kelt exploration

ANNUAL REPORT
AS AT AND FOR THE YEAR ENDED
DECEMBER 31, 2016

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FINANCIAL AND OPERATIONAL HIGHLIGHTS	Three months ended December 31			Year ended December 31		
(CA$ thousands, except as otherwise indicated)	**2016**	2015[2]	%	**2016**	2015[2]	%
FINANCIAL						
Revenue, before royalties and financial instruments	**55,737**	42,797	30	**184,613**	179,326	3
Adjusted funds from operations[1]	**23,100**	11,172	107	**58,380**	56,517	3
Basic ($/ common share)[1]	**0.13**	0.07	86	**0.34**	0.37	-8
Diluted ($/ common share)[1]	**0.13**	0.07	86	**0.34**	0.36	-6
Profit (loss) and comprehensive income (loss)	**11,856**	(92,987)	113	**(49,774)**	(141,039)	65
Basic ($/ common share)	**0.07**	(0.55)	113	**(0.29)**	(0.91)	68
Diluted ($/ common share)	**0.07**	(0.55)	113	**(0.29)**	(0.91)	68
Total capital expenditures, net of dispositions	**36,339**	42,487	-14	**98,268**	497,273	-80
Total assets	**1,255,958**	1,279,475	-2	**1,255,958**	1,279,475	-2
Bank debt, net of working capital[1]	**138,042**	212,959	-35	**138,042**	212,959	-35
Convertible debentures	**70,978**	-	-	**70,978**	-	-
Shareholders' equity	**843,301**	846,754	0	**843,301**	846,754	0
Weighted average shares outstanding (000s)						
Basic	**175,275**	168,610	4	**173,076**	154,829	12
Diluted	**176,234**	169,352	4	**173,415**	155,936	11
OPERATIONS						
Average daily production						
Oil (bbls/d)	**4,746**	5,185	-8	**5,070**	5,091	0
NGLs (bbls/d)	**2,502**	1,864	34	**2,709**	1,607	69
Gas (mcf/d)	**75,084**	78,225	-4	**79,009**	71,272	11
Combined (BOE/d)	**19,762**	20,086	-2	**20,947**	18,577	13
Production per million common shares (BOE/d)[1]	**113**	119	-5	**121**	120	1
Average realized prices, before financial instruments						
Oil ($/bbl)	**58.23**	45.19	29	**47.84**	50.83	-6
NGLs ($/bbl)	**23.11**	22.86	1	**18.28**	23.12	-21
Gas ($/mcf)	**3.62**	2.40	51	**2.69**	2.74	-2
Operating netbacks ($/BOE)[1]						
Oil and gas revenue	**30.66**	23.16	32	**24.08**	26.45	-9
Cash premiums on derivatives	**0.11**	-	-	**0.06**	-	-
Realized loss on financial instruments	**(0.24)**	(1.15)	-79	**(0.04)**	(0.12)	-67
Average realized price, after financial instruments	**30.53**	22.01	39	**24.10**	26.33	-8
Royalties	**(2.86)**	(2.72)	5	**(2.08)**	(2.81)	-26
Production expense	**(9.47)**	(9.21)	3	**(9.29)**	(11.34)	-18
Transportation expense	**(3.12)**	(2.03)	54	**(2.86)**	(2.09)	37
Operating netback[1]	**15.08**	8.05	87	**9.87**	10.09	-2
Undeveloped land						
Gross acres	**768,345**	649,297	18	**768,345**	649,297	18
Net acres	**647,770**	521,413	24	**647,770**	521,413	24
Reserves – proved plus probable						
Crude oil (mbbls)	**23,308**	21,101	10	**23,308**	21,101	10
Liquids (mbbls)	**48,585**	33,276	46	**48,585**	33,276	46
Gas (mmcf)	**733,037**	576,779	27	**733,037**	576,779	27
Combined (mBOE)	**194,066**	150,507	29	**194,066**	150,507	29

(1) Refer to advisories regarding non-GAAP financial measures and other key performance indicators.
(2) Certain comparative information has been revised, refer to information under the heading of *"Corporate Acquisition"*.

MESSAGE TO SHAREHOLDERS

Kelt Exploration Ltd. (“Kelt” or the “Company”) has reported its financial and operating results to shareholders for the fourth quarter and year ended December 31, 2016.

Average production for the three months ended December 31, 2016 was 19,762 BOE per day, down 2% compared to average production of 20,086 BOE per day during the fourth quarter of 2015. Daily average production in the fourth quarter of 2016 was 4% lower than average production of 20,542 BOE per day in the third quarter of 2016. Production disruptions from gas plant outages and pipeline and facility related downtime resulted in shut-ins of approximately 1,900 BOE per day on average during the fourth quarter of 2016. During the second half of 2016, Kelt was able to keep production relatively flat at approximately 20,000 BOE per day despite only adding 2.3 net wells of new production from the 2016 drilling program.

Kelt’s realized average oil price during the fourth quarter of 2016 was $58.23 per barrel, up 11% from $52.47 per barrel in the third quarter of 2016 and up 29% from $45.19 per barrel in the fourth quarter of 2015. The realized average NGLs price during the fourth quarter of 2016 was $23.11 per barrel, up 29% from $17.96 per barrel in the third quarter of 2016 and up 1% from $22.86 per barrel in the corresponding quarter of 2015. Kelt’s realized average gas price for the fourth quarter of 2016 was $3.62 per MCF, up 26% from $2.88 per MCF in the third quarter of 2016 and up 51% from the realized average gas price of $2.40 per MCF in the fourth quarter of the previous year.

For the three months ended December 31, 2016, revenue was $55.7 million and adjusted funds from operations was $23.1 million ($0.13 per share, diluted), compared to $42.8 million and $11.2 million ($0.07 per share, diluted) respectively, in the fourth quarter of 2015. At December 31, 2016, bank debt, net of working capital was $138.0 million, down 35% from $213.0 million at December 31, 2015.

Net capital expenditures incurred during the three months ended December 31, 2016 were $36.3 million. The Company spent $25.5 million on drilling operations, $7.1 million on facilities and pipelines and $3.1 million acquiring new undeveloped land parcels primarily at Crown sales during the quarter. As at December 31, 2016, Kelt’s net working interest land holdings were 856,754 acres (1,339 sections) of which 647,770 net acres (1,012 sections) are undeveloped.

Subsequent to the end of the year, Kelt continued to improve its financial flexibility by completing the disposition of oil and gas assets in the Karr area of Alberta for net cash proceeds of approximately $102.9 million, after estimated closing adjustments.

During 2016, Kelt continued with its 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. At December 31, 2016, Kelt’s net Montney land holdings were 416,115 acres (650 sections), of which 132,610 acres (207 sections) are in a new area located at Oak/Flatrock, British Columbia, where the Company has now drilled its first horizontal well. This well is expected to be completed in March 2017. In addition, the Company has 50,080 acres (78 sections) with Montney rights at Pipestone/Wembley, Alberta, where Kelt expects to drill its first horizontal well during the first half of 2017.

In the fourth quarter of 2016, Kelt drilled six horizontal wells that were not yet completed at year-end. Five wells were from a pad at Pouce Coupe in the middle Montney (two D1 wells and three D2 wells) and the sixth well was drilled at Fireweed in the upper Montney. These wells have all been completed in late January and February of 2017. The Fireweed well was put on production in early February and the Pouce Coupe wells are all expected to be on-stream by April.

Kelt continues to optimize its completion method on Montney horizontal wells. The Company uses the ball drop completion method for hydraulic fracturing. The horizontal lateral of the recent wells that were drilled is approximately 2,300 metres and the wells are completed using slick-water comprising 46 frac stages with average proppant (sand) of 70 tonnes per stage (approximately 3,200 tonnes in total or 1.4 tonnes per metre). The fluid (slick-water) is pumped at high intensity rates of 10 to 12 cubic metres per minute (approximately 19,000 cubic metres in total). To date, Kelt has experienced significant improvements in initial production rates from wells that have been completed with these parameters. In British Columbia, Kelt completed the upper Montney delineation well at Fireweed C-31-I/94-A-12 which is located in the northeast part of its large contiguous Montney land block (186 sections). The well was put on production in early February and in the first month, the well had an IP30 rate (gross sales) of 2,068 BOE per day of which 68% is liquids (includes field condensate and NGLs). The Company expects to be in a position to report the IP30 rates for the five-well pad at Pouce Coupe, Alberta in May 2017.

Kelt has not changed its previously reported production and financial guidance for 2017. 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 2017 after the first quarter. With continued improvement in commodity prices, Kelt will consider increasing its capital program for the balance of 2017 at that time.

Management looks forward to updating shareholders with 2017 first quarter results on or about May 10, 2017.

On behalf of the Board of Directors,

[signed]

David J. Wilson
President and Chief Executive Officer
March 7, 2017

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. 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 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 Kelt is located at Suite 300, 311 - 6th Avenue S.W., Calgary, Alberta T2P 3H2.

The Company was incorporated under the *Business Corporations Act* (Alberta) on October 11, 2012 as 1705972 Alberta Ltd. and was inactive until February 26, 2013. On October 19, 2012, Articles of Amendment were filed to change the name of the Company to Kelt Exploration Ltd.

On April 16, 2015, the Company completed the acquisition of Artek Exploration Ltd. ("Artek") by acquiring all of the issued and outstanding common shares of Artek pursuant to a statutory plan of arrangement under the *Business Corporations Act* (Alberta) (the "Artek Acquisition"). Pursuant to the arrangement, Artek common shares were delisted from the TSX and Artek became a wholly-owned subsidiary of Kelt. Immediately following the Artek Acquisition, Articles of Amendment were filed to change the name of Artek to Kelt Exploration (LNG) Ltd. ("Kelt LNG"). Kelt has transferred all of its British Columbia ("BC") assets to Kelt LNG and at the same time, Kelt LNG has transferred all of its Alberta assets to Kelt. Kelt LNG operates in BC as a wholly-owned subsidiary of Kelt, headquartered in Calgary, Alberta.

Additional information relating to Kelt can be found on SEDAR at www.sedar.com.

This Management's Discussion and Analysis ("MD&A") is dated March 7, 2017 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, 2016. 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 7, 2017.

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" 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 expectation that six wells that were drilled but uncompleted as at December 31, 2016, will all be on production by April 2017; Kelt's intention to incur sufficient qualifying expenditures to fully satisfy its flow-through share commitments; the Company's ability to continue accumulating land at a low-cost in its core operating areas and potentially monetize non-core assets; 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.

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

FINANCIAL AND OPERATING HIGHLIGHTS

- Kelt achieved record high calendar year average production in 2016. Average production for 2016 was 20,947 BOE per day, up 13% from average production of 18,577 BOE per day in 2015. Production per million shares was 121 BOE per day, up from 120 BOE per day in 2015. During the three months ended December 31, 2016, corporate production averaged 19,762 BOE per day compared to 20,086 BOE per day in the same quarter of 2015. During the fourth quarter of 2016, gas plant outages and intermittent pipeline and facility downtime negatively impacted average production by approximately 1,900 BOE per day.
- Realized oil and gas prices improved significantly during the fourth quarter of 2016 contributing to the 87% increase in Kelt's operating netback, which averaged $15.08 per BOE for the three months ended December 31, 2016 compared to $8.05 per BOE during the same quarter of 2015.
- The Company generated adjusted funds from operations of $23.1 million ($0.13 per common share, diluted) during the three months ended December 31, 2016, up 107% from $11.2 million ($0.07 per common share, diluted) in the fourth quarter of 2015. Adjusted funds from operations increased by 3% to $58.4 million ($0.34 per common share, diluted) in 2016 compared to $56.5 million ($0.36 per common share, diluted) in 2015.
- Corporate royalty rates averaged 9.3% of revenue during the fourth quarter of 2016 and 8.6% of revenue during the year ended December 31, 2016, down from 10.6% on average in 2015.
- Production expenses averaged $9.29 per BOE during the year ended December 31, 2016, down 18% from $11.34 per BOE in 2015, reflecting Kelt's ongoing operational initiatives to reduce costs. The Company performed various maintenance operations and production optimization workovers during the fourth quarter of 2016 resulting in production expenses of $9.47 per BOE, up from $9.21 per BOE in the fourth quarter of 2015.

- Kelt continues to incur below industry average general and administrative ("G&A") expenses, which on a per-unit basis, averaged $0.91 per BOE in 2016 ($0.77 per BOE in 2015), despite facing significant production downtime throughout 2016. G&A expense is reported net of standard overhead recoveries. Kelt does not capitalize any direct G&A expenses.
- Capital expenditures were $36.3 million during the fourth quarter and amounted to $98.3 million for the year ended December 31, 2016. $9.8 million was spent on land and seismic, $47.4 million was spent drilling and completing wells, $28.5 million was spent on well equipment and other infrastructure, and $12.6 million was spent on property acquisitions (net of dispositions). The Company's capital expenditures are down 80% compared to $497.3 million in 2015, which included $314.3 million for the corporate acquisition of Artek.
- During 2016, Kelt completed non-core property dispositions for aggregate cash proceeds of $5.9 million. The dispositions resulted in a gain on sale of $8.7 million for the year ended December 31, 2016. In addition, the dispositions resulted in a material reduction of Kelt's corporate decommissioning obligations as the liabilities associated with the properties disposed had a carrying amount of $11.7 million.
- The Company increased its undeveloped land acreage by 24% year-over-year by acquiring exploratory lands on two new Montney plays located at Oak/Flatrock in BC and Pipestone/Wembley in Alberta. As at December 31, 2016, the Company owned 647,770 net acres of undeveloped land. Through an active land acquisition strategy during 2015 and 2016 during the commodity price downturn, Kelt has expanded its Montney land holdings in its core areas to 416,115 net acres (650 net sections).
- Kelt drilled 15 (12.3 net) wells during the year ended December 31, 2016. The number of net wells drilled by the Company is down 21% compared to 19 (15.5 net working interest) wells drilled during the previous year ended December 31, 2015. Six wells drilled during the fourth quarter were uncompleted ("DUCs") as at December 31, 2016. These DUCs are expected to be put on production starting in the first quarter and on-stream by April 2017.
- The Company reported significant growth in reserves as at December 31, 2016:
    - Proved developed producing reserves increased 2% to 34.5 million BOE;
    - Total proved reserves increased 29% to 108.2 million BOE; and
    - Total proved plus probable reserves increased 29% to 194.1 million BOE.
- The Company's 2016 capital investment program resulted in net reserve additions that replaced 2016 production by a factor of 4.2 times on a proved basis and 6.7 times on a proved plus probable basis.
- Kelt reported proved plus probable finding, development and acquisition ("FD&A") costs, including future development capital expenditures, of $3.47 per BOE for 2016, down 77% compared to $14.79 per BOE in 2015.
- Kelt's net asset value at December 31, 2016 was $9.20 per common share, up 38% from $6.65 per common share at December 31, 2015.
- During 2016, Kelt reduced its net bank debt by 35% or $75.0 million. In addition to cost savings initiatives and reducing capital expenditures through the period of low commodity prices, the Company strengthened its liquidity and financial position by monetizing non-core assets and through the completion of strategic financing transactions:
    - On May 3, 2016, the Company issued $90.0 million principal amount of 5% convertible unsecured subordinated debentures with a maturity date of May 31, 2021.
    - The Company raised aggregate gross proceeds of $31.7 million by issuing 6.1 million common shares on a "flow-through" basis at an average issue price of $5.21 per common share.
    - As at March 7, 2017, insiders owned or controlled 31.0 million common shares, or 17.6% of the total shares outstanding. In addition, insiders own or control $14.7 million principal amount of the 5% convertible debentures outstanding.
- As at December 31, 2016, the Company had drawn $111.7 million on its $185.0 million revolving bank credit facility. Kelt is well positioned to execute on its 2017 capital expenditure program and has sufficient financial flexibility to take advantage of opportunities as they arise.

