilling and completion costs as Canadian exploration expenses ("CEE") or Canadian development expenses ("CDE") – CEE is deductible at a rate of 100% per year, whereas CDE may be deducted on a declining basis at 30% per year. Accordingly, the allocation of resource deductions will impact the period in which Kelt may become taxable in the future. In addition, the designation of certain expenditures as CEE and/or CDE impacts the Company's ability to satisfy its flow-through share obligations; and
- Recognition of unrecognized deferred income tax asset – per IAS 12, deferred income taxes are not initially recognized on transactions that are not business combinations. The Company did not initially recognize a deferred income tax asset of \$14.4 million that arose on the spin-out certain assets from Celtic Exploration Ltd. ("Celtic") at Kelt's inception on February 26, 2013. The initially unrecognized deferred tax asset is now being amortized at a rate of 3.3% per quarter, which management believes is a reasonable estimate as it reflects the weighted average

depletion rate of the properties at the time of the spin-out and is aligned with Kelt's corporate average depletion rate.

#### *Share based compensation*

The Company uses the fair value method of accounting for its long-term incentive plans, which include an Incentive Stock Option Plan and a Restricted Share Unit Plan. Judgments include which valuation model is most appropriate for the grant of the award to estimate its fair value. Estimates and assumptions are then used in the valuation model to determine fair value.

For stock options, the Company uses the Black-Scholes option pricing model which requires that management make assumptions for the expected life of the option, the anticipated volatility of the share price over the life of the option, the risk-free interest rate for the life of the option, and the number of options that will ultimately vest. The assumptions used by the Company are discussed in note 11 of these financial statements.

The fair value of restricted share units is estimated based on the volume weighted average trading price ("VWAP") on the TSX over three trading days immediately prior to the date of grant. Judgment is also required to estimate the number of restricted share units that will ultimately vest, in other words, the rate of forfeiture. The assumptions used by the Company are discussed in note 11 of these financial statements.

#### *Flow-through shares*

There is no IFRS guidance that specifically addresses accounting for flow-through shares, therefore the Company is required to develop an accounting policy. Consistent with prior years, and as set-forth in note 3, the Company has applied the residual method. Under this method, judgement is required to determine of the fair value of ordinary shares. Typically, it is based on the share price at the time the parties agree to the transaction. In situations where flow-through shares are issued concurrent with an ordinary common share offering, the difference in subscription prices is used to value the premium. Otherwise, the Company uses the VWAP of KEL common shares for the five trading days immediately preceding the date of the binding agreement, to value the ordinary common shares.

Judgment is also required to determine when the Company has fulfilled its obligation to pass on the tax deduction to investors, at which time, the premium on flow-through shares is recognized in income. The Company deems the obligation to have been fulfilled in the period that eligible expenditures are incurred, regardless of the period in which the tax deductions are legally renounced. This is based on the view that the renunciation is perfunctory and that the accounting should be reflected when the expenditure is made.

### **3. SIGNIFICANT ACCOUNTING POLICIES**

#### **Joint Interests**

A substantial portion of the Company's exploration, development and production activities is conducted jointly with others through unincorporated joint ventures. These financial statements reflect only the Company's proportionate interest of these jointly controlled assets and the proportionate share of the relevant revenue and related costs.

#### **Foreign currency translation**

The financial statements are presented in Canadian dollars, which is the Company's functional and presentation currency. Transactions in foreign currencies are initially recorded at the exchange rate in effect at the time of the transactions. Monetary assets and liabilities denominated in foreign currencies are translated to Canadian dollars using the closing exchange rate at the Consolidated Statement of Financial Position date. The resulting exchange rate differences are included in the Consolidated Statement of Profit (Loss) and Comprehensive Income (Loss).

#### **Business combinations**

Business combinations are accounted for using the acquisition method. The identifiable net assets acquired are measured at their fair value at the date of acquisition. Any excess of the purchase price over the fair value of the net assets acquired is recognized as goodwill. Any deficiency of the purchase price below the fair value of the net assets acquired is recorded as a gain in the Consolidated Statement of Profit (Loss) and Comprehensive Income (Loss). Transaction costs associated with the acquisition are expensed when incurred.

## **Common control transactions**

Business combinations involving entities under common control are outside the scope of IFRS 3 Business Combinations. IFRS provides no guidance on the accounting for these types of transactions and an entity is required to develop an accounting policy. The three most common methods utilized are the purchase method, the predecessor values since inception method, and the predecessor values from date of transaction method. A business combination involving entities under common control is a business combination in which all of the combining entities are ultimately controlled by the same party, both before and after the business combination, and control is not transitory. Management has determined the predecessor values from date of transaction method to be most appropriate. This method requires the financial statements to be prepared using the predecessor carrying values without any step up to fair value. The difference between any consideration and the aggregate carrying value of the assets and liabilities are recorded as a reserve from common control transaction in shareholders' equity. Transaction costs associated with a common control transaction are recognized as an expense in the period.

## **Principles of Consolidation**

The consolidated financial statements include the accounts of Kelt and its subsidiaries. Subsidiaries are entities controlled by the Company. Control exists when the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. As at December 31, 2017, the Company has one wholly-owned subsidiary, Kelt LNG. The financial statements of subsidiaries are prepared for the same reporting period as Kelt, using uniform accounting policies. Subsidiaries are consolidated from the date of acquisition of control and continue to be consolidated until the date there is a loss of control. All intercompany balances, transactions, revenue and expenses are eliminated on consolidation.

## **Assets held for sale**

Non-current assets and disposal groups are classified as held for sale if their carrying amounts will be recovered through a sale transaction rather than through continuing use. This condition is regarded as met only when the sale is highly probable and the asset or disposal group is available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets. Management must be committed to the sale, which should be expected to qualify for recognition as a completed sale within one year from the date of classification as held for sale. Non-current assets and disposal groups classified as held for sale are measured at the lower of the carrying amount and fair value less costs of disposal, and depletion & depreciation ceases at the time this designation is made.

If a non-current asset or disposal group has been classified as held for sale, but subsequently ceases to meet the criteria to be classified as held for sale, the Company ceases to classify the asset or disposal group as held for sale. Non-current assets and disposal groups that cease to be classified as held for sale are measured at the lower of carrying amount before the asset or disposal group was classified as held for sale (adjusted for any depreciation, amortization or revaluation that would have been recognized had the asset or disposal group not been classified as held for sale) and its recoverable amount at the date of the subsequent decision not to sell. Any adjustment to the carrying amount is recognized in profit or loss in the period in which the asset ceases to be classified as held for sale.

## **Financial instruments**

Financial assets and liabilities are recognized when the Company becomes a party to the contractual provisions of the instrument. Financial assets are derecognized when the rights to receive cash flows from the assets have expired or have been transferred and the Company has transferred substantially all risks and rewards of ownership.

Financial assets and liabilities are offset and the net amount is reported in the Consolidated Statement of Financial Position when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis, or realize the asset and settle the liability simultaneously.

At initial recognition, the Company classifies its financial instruments in the following categories depending on the purpose for which the instruments were acquired:

### **i) Financial assets and liabilities at fair value through profit or loss**

A financial asset or liability is classified in this category if acquired principally for the purpose of selling or repurchasing in the short-term. Derivatives are also included in this category unless they are designated as hedges.

Financial instruments in this category are recognized initially and subsequently at fair value. Transaction costs are expensed in the Consolidated Statement of Profit (Loss) and Comprehensive Income (Loss). Gains and losses arising from changes in fair value are presented in profit or loss in the period in which they arise.

Financial assets and liabilities at fair value through profit or loss are classified as current in the Consolidated Statement of Financial Position, except for any portion expected to be realized or paid beyond twelve months of the Consolidated Statement of Financial Position date.

ii) Available-for-sale investments

Available-for-sale investments are non-derivatives that are either designated in this category or not classified in any of the other categories. The Company does not currently hold any available-for-sale investments.

iii) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. The Company's loans and receivables are comprised of cash and cash equivalents, accounts receivable and deposits. They are included in current assets due to their short-term nature.

Loans and receivables are initially recognized at the amount expected to be received less any required discount to reduce the loans and receivables to fair value. Subsequently, loans and receivables are measured at amortized cost using the effective interest method less any provision for impairment.

iv) Financial liabilities at amortized cost

Financial liabilities at amortized cost include accounts payable and bank debt. Accounts payable are initially recognized at the amount required to be paid less any required discount to reduce the payables to fair value. Bank debt is recognized initially at fair value, net of any transaction costs incurred, and subsequently at amortized cost using the effective interest method. Financial liabilities are classified as current liabilities if payment is due within twelve months. Otherwise, they are presented as non-current liabilities.

v) Derivative financial instruments

The Company may use derivative financial instruments for risk management purposes. All derivatives have been classified at fair value through profit or loss. Financial instruments are included on the Consolidated Statement of Financial Position within derivative financial instruments and are classified as current or non-current based on the contractual terms specific to the instrument. Gains and losses on re-measurement of derivatives are included in profit or loss in the period in which they arise.

**Exploration and evaluation assets ("E&E") and Property, plant and equipment ("PP&E")**

i) Recognition and measurement

*Pre-license costs*

Costs incurred prior to acquiring the legal rights to explore an area are charged directly to profit or loss as exploration expense in the period incurred. The Company did not incur pre-license costs in the current or prior period.

*Exploration and evaluation assets*

All costs directly associated with the exploration and evaluation of petroleum and natural gas reserves are initially capitalized. Exploration and evaluation costs include unproved property acquisition costs such as undeveloped land and mineral leases, geological and geophysical costs, and costs associated with exploratory drilling, sampling and appraisals. Such costs are not subject to depletion or depreciation until they are reclassified from E&E to PP&E.

The costs are accumulated by field or exploration area pending determination of technical feasibility and commercial viability. The technical feasibility and commercial viability is considered to be achieved when proved reserves are determined to exist. Prior to being transferred to PP&E, E&E costs are first tested for impairment. If proved/probable reserves have not been established through the completion of exploration and evaluation activities and there are no future plans for activity in that field, then the costs are determined to be impaired and the amounts are charged to the Consolidated Statement of Profit (Loss) and Comprehensive Income (Loss).

### *Property, plant and equipment*

Property, plant, and equipment primarily consists of petroleum and natural gas development and production assets, and is measured at cost less accumulated depletion and depreciation and accumulated impairment losses. These costs include property acquisitions, development drilling, completion, gathering and infrastructure, estimated decommissioning costs and transfers from E&E. In addition, borrowing costs incurred for the construction of qualifying assets are capitalized during the period of time that is required to complete and prepare the assets for their intended use.