Refer to additional information under the heading of *"Subsequent events"* regarding the Karr Property Disposition.

REVENUE

	Three months ended December 31			Year ended December 31		
(CA$ thousands, except as otherwise indicated)	**2016**	2015	%	**2016**	2015	%
Average daily production:						
Oil (bbls/d)	**4,746**	5,185	-8	**5,070**	5,091	0
NGLs (bbls/d)	**2,502**	1,864	34	**2,709**	1,607	69
Gas (mcf/d)	**75,084**	78,225	-4	**79,009**	71,272	11
Combined (BOE/d)	**19,762**	20,086	-2	**20,947**	18,577	13
Average realized prices, before financial instruments:						
Oil ($/bbl)	**58.23**	45.19	29	**47.84**	50.83	-6
NGLs ($/bbl)	**23.11**	22.86	1	**18.28**	23.12	-21
Gas ($/mcf)	**3.62**	2.40	51	**2.69**	2.74	-2
Combined ($/BOE)	**30.66**	23.16	32	**24.08**	26.45	-9
Revenue, before royalties and financial instruments:						
Oil	**25,424**	21,560	18	**88,767**	94,451	-6
NGLs	**5,320**	3,920	36	**18,124**	13,558	34
Gas	**24,993**	17,317	44	**77,722**	71,317	9
Revenue, before royalties and financial instruments	**55,737**	42,797	30	**184,613**	179,326	3

Kelt achieved record high calendar year average production in 2016. Average production for 2016 was 20,947 BOE per day, up 13% from average production of 18,577 BOE per day in 2015. Production per million shares was 121 BOE per day, up from 120 BOE per day in 2015. The increase in production reflects Kelt's successful drilling program, partly offset by corporate declines and production downtime. Kelt's drilling program was complemented by a strategic acquisition of oil and gas assets in the Progress area of Alberta on April 28, 2016, which added production of approximately 600 BOE per day at the time of the acquisition. Average production reported for the year ended December 31, 2015, only includes production from the Artek Acquisition for the period following closing of the acquisition on April 16, 2015.

Production averaged 19,762 BOE per day during the fourth quarter of 2016, down 4% from 20,542 BOE during the third quarter of 2016 and down 2% from average production of 20,086 BOE per day in the fourth quarter of 2015. During the quarter ended December 31, 2016, gas plant outages and intermittent pipeline and facility downtime negatively impacted average production by approximately 1,900 BOE per day. The Company also faced approximately 1,700 BOE per day of average production downtime during the second quarter ended June 30, 2016, due to a planned turnaround of the Progress Gas Plant completed in June, along with the temporary shut-in of the West Stoddart Gas Plant as a result of forest fires in the vicinity of Fort St. John, BC, during April and May.

Revenue for the year ended December 31, 2016 was $184.6 million, up 3% compared to $179.3 million in 2015. The Company's production growth outpaced the increase in revenue year-over-year primarily due to lower oil and NGLs prices. The Company's combined average sales price was $24.08 per BOE in 2016, down 9% compared to $26.45 per BOE in 2015. Oil and NGLs represented 37% of production volumes and 58% of total revenue during 2016. In 2015, production volumes were weighted 36% to oil and NGLs and contributed to 60% of total revenue.

Despite lower fourth quarter production, the Company's revenue increased by 30% to $55.7 million compared to $42.8 million in the fourth quarter of 2015 as a result of significant improvement in oil and gas prices. Kelt's combined average sales price was $30.66 per BOE during the three month period ended December 31, 2016, up 32% compared to $23.16 per BOE during the same three month period of 2015.

OIL OPERATIONS

References to "oil" in this discussion includes crude oil and field condensate.

	Three months ended December 31			Year ended December 31		
(CA$ thousands, except as otherwise indicated)	**2016**	2015	%	**2016**	2015	%
Oil production (bbls per day)	**4,746**	5,185	-8	**5,070**	5,091	0
Oil revenue	**25,424**	21,560	18	**88,767**	94,451	-6
Oil royalties	**(3,711)**	(4,422)	-16	**(13,101)**	(15,564)	-16
Oil revenue, after royalties	**21,713**	17,138	27	**75,666**	78,887	-4
Average realized oil prices ($/bbl):						
Before financial instruments	**58.23**	45.19	29	**47.84**	50.83	-6
Realized gain (loss) on financial instruments	**-**	(1.46)	-100	**-**	(0.49)	-100
After financial instruments	**58.23**	43.73	33	**47.84**	50.34	-5
Average realized price, percentage of CLS	**96%**	86%		**91%**	88%	
Benchmark oil prices:						
WTI Cushing Oklahoma (US$/bbl) (1)	**49.29**	42.18	17	**43.32**	48.80	-11
WTI Cushing Oklahoma (CA$/bbl) (2)	**65.78**	56.22	17	**57.24**	62.12	-8
Canadian Light Sweet ("CLS") ($/bbl) (1)	**60.76**	52.55	16	**52.79**	57.45	-8
CLS % of CA$WTI	**92%**	93%	-1	**92%**	92%	-
Average exchange rate (CA$/US$) (1)	**1.3339**	1.3347	0	**1.3256**	1.2764	4

(1) Source: Sproule Associates Limited.

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

Kelt realized an average oil price of $58.23 per barrel for the three months ended December 31, 2016, up 30% from the average price of $44.64 per barrel realized for the first nine months of 2016, and up 29% compared to $45.19 per barrel realized for the fourth quarter of 2015. Benchmark oil prices strengthened during the fourth quarter of 2016 surrounding the improved outlook for global crude oil supply and demand.

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.

The average discount of Kelt's realized oil price relative to the CLS reference price was $2.53 per barrel during the fourth quarter of 2016, compared to a discount of $7.36 per barrel in the fourth quarter of 2015. The discount was $4.95 per barrel on average in 2016 compared to $6.62 per barrel in 2015. The decrease in Kelt's oil price discount in 2016 reflects a combination of improved contract pricing and fewer deductions, partly attributable to lower pipeline tariffs. In 2015, substantially all of Kelt's BC oil production was delivered on the BC Light pipeline. As a result of capacity constraints on the BC Light pipeline, Kelt trucked approximately 50% of its 2016 average BC oil volumes to terminals in Alberta with significantly lower pipeline tariffs.

Oil royalties averaged 14.8% of oil revenue for the year ended December 31, 2016, down on average from 16.5% in 2015 primarily due to lower oil prices in the first half of 2016.

NGL OPERATIONS

References to "NGLs" in this discussion includes pentanes (C5 and C5+), butane, propane and ethane.

	Three months ended December 31			Year ended December 31		
(CA$ thousands, except as otherwise indicated)	**2016**	2015	%	**2016**	2015	%
NGLs production (bbls per day)	**2,502**	1,864	34	**2,709**	1,607	69
NGLs revenue	**5,320**	3,920	36	**18,124**	13,558	34
NGLs royalties	**(552)**	(174)	217	**(908)**	(1,082)	-16
NGLs revenue, after royalties	**4,768**	3,746	27	**17,216**	12,476	38
Average realized NGLs price ($/bbl):						
Before financial instruments	**23.11**	22.86	1	**18.28**	23.12	-21
Realized gain (loss) on financial instruments (1)	**-**	-	-	**-**	3.13	-100
After financial instruments	**23.11**	22.86	1	**18.28**	26.25	-30
Average realized price, percentage of CA$WTI (2)	**35%**	41%		**32%**	37%	
Benchmark NGLs prices (3) ($/bbl):						
Edmonton Pentane	**64.88**	57.91	12	**55.71**	61.45	-9
Edmonton Butane	**42.35**	36.45	16	**34.32**	36.81	-7
Edmonton Propane	**25.08**	9.89	154	**13.60**	6.17	120
Edmonton Ethane	**8.61**	6.86	26	**6.04**	7.49	-19
Weighted average NGLs benchmark price (4)	**36.60**	32.46	13	**28.74**	33.48	-14

(1) In January 2015, the Company unwound an OPIS-Conway propane derivative contract for proceeds of US$1.5 million (CA$1.8 million).

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

(3) Source: Sproule Associates Limited.

(4) Average of Edmonton NGL prices during the period (2), weighted based on Kelt's actual NGL sales volumes in each respective period.

Kelt's NGL sales volumes were weighted 26% pentanes, 25% butane, 31% propane and 18% ethane for the year ended December 31, 2016. By comparison, NGL sales volumes were weighted 33% pentanes, 30% butane, 31% propane and 6% ethane in 2015. Kelt's average realized NGLs price as a percentage of CA$WTI is lower in 2016 compared to 2015 due to the higher weighting of ethane relative to total NGL volumes. The change in NGLs product mix is primarily attributable to a new marketing arrangement that came into effect in November 2015, resulting in higher total NGL recoveries on Company's production originating from the West Stoddart Gas Plant in northeastern BC. The arrangement results in a higher shrink of the Company's BC gas production, however, the price realized on additional NGL barrels extracted is at a premium to the Station 2 gas price.

The Company's average realized price for NGL sales was $18.28 per barrel for the year ended December 31, 2016, down 21% from 2015 primarily due to lower pentane and butane prices which are strongly correlated to the WTI oil price. In the fourth quarter of 2016, Kelt's average realized NGLs price increased to $23.11 per barrel reflecting higher oil prices and a dramatic recovery in propane prices. Propane prices were at record lows and sometimes negative starting mid-2015 and through the first half of 2016. Since then, Western Canadian propane inventories have fallen to a more normal range and exports have increased, resulting in the recovery of propane prices in the fourth quarter of 2016.

Subsequent to the end of the reporting period, Kelt entered into a financial derivative contract to lock-in the stronger propane price and reduce the Company's downside price risk on a notional 500 barrels per day of propane for the period from February 1, 2017 to December 31, 2017. Refer to additional information under the heading of *"Derivative Financial Instruments"*.

NGL royalties averaged 5.0% during the year ended December 31, 2016, down from 8.0% in 2015 primarily due to lower average NGLs prices during 2016. In addition, NGL royalties are reduced by various drilling incentive and cost allowance credits, which are allocated pro-rata to gas and NGLs and do not fluctuate with NGL prices.

GAS OPERATIONS

References to "gas" in this discussion includes natural gas and sulphur.

	Three months ended December 31			Year ended December 31		
(CA$ thousands, except as otherwise indicated)	**2016**	2015	%	**2016**	2015	%
Gas production (MCF per day)	**75,084**	78,225	-4	**79,009**	71,272	11
Gas revenue	**24,993**	17,317	44	**77,722**	71,317	9
Gas royalties	**(940)**	(427)	120	**(1,902)**	(2,387)	-20
Gas revenue, after royalties	**24,053**	16,890	42	**75,820**	68,930	10
Average realized gas price ($/MCF):						
Before financial instruments	**3.62**	2.40	51	**2.69**	2.74	-2
Cash premiums on financial instruments	**0.03**	-	-	**0.02**	-	-
Realized gain (loss) on financial instruments	**(0.06)**	(0.20)	-70	**(0.01)**	(0.07)	-86
After financial instruments	**3.59**	2.20	63	**2.70**	2.67	0
Kelt average premium (discount) to AECO 5A (1)	**17%**	-3%		**25%**	2%	
Benchmark gas prices:						
NYMEX Henry Hub (US$/MMBtu) (2)	**2.95**	2.28	29	**2.43**	2.67	-9
AECO 5A (CA$/GJ) (3)	**2.93**	2.34	25	**2.05**	2.55	-20
NGX Station #2 Day Ahead Index (CA$/GJ) (4)	**2.28**	1.04	119	**1.64**	1.70	-3
Average discount to AECO 5A (CA$/GJ)	**-22%**	-56%	34	**-20%**	-33%	13
Platts Chicago City-Gate (US$/MMBtu) (5)	**2.97**	-	-	**2.47**	-	-
Platts Chicago City-Gate (CA$/MMBtu) (5)	**3.96**	-	-	**3.27**	-	-
Average premium to AECO 5A (CA$/MMBtu)	**28%**	-	-	**52%**	-	-

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

(2) Source: Canadian Gas Price Reporter (Henry Hub 3-Day Average Close).

(3) Source: Canadian Gas Price Reporter (NGX AB-NIT Same Day Index 5A).

(4) Source: Canadian Gas Price Reporter (NGX Spectra Station #2 Day Ahead Index).

(5) Source: Platts Chicago City-Gate (US$/MMBtu) per Tidal Energy Marketing Inc. The Canadian dollar equivalent Chicago City-Gate price is calculated based on monthly average US$ price and the monthly average CA$/US$ exchange rate. Comparative information is not presented as the relevant contracts came into effect December 1, 2015.

The Company realized an average gas sales price of $3.62 per MCF during the fourth quarter of 2016, up 51% from $2.40 per MCF during the fourth quarter of 2015. By comparison, the AECO 5A gas reference price increased by 25% over the same period, and averaged $2.93 per GJ during the fourth quarter of 2016. On average during 2016, the AECO gas reference price was 20% lower compared to 2015, however Kelt's realized gas price of $2.69 per MCF in 2016 was only down 2% from 2015. Kelt generally receives a premium to the AECO 5A gas price due to the higher heat content of its gas production and has marketing arrangements in place whereby the Company receives Chicago City-Gate pricing on 25 to 30 percent of its gas sales volumes.