#### *ii) Subsequent costs*

Costs incurred subsequent to the determination of technical feasibility and commercial viability and the costs of replacing components of equipment are recognized as property, plant and equipment only when they increase the future economic benefits embodied in the specific asset to which they relate. All other expenditures are expensed as incurred. Such capitalized amounts generally represent costs incurred in developing proved and/or probable reserves and bringing in or enhancing production from such reserves. The carrying amount of any replaced or sold component is derecognized.

The gain or loss from the divestitures of property, plant and equipment is recognized in the Consolidated Statement of Profit (Loss) and Comprehensive Income (Loss). In addition, risk-sharing agreements in which the Company cedes a portion of its working interest to a third-party are generally considered to be disposals of property, plant and equipment, potentially resulting in a gain or loss on disposition.

Exchanges of assets within property, plant and equipment are measured at fair value unless the exchange transaction lacks commercial substance or the fair value of neither the asset received nor the asset given up is reliably measurable. Unless the fair value of the asset received is more clearly evident, the cost of the acquired asset is measured at the fair value of the asset given up. Where fair value is not used, the cost of the acquired asset is measured at the carrying amount of the asset given up. The gain or loss on derecognition of the asset given up is recognized in profit or loss.

An asset within property, plant and equipment is derecognized upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying value of the asset) is included in profit or loss in the period in which the item is derecognized.

#### *iii) Depletion and depreciation*

Development and production costs are accumulated on a field or geotechnical area basis ("depletion units"). The net carrying value of each depletion unit is depleted using the unit of production method by reference to the ratio of production in the year to the related proved reserves, taking into account estimated future development costs necessary to bring those reserves into production. Future development costs are estimated taking into account the level of development required to produce the reserves. These estimates are reviewed by independent reserve engineers at least annually. Where significant components of development and production ("D&P") assets have different useful lives, they are accounted for and depreciated as separate items of property, plant and equipment.

### **Impairment of assets**

#### *Non-financial assets*

The Company reviews the carrying value of its non-financial assets, including PP&E and E&E, on a quarterly basis to determine whether there is any indication of impairment. Goodwill is evaluated when facts and circumstances indicate that it is impaired, or at least on an annual basis. If any such indication exists, then the asset's recoverable amount is estimated. E&E assets are also assessed for impairment prior to being reclassified to PP&E.

For the purpose of impairment testing, assets are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or CGUs. The recoverable amount of an asset or a CGU is the greater of its value in use and its FVLCD. Goodwill is allocated to the CGU expected to benefit from the business combination. E&E assets are assessed for overall impairment at the operating segment level and individual E&E assets are assessed for impairment prior to transferring to PP&E.



FVLCD is defined as the amount obtainable from the sale of an asset or cash generating unit in an arm's length transaction between knowledgeable, willing parties, less the costs of disposal. The Company calculates FVLCD by reference to the after-tax future cash flows expected to be derived from production of proved plus probable reserves, less estimated selling costs. The estimated after-tax future cash flows are discounted to their present value using a discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Value in use is generally computed by reference to the present value of the future cash flows expected to be derived from production of proved reserves.

An impairment loss is recognized if the carrying amount of an asset or its CGU exceeds its estimated recoverable amount. Impairment losses are recognized in the Consolidated Statement of Profit (Loss) and Comprehensive Income (Loss). Impairment losses recognized in respect of CGUs are allocated to reduce the carrying amounts of the assets in the CGU on a pro rata basis.

Impairment losses recognized in prior years are assessed at each reporting date for any indication that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimate used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depletion and depreciation, if no impairment loss had been recognized.

#### *Financial assets*

A financial asset is assessed at each reporting date to determine whether there is any objective evidence that it is impaired. A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the fair value or estimated future cash flows of an asset.

An impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the original effective interest rate. Individually significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed collectively in groups that share similar credit risk characteristics.

All impairment losses are recognized in profit or loss. An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognized. For financial assets measured at amortized cost the reversal is recognized in profit or loss.

#### **Goodwill**

The Company records goodwill relating to a business combination when the consideration paid exceeds the fair value of the net identifiable assets and liabilities of the acquired business. Goodwill is reported at cost less any impairment and is not amortized. Goodwill is evaluated when facts and circumstances indicate that it is impaired, or at least on an annual basis. Goodwill impairments are not reversed.

#### **Leases**

Leases where the Company assumes substantially all the risks and rewards of ownership are classified as finance leases. Upon initial recognition, the leased asset is measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments. Subsequent to initial recognition, the asset is accounted for in accordance with the accounting policy applicable to that asset. Minimum lease payments made under finance leases are apportioned between the finance expenses and the reduction of the outstanding liability. The finance expenses are allocated to each year during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability. The Company does not currently have any finance leases.

All of the Company's leases are operating leases, which are not recognized on the Consolidated Statement of Financial Position. Rather, payments in respect of operating leases are recognized in the Consolidated Statement of Profit (Loss) and Comprehensive Income (Loss) on a straight-line basis over the term of the lease. In the event that lease inducements are received to enter into operating leases, such inducements are recognized as a deferred credit. The aggregate benefit of inducements is recognized as a reduction of the related rental expense on a straight-line basis, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed.

## **Provisions and Contingencies**

Provisions are recognized when the Company has a present obligation as a result of a past event, if it is probable that an outflow of resources will be required and if a reliable estimate can be made of the amount of the obligation. Provisions are measured based on the best estimate of discounted future cash outflows.

### *Decommissioning obligations*

The Company's activities give rise to dismantling, decommissioning and site disturbance remediation activities. An obligation is accrued for the estimated cost of site restoration and the corresponding amount is included in the cost of the assets to which the obligations relate. Decommissioning obligations are measured at the present value of management's best estimate of the expenditure required to settle the present obligation at the Consolidated Statement of Financial Position date. Subsequent to the initial measurement, the obligation is adjusted at the end of each period to reflect the passage of time and changes in the estimated future cash flows underlying the obligation, changes to the expected timing of site restoration, as well as any changes in the risk-free discount rate. Increases in the provision due to the passage of time are recognized as a financing expense in the Consolidated Statement of Profit (Loss) and Comprehensive Income (Loss) whereas increases/decreases due to changes in the estimated future cash flows are capitalized. Actual costs incurred upon settlement of the decommissioning obligations are charged against the provision to the extent the provision is established.

### *Contingencies*

Contingent liabilities are possible obligations whose existence will only be confirmed by future events not wholly within the control of the Company. When a contingency is substantiated by confirming events, can be reliably measured and will likely result in an economic outflow, a liability is recognized in the financial statements as the best estimate required to settle the obligation. A contingent liability is disclosed where the existence of an obligation will only be confirmed by future events, or where the amount of a present obligation cannot be measured reliably or will likely not result in an economic outflow.

Contingent assets are only disclosed when the inflow of economic benefits is probable. When the economic benefit becomes virtually certain, the asset is no longer contingent and is recognized in the financial statements.

## **Convertible debentures**

The Debentures are a non-derivative financial instrument that creates a financial liability of the entity and grants an option to the holder of the instrument to convert it into common shares of the Company. The liability component of the Debentures is initially recorded at the fair value of a similar liability that does not have a conversion option. The equity component is recognized initially, net of deferred income taxes, as the difference between gross proceeds and the fair value of the liability component. Transaction costs are allocated to the liability and equity components in proportion to the allocation of proceeds. Subsequent to initial recognition, the liability component of the Debentures is measured at amortized cost using the effective interest method and is accreted each period, such that the carrying value will equal the principal amount outstanding at maturity. The equity component is not re-measured. The carrying amounts of the liability and equity components of the Debentures are reclassified to shareholders' capital on conversion to common shares.

## **Income taxes**

Total income tax expense is composed of both current and deferred income taxes.

Current tax is the expected tax payable on taxable income for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

The Company follows the liability method of accounting for income taxes. Under this method, deferred income tax is recognized in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred taxes are allocated between income and equity depending on the nature of the account balance or transaction that gives rise to the temporary difference.

Deferred tax liabilities are recognized for taxable temporary differences. Deferred tax assets are recognized for deductible temporary differences, unused tax losses and unused tax credits only if it is probable that sufficient future taxable income will be available to utilize those temporary differences and losses. Such deferred tax liabilities and

assets are not recognized if the temporary difference arises from goodwill or from the initial recognition of an asset or liability in a transaction which is not a business combination and, at the time of the transaction, affects neither accounting profit nor taxable income. 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. The effect of a change in income tax rates on deferred tax assets and liabilities is recognized in the Consolidated Statement of Profit (Loss) and Comprehensive Income (Loss) in the period that the change occurs.

Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to income taxes levied by the same tax authority on the same taxable entity or on different tax entities but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously. Deferred tax assets and liabilities are recorded on a non-discounted basis.

### **Revenue recognition**

Revenue from the sale of oil and natural gas is recorded when the significant risks and rewards of ownership of the product are transferred to the buyer which is usually when legal title passes to the external party and collectability is reasonably assured. This is generally at the time product enters the pipeline. Royalties, which are presented as a reduction in revenue in the Consolidated Statement of Profit (Loss) and Comprehensive Income (Loss), are recognized at the time of production. Net revenues earned from properties in which the Company shares a joint interest, are recognized proportionately based on the Company's working interest in those properties.

Royalty income is recognized as it accrues in accordance with the terms of the overriding royalty agreements.

### **Financing expense**

Financing expenses include interest expense on borrowings and accretion of the discount on decommissioning obligations due to the passage of time.

Borrowing costs incurred for the construction of qualifying assets are capitalized during the period of time required to complete and prepare the assets for their intended use. All other borrowing costs are recognized in financing expense using the effective interest method.

### **Share based compensation**

The Company has an Incentive Stock Option Plan and Restricted Share Unit Plan (collectively, the "Plans"). Pursuant to the Plans, stock options and restricted share units ("RSUs") may be granted to officers, directors, employees and certain consultants, which call for settlement through the issuance of new common shares of the Company.

The Company applies the fair value method of accounting for stock options, whereby each tranche in an award is valued separately on the grant date using the Black-Scholes option pricing model. The fair value of RSUs is calculated based on the volume weighted average trading price over three trading days immediately prior to the date of grant. The total fair value associated the stock options and RSUs is recognized over the service period using graded vesting, as share based compensation expense with a corresponding increase to contributed surplus. An estimated forfeiture rate is applied against the total fair value on the grant date and is adjusted to reflect the actual number of options that ultimately vest each period. The consideration received by the Company on the exercise of stock options is recorded as an increase in shareholders' capital, together with the corresponding amounts previously recognized in contributed surplus.

### **Flow-through shares**

Canadian tax legislation permits entities meeting specified criteria to issue securities to investors whereby the deductions for tax purposes related to eligible expenditures may be claimed by the investors rather than by the entity (herein referred to as "flow-through shares"). The Company uses the residual method to account for flow-through shares. Under this method, the proceeds from the issuance are allocated between i) the proceeds of the offering of shares, and ii) the renunciation of tax deductions. At the time the flow-through shares are issued: i) shareholders' capital is credited based on the fair value of ordinary common shares, and ii) the tax deductions to be renounced are deferred and presented a liability in the Consolidated Statement of Financial Position, at an amount equal to the residual difference between the fair value of the Company's ordinary common shares relative to the amount the investor pays for the flow-through shares. At the time the Company fulfills its obligation to pass on the tax deductions to investors, which is deemed to occur when the eligible expenditures are incurred, the liability (deferred premium) is

drawn down in proportion to the eligible expenditures incurred in the period and the premium on flow-through shares is recognized as income in the Consolidated Statement of Profit (Loss) and Comprehensive Income (Loss). Concurrently, a deferred income tax liability is recognized for the taxable temporary difference that arises from the difference between the carrying amount of the eligible expenditures capitalized as an asset for accounting purposes and a tax base of nil, because the deduction has been renounced to investors.

### **Per share amounts**

Basic profit (loss) per common share is calculated by dividing profit (loss) for the period attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the period. Common shares issued as part of the consideration transferred in a business combination or common control transaction are included in the weighted average number of common shares starting from the acquisition date.

Diluted profit (loss) per common share is calculated giving effect to the potential dilution that would occur if all outstanding “in-the-money” stock options were exercised or converted to common shares. The weighted average number of common shares outstanding during the period is adjusted by the incremental number of shares calculated in accordance with the treasury stock method. The treasury stock method assumes that the proceeds received from the exercise of all potentially dilutive instruments are used to repurchase common shares at the volume weighted average market price during the period.

### **Changes in Accounting Policies**

As of January 1, 2017, the Company adopted all of the requirements of IFRS 9 *Financial Instruments*, as amended in July 2014 (“IFRS 9”).

IFRS 9 uses a single approach to determine whether a financial asset is classified and measured at amortized cost or fair value, replacing the multiple rules in IAS 39. The approach in IFRS 9 is based on how an entity manages its financial instruments and the contractual cash flow characteristics of the financial assets. Most of the requirements in IAS 39 for classification and measurement of financial liabilities were carried forward in IFRS 9, and IFRS 9 has introduced a single expected credit loss impairment model, which is based on changes in credit quality since initial recognition. The adoption of the expected credit loss impairment model did not have a significant impact on the financial statements of the Company, however there are additional required disclosures which have been included in note 13 of the consolidated annual financial statements.

IFRS 9 also contains a new hedge accounting model, however the Company did not apply hedge accounting to any of its commodity price risk management contracts in 2017. In addition, IFRS 9 includes amended guidance for the classification and measurement of financial assets by introducing a fair value through other comprehensive income category for certain debt instruments. The Company did not have any investments in debt instruments in 2017 for which this guidance applies to.

The early adoption of IFRS 9 has been applied retrospectively and did not result in a change in the carrying value of any of Kelt’s financial instruments on the transition date.

### **Accounting standards issued but not yet effective**

IFRS 15 *Revenue from Contracts with Customers* will be adopted by the Company effective January 1, 2018, and will replace IAS 18 *Revenue*, IAS 11 *Construction Contracts*, and related interpretations. IFRS 15 provides clarification on how and when an entity will recognize revenue and provides a single, principles-based, five-step model that will be applied to all contracts with customers. The Company has performed an initial assessment of IFRS 15 and plans to adopt the standard under the modified retrospective approach on January 1, 2018. Under this method, comparative figures are not restated and the cumulative effect of initially applying the standard (if any) would be recognized at the date of adoption. The Company will be required to disclose additional information regarding the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers, including a disaggregation of revenue by product type. The Company’s initial assessment that adoption of IFRS 15 will not have a material impact on the Company’s Consolidated Statement of Profit (Loss) and Comprehensive Income (Loss) is made as of the date of these annual financial statements and may change as new publications or interpretations of the new standard become available. The evaluation of all potential measurement and disclosure impacts is ongoing.

IFRS 16 *Leases*, is intended to replace IAS 17 and will bring fundamental changes for all companies, including Kelt, who lease assets. The new standard is effective for annual reporting periods beginning on or after January 1, 2019, with early application permitted. The most significant financial reporting impacts of the changes include: all leases will be on the balance sheet of lessees, except those that meet the limited exception criteria; the measurement and presentation of expenses will be significantly impacted as rent expense is removed and replaced by the recording of depreciation and financing expenses; the amount of profit (loss) recognized in a period will likely change as the timing of expenses is accelerated when applying the new standard which uses a finance lease model compared to a straight line operating lease expense; and key ratios may be impacted with the introduction of lease assets and liabilities on the balance sheet and changes to the timing of expenses. Management is currently implementing corporate processes to ensure contract completeness required to identify impacted leases, and will continue to evaluate the potential impact of IFRS 16 on the consolidated financial statements.

#### 4. PROPERTY ACQUISITIONS

The following table summarizes the fair value of net assets acquired pursuant to property acquisitions during the year ended December 31, 2017 and the prior year ended December 31, 2016:

	December 31, 2017	December 31, 2016
Exploration and evaluation assets	531	252
Property, plant and equipment	-	18,538
Decommissioning obligations	-	(278)
<b>Fair value of net assets acquired</b>	<b>531</b>	<b>18,512</b>
<b>Cash consideration, after closing adjustments</b>	<b>531</b>	<b>18,512</b>

On April 28, 2016, the Company acquired oil and gas assets in its core area at Progress, Alberta, for cash consideration of \$18.5 million after closing adjustments. The transaction was accounted for as a business combination whereby the net assets acquired and the liabilities assumed were recorded at fair value on the acquisition date.

#### 5. PROPERTY DISPOSITIONS

The table below summarizes the aggregate proceeds received and carrying values of the assets and associated decommissioning obligations disposed during the year ended December 31, 2017, and prior year ended December 31, 2016, as well as the resulting net gain on sale in each period:

	December 31, 2017	December 31, 2016
Exploration and evaluation assets	7,310	2,575
Property, plant and equipment	102,985	6,257
Decommissioning obligations	(4,408)	(11,687)
<b>Carrying value of net assets (liabilities) disposed</b>	<b>105,887</b>	<b>(2,855)</b>
<b>Cash proceeds, after closing adjustments <sup>(1)</sup></b>	<b>116,323</b>	<b>5,891</b>
<b>Gain on sale of assets <sup>(1)</sup></b>	<b>10,436</b>	<b>8,746</b>

(1) The amounts reported in the table above were estimated based on information available at the time of preparation of these financial statements. In particular, closing adjustments were estimated based on interim statements of adjustments. The net gain or loss ultimately recognized by the Company upon determination of final closing adjustments may differ from these estimates.

#### *Karr Property Disposition*

On January 18, 2017, Kelt completed the disposition of the majority of its oil and gas assets located in the Karr area of Alberta, for cash consideration of \$100.0 million before adjustments. The disposition (hereinafter referenced as the "Karr Property Disposition") had an effective date of January 1, 2017. Net proceeds were used, initially, to reduce indebtedness under the Company's Credit Facility.

The assets and associated decommissioning obligations disposed pursuant to the Karr Property Disposition were classified as held for sale as at December 31, 2016. Immediately prior to the initial classification as held for sale, the net carrying amount of PP&E was \$68.9 million, including accumulated impairment of \$46.2 million recognized during the year ended December 31, 2015. As at December 31, 2016, the impairment loss was partially reversed by \$32.2 million based on the estimated fair value of consideration in excess of the carrying amount.

<i>(CA\$ thousands)</i>	<b>December 31 2017</b>	December 31 2016	Change in Estimates
Gross purchase price	100,000	100,000	-
Estimated closing adjustments	3,054	2,926	128
<b>Fair value of consideration</b>	<b>103,054</b>	<b>102,926</b>	<b>128</b>
Exploration and evaluation assets	4,377	4,377	-
Property, plant and equipment, net <sup>(1)</sup>	101,264	101,081	183
Assets held for sale and disposed	105,641	105,458	183
Decommissioning obligations held for sale and disposed <sup>(2)</sup>	(2,532)	(2,532)	-
<b>Net assets held for sale and disposed</b>	<b>103,109</b>	<b>102,926</b>	<b>183</b>

(1) Cost of \$163.3 million, net of accumulated depletion and depreciation of \$48.1 million and accumulated impairment of \$14.0 million (net of impairment reversal).

(2) The carrying amount of the decommissioning obligations held for sale was estimated based on a risk-free rate of 2.3% and an inflation rate of 2.0% as at December 31, 2016. The undiscounted cash flows required to settle the obligations were estimated to be approximately \$2.7 million.

#### *Minor Property Dispositions*

During the year ended December 31, 2017, Kelt completed dispositions of certain non-core assets for cash proceeds of \$13.3 million, after closing adjustments. The assets and associated decommissioning obligations disposed had a net carrying value of approximately \$2.8 million resulting in a gain on sale of \$10.5 million (after estimated closing adjustments).

## **6. EXPLORATION AND EVALUATION ASSETS**

Exploration and evaluation ("E&E") assets consist of the Company's undeveloped land, geological and geophysical assets, and exploratory drilling costs for projects in which the technical feasibility or commercial viability has yet to be determined. At the time sufficient information becomes available to determine whether the project is technically feasible or commercially viable, which is generally the point at which proved reserves are discovered, the costs are either transferred to property, plant, and equipment ("PP&E") or charged to exploration and evaluation expense.

The following table reconciles movements of exploration and evaluation assets:

	<b>December 31, 2017</b>	December 31, 2016
Balance, beginning of period	<b>120,166</b>	124,305
Additions	<b>42,627</b>	35,575
Property acquisitions [note 4]	<b>531</b>	252
Reclassification (to) from held for sale [note 5]	<b>4,377</b>	(4,377)
Property dispositions [note 5]	<b>(7,310)</b>	(2,575)
Transfers to property, plant and equipment	<b>(35,731)</b>	(28,754)
Expired mineral leases	<b>(1,311)</b>	(4,260)
Balance, end of period	<b>123,349</b>	120,166

The Company reviewed its E&E assets for indicators of potential impairment as at December 31, 2017. Except for \$1.3 million of costs associated with the expiry of mineral leases which have been recognized as an expense, the Company concluded that there are no indicators of potential impairment of its E&E assets at December 31, 2017.