Effective December 1, 2015, Kelt entered into gas sales agreements in BC and Alberta with firm transportation on the Alliance pipeline. Kelt receives Chicago City-Gate pricing under these contracts, which are currently in effect at different volume levels until October 31, 2017. The Canadian dollar equivalent Chicago City-Gate price averaged $3.27 per MMBtu during the year ended December 31, 2016, representing a significant premium to AECO 5A and Station 2 prices. Approximately two-thirds of the Company's gas production from its Inga-Fireweed-Stoddart assets was sold under these contracts during 2016, resulting in stronger realized prices compared to previous periods in which the majority of Kelt's BC gas production was sold at Station 2 or CREC prices. 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.

During the fourth quarter and year ended December 31, 2016, gas royalties averaged 3.8% and 2.4% of gas revenue, respectively. The increase in gas royalties during the fourth quarter of 2016 reflects the increase in gas prices relative to the first nine months of 2016. Gas royalties averaged 2.5% and 3.3% of gas revenue, respectively during the comparative periods of 2015. Crown royalties are calculated based on gas reference prices determined by the government and are reduced by royalty incentive credits, BC producer cost of service and Alberta gas cost allowance credits. These credits do not fluctuate with gas prices and impact the Company's reported average gas royalty rate each period.

PRODUCTION EXPENSES

	Three months ended December 31			Year ended December 31		
(CA$ thousands, unless otherwise indicated)	**2016**	2015	%	**2016**	2015	%
Production expense(1)	**17,231**	17,012	1	**71,204**	76,914	-7
$ per BOE	**9.47**	9.21	3	**9.29**	11.34	-18

(1) The presentation of comparative information for the first nine months of 2015 has been revised. Details regarding the reclassification are set-forth under the heading of *Change in Classification of Certain Production and Transportation Expenses* in this MD&A.

Kelt reported 13% growth in average production during 2016. At the same time, the Company's total production expenses decreased by 7% to $71.2 million during the year ended December 31, 2016, compared to $76.9 million in 2015. On a per unit basis, production expenses are down 18% year-over-year as a result of the Company's continued operational initiatives and previous expenditures to construct and acquire strategic infrastructure. In addition, with the Company's geographically concentrated asset base, Kelt is able to add new production at a lower incremental cost, reducing average production expenses per BOE.

The Company performed various maintenance operations and production optimization workovers during the fourth quarter of 2016 resulting in production expenses of $9.47 per BOE, up from $9.21 per BOE in the fourth quarter of 2015.

TRANSPORTATION EXPENSES

	Three months ended December 31			Year ended December 31		
(CA$ thousands, unless otherwise indicated)	**2016**	2015	%	**2016**	2015	%
Transportation expense(1)	**5,677**	3,756	51	**21,943**	14,192	55
$ per BOE	**3.12**	2.03	54	**2.86**	2.09	37

(1) The presentation of comparative information for the first nine months of 2015 has been revised. Details regarding the reclassification are set-forth under the heading of *Change in Classification of Certain Production and Transportation Expenses* in this MD&A.

Transportation expenses were $2.86 per BOE on average during 2016 compared to $2.09 per BOE in 2015. The increase is primarily due to the Company's firm commitments for gas transportation on the Alliance pipeline that came into effect December 1, 2015. Kelt incurs higher transportation expenses on these volumes, however, the tolls are more than offset by higher realized gas prices as Kelt receives Chicago City-Gate pricing, providing a premium to the gas price previously realized at CREC and Station 2.

Oil transportation expenses averaged $2.42 per barrel for the year ended December 31, 2016, down 17% from $2.91 per barrel on average during 2015. The majority of Kelt's oil production is pipeline connected as a result of expenditures to construct and acquire strategic infrastructure in 2015. During the fourth quarter of 2016, Kelt incurred above normal oil transportation costs ($3.18 per barrel) due to third-party pipeline downtime in Alberta and BC. However, the Company estimates that the impact of higher oil trucking expenses on operating netbacks in these circumstances has been relatively neutral as Kelt realized higher oil prices due to lower pipeline tariffs.

FINANCING EXPENSES

	Three months ended December 31			Year ended December 31		
(CA$ thousands, unless otherwise indicated)	**2016**	2015	%	**2016**	2015	%
Interest and fees on bank debt	**1,376**	1,957	-30	**7,308**	6,584	11
Interest on convertible debentures	**1,134**	-	-	**2,983**	-	-
Accretion of convertible debentures	**844**	-	-	**2,145**	-	-
Accretion of decommissioning obligations	**555**	783	-29	**2,817**	2,816	0
Financing expense	**3,909**	2,740	43	**15,253**	9,400	62
Average bank debt outstanding	**119,160**	163,295	-27	**149,562**	151,781	-1
Average interest rate on indebtedness	**3.9%**	3.9%	-	**4.2%**	3.6%	17
Average principal amount of convertible debentures outstanding in the period	**90,000**	-	-	**59,671**	-	-
Interest expense per BOE(1)	**1.38**	1.06	30	**1.34**	0.97	38

(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.

The Company’s financing expenses increased due to higher total debt levels on average in 2016 compared to 2015. The assumption of corporate indebtedness on the Artek Acquisition on April 16, 2015 was compounded by the subsequent rapid decline in commodity prices which hit historical lows during the first quarter of 2016. The combination of significantly lower cash flow, higher debt and tighter credit markets also resulted in an increase in the cost of capital during the first nine months of 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 31st and November 30th. The Company made its first cash interest payment of $2.6 million to debentureholders on November 30, 2016. Financing expense for the year ended December 31, 2016 includes $3.0 million of cash and accrued cash interest and $2.1 million of non-cash accretion expense. The Debentures are convertible onto common shares of the Company at a conversion price of $5.50 per share. Based on the closing price of Kelt common shares on the TSX of $6.77 per share on December 31, 2016, the Debentures are “in-the-money”.

The Company has a revolving committed term credit facility (the “Credit Facility”) with a syndicate of financial institutions. For the year ended December 31, 2016, amounts drawn under the Credit Facility were primarily in the form of bankers’ acceptances (“BAs”). Under the Credit Facility, BA stamping fees 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 on outstanding bank indebtedness increased in 2016 as higher stamping fees on BAs more than offset the decrease in the Canadian Dollar Offered Rate (“CDOR”) and lower standby fees on the reduced borrowing base compared to 2015. The Company’s debt to cash flow ratio improved significantly in the second half of 2016 and Kelt realized a 50 basis point decrease in the applicable margin during the fourth quarter ended December 31, 2016.

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

Accretion expense on decommissioning obligations decreased during the fourth quarter of 2016 as Kelt disposed liabilities with a carrying amount of $9.2 million on October 7, 2016.

GENERAL AND ADMINISTRATIVE (“G&A”) EXPENSES

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

	Three months ended December 31			Year ended December 31		
(CA$ thousands, unless otherwise indicated)	**2016**	2015	%	**2016**	2015	%
Salaries and benefits	**1,783**	1,342	33	**6,757**	5,502	23
Other G&A expenses	**1,101**	1,299	-15	**3,924**	3,832	2
Gross G&A expenses	**2,884**	2,641	9	**10,681**	9,334	14
Overhead recoveries	**(1,102)**	(1,130)	-2	**(3,687)**	(4,134)	-10
G&A expense, net of recoveries	**1,782**	1,511	18	**6,994**	5,200	35
Gross G&A ($ per BOE)	**1.59**	1.43	11	**1.39**	1.38	1
Net G&A ($ per BOE)	**0.98**	0.82	20	**0.91**	0.77	18

Kelt continues to incur below industry average G&A expenses, which were $0.91 per BOE on average during 2016. While total gross G&A expenses (before recoveries) increased in conjunction with the Company’s growth, on a per unit basis, gross G&A expenses are relatively unchanged at $1.39 per BOE (before recoveries) due to management’s ongoing efforts to maintain a low cost structure.

G&A expenses are reported net of overhead recoveries, however, Kelt does not capitalize any direct G&A expenses. Net G&A expense of $0.91 per BOE for the year ended December 31, 2016, increased compared to $0.77 per BOE in 2015 due to lower overhead recoveries. Kelt earned lower capital overhead recoveries in the current year due to significantly lower capital expenditures.

PROVISION FOR POTENTIAL CREDIT LOSSES

During 2016, the Company recognized a provision for potential credit losses of $0.3 million (2015 – $0.6 million). Many oil and gas companies, including some of Kelt’s partners, continue to face significant financial challenges as a result of low commodity prices and continued volatility. The Company has been diligent with respect to its credit risk management practices and 94% of accounts receivable outstanding at December 31, 2016 are current, an improvement from 85% at December 31, 2015.

SHARE BASED COMPENSATION (“SBC”)

	Three months ended December 31			Year ended December 31		
(CA$ thousands, unless otherwise indicated)	**2016**	2015	%	**2016**	2015	%
Stock options	**1,108**	1,142	-3	**4,099**	4,472	-8
Restricted share units (“RSUs”)	**415**	944	-56	**1,766**	3,900	-55
Total SBC expense	**1,523**	2,086	-27	**5,865**	8,372	-30
$ per BOE	**0.84**	1.13	-26	**0.77**	1.23	-37

Share based compensation is expensed using graded amortization over the three year vesting period. SBC expense for stock options decreased in 2016 as the average fair value of options granted over the three most recent years ended December 31, 2016 was lower compared to the average fair value over the three year period ended December 31, 2015. The majority of RSUs were granted in the first quarter of 2013 when Kelt first commenced operations. The expense associated with these initial RSU grants was fully amortized by the first quarter of 2016, resulting in the 55% decrease in RSU expense in 2016 compared to 2015.

The significant decrease in SBC expense on a per unit basis, down 37% year-over-year, reflects management’s efforts to provide long term incentives to employees and grow production, while minimizing the dilutive impact to shareholders. As at December 31, 2016, stock options and RSUs outstanding represent 5% of total shares outstanding (5% of total shares outstanding at December 31, 2015).

EXPLORATION AND EVALUATION (“E&E”) EXPENSES

	Three months ended December 31			Year ended December 31		
(CA$ thousands, unless otherwise indicated)	**2016**	2015	%	**2016**	2015	%
Expired mineral leases	**862**	434	99	**4,260**	3,117	37
Impairment of E&E assets	**-**	7,357	-100	**-**	7,357	-100
Total E&E expenses	**862**	7,791	-89	**4,260**	10,474	-59
$ per BOE	**0.47**	4.22	-89	**0.56**	1.54	-64

The Company expensed $4.3 million of costs related to the expiry of non-core land holdings during the year ended December 31, 2016. Lease expiries increased compared to the previous year as the Company focused on the development of its core areas. The majority of the mineral leases expired during 2016 were acquired through corporate acquisitions.

The Company concluded there were no indicators of impairment of its E&E assets as at December 31, 2016. As at the prior year ended December 31, 2015, $7.4 million of impaired exploratory drilling costs were charged to exploration expense.

DEPLETION, DEPRECIATION AND IMPAIRMENT

	Three months ended December 31			Year ended December 31		
(CA$ thousands, unless otherwise indicated)	**2016**	2015	%	**2016**	2015	%
Depletion of D&P assets	**28,592**	37,799	-24	**139,217**	140,518	-1
Depreciation of corporate assets	**226**	198	14	**830**	618	34
Total depletion and depreciation	**28,818**	37,997	-24	**140,047**	141,136	-1
Impairment of PP&E (net of impairment reversals)	**(26,141)**	64,068	-141	**(26,141)**	64,068	-141
Total depletion, depreciation and impairment	**2,677**	102,065	-97	**113,906**	205,204	-44
Depletion and depreciation ($/BOE)	**15.85**	20.56	-23	**18.27**	20.82	-12
Impairment (reversal) loss ($/BOE)	**(14.38)**	34.67	-141	**(3.41)**	9.45	-136

The Company calculates depletion of development and production (“D&P”) assets based on production relative to total proved reserves, for each depletion unit. The significant decrease in depletion expense per BOE reflects the addition of proved reserves at lower than historical capital costs.

As a result of the significant decrease in forecast oil and natural gas prices as at December 31, 2016, an indication of potential impairment was identified for all cash generating units (“CGUs”). Recoverable amounts for the Company’s CGUs were estimated based on fair value less costs of disposal (“FVLCD”) methodology. With the exception of the Karr assets classified as held for sale at December 31, 2016, 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, 2016. The projected cash flows used in the FVLCD calculation reflect current market assessments of key assumptions, 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, 2016 ranged from 9% to 12%, depending on the risks specific to the assets in the CGU. Based on the FVLCD calculation, the carrying value of the Leduc-Woodbend CGU was in excess of the recoverable amount, resulting in an impairment loss of $6.0 million as at December 31, 2016.

During the previous year ended December 31, 2015, recoverable amounts for each CGU were estimated based on after-tax discount rates between 9% to 10%. Based on the FVLCD calculation as at December 31, 2015, the carrying value of each of the Company’s Alberta CGUs was in excess of the recoverable amount, resulting in an impairment of PP&E of $64.1 million and an impairment of goodwill allocated to the Grande Prairie CGU of $18.2 million.

Of the total PP&E impairment loss recognized at December 31, 2015, $48.5 million related to the Karr CGU. As more particularly described in note 4 of the consolidated 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 on January 18, 2017. As at December 31, 2016, the impairment of the Karr CGU 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 (refer to additional information under the heading of *"Subsequent Events"*).

The recoverable amounts calculated for each CGU as at December 31, 2016 are highly sensitive to the discount rate and forecast future commodity prices used in the FVLCD calculation. Holding all other variables constant:

- if the discount rate applied to all CGUs increased (decreased) by 1%, the impairment of the Leduc-Woodbend CGU would increase (decrease) by approximately $0.5 million; and
- if the forecast combined average realized price increased (decreased) by 5%, the impairment of the Leduc-Woodbend CGU would decrease (increase) by approximately $1.0 million.

A 1% increase in the discount rate or 5% decrease in the forecast combined average realized price would not trigger an impairment of the Company's other CGUs as at December 31, 2016. Similarly, a 1% decrease in the discount rate or 5% increase in the forecast combined average realized price would not trigger a reversal of impairment of the Company's other CGUs.

Forecast future prices used in the impairment evaluations as at December 31, 2016 and 2015, 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.