## 7. PROPERTY, PLANT AND EQUIPMENT

Net carrying value	December 31, 2017	December 31, 2016
Development and production ("D&P") assets	1,107,715	997,646
Corporate assets	357	531
Total net carrying value of property, plant and equipment	1,108,072	998,177

The following table reconciles movements of property, plant and equipment ("PP&E") during the period:

Property, plant and equipment, at cost	D&P Assets	Corporate Assets	Total PP&E
Balance at December 31, 2015	1,458,222	1,838	1,460,060
Additions	49,436	636	50,072
Property acquisitions [note 4]	18,538	-	18,538
Reclassification (to) from held for sale [note 5]	(163,166)	-	(163,166)
Property dispositions [note 5]	(11,520)	-	(11,520)
Decommissioning costs	(2,848)	-	(2,848)
Transfers from E&E	28,754	-	28,754
Balance at December 31, 2016	1,377,416	2,474	1,379,890
Additions	200,349	793	201,142
Reclassification (to) from held for sale [note 5]	163,166	-	163,166
Property dispositions [note 5]	(172,821)	-	(172,821)
Decommissioning costs	9,288	-	9,288
Transfers from E&E	35,731	-	35,731
<b>Balance at December 31, 2017</b>	<b>1,613,129</b>	<b>3,267</b>	<b>1,616,396</b>

  

Accumulated depletion, depreciation and impairment	D&P Assets	Corporate Assets	Total PP&E
Balance at December 31, 2015	334,042	1,113	335,155
Depletion and depreciation expense	139,217	830	140,047
Impairments, net of impairment reversals	(26,141)	-	(26,141)
Reclassification (to) from held for sale [note 5]	(62,085)	-	(62,085)
Property dispositions [note 5]	(5,263)	-	(5,263)
Balance at December 31, 2016	379,770	1,943	381,713
Depletion and depreciation expense	126,531	967	127,498
Impairments, net of impairment reversals	6,864	-	6,864
Reclassification (to) from held for sale [note 5]	62,085	-	62,085
Property dispositions [note 5]	(69,836)	-	(69,836)
<b>Balance at December 31, 2017</b>	<b>505,414</b>	<b>2,910</b>	<b>508,324</b>

There were no borrowing costs capitalized in the current or prior year, as the Company did not have any qualifying assets. Future capital costs required to develop proved reserves in the amount of \$776.0 million (December 31, 2016 – \$588.5 million) are included in the depletion calculation for development and production assets.

As a result of the decrease in forecast oil and natural gas prices as at December 31, 2017 compared to forecast prices as at December 31, 2016, an indication of potential impairment was identified for certain CGUs comprised of non-core properties located in Alberta. Notwithstanding the decrease in price forecasts, there is no indication of impairment for the Company's British Columbia and Grande Prairie CGUs, which comprise approximately 95% of the carrying value of PP&E as at December 31, 2017.

Recoverable amounts were estimated based on FVLCD methodology for the CGUs in which impairment indicators were identified, namely: Grande Cache, Karr Non-Operated, and Leduc-Woodbend. The FVLCD was calculated

using the present value of the CGUs' expected future cash flows (after-tax). The cash flow information was derived from a report on the Company's oil and gas reserves which was prepared by an independent qualified reserve evaluator, Sproule Associates Limited ("Sproule") as of December 31, 2017. The projected cash flows used in the FVLCD calculation reflect market assessments of key assumptions as at December 31, 2017, including long-term forecasts of commodity prices, inflation rates, and foreign exchange rates (Level 3 fair value inputs). Cash flow forecasts are also based on past experience, historical trends and Sproule's evaluation of the Company's reserves and resources to determine production profiles and volumes, operating costs, maintenance and future development capital expenditures. Future cash flow estimates are discounted using after-tax risk-adjusted discount rates. The after-tax discount rates applied in the impairment calculation as at December 31, 2017 ranged from 9% to 12% depending on the risks specific to the assets in the CGUs.

Based on the FVLCD calculation, the carrying value of the Grande Cache CGU was in excess of the recoverable amount resulting in an impairment loss of \$6.9 million (before-tax) as at December 31, 2017. The Grande Cache CGU is comprised of mature, low-decline dry gas assets. Despite being a low-cost property, the decrease in forecast gas prices had a pervasive impact on the recoverable amount calculated for the CGU, given that 99% of proved plus probable reserves of the Grande Cache property are natural gas. Compared to Sproule's prior forecast at December 31, 2016, forecast AECO-C gas prices fell by 13% for 2018 and by 5% on average based on Sproule's forecast at December 31, 2017.

The impairment test as at December 31, 2017 did not result in an impairment or reversal of previous impairment losses for the Karr Non-Operated or Leduc-Woodbend CGUs, which are both non-core oil weighted properties. As at December 31, 2017, the net carrying amount of PP&E for the Karr Non-Operated CGU was \$5.0 million (including \$2.4 million of accumulated impairment) and for Leduc-Woodbend, the net carrying amount of PP&E was \$7.7 million (including \$13.0 million of accumulated impairment).

The recoverable amounts estimated pursuant to FVLCD calculations are sensitive to the discount rate and future commodity price assumptions. As at December 31, 2017, holding all other variables in the FVLCD calculation for each CGU constant:

- if the discount rate increased (decreased) by 1%, the impairment of the Grande Cache CGU would increase (decrease) by approximately \$1.6 million; and
- if the forecast combined average realized price decreased (increased) by 5%, the impairment of the Grande Cache CGU would increase (decrease) by approximately \$4.0 million.

Given the relatively low value of the Karr Non-Operated and Leduc-Woodbend CGUs, the sensitivity analysis did not have a significant impact on the recoverable amounts or conclusions from the impairment calculation, being that, a 1% increase (decrease) in the discount rate or 5% decrease (increase) in the forecast combined average realized price would not trigger an impairment (reversal) for those CGUs as at December 31, 2017.

Forecast future prices used in the impairment evaluations as at December 31, 2017 and December 31, 2016, reflect the benchmark prices set-forth in the tables below, adjusted for basis differentials to determine local reference prices, transportation costs and tariffs, heat content and quality. In addition, the impairment loss calculation for Grande Cache is based on an external consultant average AECO forecast benchmark price.

As at December 31, 2017	2018	2019	2020	2021	2022 <sup>(1)</sup>
WTI Cushing Oklahoma (US\$/bbl)	55.00	65.00	70.00	73.00	74.46
Canadian Light Sweet 40 API (\$/bbl)	65.44	74.51	78.24	82.45	84.10
NYMEX Henry Hub (US\$/MMBtu)	3.25	3.50	4.00	4.08	4.16
AECO-C Spot (\$/MMBtu)	2.85	3.11	3.65	3.80	3.95
Exchange rate (CA\$/US\$)	1.2658	1.2195	1.1765	1.1765	1.1765

(1) Prices escalate at 2.0% thereafter



As at December 31, 2016	2017	2018	2019	2020	2021 <sup>(1)</sup>
WTI Cushing Oklahoma (US\$/bbl)	55.00	65.00	70.00	71.40	72.83
Canadian Light Sweet 40 API (\$/bbl)	65.58	74.51	78.24	80.64	82.25
NYMEX Henry Hub (US\$/MMBtu)	3.50	3.50	3.50	4.00	4.08
AECO-C Spot (\$/MMBtu)	3.44	3.27	3.22	3.91	4.00
Exchange rate (CA\$/US\$)	1.2821	1.2195	1.1765	1.1765	1.1765

(1) Prices escalate at 2.0% thereafter

During the previous year ended December 31, 2016, indicators of potential impairment were identified and recoverable amounts for each CGU were estimated based on after-tax discount rates between 9% to 12%. Based on the FVLCD calculation as at December 31, 2016, the carrying value of the Leduc-Woodbend CGU was in excess of the recoverable amount, resulting in an impairment loss of \$6.0 million. In addition, and as described in note 5, as at December 31, 2016 the majority of the assets included in the Karr CGU were classified as held for sale and subsequently disposed of on January 18, 2017. As at December 31, 2016, the previous impairment of the Karr CGU of \$48.5 million was partially reversed by \$32.2 million to reflect the increase in carrying amount of the assets that has ultimately been recovered by proceeds of the Karr Property Disposition.

## 8. BANK DEBT

	December 31, 2017	December 31, 2016
Bank loan	17,000	82,100
Bankers' acceptances ("BAs")	75,000	30,000
Unamortized financing fees and prepaid interest on BAs	(535)	(407)
Bank debt	91,465	111,693

The Company has a revolving committed term credit facility (the "Credit Facility") with a syndicate of financial institutions. As at December 31, 2017, the authorized borrowing amount available under the Credit Facility was \$185.0 million (unchanged from December 31, 2016). The Credit Facility is available for a revolving period of 364 days, maturing on April 28, 2018, and may be extended annually at Kelt's option and subject to lender approval, with a term-out to April 28, 2019 if not renewed.

The Credit Facility is subject to semi-annual borrowing base reviews, occurring approximately in April and October of each year. In the event that the lenders reduce the borrowing base below the amount drawn at the time of the redetermination, the Company would have 60 days to eliminate any borrowing base shortfall by repaying the amount drawn in excess of the re-determined borrowing base or by providing additional security or other consideration satisfactory to the lenders. Repayments of principal are not required provided that the borrowings under the facility do not exceed the authorized borrowing amount and the Company is in compliance with all covenants, representations and warranties.

There are no financial covenants under the Credit Facility and Kelt is in compliance with all other covenants. Covenants include industry standard positive and negative covenants including reporting requirements, permitted indebtedness, permitted dispositions (to a maximum in each calendar year which are in the aggregate not more than 5% of the borrowing base then in effect), permitted risk management activities (as more particularly described in note 13), permitted encumbrances and other standard business operating covenants. Security is provided for by a first fixed and floating charge debenture over all assets in the amount of \$800.0 million and general assignment of book debts.

Interest is payable monthly for borrowings through direct advances. Interest rates fluctuate based on a pricing grid and range from bank prime plus 1.0% to bank prime plus 2.5%, depending upon the Company's then current debt to cash flow ratio of between less than one and one tenth times to greater than three times. Under the Credit Facility, borrowings through the use of bankers' acceptances are also available. Stamping fees fluctuate based on a pricing grid and range from 2.0% to 3.5%, depending upon the Company's then current debt to cash flow ratio of between less than one and one tenth times to greater than three times.