As at December 31, 2016	**2017**	**2018**	**2019**	**2020**	**2021[1]**
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

As at December 31, 2015	2016	2017	2018	2019	2020[1]
WTI Cushing Oklahoma (US$/bbl)	45.00	60.00	70.00	80.00	81.20
Canadian Light Sweet 40 API ($/bbl)	55.20	69.00	78.43	89.41	91.71
NYMEX Henry Hub (US$/MMBtu)	2.25	3.00	3.50	4.00	4.25
AECO-C Spot ($/MMBtu)	2.13	2.80	3.24	3.71	3.98
Exchange rate (CA$/US$)	1.3333	1.2500	1.2048	1.1765	1.1765

(1) Prices escalate at 1.5% thereafter

GAIN ON ACQUISITION

Kelt reported a gain of $15.9 million in respect of the Artek Acquisition completed during the previous year ended December 31, 2015. Refer to additional information under the heading of *"Corporate Acquisition"*. Transaction costs of $2.4 million related to the Artek Acquisition were recognized as an expense in 2015.

GAIN ON SALE OF ASSETS

	Three months ended December 31			Year ended December 31		
(CA$ thousands, unless otherwise indicated)	**2016**	2015	%	**2016**	2015	%
Gain on sale of assets	**3,912**	-	-	**8,747**	190	4504

During the year ended December 31, 2016, Kelt received cash proceeds of $5.9 million from non-core property dispositions and reported a gain on sale of $8.7 million. Refer to additional information under the heading of *"Property Dispositions"*.

DERIVATIVE FINANCIAL INSTRUMENTS

The Company may, from time to time, enter into fixed price contracts and derivative financial instruments with respect to oil and gas sales, 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.

	Three months ended December 31			Year ended December 31		
(CA$ thousands, unless otherwise indicated)	**2016**	2015	%	**2016**	2015	%
Realized loss	**(439)**	(2,155)	-80	**(350)**	(886)	-60
Unrealized gain (loss)	**81**	1,460	-94	**91**	(1,975)	-105
Loss on derivative financial instruments	**(358)**	(695)	-48	**(259)**	(2,861)	-91
$ per BOE	**(0.20)**	(0.38)	-47	**(0.03)**	(0.42)	-93

During the year ended December 31, 2016, the Company had a derivative financial contract that fixed the basis differential between the Chicago Monthly Index and AECO 7A at US$0.96 per MMBtu on a notional 10,000 MMBtu per day for the period from June to October 2016. The actual differential was US$1.02 per MMBtu over the term of the contract, which resulted in a realized gain of approximately $0.1 million. Kelt also had a derivative financial contract that fixed the basis differential between NYMEX Henry Hub and AECO 5A at $0.94 per MMBtu on a notional 30,000 MMBtu per day in September and October 2016. In October, the basis differential narrowed to US$0.59 resulting in a realized loss of $0.4 million in the fourth quarter of 2016.

Commodity price risk management contracts

As at December 31, 2016, the following commodity price risk management contracts are outstanding:

Remaining Term	Notional Volume	Reference Prices	Fixed Contract Price	Fair value Asset (Liability)(1)
April 2017 to October 2017	10,000 MMBtu/d	Southern California Border Avg. NYMEX Henry Hub	Southern California Border Avg. plus US$0.055 per MMBtu	**(282)**

(1) The fair value is sensitive to changes in the reference prices. If the Southern California Border Average-NYMEX basis differential increased (decreased) by $0.10/MMBtu, the fair market value of the contract would decrease (increase) by approximately $0.3 million.

Subsequent to the end of the reporting period, Kelt entered into a financial derivative to lock in stronger propane prices on notional contract volumes of 500 barrels per day from February 1, 2017 to December 31, 2017. Kelt will receive 50% of the average US$WTI oil price for the month and will pay a floating price referenced to the current month average OPIS-Conway propane price.

Interest rate risk management contracts

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 $149.6 million during 2016, an increase (decrease) in the market rate of interest by 25 basis points would have increased (decreased) interest expense by $0.4 million, before financial instruments. As at and during the 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. The fair value of the contract was a liability of $3 thousand as of December 31, 2016. 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 management contracts

As at December 31, 2016, the following foreign exchange risk management contracts were outstanding:

Contract Type	Notional Amount per month	Fixed Contract Price	Remaining Term	Fair value Asset (Liability)(2)
FX swap(1)	$1,000,000	CA$/US$ 1.3300	January to December 2017	**(115)**

(1) The FX swap outstanding at December 31, 2016 resulted from an FX swaption contract which was exercised by the counterparty on December 30, 2016. Kelt received a cash premium of $0.255 million at the time of entering into the contract on July 11, 2016.

(2) The fair value of the contract is sensitive to changes in the exchange rate. If the CA$/US$ exchange rate increased (decreased) by $0.05, the fair market value of the contract would decrease (increase) by approximately $0.6 million.

As at December 31, 2016, the Company had a forward foreign exchange swaption contract whereby the counterparty has the right, if exercised on March 31, 2017, to enter a series of forward foreign exchange transactions fixing the exchange rate on a notional US$1.0 million per month at CA$/US$ 1.3600 from April 2017 to March 2018. In consideration for the swaption, Kelt received a cash premium of $0.205 million at the time of entering into the contract on November 11, 2016. The fair value of the forward foreign exchange swaption as at December 31, 2016, resulted in a derivative financial instrument liability of $0.2 million.

PREMIUM ON FLOW-THROUGH SHARES

	Three months ended December 31			Year ended December 31		
(CA$ thousands, unless otherwise indicated)	**2016**	2015	%	**2016**	2015	%
Premium on flow-through shares	**2,459**	463	431	**3,305**	3,564	-7

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. Kelt recognized a premium of $2.5 million and $3.3 million, respectively, based on qualifying capital expenditures incurred during the fourth quarter and year ended December 31, 2016.

On April 7, 2016, the Company completed private placements of 4.7 million flow-through common shares ("FTS") at a price of $4.70 per FTS, resulting in gross proceeds of $22.1 million (including $0.9 million of proceeds on the subscription of 0.2 million FTS by certain directors and officers of the Company). The implied premium was determined to be $2.6 million or $0.55 per FTS. Pursuant to the provisions of the *Income Tax Act* (Canada), the Company was obligated to incur eligible Canadian development expenses prior to December 31, 2016 in the aggregate amount of not less than the gross proceeds raised from the offering. As at December 31, 2016, Kelt had fully satisfied the commitment and renounced $22.1 million of qualifying expenditures to the subscribers.

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 Company is obligated to incur eligible Canadian exploration expenses prior to December 31, 2017. The premium is deferred at December 31, 2016 as Kelt did not incur the qualifying expenditures in the current year.

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 expects to fully satisfy the remaining commitment of $1.3 million during the first quarter of 2017. The qualifying expenditures will be renounced to subscribers with an effective date of March 31, 2017.

INCOME TAXES

	Three months ended December 31			Year ended December 31		
(CA$ thousands, unless otherwise indicated)	**2016**	2015	%	**2016**	2015	%
Deferred income tax expense (recovery)	**10,944**	(25,397)	-143	**(9,489)**	(32,847)	-71
Profit (loss) before taxes	**22,800**	(118,384)	-119	**(59,263)**	(173,886)	-66
Effective tax rate	**48%**	21%		**16%**	19%	

The consolidated combined federal and provincial statutory tax rate averaged 26.4% during the year ended December 31, 2016, up from 26.0% in 2015 due to the increase in Alberta's general corporate tax rate from 10% to 12% effective July 1, 2015.

A detailed analysis of the provision for deferred income taxes is included in note 14 of the consolidated annual financial statements, 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 expected to be 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. Kelt incurred $27.9 million of qualifying expenditures during 2016, of which, $20.7 million was incurred during the fourth quarter ended December 31, 2016 contributing to the high effective rate of tax expense of 48% for the quarter.

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 $1.3 million were charged directly to equity in respect of share issue costs incurred in 2016 and 2015, 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 $975.4 million as of December 31, 2016, up 2% from $957.9 million at December 31, 2015.

(CA$ thousands, unless otherwise indicated)	Rate	**2016**	2015	% change
Canadian oil and gas property expenses (COGPE)	10%	**248,468**	260,383	-5
Canadian development expenses (CDE)	30%	**154,830**	187,919	-18
Canadian exploration expenses (CEE)	100%	**94,597**	88,826	6
Undepreciated capital cost(1) (UCC)	25%	**177,487**	193,420	-8
Share and debt issue costs (SIC/DIC)	5 years	**13,795**	16,677	-17
Non-capital losses(2) (NCL)	100%	**286,219**	210,628	36
Estimated tax deductions available, end of year		**975,396**	957,853	2

(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 2036.

ADJUSTED FUNDS FROM OPERATIONS

Three months ended December 31	**2016**		2015		% change	
(CA$ thousands, unless otherwise indicated)	**Amount**	**$/BOE**	Amount	$/BOE	Amount	$/BOE
Oil and gas revenue	**55,737**	**30.66**	42,797	23.16	30	32
Cash premiums on financial instruments	**205**	**0.11**	-	-	-	-
Realized loss on financial instruments(1)	**(428)**	**(0.24)**	(2,129)	(1.15)	-80	-79
Royalties	**(5,203)**	**(2.86)**	(5,022)	(2.72)	4	5
Production expense	**(17,231)**	**(9.47)**	(17,012)	(9.21)	1	3
Transportation expense	**(5,677)**	**(3.12)**	(3,756)	(2.03)	51	54
Operating income(2)	**27,403**	**15.08**	14,878	8.05	84	87
Financing expense(3)	**(2,510)**	**(1.38)**	(1,957)	(1.06)	28	30
G&A expense	**(1,782)**	**(0.98)**	(1,511)	(0.82)	18	20
Other income (expense)	**-**	**-**	(212)	(0.11)	-100	-100
Realized loss on financial instruments(4)	**(11)**	**(0.01)**	(26)	(0.01)	-58	-
Adjusted funds from operations(5)	**23,100**	**12.71**	11,172	6.05	107	110
Basic ($ per common share)(6)	**0.13**		0.07		86	
Diluted ($ per common share)(6)	**0.13**		0.07		86	
Common shares outstanding (000s):						
Basic, weighted average	**175,275**		168,610		4	
Diluted, weighted average	**176,234**		169,352		4	

(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 oil and 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: 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.

The Company generated adjusted funds from operations of $23.1 million ($0.13 per common share, diluted) during the fourth quarter of 2016, up 107% from $11.2 million ($0.07 per common share, diluted) in the same quarter of 2015. The increase in adjusted funds from operations is primarily attributed to the 30% increase in revenues driven by significant improvement in realized oil and gas prices, which more than offset slightly lower production during the fourth quarter of 2016. Kelt incurred higher transportation expenses for its commitments on the Alliance pipeline, however realized stronger gas prices under these contracts. The increase in revenue contributed to the 87% increase in Kelt's operating netback, which averaged $15.08 per BOE for the three months ended December 31, 2016, as royalties and production expenses were relative flat quarter-over-quarter.

Adjusted funds from operations for the year ended December 31, 2016 was $58.4 million ($0.34 per common share, diluted), up 3% from $56.5 million ($0.36 per common share, diluted) in 2015. The Company grew its production by 13% year-over-year and reported 11% growth in operating income, despite realized oil and gas prices being 9% lower on average during 2016. The increase in operating income is primarily due to the significant reduction in production expenses, which decreased by 18% or $2.05 per BOE in 2016 compared to 2015. In addition, per unit royalties were 26% lower than 2015 as a result of lower commodity prices in the first nine months of 2016. Kelt's adjusted funds from operations was impacted by the significant increase in financing expenses resulting from higher average debt levels combined with an increase in the cost of capital during 2016.

Years ended December 31	**2016**		2015		% change	
(CA$ thousands, unless otherwise indicated)	**Amount**	**$/BOE**	Amount	$/BOE	Amount	$/BOE
Oil and gas revenue	**184,613**	**24.08**	179,326	26.45	3	-9
Cash premiums on financial instruments	**460**	**0.06**	-	-	-	-
Realized loss on financial instruments[1]	**(315)**	**(0.04)**	(833)	(0.12)	-62	-67
Royalties	**(15,911)**	**(2.08)**	(19,033)	(2.81)	-16	-26
Production expense	**(71,204)**	**(9.29)**	(76,914)	(11.34)	-7	-18
Transportation expense	**(21,943)**	**(2.86)**	(14,192)	(2.09)	55	37
Operating income[2]	**75,700**	**9.87**	68,354	10.09	11	-2
Financing expense[3]	**(10,291)**	**(1.34)**	(6,584)	(0.97)	56	38
G&A expense	**(6,994)**	**(0.91)**	(5,200)	(0.77)	35	18
Realized loss on financial instruments[4]	**(35)**	**-**	(53)	(0.01)	34	-100
Adjusted funds from operations[5]	**58,380**	**7.62**	56,517	8.34	3	-9
Basic ($ per common share)[6]	**0.34**		0.37		-8	
Diluted ($ per common share)[6]	**0.34**		0.36		-6	
Common shares outstanding (000s):						
Basic, weighted average	**173,076**		154,829		12	
Diluted, weighted average	**173,415**		155,936		11	

(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 oil and 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: 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.

PROFIT (LOSS) AND COMPREHENSIVE INCOME (LOSS)

	Three months ended December 31			Year ended December 31		
(CA$ thousands, unless otherwise indicated)	**2016**	2015	%	**2016**	2015	%
Profit (loss) and comprehensive income (loss)	**11,856**	(92,987)	113	**(49,774)**	(141,039)	65
Wtd avg. shares outstanding, basic (000s)	**175,275**	168,610	4	**173,076**	154,829	12
Wtd avg. shares outstanding, diluted (000s)[1][2]	**176,234**	168,610	5	**173,076**	154,829	12
$ per common share, basic	**0.07**	(0.55)	113	**(0.29)**	(0.91)	68
$ per common share, diluted[1][2]	**0.07**	(0.55)	113	**(0.29)**	(0.91)	68
$ per BOE	**6.52**	(50.32)	113	**(6.49)**	(20.80)	69

(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 the year ended December 31, 2016 and for the fourth quarter and year ended December 31, 2015, 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 for the quarter and year ended December 31, 2016.

Kelt reported a profit of $11.9 million ($0.07 per common share, diluted) for the three months ended December 31, 2016, compared to a loss of $93.0 million ($0.55 per common share, diluted) in the same three month period of 2015. For the year ended December 31, 2016, the loss reported by Kelt is $49.8 million, down $91.3 million from the loss of $141.0 million in 2015. The prior period loss included impairments of PP&E, E&E and goodwill in the amounts of $64.1 million, $7.4 million and $18.2 million, respectively, as at December 31, 2015. By comparison, the Company recognized a net reversal of PP&E impairment of $26.1 million as at December 31, 2016. In addition, a gain of $8.7 million on the sale of non-core assets during 2016 contributed to the increase in Kelt's net profit.

INVESTING ACTIVITIES

CAPITAL EXPENDITURES

Kelt is committed to future growth through its strategy to implement a full-cycle exploration and development program. In addition, Kelt has 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:

	Three months ended December 31			Year ended December 31		
(CA$ thousands, unless otherwise indicated)	**2016**	2015	%	**2016**	2015[1]	%
Capital expenditures:						
Lease acquisition and retention	**3,141**	1,317	138	**9,127**	8,618	6
Geological and geophysical	**477**	16	2881	**638**	1,093	-42
Drilling and completion of wells	**25,502**	30,340	-16	**47,373**	100,868	-53
Facilities, pipeline and well equipment	**7,143**	9,557	-25	**27,873**	55,216	-50
Corporate assets	**67**	247	-73	**636**	810	-21
Capital expenditures, before A&D	**36,330**	41,477	-12	**85,647**	166,605	-49
Property acquisitions	**(349)**	1,602	-122	**18,512**	16,350	13
Property dispositions	**358**	-	-	**(5,891)**	-	-
Corporate acquisition [1][2]	**-**	(592)	-100	**-**	314,318	-100
Total capital expenditures, net of dispositions	**36,339**	42,487	-14	**98,268**	497,273	-80

(1) Total capital expenditures for the previous year ended December 31, 2015 have been revised to reflect an adjustment to the purchase price of the Artek Acquisition. Refer to additional information under the heading of *"Corporate Acquisition"*.

(2) The total cost of the Artek Acquisition of $314.3 million, as reported in the table above, includes $217.9 million of common share consideration valued based on the negotiated price of $8.10 per common share of Kelt, and the $101.2 million working capital deficit assumed, net of $4.8 million of intercompany balances extinguished upon completion of the arrangement.

LAND HOLDINGS

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 2016, the Company expended approximately $6.1 million at Crown land sales acquiring 155,525 net acres (243 net sections) of petroleum and natural gas rights at an average bonus cost of $39 per acre. The average bonus cost is down 77% compared to $169 per acre during the year ended December 31, 2015.

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	**As at December 31, 2016**		As at December 31, 2015		Percentage Change	
(Acres)	**Gross**	**Net**	Gross	Net	Gross	Net
Developed	**389,280**	**208,984**	389,916	208,895	0%	0%
Undeveloped	**768,345**	**647,770**	649,297	521,413	18%	24%
Total	**1,157,625**	**856,754**	1,039,213	730,308	11%	17%
Average working interest		**74%**		70%		4%

As at December 31, 2016, the Company owned 647,770 net acres of undeveloped land. Based on an internal evaluation of the fair market value of the Company's land holdings at December 31, 2016, Kelt estimates the fair market value of its undeveloped land at $212.5 million. This implies an average fair value of $328 per acre.

MONTNEY LAND EXPANSION

In northeastern BC, Kelt has accumulated and currently holds 132,610 net acres (207 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 seven upper Montney wells and two middle Montney wells on its 186 section substantially contiguous land block at Inga/Fireweed, de-risking and delineating a large portion of the lands.

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 acquired 43 gross (29 net) sections of land with Montney rights at Progress. To date, results from the Progress Montney play are demonstrating similar characteristics to the Pouce Coupe/Gordondale Montney B pool, which Kelt used as an analogy prior to acquiring its Progress acreage position. In addition, Kelt has accumulated and currently holds 50,080 net acres (78 sections) of land with Montney rights in a new core exploration area at Pipestone/Wembley, Alberta, adjacent to its Valhalla/La Glace assets. Kelt established its original Montney core position at Valhalla/La Glace and Pipestone/Wembley through certain acquisitions completed in 2013 and 2014. Prior to the commodity price downturn, the Company held 38,513 net acres (60 sections) of lands with Montney rights. Through an active land acquisition strategy during 2015 and 2016, primarily through Crown land sales, Kelt has expanded its Montney land holdings in the area to 78,241 net acres (122 sections), an increase of 103%. Competitor drilling adjacent to newly acquired Kelt acreage has resulted in prolific well results from the Montney formation.

The table below sets-out Kelt's Montney land holdings as at December 31, 2016:

MONTNEY RIGHTS	**Net Acres**	Net Sections
British Columbia	**259,658**	406
Alberta	**156,457**	244
Total	**416,115**	650

DRILLING

During the year ended December 31, 2016, the Company drilled 15 (12.3 net) wells. The Company's average working interest in wells drilled during 2016 was 82% (2015 – 82%). In 2016, Kelt's active horizontal drilling program resulted in an average measured depth of net wells drilled of 4,390 metres (2015 – 4,158 meters). The Company drilled a total of 56,237 net metres during the year ended December 31, 2016 (2015 – 66,938 net metres).

DRILLING ACTIVITY	**Three months ended December 31, 2016**		**Year ended December 31, 2016**	
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**

DRILLING ACTIVITY	Three months ended December 31, 2015		Year ended December 31, 2015	
2015	Gross	Net	Gross	Net
Oil	4	4.0	9	8.1
Gas	4	2.0	9	6.4
Service	-	-	1	1.0
Dry	-	-	-	-
Total wells	8	6.0	19	15.5

PROPERTY ACQUISITIONS

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 $18.6 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

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.

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 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. The petroleum and natural gas assets disposed were previously acquired by Kelt through larger strategic acquisitions, and were peripheral to the core assets and infrastructure being targeted in those acquisitions. 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. The table summarizes the accounting for the disposition, which was effective July 1, 2016.

Purchase price, after closing adjustments (1)	38
Estimated costs of disposal (1)	(424)
Net proceeds (costs) of disposal (1)	**(386)**
Exploration and evaluation assets	(48)
Property, plant and equipment, net	(4,892)
Decommissioning obligations	9,173
Net carrying value of (assets) liabilities disposed	**4,233**
Gain on sale of assets (1)	**3,847**

(1) The proceeds and costs of disposal were estimated at the time of preparation of the December 31, 2016 financial statements. The gain on sale ultimately recognized by the Company upon finalizing the accounting for the property disposition may differ from these estimates.

Refer to additional information under the heading of "*Subsequent Events"* regarding the Karr Property Disposition completed subsequent to the year ended December 31, 2016.

CORPORATE ACQUISITION

On April 16, 2015, the Company closed the acquisition of Artek Exploration Ltd. by acquiring all of the issued and outstanding common shares of Artek on the basis of 0.34 of a Kelt common share for each Artek common share, resulting in the issuance of 26,900,375 common shares of Kelt to the former shareholders of Artek. The Artek Acquisition was completed by way of a statutory plan of arrangement under the *Business Corporations Act* (Alberta), pursuant to which, Artek common shares were delisted from the TSX and Artek became a wholly-owned subsidiary of Kelt. Immediately following the Arrangement, a name change was effected to change the name of Artek to Kelt Exploration (LNG) Ltd. The acquisition of Artek consolidated the majority of Kelt's land acreage in its Inga-Fireweed-Stoddart, British Columbia core area to 100% working interest and is consistent with the Company's strategy to operate and control all of its major core exploration and development prospects. In addition, Kelt's acquisition of Artek resulted in 100% ownership by Kelt in key infrastructure including compression facilities and pipelines in northeastern BC.

The Artek Acquisition was accounted for as a business combination using the acquisition method of accounting, whereby the assets acquired and the liabilities assumed were recorded at the fair value on the acquisition date of April 16, 2015. Certain comparative information within this MD&A, including the gain on acquisition, loss and comprehensive loss, total capital expenditures, total assets, working capital deficiency, and shareholders' equity, has been revised to reflect all purchase price adjustments made within the measurement period as if the information was known as of the acquisition date. The following table summarizes the acquisition date fair value of the consideration paid and the final allocation of the purchase price:

(CA$ thousands, unless otherwise indicated)	
Number of Kelt common shares issued (thousands)	26,900
Fair value of Kelt common shares ($/share)(1)	$9.02
Fair value of common share consideration(1)	242,641
Settlement of pre-existing relationship(2)	(4,760)
Net consideration	**237,881**
Bank debt, net of working capital(3)	(101,185)
Exploration and evaluation assets	52,340
Property, plant and equipment	346,014
Decommissioning obligations	(11,966)
Deferred income tax liability	(31,412)
Fair value of net assets acquired	**253,791**
Gain on acquisition(4)	**15,910**

(1) Pursuant to IFRS 3, the fair value of common share consideration is measured based on the share price on the closing date of the acquisition. The share exchange ratio of 0.34 was negotiated based on the volume weighted average trading price of Kelt common shares that traded on the TSX during the five day period ended February 20, 2015 of $8.10 per share. If the negotiated price of $8.10 per share was used, the common share consideration would be valued at $217.9 million.

(2) Artek and Kelt were partners in joint operations. The settlement of the pre-existing relationship relates to $6.6 million of accounts payable by Kelt to Artek, net of $1.9 million of accounts receivable by Kelt from Artek, which were extinguished upon completion of the arrangement.

(3) The net working capital deficit includes $7.0 million of accounts receivable and accrued revenue, $0.4 million of deposits, $12.8 million of accounts payable and accrued liabilities (includes $0.9 million of additional royalties payable resulting from the BC Royalty Audit) and $13.7 million of bank overdraft. Pursuant to the change in control provisions in Artek's credit agreement, Artek's demand loan credit facility, on which $82.1 million was outstanding as of the closing date, was repaid and terminated by Kelt at closing using borrowings available under Kelt's Credit Facility.

(4) The Company recognized a gain on the acquisition of Artek as the total fair value of net assets acquired exceeds the fair value of the consideration paid for Artek's shares by $15.9 million. The gain has been revised from $16.8 million previously reported in the Company's consolidated annual financial statements as at and for the year ended December 31, 2015, as a result of the BC Royalty Audit.

The Consolidated Statement of Profit (Loss) and Comprehensive Income (Loss) includes the results of operations for the period following closing of the Artek Acquisition on April 16, 2015. Specifically, Kelt's profit (loss) for year ended December 31, 2015 includes approximately $24.7 million of revenue and $7.8 million of operating income generated from the acquired interest in the properties subsequent to closing. If the acquisition had occurred on January 1, 2015, pro-forma revenue and operating income is estimated to be approximately $38.2 million and $9.3 million, respectively, for the year ended December 31, 2015. Operating income is defined as revenue, net of royalties, less production and transportation expenses. This pro-forma information is not necessarily indicative of the results of operations that would have resulted had the acquisition been effected on the dates indicated, or the results that may be obtained in the future.

In March 2016, the British Columbia Ministry of Energy and Mining ("BC Ministry") completed a petroleum and natural gas by-products royalty audit, focused on NGLs and Sulphur Crown royalties, for the years 2011 to 2014 (the "BC Royalty Audit"). As a result of the BC Royalty Audit, it was determined that Artek's share of Crown royalties were miscalculated and underpaid by Artek for the years 2011 to 2014, resulting in a net settlement of approximately $0.9 million payable to the BC Ministry. If known at the time of acquisition, the additional royalties payable to the BC Ministry would have resulted in the recognition of additional liabilities as at April 16, 2015 and a reduction in the gain recorded on acquisition of Artek by approximately $0.9 million for the year ended December 31, 2015. Accordingly, comparative period amounts previously reported for the Artek Acquisition were revised to reflect the final allocation of the purchase price as at April 16, 2015.

The effect of the revision on the Company's consolidated financial statements as at and for the year ended December 31, 2015, as well as the impact on certain comparative disclosures in this MD&A, are summarized in the table below.

As at and for the year ended December 31, 2015	**Previously Reported**	**Revision**	**Revised Comparative**
Gain on acquisition	16,774	(864)	**15,910**
Loss and comprehensive loss	(140,175)	(864)	**(141,039)**
Loss per common share, basic and diluted	(0.91)	-	**(0.91)**
Adjusted funds from operations	56,517	-	**56,517**
Total capital expenditures, net of dispositions	496,408	864	**497,273**
Accounts payable and accrued liabilities	64,067	864	**64,931**
Retained earnings (deficit)	(134,662)	(864)	**(135,526)**
Working capital deficiency	34,525	864	**35,389**
Bank debt, net of working capital	212,095	864	**212,959**

RESERVES

Kelt retained Sproule Associates Limited ("Sproule"), an independent qualified reserve evaluator to prepare a report on its oil and gas reserves (the "2016 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, 2016 and at December 31, 2015 were determined using the guidelines and definitions set out under National Instrument 51-101 ("NI 51-101").

At December 31, 2016, Kelt's proved plus probable reserves were 194.1 million BOE, up 29% from 150.5 million BOE at December 31, 2015. The Company's net present value of proved plus probable reserves at December 31, 2016, discounted at 10% before tax, was $1.7 billion, an increase of 46% from $1.2 billion at December 31, 2015. This increase was achieved despite lower forecasted oil and gas prices for the majority of the future years in the December 31, 2016 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, 2016, are US$55.00 per barrel for WTI oil and $3.26 per GJ for AECO-C gas.

Proved developed producing reserves at December 31, 2016 were 34.5 million BOE, an increase of 2% from 33.8 million BOE at December 31, 2015. Total proved reserves at December 31, 2016 were 108.2 million BOE, up 29% from 83.8 million BOE at December 31, 2015. Proved plus probable reserves at December 31, 2016 were 194.1 million BOE, an increase of 29% from 150.5 million BOE at December 31, 2015.

At December 31, 2016, the weighting of proved plus probable reserves was 37% oil/NGLs and 63% natural gas. At December 31, 2015, the weighting of proved plus probable reserves was 36% oil/NGLs and 64% gas.

The following table outlines a summary of the Company's reserves at December 31, 2016:

SUMMARY OF RESERVE VOLUMES	Crude Oil (mbbls)	Liquids[1] (mbbls)	Natural Gas (mmcf)	Combined (mBOE)	FDC Costs ($ thousands)
Proved developed producing	6,276	5,639	135,318	34,468	2,046
Proved developed non-producing	369	209	4,890	1,393	4,319
Proved undeveloped	6,137	19,298	281,384	72,332	582,176
Total Proved	**12,782**	**25,146**	**421,592**	**108,193**	**588,541**
Probable additional	10,526	23,439	311,445	85,873	359,075
Total Proved plus Probable	**23,308**	**48,585**	**733,037**	**194,066**	**947,616**

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

The following table reconciles the change in total proved reserves during the year:

RESERVES RECONCILIATION TOTAL PROVED	Crude Oil (mbbls)	Liquids[1] (mbbls)	Natural Gas (mmcf)	Combined (mBOE)
Balance, December 31, 2015 [2]	11,614	17,650	327,423	83,835
Extensions	1,505	5,124	88,308	21,347
Infill drilling	895	704	10,578	3,362
Technical revisions	(158)	3,578	27,931	8,075
Economic factors	(247)	(458)	(6,734)	(1,827)
Acquisitions	620	50	3,092	1,185
Dispositions	(85)	(17)	(178)	(132)
Net additions	**2,530**	**8,981**	**122,997**	**32,010**
2016 Production [3]	(1,362)	(1,485)	(28,828)	(7,652)
Balance, December 31, 2016 [3]	**12,782**	**25,146**	**421,592**	**108,193**

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

(2) 6,463.1 mbbls of 1P field condensate volumes (Inga and Fireweed BC areas) were classified as oil at December 31, 2015 but are now called condensate (included in natural gas liquids by Sproule) and are presented under the heading of "Liquids" in the reserves reconciliation at December 31, 2016. To make the reconciliation more meaningful these volumes have been reclassified in the opening balances as at December 31, 2015.