The following table reconciles movements in the balance of bank debt during the year:

	December 31, 2017
Balance, beginning of year	111,693
Net draw (repayment)	(20,100)
Decrease in unamortized financing fees	98
Increase in prepaid interest on BAs	(226)
Balance, end of year	91,465

## 9. CONVERTIBLE DEBENTURES

	Number of convertible debentures	Liability component (\$ thousands)	Equity Component (\$ thousands)
Balance at December 31, 2015	-	-	-
Issuance of convertible debentures	90,000	71,665	18,335
Issue costs	-	(2,832)	(725)
Deferred income tax liability	-	-	(4,754)
Accretion of discount <sup>(1)</sup>	-	2,145	-
<b>Balance at December 31, 2016</b>	<b>90,000</b>	<b>70,978</b>	<b>12,856</b>
Accretion of discount <sup>(1)</sup>	-	3,539	-
<b>Balance at December 31, 2017</b>	<b>90,000</b>	<b>74,517</b>	<b>12,856</b>

(1) Accretion of the liability component and accrued interest payable on the Debentures are included in financing expenses in the Consolidated Statement of Profit (Loss) and Comprehensive Income (Loss) (note 14).

On May 3, 2016, the Company issued \$90.0 million principal amount of convertible unsecured subordinated debentures for net proceeds of \$86.4 million. The Debentures mature on May 31, 2021 (the "Maturity Date") and bear interest at 5.0% per annum payable semi-annually on May 31<sup>st</sup> and November 30<sup>th</sup>, commencing November 30, 2016. At the holder's option, the Debentures may be converted into common shares of the Company at any time prior to the close of business on the earlier of the business day immediately preceding (i) the Maturity Date, (ii) if called for redemption, the date fixed for redemption by the Company, or (iii) if called for repurchase in the event of a change of control, the payment date, at a conversion price of \$5.50 per share (the "Conversion Price"), being a conversion rate of approximately 181.8182 common shares per \$1,000 principal amount of Debentures, subject to adjustment in certain events.

As at December 31, 2017, the Debentures are "in-the-money" based on the closing price of Kelt common shares on the TSX of \$7.19 on December 29, 2017, being the last trading day in the year. To date, there have been no conversions and the \$90.0 million principal amount is outstanding. The fair value of the Debentures was \$135.0 million as at December 31, 2017 (note 13).

The Debentures are redeemable by the Company after May 31, 2019 and prior to May 31, 2020, in whole or in part, from time to time, on not more than 60 days and not less than 40 days prior notice at a redemption price equal to their principal amount plus accrued and unpaid interest, if any, up to but excluding the date set for redemption, provided that the volume weighted average trading price of the common shares on the TSX for the 20 consecutive trading days ending five trading days (the "Current Market Price") prior to the date on which notice of redemption is provided is at least 125% of the Conversion Price. On or after May 31, 2020 and prior to the Maturity Date, the Debentures may be redeemed by the Company, in whole or in part, from time to time, on not more than 60 days and not less than 40 days prior notice at a redemption price equal to their principal amount plus accrued and unpaid interest, if any, up to but excluding the date set for redemption.

The Company may, at its option, elect to satisfy its obligation to repay all or any portion of the principal amount of the Debentures upon redemption or due at maturity, by issuing common shares instead of cash (subject to the receipt of any required regulatory approvals and provided that no event of default has occurred). The number of common shares to be issued would be obtained by dividing the principal amount of the Debentures by 95% of the Current Market Price on the date fixed for redemption or maturity, as applicable.

## 10. DECOMMISSIONING OBLIGATIONS

Decommissioning obligations arise as a result of the Company's net ownership interests in petroleum and natural gas assets including well sites, processing facilities and infrastructure. The following table provides a reconciliation of the carrying amount of the obligation associated with the retirement of oil and gas properties:

	December 31, 2017	December 31, 2016
Balance, beginning of period	128,047	142,801
Obligations incurred	6,624	1,233
Obligations acquired [note 4]	-	278
Reclassification (to) from held for sale [note 5]	2,532	(2,532)
Obligations disposed [note 5]	(4,408)	(11,687)
Obligations settled	(1,512)	(782)
Changes in discount rate	2,221	(8,502)
Revisions to estimates	443	4,421
Accretion expense	2,981	2,817
Balance, end of period	136,928	128,047
Decommissioning obligations – current	1,585	1,450
Decommissioning obligations – non-current	135,343	126,597

The underlying cost estimates are derived from a combination of published industry benchmarks as well as site specific information. As at December 31, 2017, the undiscounted amount of the estimated cash flows required to settle the obligation is \$148.3 million (December 31, 2016 – \$145.8 million), and is expected to be incurred over the next 50 years. Based on an inflation rate of 2.0%, the undiscounted amount of the estimated future cash flows required to settle the obligation is \$303.1 million at December 31, 2017 (December 31, 2016 – \$305.9 million). The inflated future cost estimates are discounted based on a risk-free rate to determine the carrying amounts presented in the table above. As at December 31, 2017, the carrying amount of the decommissioning obligations is based on a risk-free rate of 2.26% (December 31, 2016 – 2.31%).

Accretion of the decommissioning obligation due to the passage of time is presented within financing expenses in the Consolidated Statement of Profit (Loss) and Comprehensive Income (Loss) (note 14).

## 11. SHARE CAPITAL

### Authorized

The Company is authorized to issue an unlimited number of common shares and an unlimited number of preferred shares, each without par value.

### Issued and outstanding

The following table summarizes the change in common shares issued and outstanding. There are no preferred shares issued or outstanding as of December 31, 2017 (December 31, 2016 – nil).

	Number of Shares (000s)	Amount (\$ thousands)
Balance at December 31, 2015	168,668	1,022,115
Issued for cash through common share offerings	6,085	31,690
Deferred premium on flow-through shares	-	(4,103)
Issued for cash on exercise of stock options	67	293
Transfer from contributed surplus on exercise of stock options	-	91
Released upon vesting of restricted share units	852	6,153
Share issue costs, net of deferred taxes	-	(280)
Balance at December 31, 2016	<b>175,672</b>	<b>1,055,959</b>
Issued for cash through common share offerings	<b>2,585</b>	<b>20,605</b>
Deferred premium on flow-through shares	-	<b>(2,553)</b>
Issued for cash on exercise of stock options	<b>415</b>	<b>2,299</b>
Transfer from contributed surplus on exercise of stock options	-	<b>935</b>
Released upon vesting of restricted share units	<b>186</b>	<b>1,740</b>
Share issue costs, net of deferred income taxes	-	<b>(212)</b>
<b>Balance at December 31, 2017</b>	<b>178,858</b>	<b>1,078,773</b>

### Private placements of flow-through common shares

The table below summarizes flow-through common shares (“FTS”) issued pursuant to private placements during the years ended December 31, 2017 and 2016, and the cumulative amount of qualifying expenditures incurred over the expenditure periods.

(CA\$ thousands, except as otherwise indicated)					Eligible Expenditures (1)			Expenditure Period End /
Closing Dates	# of FTS	Price per FTS	Gross Proceeds	Deferred Premium	Type	As at December 31, 2017		Effective date of Renunciation
						Incurred	Remaining	
April 7, 2016	4.7 million	\$4.70	22,090	2,585	CDE	22,090 <sup>(2)</sup>	-	December 31, 2016 December 31, 2016
August 23, 2016	0.385 million	\$6.50	2,500	638	CEE	2,500 <sup>(3)</sup>	-	December 31, 2017 December 31, 2016
November 2, 2016	1.0 million	\$7.10	7,100	880	CDE	7,100 <sup>(4)</sup>	-	March 31, 2017 March 31, 2017
October 11, 2017	1.263 million	\$7.75	9,785	896	CDE	9,785	-	December 31, 2017 December 31, 2017
October 27, 2017	0.75 million	\$7.75	5,811	615	CDE	5,811	-	December 31, 2017 December 31, 2017
October 27, 2017	0.572 million	\$8.75	5,009	1,042	CEE	-	5,009	December 31, 2018 December 31, 2017

- (1) Pursuant to the provisions of the *Income Tax Act* (Canada), the Company has incurred eligible Canadian development expenses ("CDE") or Canadian exploration expenses ("CEE") as required under the respective subscription agreements.
- (2) The full commitment of \$22.1 million of qualifying expenditures were incurred as of December 31, 2016.
- (3) The full commitment of \$2.5 million of qualifying expenditures were incurred as of June 30, 2017.
- (4) Of the total commitment of \$7.1 million, Kelt incurred \$5.8 million during the fourth quarter of 2016 and \$1.3 million during the first quarter of 2017.

In October 2017, the Company completed non-brokered private placements of 2.6 million common shares for aggregate gross proceeds of \$20.6 million, of which: 2.0 million common shares were issued on a "flow-through" basis in respect of Canadian Development Expenses at a price of \$7.75 per share for gross proceeds of \$15.6 million (the "CDE Private Placement"); and 0.6 million common shares were issued on a "flow-through" basis in respect of Canadian Exploration Expenses at a price of \$8.75 per share for gross proceeds of \$5.0 million (the "CEE Private Placement"). After expenses related to the private placements, net proceeds to Kelt were \$20.3 million.

Pursuant to the provisions in the *Income Tax Act* (Canada), Kelt incurred eligible Canadian Development Expenses of \$15.6 million after the respective closing dates of the CDE Private Placement and prior to December 31, 2017. The Company has fully satisfied all obligations related to CDE Private Placement and renounced the qualifying expenditures to the subscribers with an effective date of December 31, 2017.

In respect of the CEE Private Placement, Kelt committed to incur eligible Canadian Exploration Expenses prior to December 31, 2018, in the aggregate amount of not less than the gross proceeds of \$5.0 million. The qualifying expenditures, which were incurred subsequent to year-end during the first two months of 2018, have been renounced to the subscribers of the flow-through common shares with an effective date of December 31, 2017, under the "look-back" provisions in the *Income Tax Act* (Canada).

### Stock options

Kelt has an Incentive Stock Option Plan (the "Option Plan") that provides for granting of stock options to directors, officers, employees and certain consultants. The stock options granted pursuant to the Option Plan are to be settled through the issuance of new common shares of the Company and have a maximum term of five years to expiry. The vesting schedule is determined at the discretion of the Company's Compensation Committee of the Board of Directors; stock options typically vest in equal tranches over a three year period. Each stock option granted permits the holder to purchase one common share of the Company at the stated exercise price. The exercise price is determined based on the volume weighted average trading price on the TSX over three trading days immediately prior to the date of grant.