(3) Sulphur production of 15 mBOE and 1P sulphur reserves of 1,747 mBOE have been excluded in the above table.

The following table reconciles the change in total proved plus probable reserves during the year:

RESERVES RECONCILIATION TOTAL PROVED PLUS PROBABLE	Crude Oil (mbbls)	Liquids[1] (mbbls)	Natural Gas (mmcf)	Combined (mBOE)
Balance, December 31, 2015 [2]	21,101	33,276	576,779	150,507
Extensions	4,780	8,059	149,769	37,801
Infill drilling	971	389	6,470	2,438
Technical revisions	(2,325)	9,007	34,649	12,457
Economic factors	(513)	(700)	(9,414)	(2,782)
Acquisitions	771	62	3,851	1,475
Dispositions	(115)	(23)	(239)	(178)
Net additions	**3,570**	**16,794**	**185,086**	**51,211**
2016 Production [3]	(1,362)	(1,485)	(28,828)	(7,652)
Balance, December 31, 2016 [3]	**23,308**	**48,585**	**733,037**	**194,066**

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

(2) 12,265.9 mbbls of 2P field condensate volumes (Inga and Fireweed BC areas) were classified as oil at December 31, 2015 but are now called condensate (included in natural gas liquids by Sproule) and are presented under the heading of "Liquids" in the reserves reconciliation at December 31, 2016. To make the reconciliation more meaningful these volumes have been reclassified in the opening balances as at December 31, 2015.

(3) Sulphur production of 15 mBOE and 2P sulphur reserves of 3,317 mBOE have been excluded in the above table.

Future development capital ("FDC") expenditures of $589 million are included in the reserve evaluation for total proved reserves and are expected to be spent as follows: $113 million in 2017, $182 million in 2018, $135 million in 2019, $136 million in 2020 and $23 million thereafter. FDC expenditures of $948 million are included for proved plus probable reserves and are expected to be spent as follows: $146 million in 2017, $224 million in 2018, $225 million in 2019, $231 million in 2020 and $122 million thereafter.

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

FDC EXPENDITURES	**Year ended December 31, 2016**			Year ended December 31, 2015		
TOTAL PROVED PLUS PROBABLE	**FDC ($M)**	**Net Wells**	**M$ / Well**	FDC ($M)	Net Wells	M$ / Well
Alberta Montney HZ Wells	**260,716**	**49.3**	**5,288**	276,625	41.8	6,618
B.C. Montney HZ Wells	**312,482**	**51.0**	**6,127**	137,057	21.0	6,527
Total Montney HZ Wells	**573,198**	**100.3**	**5,715**	413,682	62.8	6,587
Other formations HZ wells	**347,556**	**76.7**	**4,531**	444,654	64.1	6,937
Other expenditures	**26,862**	**n/a**	**n/a**	9,847	n/a	n/a
Total FDC Expenditures	**947,616**	**177.0**	**n/a**	868,183	126.9	n/a

The WTI oil price during the three years 2014 to 2016 averaged US$61.71 per barrel. After a precipitous decline since 2014, Sproule is forecasting an average WTI oil price of US$55.00 per barrel in 2017. Natural gas prices during the 2014 to 2016 period at AECO-C averaged $2.97 per GJ. Sproule is forecasting an average AECO-C gas price of $3.26 per GJ in 2017.

The following table outlines forecasted future prices that Sproule has used in their evaluation of the Company's reserves at December 31, 2016:

FUTURE COMMODITY PRICE FORECAST	WTI Cushing Oklahoma US$/bbl	Canadian Light Sweet CA$/bbl	NYMEX Henry Hub US$/MMBtu	AECO-C Spot CA$/GJ	USD/CAD Exchange US$/CA$
2017	55.00	65.58	3.50	3.26	0.78
2018	65.00	74.51	3.50	3.10	0.82
2019	70.00	78.24	3.50	3.05	0.85
2020	71.40	80.64	4.00	3.70	0.85
2021	72.83	82.25	4.08	3.79	0.85
Five year average	**66.85**	**76.24**	**3.72**	**3.38**	**0.83**

The Company's net present value of proved plus probable reserves, discounted at 10% before tax, was $1.7 billion as at December 31, 2016, up 46% from $1.2 billion as of December 31, 2015. The undiscounted future net cash flow, before tax, was $3.9 billion as of December 31, 2016, an increase of 47% from $2.7 billion as of December 31, 2015.

The following table summarizes the net present value of the Company's reserves (before tax) as at December 31, 2016:

NET PRESENT VALUE (BEFORE TAX) *(CA$ millions)*	Undiscounted	NPV 5% BT	NPV 8% BT	NPV 10% BT
Proved developed producing	623.8	504.0	451.7	422.8
Proved developed non-producing	20.9	16.8	14.3	13.6
Proved undeveloped	1,309.3	768.2	591.4	503.8
Total Proved	**1,954.0**	**1,289.0**	**1,057.4**	**940.2**
Probable additional	1,954.9	1,170.5	914.7	790.5
Total Proved plus Probable	**3,908.9**	**2,459.5**	**1,972.1**	**1,730.7**

The Company's net present value of proved plus probable reserves, discounted at 10% after tax, was $1.4 billion as of December 31, 2016, up 41% from $1.0 billion as of December 31, 2015. The undiscounted future net cash flow, after tax, was $3.1 billion as of December 31, 2016, an increase of 42% from $2.2 billion as of December 31, 2015.

The following table summarizes the net present value of the Company's reserves (after tax) as at December 31, 2016:

NET PRESENT VALUE (AFTER TAX)				
(CA$ millions)	Undiscounted	NPV 5% AT	NPV 8% AT	NPV 10% AT
Proved developed producing	623.8	504.0	451.7	422.8
Proved developed non-producing	20.9	16.8	14.3	13.6
Proved undeveloped	1,047.0	623.9	483.9	413.7
Total Proved	**1,691.7**	**1,144.7**	**949.9**	**850.1**
Probable additional	1,430.6	854.9	666.0	574.4
Total Proved plus Probable	**3,122.3**	**1,999.6**	**1,615.9**	**1,424.5**

During 2016, the Company's capital expenditures, net of dispositions, resulted in proved plus probable reserve additions of 51.2 million BOE, resulting in 2P FD&A costs of $3.47 per BOE, including FDC expenditures. Proved reserve additions in 2016 were 32.0 million BOE, resulting in 1P FD&A costs of $4.86 per BOE, including FDC expenditures. Despite a significant reduction in capital expenditures in 2016, Kelt was able to show significant reserve additions from new wells and from existing wells, which after an additional twelve months of production history, have exceeded previous type curve estimates. Capital expenditures in 2016 were $98.3 million, down 80% from $497.3 million in 2015. The Company considers the significant reduction in FD&A costs in 2016 to be a good result considering it also increased its undeveloped land acreage by 24% year-over-year by acquiring exploratory lands on two new Montney plays located at Oak/Flatrock in BC and Pipestone/Wembley in Alberta.

"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. Since inception, Kelt has successfully added high quality reserves at an all-in 2P FD&A cost of $11.36 per BOE. Since inception, corporate operating netbacks have averaged $14.01 per BOE, giving the Company an inception to date recycle ratio of 1.2 times. With the purchase and construction of facilities and infrastructure in 2015 and 2016, 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 transitions to development/pad drilling.

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

FINDING, DEVELOPMENT & ACQUISITION COSTS (1P)	Year ended December 31		Cumulative since
(CA$ thousands, except as otherwise noted)	**2016**	2015	Incorporation
Proved (1P) reserves:			
Total capital expenditures, net of dispositions (1)	**98,268**	497,273	1,490,545
Change in FDC costs required to develop 1P reserves	**57,241**	148,500	588,541
Total capital costs	**155,509**	645,773	2,079,086
1P Reserve additions, net (mBOE)	**32,010**	29,489	128,699
FD&A cost, before FDC ($/BOE)	**3.07**	16.86	11.58
1P FD&A cost, including FDC ($/BOE)	**4.86**	21.90	16.15
Operating netback ($/BOE) (2)	**9.87**	10.09	14.01
1P Recycle ratio	**2.0 x**	0.5 x	0.9 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:

FINDING, DEVELOPMENT & ACQUISITION COSTS	Year ended December 31		Cumulative since
(CA$ thousands, except as otherwise noted)	**2016**	2015	Incorporation
Proved plus probable (2P) reserves:			
Total capital expenditures, net of dispositions (1)	**98,268**	497,273	1,490,545
Change in FDC costs required to develop 2P reserves	**79,416**	362,900	947,616
Total capital costs	**177,684**	860,173	2,438,161
2P Reserve additions, net (mBOE)	**51,211**	58,150	214,572
FD&A cost, before FDC ($/BOE)	**1.92**	8.55	6.95
2P FD&A cost, including FDC ($/BOE)	**3.47**	14.79	11.36
Operating netback ($/BOE) (2)	**9.87**	10.09	14.01
2P Recycle ratio	**2.8 x**	0.7 x	1.2 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 2016 capital investment program resulted in net reserve additions that replaced 2016 production by a factor of 4.2 times on a proved basis (2015 – 4.4 times) and 6.7 times on a proved plus probable basis (2015 – 8.6 times).

The tables below summarize production replacement for 2016:

PRODUCTION REPLACEMENT	Crude Oil	Liquids(1)	Natural Gas	Combined
TOTAL PROVED RESERVES	(mbbls)	(mbbls)	(mmcf)	(mBOE)
Reserve additions, including revisions	2,530	8,981	122,997	32,010
2016 Production (2)	1,362	1,485	28,828	7,652
Production replacement ratio – 1P	**1.9 x**	**6.0 x**	**4.3 x**	**4.2 x**

PRODUCTION REPLACEMENT	Crude Oil	Liquids(1)	Natural Gas	Combined
TOTAL PROVED PLUS PROBABLE RESERVES	(mbbls)	(mbbls)	(mmcf)	(mBOE)
Reserve additions, including revisions	3,570	16,794	185,086	51,211
2016 Production (2)	1,362	1,485	28,828	7,652
Production replacement ratio – 2P	**2.6 x**	**11.3 x**	**6.4 x**	**6.7 x**

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

(2) Sulphur production of 15 mBOE has been excluded in the above tables.

NET ASSET VALUE

The Company estimates its net asset value to be $1.8 billion or $9.20 per common share as at December 31, 2016. 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, 2016 was internally valued at an average price of $328 per acre (2015 – $323 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

(CA$ thousands, except per share amounts)	**December 31, 2016**	December 31, 2015
Present value of 2P P&NG reserves, discounted at 10% before tax	**1,730,690**	1,185,240
Undeveloped land	**212,528**	168,674
Present value of decommissioning obligations	**(9,462)**	(11,702)
Bank debt, net of working capital	**(138,044)**	(212,959)
Proceeds from exercise of stock options (1)	**29,683**	-
Net asset value	**1,825,395**	1,129,253
Fully diluted common shares outstanding (000s) (1)(2)(3)	**198,504**	169,872
Net asset value ($ per common share)	**9.20**	6.65

(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 $6.77 and $4.24 as at December 31, 2016 and 2015, respectively. There were no "in-the-money" stock options at December 31, 2015.

(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, 2016 closing price of Kelt common shares of $6.77, the convertible debentures are "in-the-money" and 16.4 million shares issuable upon conversion are included in diluted common shares outstanding.

CAPITAL RESOURCES AND LIQUIDITY

MARKET CAPITALIZATION

The Company's total capitalization was $1.6 billion as of December 31, 2016. The market value of common shares, based on the closing share price on the TSX, represented 73% of the total capitalization.

The following table summarizes the Company's capitalization:

CAPITALIZATION	**As at December 31, 2016**		As at December 31, 2015		%
(CA$ thousands, except per share amounts)	**Amount**	**% of total**	Amount	% of total	change
Common shares outstanding (000s)	**175,672**		168,668		4
Share price (1)	**$6.77**		$4.24		60
Capitalization of common shares	**1,189,299**	**73**	715,152	64	66
Convertible debentures outstanding	**90,000**		-		-
Market price of Debentures (1)	**$145.00**		-		-
Capitalization of convertible debentures	**130,500**	**8**	-	0	-
Market capitalization	**1,319,799**	**81**	715,152	64	85
Bank debt, net of working capital	**138,042**	**8**	212,959	19	-35
Decommissioning obligations	**126,597**	**8**	142,308	13	-11
Deferred income tax liability	**42,351**	**3**	47,189	4	-10
Total capitalization	**1,626,789**	**100**	1,117,608	100	46

(1) Last price traded at in the year.

As at December 31, 2016, the Company had $111.7 million of bank debt outstanding on its $185.0 million Credit Facility. Net bank debt was $138.0 million at December 31, 2016, representing 2.4 times 2016 annual adjusted funds from operations. By comparison, net bank debt of $213.0 million at December 31, 2015 was 3.8 times 2015 annual adjusted funds from operations.

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, 2016, Kelt's capital structure was comprised of shareholders' capital, convertible debentures, bank debt and working capital.

During the year ended December 31, 2016, the Company's net capital expenditures of $98.3 million were primarily funded by $44.7 million of cash provided by operating activities and $31.3 million of net proceeds from equity private placements, 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.

Liquidity risk is the risk the Company will encounter difficulties in meeting its financial obligations. The Company's financial liabilities are comprised of accounts payable, derivative financial instruments, bank debt and convertible debentures. A contractual maturity analysis of Kelt's financial liabilities is provided in note 15 to the consolidated annual financial statements as at December 31, 2016. 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, 2016	December 31, 2015
Bank debt	**111,693**	177,570
Working capital deficiency (1)	**26,349**	35,389
Bank debt, net of working capital (1)	**138,042**	212,959
Trailing adjusted funds from operations (2)(3)	**92,400**	44,688
Net bank debt to trailing adjusted funds from operations ratio (1)	**1.5**	4.8

(1) Comparative information for the year ended December 31, 2015 has been revised. Details regarding the revision are provided under the heading of *"Corporate Acquisition"*. Kelt previously reported a debt to trailing funds from operation ratio of 4.7 times as at December 31, 2015.

(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: 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 has reduced its net bank debt to trailing adjusted funds from operations ratio to 1.5 times as at December 31, 2016 from 4.8 times at December 31, 2015. On May 3, 2016, the Company significantly reduced the amount drawn under its revolving bank credit facility using net proceeds of the offering of $90.0 million principal amount of convertible debentures that mature on May 31, 2021. In addition, the Company closed private placements of 6.1 million common shares for net proceeds of $31.3 million and received $5.9 million of proceeds on the disposition of non-core assets during the year ended December 31, 2016.

Subsequent to the end of the reporting period, on January 18, 2017, Kelt completed the Karr Property Disposition for gross proceeds of $100.0 million, before closing adjustments. The net proceeds have been used initially to reduce indebtedness under the Credit facility, further strengthening the Company's liquidity and financial position.

CREDIT FACILITY

The Company has a revolving committed term credit facility with a syndicate of financial institutions. As at December 31, 2016, the authorized borrowing amount available under the Credit Facility was $185.0 million. The Credit Facility is available for a revolving period of 364 days, maturing on April 29, 2017, and may be extended for an additional 364 days at the discretion of the lenders, with a term-out to April 27, 2018 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 15 of the consolidated 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.

The Company's syndicate of lenders has confirmed that the authorized borrowing amount available under the Credit Facility remains unchanged at $185.0 million following completion of the Karr Property Disposition (refer to "*Subsequent Events"*).

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 31st and November 30th, 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. The Debentures are "in-the-money" based on the closing price of Kelt common shares on the TSX of $6.77 as at December 31, 2016. To date, there have been no conversions 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 liability component of the Debentures was recognized initially at the fair value of a similar liability that does not have an equity conversion option, which was calculated based on a market interest rate of 10.5%. The difference between the $90.0 million principal amount of the Debentures and the fair value of the liability component was recognized in shareholders' equity, net of deferred income taxes. Transaction costs directly attributable to the offering of $3.6 million were allocated to the liability and equity components of the Debentures proportionately at $2.8 and $0.7 million, respectively. 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 on the Maturity Date. The equity component is not re-measured subsequent to initial recognition. The carrying amounts of the liability and equity components of the Debentures are reclassified to shareholders' capital on conversion to common shares.

The Debentures trade on the TSX under the symbol "KEL.DB". During the period following issuance on May 3, 2016 to December 31, 2016, 340.8 thousand Debentures traded on the TSX at a weighted average price of $116.13 per Debenture. The fair value of the Debentures was $130.5 million based on the closing market price of $145.00 per Debenture as at December 31, 2016.

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

DEBENTURE TRADING ACTIVITY (KEL.DB)	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

WORKING CAPITAL

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, 2016, the Company's working capital deficit of $26.3 million combined with outstanding bank debt of $111.7 million, represented 75% of the authorized borrowing amount available under the Credit Facility of $185.0 million.

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 significant financial challenges through this period of low and volatile commodity prices. The Company has been diligent with respect to its credit risk management practices and 94% of accounts receivable outstanding at December 31, 2016 are current, an improvement from 85% at December 31, 2015. 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 $0.8 million of accounts receivable which are provided for in the allowance for doubtful accounts.

Accounts payable and accrued liabilities are $55.7 million as at December 31, 2016, of which approximately $8.9 million is payable and $46.7 million is accrued. Accrued liabilities include approximately $25.7 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.

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, 2016 there were 175.7 million common shares issued and outstanding (as at March 7, 2017, there are 175.7 million common shares outstanding). There are no preferred shares issued or outstanding.

As at December 31, 2016, officers, directors, and employees have been granted options to purchase 8.4 million common shares of the Company at an average exercise price of $6.57 per common share. In addition, there are 0.7 million RSUs outstanding. Options and RSUs outstanding at December 31, 2016 represented 5.2% of total common shares issued and outstanding. Additional information regarding the Company's stock options and RSUs is included in note 13 of the consolidated annual financial statements.

The Company's common shares trade on the TSX under the symbol "KEL". During the period from January 1, 2016 to December 31, 2016, 377.6 million common shares traded on the TSX at a weighted average price of $4.93 per common share.

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

SHARE TRADING ACTIVITY (KEL)	**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**

	Q1 2015	Q2 2015	Q3 2015	Q4 2015	YTD 2015
High ($)	8.39	9.95	8.85	7.38	9.95
Low ($)	5.79	7.65	4.91	3.29	3.29
Close ($)	7.57	8.44	5.71	4.24	4.24
Volume traded (thousands)	57,663	41,511	48,683	70,456	218,313
Value traded ($ thousands)	418,446	365,799	316,207	350,779	1,451,231
Weighted average trading price ($)	7.26	8.81	6.50	4.98	6.65

CONTRACTUAL OBLIGATIONS

As of December 31, 2016, the Company is committed to future payments under the following agreements:

(CA$ thousands)	2017	2018	2019	2020	2021	Thereafter
Operating lease - office buildings	1,334	559	108	18	-	-
Operating lease - vehicles	299	205	95	3	-	-
Flow-through shares	3,758	-	-	-	-	-
Firm processing commitments	10,304	3,881	-	-	-	-
Firm transportation commitments(1)	18,029	8,254	5,643	2,519	2,038	8,656
Total annual commitments	**33,724**	**12,899**	**5,846**	**2,540**	**2,038**	**8,656**

(1) 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, 2017, however, the maximum US denominated commitment in a given month does not exceed US$0.31 million. Amounts are translated to Canadian dollars at the spot rate on December 31, 2016 of CA$/US$1.3427.

The Company has firm commitments for oil and gas transportation on major pipelines in Alberta and British Columbia. For periods subsequent to 2021, Kelt has an annual commitment of $1.2 million for gas transportation until March 31, 2026 and an annual commitment of $0.6 million for oil transportation until June 30, 2027.

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, 2018, February 28, 2020, and November 30, 2018, respectively, if not extended.

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, 2016, the Company incurred $0.6 million (2015 – $0.6 million) in legal fees and disbursements, of which, less than $0.1 million is payable at December 31, 2016 ($0.1 million at December 31, 2015). 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	
	2016	2015
Salaries, bonuses and other benefits	**1,437**	958
Share based compensation	**3,339**	3,251
Total compensation	**4,776**	4,209

During the 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. During the previous year ended December 31, 2015, key management personnel were granted 87,684 RSUs and 750,000 stock options with an exercise price of $4.38 per share.

OFF-BALANCE SHEET TRANSACTIONS

The Company did not engage in any off-balance sheet transactions during the years ended December 31, 2016 and 2015.

SUBSEQUENT EVENTS

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 have been 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 subsequent to the end of the reporting period were classified as held for sale at December 31, 2016.

Gross purchase price	100,000
Estimated closing adjustments (1)	2,926
Fair value of consideration (1)	**102,926**
Exploration and evaluation assets	4,377
Property, plant and equipment, net (2)(3)	101,081
Assets held for sale	105,458
Decommissioning obligations held for sale (4)	(2,532)
Net assets held for sale	**102,926**

(1) Closing adjustments include estimates for certain capital expenditures and operating income between the effective and closing date of the disposition. At the time of preparation of the consolidated annual financial statements as at December 31, 2016, closing adjustments are estimated to be approximately $2.9 million. The total amount of adjustments will not be known until completion of the final statement of adjustments and as a result, the fair value of consideration may differ from this estimate.

(2) 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 previous year ended December 31, 2015. As at December 31, 2016, the impairment loss was partially reversed by $32.2 million based on the fair value of consideration in excess of the carrying amount.

(3) Cost of $163.2 million, net of accumulated depletion and depreciation of $48.1 million and accumulated impairment of $14.0 million [net of impairment reversal per (2)].

(4) 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 estimated undiscounted cash flows required to settle the obligations are 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;
- Estimated average production for December 2016 based upon field reports 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 124 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.

SUMMARY OF QUARTERLY RESULTS

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

(CA$ thousands, except as otherwise indicated)	**Q4 2016**	Q3 2016	Q2 2016	Q1 2016
Revenue, before royalties and financial instruments	**55,737**	47,760	40,718	40,398
Adjusted funds from operations	**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)	**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	**111,693**	122,024	126,993	214,360
Working capital deficiency	**26,349**	10,447	12,087	15,930
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, after financial instruments ($/BOE)	**30.53**	25.47	22.13	19.06
Operating netback ($/BOE)	**15.08**	11.73	8.72	4.76
Netback as a percentage of revenue	**49%**	46%	39%	25%

	Q4 2015(1)	Q3 2015(1)	Q2 2015(1)	Q1 2015
Revenue, before royalties and financial instruments	42,797	45,015	52,131	39,383
Adjusted funds from operations	11,172	16,601	14,701	13,980
Per share – basic ($/common share)	0.07	0.10	0.10	0.11
Per share – diluted ($/common share)	0.07	0.10	0.09	0.11
Profit (loss) and comprehensive income (loss)(1)	(92,987)	(21,557)	(9,971)	(16,524)
Per share – basic ($/common share)(1)	(0.55)	(0.13)	(0.06)	(0.13)
Per share – diluted ($/common share)(1)	(0.55)	(0.13)	(0.06)	(0.13)
Total capital expenditures, net of dispositions(1)	42,487	33,389	343,697	77,700
Total assets(1)	1,279,475	1,363,348	1,365,445	966,613
Bank debt	177,570	147,801	224,221	105,117
Working capital deficiency(1)	35,389	34,729	27,031	33,633
Shareholders' equity(1)	846,754	937,658	870,083	635,708
Average daily production (BOE/d)	20,086	18,695	19,473	16,005
Average realized price, after financial instruments ($/BOE)	22.01	25.71	29.57	28.61
Operating netback ($/BOE)	8.05	11.52	10.23	10.78
Netback as a percentage of revenue	37%	45%	35%	38%

(1) Certain comparative information has been revised, refer to information under the heading of "*Corporate Acquisition*".

Since commencing active operations on February 26, 2013 with initial production of approximately 3,500 BOE per day, the Company has reported cumulative compound annual growth in average production of 74% (32% compound annual growth per million common shares) through the efficient execution of its capital program as well as by completing strategic acquisitions in its core areas, including the Artek Acquisition on April 16, 2015. Kelt achieved corporate record average production of 23,295 BOE per day during the first quarter of 2016. Average production was lower in subsequent quarters of 2016 due to corporate declines in conjunction with much lower capital expenditures, as well as significant production downtime resulting from third-partly pipeline restrictions and plant/facility outages.

In the second half of 2014, global crude oil prices began a precipitous decline that 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, currently above US$50.00 per barrel. The impact is seen in the fourth quarter of 2016, in which the Company reported its highest average realized price and operating netback in the past eight consecutive quarters. Adjusted funds from operations of $23.1 million ($0.13 per common share, diluted) for the quarter ended December 31, 2016 was also at its highest level over this period. The improvement in operating netbacks and adjusted funds from operations was also achieved as a result of the Company's operational initiatives and significantly lower production expenses.

In addition to cash provided by operating activities, the Company's capital expenditures 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.

SELECTED ANNUAL INFORMATION

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

(CA$ thousands, except as otherwise indicated)	**2016**	2015[1]	2014
Revenue, before royalties and financial instruments	**184,613**	179,326	214,691
Adjusted funds from operations	**58,380**	56,517	115,503
Per share – basic ($/common share)	**0.34**	0.37	0.95
Per share – diluted ($/common share)	**0.34**	0.36	0.93
Profit (loss) and comprehensive income (loss)	**(49,774)**	(141,039)	10,628
Per share – basic ($/common share)	**(0.29)**	(0.91)	0.09
Per share – diluted ($/common share)	**(0.29)**	(0.91)	0.09
Total capital expenditures, net of dispositions	**98,268**	497,273	423,900
Total assets	**1,255,958**	1,279,475	908,709
Bank debt	**111,693**	177,570	46,929
Working capital deficiency	**26,349**	35,389	57,501
Convertible debentures	**70,978**	-	-
Shareholders' equity	**843,301**	846,754	619,639
Average daily production (BOE/d)	**20,947**	18,577	12,756
Average realized price, after financial instruments ($/BOE)	**24.10**	26.33	46.03
Operating netback ($/BOE)	**9.87**	10.09	25.62
Netback as a percentage of revenue	**41%**	38%	56%

(1) Certain comparative information has been revised, refer to information under the heading of "*Corporate Acquisition*".

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 oil and gas revenue, 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: 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:

	Three months ended December 31			Year ended December 31		
(CA$ thousands, except as otherwise indicated)	**2016**	2015	%	**2016**	2015	%
Cash provided by operating activities	**21,919**	11,268	95	**44,720**	63,010	-29
Change in non-cash working capital	**776**	(795)	-198	**12,546**	(9,896)	-227
Funds from operations	**22,695**	10,473	117	**57,266**	53,114	8
Transaction costs	**4**	-	-	**23**	2,409	-99
Provision for potential credit losses	**81**	548	-85	**309**	611	-49
Settlement of decommissioning obligations	**320**	151	112	**782**	383	104
Adjusted funds from operations	**23,100**	11,172	107	**58,380**	56,517	3

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

	Three months ended December 31			Year ended December 31		
(CA$ thousands, except as otherwise indicated)	**2016**	2015	%	**2016**	2015	%
Oil and gas sales	**55,737**	42,797	30	**184,613**	179,326	3
Cash premiums on financial instruments	**205**	-	-	**460**	-	-
Realized loss on financial instruments(1)	**(428)**	(2,129)	-80	**(315)**	(833)	-62
Royalties	**(5,203)**	(5,022)	4	**(15,911)**	(19,033)	-16
Production expenses	**(17,231)**	(17,012)	1	**(71,204)**	(76,914)	-7
Transportation expenses	**(5,677)**	(3,756)	51	**(21,943)**	(14,192)	55
Operating income	**27,403**	14,878	84	**75,700**	68,354	11
Production (mBOE)	**1,818**	1,848	-2	**7,667**	6,780	13
Operating netback ($/BOE)	**15.08**	8.05	88	**9.87**	10.09	-2

(1) Excludes realized gains/losses on interest rate swaps

Throughout this MD&A, 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.

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. References to oil in this MD&A include crude oil and field condensate. References to natural gas liquids ("NGLs") include pentane, butane, propane, and ethane. References to "liquids" includes field condensate and NGLs. References to gas in this discussion include natural gas and sulphur. Such abbreviation may be misleading, particularly if used in isolation.