The following table summarizes the change in stock options outstanding:

	Number of Options (000s)	Average Exercise Price (\$/share)
Balance at December 31, 2015	6,690	7.40
Granted	2,533	4.71
Exercised <sup>(1)</sup>	(67)	4.38
Forfeited	(780)	7.85
Balance at December 31, 2016	<b>8,376</b>	<b>6.57</b>
Granted	<b>2,347</b>	<b>6.25</b>
Exercised <sup>(1)</sup>	<b>(415)</b>	<b>5.54</b>
Forfeited	<b>(414)</b>	<b>7.03</b>
<b>Balance at December 31, 2017 <sup>(2)</sup></b>	<b>9,894</b>	<b>6.51</b>

(1) The weighted average share price on the date stock options were exercised during the period ended December 31, 2017 was \$6.96 per common share (\$5.25 per common share on average during the year ended December 31, 2016).

(2) Subsequent to the end of the reporting period, in January 2018, 1.4 million stock options were exercised at an average exercise price of \$6.35 per share for proceeds to Kelt of approximately \$8.9 million.

The total fair value of each option granted is estimated on the date of grant using the Black-Scholes option pricing model with weighted average assumptions as follows:

	Year ended December 31	
	2017	2016
Risk free interest rate	1.3%	0.6%
Expected life (years)	3.5	3.5
Expected volatility <sup>(1)</sup>	53.8%	52.6%
Expected dividend yield	0.0%	0.0%
Expected forfeiture rate	2.5%	2.4%
Fair value of options granted during the year (\$/share)	2.44	1.76

(1) The expected volatility for options granted is estimated based on Kelt's historical volatility over the expected life.

The following table summarizes information regarding stock options outstanding at December 31, 2017:

Range of exercise prices per common share	Number of options outstanding (000s)	Weighted average remaining term (years)	Weighted average exercise price for options outstanding (\$/share)	Number of options exercisable (000s)	Weighted average exercise price for options exercisable (\$/share)
\$0.00 to \$5.00	3,399	3.2	4.51	1,537	4.48
\$5.01 to \$10.00	5,492	2.6	6.64	3,033	6.97
\$10.01 to \$15.00	943	1.3	12.41	943	12.41
\$15.01 to \$20.00	60	1.5	15.40	60	15.40
<b>Total <sup>(1)</sup></b>	<b>9,894</b>	<b>2.7</b>	<b>6.51</b>	<b>5,573</b>	<b>7.29</b>

(1) Subsequent to the end of the reporting period, in January 2018, 1.4 million stock options were exercised at an average exercise price of \$6.35 per share for proceeds to Kelt of approximately \$8.9 million.

### Restricted share units

Kelt has a Restricted Share Unit Plan (the "RSU Plan") that provides for granting of RSUs to officers, employees and certain consultants. The RSUs granted under the RSU Plan are to be settled through the issuance of new common shares upon vesting. The vesting schedule is determined at the discretion of the Company's Compensation Committee of the Board of Directors; RSUs typically vest in two equal tranches with the first half vesting after two years and the second half after three years. On the vesting date, one common share is released from treasury for each RSU.

The following table summarizes the change in RSUs outstanding:

	Number of RSUs (000s)
Balance at December 31, 2015	1,204
Granted	439
Released upon vesting	(852)
Forfeited	(71)
Balance at December 31, 2016	720
Granted	325
Released upon vesting	(186)
Forfeited	(66)
<b>Balance at December 31, 2017</b>	<b>793</b>

## Share based compensation expense

The total fair value associated with stock options and RSUs is recognized over the service period using graded vesting, resulting in share based compensation expense as follows:

	Year ended December 31	
	2017	2016
Stock options	3,867	4,099
Restricted share units	1,572	1,766
Total share based compensation expense	5,439	5,865

## Per share amounts

The table below summarizes the weighted average number of common shares outstanding used in the calculation of basic and diluted profit (loss) per common share:

	Year ended December 31	
(000s of common shares)	2017	2016
Weighted average common shares outstanding, basic	176,466	173,076
Effect of stock options and RSUs	1,454	339
Effect of convertible debentures	-	-
Weighted average common shares outstanding, diluted	177,920	173,415

The Company uses the treasury stock method to determine the dilutive effect of stock options and RSUs. Under this method, only "in-the-money" dilutive instruments impact the calculation of diluted profit per common share. Accordingly, in computing the diluted loss per common share for the years ended December 31, 2017 and 2016, the Company excluded the effect of stock options and RSUs as they were anti-dilutive. The common shares potentially issuable on conversion of the Debentures are also excluded as they are anti-dilutive to the loss reported per share, for all periods outstanding.

## 12. INCOME TAXES

Kelt was not required to pay income taxes in the current or prior year as the Company had sufficient income tax deductions available to shelter taxable income. Tax deductions available as of December 31, 2017 are estimated to be approximately \$977.8 million (December 31, 2016 – \$975.4 million).

The following table reconciles income taxes calculated at the weighted average Canadian statutory rate with the actual provision for deferred income taxes per the Consolidated Statement of Profit (Loss) and Comprehensive Income (Loss):

	Year ended December 31	
	2017	2016
Loss before income taxes	(26,320)	(59,263)
Canadian statutory tax rate	26.7%	26.4%
Expected income tax recovery	(7,033)	(15,645)
Increase (decrease) resulting from:		
Non-deductible expenses <sup>(1)</sup>	1,473	1,599
Recognition of unrecognized deferred tax asset	(2,055)	(2,055)
Qualifying expenditures on flow-through shares	5,094	7,434
Premium on flow-through shares	(624)	(892)
True-up of tax pools	3	70
Deferred income tax recovery	(3,142)	(9,489)

(1) Non-deductible expenses primarily include share based compensation.

The Canadian statutory tax rate per the rate reconciliation above represents the weighted average combined federal and provincial corporate tax rate. The federal corporate tax rate is 15.0% and the provincial tax rate is 11.0% in British Columbia and 12.0% in Alberta.

The movement in deferred income tax assets and liabilities, without taking into consideration the offsetting balances within the same tax jurisdiction are as follows:

Deferred income tax asset (liability)	Balance at December 31, 2016	Recognized in profit and CI <sup>(1)</sup>	Recognized in balance sheet	Balance at December 31, 2017
Derivative financial instruments	162	(162)	-	-
PP&E and E&E	(144,335)	(14,231)	-	(158,566)
Decommissioning obligations	34,144	2,361	-	36,505
Convertible debentures	(4,368)	764	-	(3,604)
Share and debt issue costs	2,847	(1,592)	78	1,333
Reserve from common control transaction	(7,113)	2,055	-	(5,058)
Non-capital losses <sup>(2)</sup>	76,312	13,947	-	90,259
	(42,351)	3,142	78	(39,131)

Deferred income tax asset (liability)	Balance at December 31, 2015	Recognized in profit and CI <sup>(1)</sup>	Recognized in balance sheet	Balance at December 31, 2016
Derivative financial instruments	62	100	-	162
PP&E and E&E	(136,416)	(7,919)	-	(144,335)
Decommissioning obligations	38,015	(3,871)	-	34,144
Convertible debentures	-	386	(4,754)	(4,368)
Share and debt issue costs	4,364	(1,620)	103	2,847
Reserve from common control transaction	(9,168)	2,055	-	(7,113)
Non-capital losses <sup>(2)</sup>	55,954	20,358	-	76,312
	(47,189)	9,489	(4,651)	(42,351)

(1) Comprehensive income has been abbreviated as "CI".

(2) The Company's non-capital losses expire in years 2023 to 2037.

The amount and timing of reversals of temporary differences will be dependent upon a number of factors, including the nature and timing of future capital expenditures and the Company's future operating results. In the next twelve months, the Company expects approximately \$1.1 million of deferred income tax assets to be recovered related to temporary differences in respect of share and debt issue costs, and the provision for potential credit losses. The Company does not expect any other deferred income tax assets or liabilities to reverse within the next twelve months.



### 13. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Financial instruments of the Company include cash and cash equivalents, accounts receivable and accrued revenue, deposits, accounts payable and accrued liabilities, derivative financial instruments, convertible debentures, and bank debt. The Company is exposed to financial risks arising from its financial assets and liabilities that include credit and liquidity risk in addition to the market risks associated with commodity prices, and interest and foreign exchange rates. Profit (loss), cash flows and the fair value of financial assets and liabilities may fluctuate due to movement in market prices or as a result of the Company's exposure to credit and liquidity risks.

As at December 31, 2017, there are no derivative financial assets or liabilities currently outstanding, however the Company uses derivative financial instruments from time to time in order to manage market risks. The objective of market risk management is to manage and control market risk exposures within acceptable limits, while maximizing long-term returns. All such transactions are conducted in accordance with the Company's established risk management policies that permit management to enter into commodity price agreements, provided that:

- i) the contracts are not entered into for speculative purposes;
- ii) the total notional quantity hedged, at the time of entering into the contract, does not exceed 65% of average daily production; and
- iii) the contracted term does not exceed 36 months.

#### Commodity price risk

Inherent to the business of producing oil and gas, the Company's cash provided by operating activities is subject to commodity price risk. Commodity price risk is the risk that future cash flows will fluctuate as a result of changes in commodity prices. Commodity prices are impacted by world economic events that dictate the levels of supply and demand as well as the currency exchange rate relationship between the Canadian and U.S. dollar.

As at December 31, 2017, there are no commodity price risk management contracts outstanding.

#### Interest rate risk

The Company is exposed to interest rate risk to the extent that changes in market interest rates will impact the Company's Credit Facility which is subject to a floating interest rate. Based on average bank debt outstanding of \$67.3 million during 2017, an increase (decrease) in the market rate of interest by 25 basis points would have increased (decreased) interest expense by \$0.2 million.

As at December 31, 2017, there are no interest rate risk management contracts outstanding.

#### Foreign exchange risk

Kelt is exposed to fluctuations of the Canadian to U.S. dollar exchange rate given realized pricing is directly influenced by U.S. dollar denominated benchmark pricing. In addition, the Company has natural gas marketing arrangements in place whereby Kelt receives revenue in U.S. dollars. The Company also has commitments for firm gas transportation service under contracts denominated in U.S. dollars as outlined in note 16. The Company may enter into derivative contracts to mitigate the impact of foreign currency fluctuations. As at December 31, 2017, there were no foreign exchange risk management contracts outstanding.

On July 11, 2016, the Company entered into a foreign exchange swaption contract and received a cash premium of \$0.255 million. The swaption was exercised by the counterparty resulting in a derivative contract that fixed the exchange rate at CA\$/US\$1.33 on a notional US\$1.0 million per month over the initial contract term of January to December 2017. On July 26, 2017, the Company unwound the foreign exchange swap for cash proceeds of \$0.4 million, extinguishing the contract for the remaining five month term from August to December 2017. Kelt realized a cumulative net cash gain of \$0.7 million under this contract, including the cash premium earned at inception.

As at December 31, 2017, there are no foreign exchange risk management contracts outstanding.

## Gains and losses on risk management contracts

The table below summarizes realized and unrealized gains (losses) on risk management contracts:

	Year ended December 31	
	2017	2016
Realized loss	(1,050)	(350)
Unrealized gain	599	91
Loss on derivative financial instruments	(451)	(259)

## Fair value measurements

The Company classifies fair value measurements using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The Company maximizes the use of observable inputs when preparing calculations of fair value, where possible. The fair value hierarchy has the following levels:

- Level 1 - Values are based on unadjusted quoted prices available in active markets for identical assets or liabilities as of the reporting date.
- Level 2 - Values 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. Prices in Level 2 are either directly or indirectly observable as of the reporting date.
- Level 3 - Values are based on prices or valuation techniques that are not based on observable market data.

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.

The fair value of cash and cash equivalents, accounts receivable and accrued revenue, deposits, accounts payable and accrued liabilities approximate their carrying value due to the short term to maturity of these instruments. Bank debt bears interest at a floating market rate and accordingly the fair market value of bank debt approximates the carrying amount. The fair value of the convertible debentures is estimated using quoted market prices on the TSX as of the Consolidated Statement of Financial Position date.

The fair value of financial assets and liabilities, excluding working capital, is attributable to the following fair value hierarchy levels at December 31, 2017:

	Carrying Value ("CV")			Fair Value		
	Gross	Netting <sup>(1)</sup>	Net CV	Level 1	Level 2	Level 3
<b>Financial liabilities</b>						
Convertible debentures (note 9)	74,517	-	74,517	135,000	-	-

(1) Financial assets and liabilities are only offset if the Company has the current legal right to offset and intends to settle on a net basis or settle the asset and liability simultaneously. Kelt offsets derivative contracts assets and liabilities when the counterparty, commodity, currency and timing of settlement are the same. As at December 31, 2017, there are no outstanding or offsetting derivative financial contracts.

The fair value of the convertible debentures of \$135.0 million as at December 31, 2017, is based on the closing market price of \$150.00 per Debenture, being the price at which the Debentures last traded in the year, and represents the market value of the entire instrument. As at December 31, 2016, the fair value was \$130.5 million based on the closing market price of \$145.00 per Debenture at the end of the previous year.

## Credit Risk

As at December 31, 2017, the carrying amount of cash and cash equivalents, accounts receivable and accrued revenue, and deposits, represent the Company's maximum credit exposure. Cash and cash equivalents are held on deposit with a Canadian chartered bank. The Company's credit risk exposure arises primarily from receivables from oil and gas marketers and joint venture partners.

The composition of the Company's accounts receivable is set out in the following table:

Accounts receivable and accrued revenue	December 31, 2017	December 31, 2016
Oil and gas marketers	30,996	21,949
Joint venture partners	3,654	3,525
GST input tax credits	4,419	3,438
Other	377	1,494
Accounts receivable and accrued revenue	39,446	30,406

During the year ended December 31, 2017, sales to three oil and gas marketers each individually represented more than 10% of total revenue. Sales to these marketers account for approximately 38%, 17%, and 11%, of total revenue, respectively. During the comparative period ended December 31, 2016, sales to four oil and gas marketers accounted for approximately 37%, 23%, 13%, and 10% of total revenue, respectively. Kelt's oil and gas marketers have provided parental guarantees (with terms ranging from two to five years), letters of credit, or have been rated investment-grade by a reputable ratings agency for substantially all of the Company's monthly credit exposure.

The oil and gas industry has a pre-arranged monthly clearing day for payment of revenues from all buyers of oil and natural gas; this occurs on the 25th day following the month of sale. As a result, the Company's production revenues are current. All other accounts receivable are generally contractually due within 30 days.

The balance of accounts receivable outstanding for more than 90 days relates primarily to receivables from the Company's joint venture partners. Credit risk related to joint venture receivables is mitigated by obtaining partner approval of significant capital expenditures prior to expenditure and in certain circumstances may require cash deposits in advance of incurring financial obligations on behalf of joint venture partners. The Company has the ability to withhold production from joint venture partners in the event of non-payment or may be able to register security on the assets of joint venture partners.

The Company applies the simplified approach to providing for expected credit losses prescribed by IFRS 9, which permits the use of the lifetime expected loss provision for all trade receivables. The Company uses a combination of historical and forward looking information to determine the appropriate loss allowance provision. The ageing of the Company's accounts receivable and the loss allowance provision is determined as follows:

Accounts receivable and accrued revenue	Current	30-60 days	60-90 days	Over 90 days	Total
Gross accounts receivable	38,138	337	203	1,434	40,112
Estimated credit loss rate	0.7%	3.6%	6.6%	27.3%	
Loss allowance provision	(249)	(12)	(13)	(392)	(666)
<b>Balance at December 31, 2017</b>	<b>37,889</b>	<b>325</b>	<b>189</b>	<b>1,043</b>	<b>39,446</b>
Balance at December 31, 2016 <sup>(1)</sup>	28,657	539	253	957	30,406

(1) The Company began using the expected credit loss model upon adoption of IFRS 9 effective January 1, 2017, therefore there is no 2016 comparative for the loss allowance provision. The continuity of the allowance for doubtful accounts as at December 31, 2016 as determined using previous methodology is summarized in the table below.

The low allowance provision as at December 31, 2017 reconciles to the opening loss allowance as at January 1, 2017 in the following table:

	December 31, 2017	December 31, 2016
Allowance for doubtful accounts, beginning of year	789	1,002
Direct write-off of amounts included in provision	(123)	(522)
Provisions for potential credit losses through profit or loss	-	309
Loss allowance, end of year	666	789

During the year, there were no losses recognized in the Company's Consolidated Statement of Profit (Loss) and Comprehensive Income in relation to impaired receivables (December 31, 2016 – \$0.3 million).

### Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they are due. The Company's financial liabilities as at December 31, 2017 include accounts payable, bank debt and convertible debentures. The Company manages liquidity risk through prudent use of bank debt and an actively managed production and capital expenditure budgeting process. In addition, risk management contracts such as derivative financial instruments may be used from time to time. As discussed further under the *Capital Management* section to follow, Kelt targets a relatively low debt to trailing adjusted funds from operations ratio. To manage this, the Board of Directors approves an annual capital expenditure budget, which is regularly monitored and updated as necessary in response to changing capital requirements. The Company utilizes a control system with respect to authorizations for expenditures on both operated and non-operated projects to further manage capital expenditures.

The capital intensive nature of Kelt's operations may create a working capital deficiency position during periods with high levels of capital investment. However, during such periods, the Company maintains sufficient unused bank credit lines to satisfy such working capital deficiencies. As at December 31, 2017, the Company's working capital deficit of \$45.3 million combined with outstanding bank debt of \$91.5 million, represented 74% of the authorized borrowing amount available under the Credit Facility of \$185.0 million (75% at December 31, 2016). As discussed in Note 8, the Credit Facility is available for a revolving period of 364 days, maturing on April 28, 2018, and may be extended annually at Kelt's option and subject to lender approval, with a term-out to April 28, 2019 if not renewed. The Credit Facility is subject to semi-annual borrowing base reviews, occurring approximately in April and October of each year. In an event that the lenders reduce the borrowing base below the amount drawn at the time of the redetermination, the Company would have 60 days to eliminate any borrowing base shortfall by repaying the amount drawn in excess of a re-determined borrowing base or by providing additional security or other consideration satisfactory to the lenders.

The table below outlines a contractual maturity analysis for Kelt's financial liabilities as at December 31, 2017:

	Within 1 Year	1 to 5 Years	More than 5 Years	Total
Accounts payable and accrued liabilities	87,783	-	-	87,783
Bank debt and estimated interest <sup>(1)</sup>	3,293	92,520	-	95,813
Convertible debentures <sup>(2)</sup>	4,500	100,862	-	105,362
<b>Total</b>	<b>95,576</b>	<b>193,382</b>	<b>-</b>	<b>288,958</b>

(1) Estimated interest for future periods related to the Credit Facility was calculated using the weighted average interest rate of 3.6% for the quarter ended December 31, 2017, applied to the principal balance outstanding as at that date. For purposes of this analysis, principal repayment of the Company's revolving Credit Facility is assumed to occur on April 28, 2019.

(2) The contractual maturity analysis includes semi-annual cash interest payments at the fixed coupon rate of 5.0%, assuming that the \$90.0 million principal amount of the Debentures is outstanding for the full term to maturity on May 31, 2021, provided that: the equity conversion option is not first exercised by the holder; and that the Company does not elect to settle its financial obligation by issuing common shares instead of cash at redemption or maturity. Refer to additional information regarding the Debentures in note 9.

## Capital Management

The Company's capital structure is comprised of shareholders' capital, convertible debentures, bank debt and working capital. Kelt's objectives when managing its capital structure is to maintain financial flexibility in order to meet financial obligations, as well as to finance future growth through capital expenditures relating to exploration, development and acquisition activities.

The Company monitors its capital structure and short-term financing requirements using a net bank debt to trailing adjusted funds from operations ratio, which is a non-GAAP financial measure.

	December 31, 2017	December 31, 2016
Bank debt	91,465	111,693
Working capital deficiency	45,264	26,349
Bank debt, net of working capital <sup>(1)</sup>	136,729	138,042
Trailing annualized adjusted funds from operations <sup>(2)(3)</sup>	131,592	92,400
Net bank debt to trailing adjusted funds from operations ratio <sup>(1)</sup>	1.0	1.5

(1) "Net bank debt" is equal to "Bank debt, net of working capital" determined in accordance with GAAP.

(2) Adjusted funds from operations is a non-GAAP financial measure which is calculated as cash provided by operating activities before changes in non-cash operating working capital, and adding back (if applicable): transaction costs, provisions for potential credit losses, and settlement of decommissioning obligations.

(3) Trailing adjusted funds from operations is annualized based on the most recent quarter's adjusted funds from operations.

Kelt targets a net bank debt to trailing adjusted funds from operations ratio of less than 2.0 times. The Company manages its capital structure and makes adjustments according to market conditions in order to maintain flexibility to achieve its objectives stated above. To adjust its capital structure, the Company may increase or decrease capital expenditures, issue new shares, issue new debt or repay existing debt.

The Company's net bank debt to trailing adjusted funds from operations ratio was 1.0 times as at December 31, 2017, down from 1.5 times at December 31, 2016. The Karr Property Disposition was completed on January 18, 2017 for cash proceeds of \$103.1 million (note 5). The proceeds were used initially to reduce bank indebtedness under the Credit Facility, and a portion subsequently used, along with \$115.2 million of cash provided by operating activities, to fund exploration and development capital expenditures during the year ended December 31, 2017.

As more particularly described in note 8, Kelt is subject to certain non-financial covenants under the Credit Facility agreement. As at December 31, 2017, the Company is in compliance with all covenants. The Company is not subject to any other externally imposed capital requirements.

## 14. FINANCING EXPENSES

The following table summarizes significant components of the Company's financing expenses:

	Year ended December 31	
	2017	2016
Interest on bank debt	3,310	7,308
Interest on convertible debentures	4,500	2,983
Accretion of convertible debentures	3,539	2,145
Accretion of decommissioning obligations [note 10]	2,981	2,817
Financing expense	14,330	15,253

## 15. GENERAL AND ADMINISTRATIVE (“G&A”) EXPENSES

The following table summarizes significant components of the Company's G&A expenses:

	Year ended December 31	
	2017	2016
Salaries and benefits <sup>(1)</sup>	8,247	6,757
Other G&A expenses	4,323	3,924
G&A expenses before recoveries	12,570	10,681
Overhead recoveries	(5,006)	(3,687)
General and administrative expense	7,564	6,994

(1) Refer to additional information regarding salaries and benefits paid to key management personnel in note 18 of these financial statements.

## 16. COMMITMENTS

As of December 31, 2017, the Company is committed to future payments under the following agreements:

(CA\$ thousands)	2018	2019	2020	2021	2022	Thereafter
Operating lease - office buildings	589	900	968	987	1,006	335
Operating lease - vehicles	366	262	112	13	-	-
Capital commitments <sup>(1)</sup>	5,568	-	-	-	-	-
Firm processing commitments	6,490	1,528	1,566	1,605	1,365	-
Firm transportation commitments <sup>(2)</sup>	28,106	16,448	13,650	10,974	10,374	36,586
<b>Total annual commitments</b>	<b>41,119</b>	<b>19,138</b>	<b>16,296</b>	<b>13,579</b>	<b>12,745</b>	<b>36,921</b>

(1) Estimated cost to complete relocation of equipment purchased on July 31, 2017 (note 7). Under the terms of the asset purchase agreement, Kelt is contractually obligated to remove the equipment from the seller's location on or before December 31, 2018.

(2) A portion of Kelt's commitments on the Alliance pipeline are denominated in US dollars. The volumes committed vary over the term of the contracts, which are effective until October 31, 2018 and October 31, 2020, respectively. However, the maximum US denominated commitment in a given month does not exceed US\$0.2 million. Amounts are translated to Canadian dollars at the spot rate on December 31, 2017 of CA\$/US\$1.2545.

Payments under the office building operating leases relate to the Company's head office in Calgary, Alberta, and field offices in Grande Prairie, Alberta and Fort St. John, British Columbia. The leases expire on April 30, 2023, February 28, 2020, and November 30, 2018, respectively, if not extended.

The Company has firm commitments for oil and gas transportation on major pipelines in Alberta and British Columbia. For periods subsequent to 2020, Kelt has an average annual commitment of \$7.4 million for gas transportation until October 31, 2027 and an average annual commitment of \$0.9 million for oil transportation until December 31, 2027.

## 17. SUPPLEMENTAL CASH FLOW INFORMATION

	Year ended December 31	
Changes in non-cash working capital	2017	2016
Accounts receivable and accrued revenue	(9,040)	(3,140)
Prepaid expenses and deposits	(814)	938
Accounts payable and accrued liabilities	32,124	(9,272)
Change in non-cash working capital	22,270	(11,474)
Relating to:		
Operating activities	8,723	(12,546)
Investing activities	13,547	1,072
Change in non-cash working capital	22,270	(11,474)

During the reporting period, the Company made the following cash outlays in respect of interest and taxes:

<b>Cash outlays in respect of interest and taxes</b>	Year ended December 31	
	<b>2017</b>	2016
Interest and standby fees on bank debt	<b>3,193</b>	6,930
Interest on convertible debentures <sup>(1)</sup>	<b>4,500</b>	2,601
Taxes <sup>(2)</sup>	-	-

(1) Interest on the Debentures is payable semi-annually on May 31<sup>st</sup> and November 30<sup>th</sup> (note 9).

(2) Kelt was not required to pay cash income taxes as the Company had sufficient income tax deductions available to shelter taxable income (note 12).

## 18. RELATED PARTY TRANSACTIONS

A director of the Company is also a partner at a law firm which Kelt has engaged to provide legal services. During the year ended December 31, 2017, the Company incurred \$0.3 million (2016 – \$0.6 million) in legal fees and disbursements. The Company expects to continue using the services of this law firm from time to time.

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Company. The following table summarizes compensation paid or payable to officers and directors of the Company:

	Year ended December 31	
	<b>2017</b>	2016
Salaries, bonuses and other benefits	<b>1,752</b>	1,437
Share based compensation	<b>2,185</b>	2,521
<b>Total compensation</b>	<b>3,937</b>	3,958

During the year ended December 31, 2017, key management personnel were granted 89,000 RSUs and 984,000 stock options with an exercise price of \$6.09 per share. During the previous year ended December 31, 2016, key management personnel were granted 146,210 RSUs and 988,000 stock options with an exercise price of \$4.52 per share.

**ABBREVIATIONS**

bbls	barrels
mbbls	thousand barrels
bbls/d	barrels per day
BOE	barrels of oil equivalent
mBOE	thousand barrels of oil equivalent
BOE/d	barrels of oil equivalent per day
mcf	thousand cubic feet
mmcf	million cubic feet
bcf	billion cubic feet
mmcf/d	million cubic feet per day
MMBtu	million British Thermal Units
GJ	gigajoules
LT	long tonnes
AECO	Alberta Energy Company "C" Meter Station of the NOVA Pipeline System
NIT	NOVA Inventory Transfer ("AB-NIT"), being the reference price at the AECO Hub
WTI	West Texas Intermediate
NYMEX	New York Mercantile Exchange
Station 2	Spectra Energy receipt location
NGX	Natural Gas Exchange Inc. (Canada)
API	American Petroleum Institute
MD&A	Management's Discussion and Analysis
Q1	First quarter ended March 31 <sup>st</sup>
Q2	Second quarter ended June 30 <sup>th</sup>
Q3	Third quarter ended September 30 <sup>th</sup>
Q4	Fourth quarter ended December 31 <sup>st</sup>
YTD	Year to date
BT	Before income taxes
AT	After income taxes
1P	Proved reserves
2P	Proved plus probable reserves
FVLCD	Fair value less costs of disposal
CGU	Cash generating unit
DUC	refers to drilled but un-completed wells
CDE	Canadian Development Expenses
CEE	Canadian Exploration Expenses

**CONVERSION OF UNITS**

Imperial = Metric
1 acre = 0.4 hectares
2.5 acres = 1 hectare
1 bbl = 0.159 cubic metres
6.29 bbls = 1 cubic metre
1 foot = 0.3048 metres
3.281 feet = 1 metre
1 mcf = 28.2 cubic metres
0.035 mcf = 1 cubic metre
1 mile = 1.61 kilometres
0.62 miles = 1 kilometre
1 MMBtu = 1.054 GJ
0.949 MMBtu = 1 GJ
Natural gas is equated to oil on the basis of 6 mcf = 1 BOE
Sulphur is equated to gas on the basis of 1LT = 10 mcf (1 BOE = 0.6 LT)
IP120 = initial production from a well for the first 2,880 hours (120 days) based on operating / producing hours



## **CORPORATE INFORMATION**

### **BOARD OF DIRECTORS**

**Robert J. Dales** <sup>2, 3, 4, 6</sup>

President, Valhalla Ventures Inc.

**Geri Greenall** <sup>2, 6</sup>

Vice President, Portfolio Manager & Chief Operating Officer of Kyklopes Capital Management Ltd.

**William C. Guinan** <sup>1, 5</sup>

Partner, Borden Ladner Gervais LLP

**Eldon A. McIntyre** <sup>2, 3, 4, 6</sup>

President, Jarrod Oils Ltd.

**Neil G. Sinclair** <sup>2, 3, 4, 5, 6</sup>

President, Sinson Investments Ltd.

**David J. Wilson** <sup>5</sup>

President & Chief Executive Officer  
Kelt Exploration Ltd.

1 chairman of the board

2 member of the audit committee

3 member of the reserves committee

4 member of the compensation committee

5 member of the health, safety and environment committee

6 member of the nominating committee

### **OFFICERS**

**David J. Wilson**

President & Chief Executive Officer

**Sadiq H. Lalani**

Vice President & Chief Financial Officer

**Douglas J. Errico**

Vice President, Land

**Alan G. Franks**

Vice President, Production

**Bruce D. Gigg**

Vice President, Engineering

**Ashley D. Hohm**

Vice President, Finance

**Douglas O. MacArthur**

Vice President, Operations

**Patrick W.G. Miles**

Vice President, Exploration

### **HEAD OFFICE**

Suite 300, East Tower, 311 Sixth Avenue S.W.  
Calgary, Alberta T2P 3H2

Phone: 403.294.0154

Fax: 403.291.0155

[www.keltexploration.com](http://www.keltexploration.com)

### **REGISTRAR AND TRANSFER AGENT**

Computershare

6<sup>th</sup> Floor, 530 Eighth Avenue S.W.

Calgary, Alberta T2P 3S8

### **LEGAL COUNSEL**

Borden Ladner Gervais LLP

Centennial Place, East Tower,

Suite 1900, 520 Third Avenue S.W.

Calgary, Alberta T2P 0R3

### **BANKERS**

National Bank of Canada

Suite 1800, 311 Sixth Avenue S.W.

Calgary, Alberta T2P 3H2

### **AUDITORS**

PricewaterhouseCoopers LLP

Suite 3100, 111 Fifth Avenue S.W.

Calgary, Alberta T2P 5L3

### **EVALUATION ENGINEERS**

Sproule Associates Limited

Suite 900, 140 Fourth Avenue S.W.

Calgary, Alberta T2P 3N3

### **STOCK EXCHANGE LISTING**

Toronto Stock Exchange

Common shares "KEL"

Convertible Debentures "KEL.DB"



SUITE 300, EAST TOWER  
311 SIXTH AVENUE SOUTH WEST  
CALGARY, ALBERTA T2P 3H2