NEW ACCOUNTING POLICIES

On May 3, 2016, the Company issued $90.0 million principal amount of convertible debentures that bear interest at a fixed rate of 5% per annum (refer to additional information regarding the Debentures under the heading of *"Capital Resources and Liquidity"*). 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.

ACCOUNTING STANDARDS ISSUED BUT NOT YET EFFECTIVE

IFRS 15 *Revenue from Contracts with Customers* provides clarification for recognizing revenue from contracts with customers and establishes a single revenue recognition and measurement framework that applies to contracts with customers. The new standard is effective for annual periods beginning on or after January 1, 2018, with early adoption permitted. The evaluation of all potential measurement and disclosure impacts is ongoing.

IFRS 9 *Financial Instruments*, is intended to replace IAS 39 *Financial Instruments: Recognition and Measurement* and uses a single approach to determine whether a financial asset is measured at amortized cost or fair value, replacing the multiple rules in IAS 39. For financial liabilities designated at fair value through profit or loss, a company can recognize the portion of the change in fair value related to the change in the company's own credit risk through other comprehensive income rather than profit or loss. The new standard also requires a single impairment method to be used, replacing the multiple impairment methods in IAS 39, and incorporates new hedge accounting requirements. The new standard is effective for annual periods beginning on or after January 1, 2018, with early adoption permitted. Based on the nature of the Company's existing financial assets and liabilities, management does not expect the adoption of IFRS 9 to have a material impact on the consolidated financial statements, however, 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; non-GAAP financial measures such as "Adjusted funds from operations" or other key metrics disclosed in this MD&A including "G&A per BOE" will be significantly impacted as rent expense is removed and replaced by the recording of depreciation and finance 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 evaluating 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, 2016. 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, 2016 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 current production forecasts, prices and economic conditions. As circumstances change and additional data becomes available, reserve estimates also change. Estimates made are reviewed and revised, either upward or downward, as warranted by 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, 2016, 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, 2015.

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 the significant decrease in forecast oil and natural gas prices, an indication of potential impairment was identified for all CGUs and an impairment test was performed for PP&E at December 31, 2016. 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 9 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, 2016 and 2015 under the heading of "*Capital expenditures*" of this MD&A and in notes 5 and 6 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 12 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.

Convertible debentures

On May 3, 2016, the Company issued $90.0 million principal amount of 5% convertible debentures (additional information regarding the Debentures is provided under the heading of *"Capital Resources and Liquidity"*). Calculation of the fair value of the liability component of the Debentures requires significant judgement with respect to the determination of a market interest rate for similar debt instruments without a conversion option. A change in the market rate of interest would impact the fair value allocated to the liability and equity components on initial recognition, deferred income taxes, and subsequent finance expense related to the accretion of the liability component recorded in profit or loss.

The Company's calculation of the fair value of the liability component assumes a market interest rate of 10.5%. If the estimated market interest rate increased (decreased) by 0.5% the fair value of the liability component would decrease (increase) by approximately $1.5 million and the value of the equity component, net of deferred taxes, would increase (decrease) by approximately $1.1 million.

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, 2016, the Company has a consolidated deferred income tax liability of $42.4 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 $76.1 million related to non-capital losses which are estimated to be approximately $286.2 million at December 31, 2016. The Company's non-capital losses expire in years 2023 to 2036. 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 13 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 13 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, 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.

CHANGE IN CLASSIFICATION OF CERTAIN PRODUCTION AND TRANSPORTATION EXPENSES

During the previous year ended December 31, 2015, the Company reclassified certain charges that were previously presented as transportation expenses to production expenses. The Company concluded that a portion of the charges being incurred pursuant to a firm transportation contract and gas sales agreement related to upstream services, primarily gas gathering and processing fees, which are more appropriately presented as a production expense rather than transportation expense. The adjustment, which was recognized in the Company's financial statements during the fourth quarter of 2015, resulted in a total reclassification of production and transportation expenses previously reported by $1.8 million for the nine month period ended September 30, 2015. The reclassification has a net nil impact on cash flow provided by operating activities and profit (loss) and comprehensive income (loss) reported for the periods.

Production expenses	Q1 2015	Q2 2015	Q3 2015	Q4 2015	YTD 2015
Total expense – previously reported	16,786	24,070	17,247	n/a	n/a
Reclassification	398	668	733	n/a	n/a
Total expense – revised presentation	**17,184**	**24,738**	**17,980**	**17,012**	**76,914**
$ per BOE – previously reported	11.66	13.58	10.03	n/a	n/a
$ per BOE – revised presentation	**11.93**	**13.95**	**10.45**	**9.21**	**11.34**

Transportation expenses	Q1 2015	Q2 2015	Q3 2015	Q4 2015	YTD 2015
Total expense – previously reported	4,151	5,055	3,029	n/a	n/a
Reclassification	(398)	(668)	(733)	n/a	n/a
Total expense – revised presentation	**3,753**	**4,387**	**2,296**	**3,756**	**14,192**
$ per BOE – previously reported	2.88	2.85	1.76	n/a	n/a
$ per BOE – revised presentation	**2.61**	**2.48**	**1.34**	**2.03**	**2.09**

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, 2016 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, 2016 to December 31, 2016. The CEO and the CFO have evaluated the effectiveness of Kelt’s internal controls over financial reporting as at December 31, 2016 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 Corporation and should be read in conjunction with the Company's Annual Information Form dated March 11, 2016 which can be found at www.sedar.com. In addition, the Company's Annual Information Form as at December 31, 2016, will be filed on or about March 10, 2017. 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, recent 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 2017 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 a federal level and, in case of Alberta, 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 Facilities, 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 Facilities

The amount authorized under the Company's Credit Facility is dependent on the borrowing base determined by its lenders. The lenders under the Credit Facility 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: (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, including the risk of hostilities in the Middle East and global terrorism; (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; (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 "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 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 from operations, Kelt believes it has sufficient funds available to fund its projected capital expenditures. However, if funds 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. On January 29, 2016, the Government of Alberta adopted a new royalty regime which took effect on January 1, 2017. See "*Recent Developments – Alberta Modernized Royalty Framework*" section of this MD&A.

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.

The Federal Government has signaled that it plans to review the National Energy Board approval for large projects. This may cause the timeframe for project approvals for current and future applications to increase.

Following major accidents in Lac-Megantic, 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. Current greenhouse gas ("GHG") emissions legislation has not resulted in material compliance costs, however, it is not possible at this time to predict whether proposed legislation or regulations will be adopted, and any such future laws and regulations could result in additional compliance costs or additional operating restrictions.

Adverse impacts to the Company's business as a result of comprehensive GHG 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: increased compliance costs; permitting delays; substantial costs to generate or purchase emission credits or allowances adding costs to the products the Company produces; and 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. Consequently, no assurances can be given that the effect of future climate change regulations will not be significant to the Company.

Beyond existing legal requirements, the extent and magnitude of any adverse impacts of any additional programs or additional regulations cannot be reliably or accurately estimated at this time because specific legislative and regulatory requirements have not been finalized and uncertainty exists with respect to the additional measures being considered and the time frames for compliance. See "*Recent Developments – Climate Change Regulation*" section of this MD&A.

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 2016 Sproule Report, and such variations could be material. The 2016 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 2016 Sproule Report will be reduced to the extent that such activities do not achieve the level of success assumed in the 2016 Sproule Report.

The 2016 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. During the recent United States presidential campaign a number of election promises were made and the new American administration has begun taking steps to implement certain of these promises. Included in the actions that the administration has discussed are the renegotiation of the terms of NAFTA, withdrawal of the United States from the Trans-Pacific Partnership, 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 recently voted to withdraw from the European Union and the Government of the United Kingdom has begun taken 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 2016 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 2016 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 a 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 ABCA.

Internal Controls

Effective internal controls are necessary for Kelt to provide reliable financial reports and to help prevent fraud. Although Kelt has undertaken 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. Refer to additional information under the headings of "*Internal Controls over Financial Reporting*" and "*Disclosure Controls and Procedures*" in this MD&A.

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.

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 "*Advisory Regarding Forward-Looking Statements*". 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.

Commodity Prices

The Company's operational and financial results are dependent on the prices received for oil and natural gas production. Any substantial and extended decline in the price of oil and natural gas would have an adverse effect on, among other things, the Company's revenues and financial condition.

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. 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.

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.

CURRENT ECONOMIC ENVIRONMENT

The current economic environment in the energy industry continues to be volatile. Global crude oil supplies and high inventory levels in excess of global demand have persisted affecting crude oil prices negatively. Last year's record mild winter conditions resulted in lower North American demand for natural gas related to heating, however, a hotter than normal summer in 2016 has resulted in much of the excess amounts of natural gas in storage to dissipate. In addition, natural gas infrastructure and capacity constraints continue to impact commodity prices being realized in domestic markets relative to world markets.

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.

RECENT DEVELOPMENTS

Alberta Modernized Royalty Framework

On April 21, 2016, the Government of Alberta released further details of the Alberta Modernized Royalty Framework (the "MRF") previously announced in the Royalty Review Advisory Panel Report dated January 29, 2016. The MRF will apply to wells drilled on or after January 1, 2017. Existing wells will continue to be governed by current royalty system for ten (10) years, after which time, the MRF will apply. The MRF will apply different royalty rates in three stages of the life cycle of a well, Pre-C*, Post-C*, and Post-C* Mature. Note that C* is the revised Drilling and Completion Cost Allowance which is based on industry average drilling and completion costs to be used as a proxy for well costs. Initially, a company will pay a flat 5% royalty on production until total revenue from the well equals C*. Once the C* threshold has been achieved the royalty rate will fluctuate with market pricing to a maximum of 40% on oil production and 36% on natural gas production, until monthly production from the well is below 194 m3e for oil wells or 345.5 e3m3e for gas wells (the "Maturity Threshold"), where a quantity adjustment is introduced tying the royalty rate to reduced production levels.

The intended outcome under the MRF is to provide industry with similar or better returns for wells under high and low prices and as good or better returns for Albertans. As royalty rates will not be tied to production until the well reaches the Maturity Threshold, highly productive wells will benefit. The full extent of the impact of the MRF on the Company's future financial condition and performance is still being evaluated, however, high productivity deep oil plays are expected to realize the most significant benefit under the new regime. Kelt is exposed to such plays in its core Montney oil development areas at Pouce Coupe, Progress, La Glace and Karr. The Company's gas prospects appear to be value neutral under the MRF using current strip pricing.

On July 12, 2016, the government announced that new wells spud before January 1, 2017 may elect to opt-in early to the MRF, if they meet certain criteria. Kelt did receive approval for early adoption on certain wells and increased its capital spending plans in Alberta for 2016, by reallocating funds within the budget in order to take advantage of this opportunity.

Climate Change Regulation

Federal

The Government of Canada is a signatory to the United Nations Framework Convention on Climate Change (the "UNFCCC") and a participant to the Copenhagen Accord (a non-binding agreement created by the UNFCCC which represents a broad political consensus and reinforces commitments to reducing GHG emissions). On January 29, 2010, Canada inscribed in the Copenhagen Accord its 2020 economy-wide target of a 17% reduction of GHG emissions from 2005 levels; however, the GHG emission reduction targets are not binding. In May 2015, Canada submitted its Intended Nationally Determined Contribution ("INDC") to the UNFCCC. INDCs were communicated prior to the 2015 United Nations Climate Change Conference, held in Paris, France, which led to the Paris Agreement that came into force November 4, 2016 (the "Paris Agreement"). Among other items, the Paris Agreement constitutes the actions and targets that individual countries will undertake to help keep global temperatures from rising more than 2° Celsius and to pursue efforts to limit below 1.5° Celsius. The federal government ratified the Paris Agreement on December 12, 2016, and pursuant to the agreement, Canada's INDC became its Nationally Determined Contributions ("NDC"). As a result, the federal government replaced its INDC of a 17% reduction target established in the Copenhagen Accord with an NDC of 30% reduction below 2005 levels by 2030.

On June 29, 2016, the North American Climate, Clean Energy and Environment Partnership was announced among Canada, Mexico and the United States, which announcement included an action plan for achieving a competitive, low-carbon and sustainable North American economy. The plan includes setting targets for clean power generation, committing to implement the Paris Agreement, setting out specific commitments to address certain short-lived climate pollutants, and the promotion of clean and efficient transportation.

Additionally, on December 9, 2016, the federal government formally announced the Pan-Canadian Framework on Clean Growth and Climate Change. As a result, the federal government will implement a Canada-wide carbon pricing scheme beginning in 2018. This may be implemented through either a cap and trade system or a carbon tax regime at the option of each province or territory. The federal government will impose a price on carbon of $10 per tonne on any province or territory which fails to implement its own system by 2018. This amount will increase by $10 annually until it reaches $50 per tonne in 2022 at which time the program will be reviewed.

In general, there is uncertainty with regard to the impact of federal or provincial climate change and environmental laws and regulations, as it is currently not possible to predict the extent of future requirements. Any new laws and regulations, or additional requirements to existing laws and regulations, could have a material impact on the Company's operations and cash flow.

Alberta

Alberta enacted the *Climate Change and Emissions Management Act* (the "CCEMA") on December 4, 2003, amending it through the *Climate Change and Emissions Management Amendment Act*, which received royal assent on November 4, 2008. The CCEMA is based on an emissions intensity approach similar to the Updated Action Plan and aims for a 50% reduction from 1990 emissions relative to GDP by 2020. The accompanying regulations include the Specified Gas Emitters Regulation ("SGER"), which imposes GHG limits. The SGER applies to facilities emitting more than 100,000 tonnes of GHG emissions in 2003 or any subsequent year ("Regulated Emitters"), and requires reductions in GHG emissions intensity (e.g. the quantity of GHG emissions per unit of production) from emissions intensity baselines established in accordance with the SGER.

On June 25, 2015, the Government of Alberta renewed the SGER for a period of two years with significant amendments while Alberta's newly formed Climate Advisory Panel conducted a comprehensive review of the province's climate change policy. As of 2015, Regulated Emitters are required to reduce their emissions intensity by 2% from their baseline in the fourth year of commercial operation, 4% of their baseline in the fifth year, 6% of their baseline in the sixth year, 8% of their baseline in the seventh year, 10% of their baseline in the eighth year, and 12% of their baseline in the ninth or subsequent years. These reduction targets will increase, meaning that Regulated Emitters in their ninth or subsequent years of commercial operation must reduce their emissions intensity from their baseline by 15% in 2016 and 20% in 2017.

A Regulated Emitter can meet its emissions intensity targets through a combination of the following: (1) producing its products with lower carbon inputs, (2) purchasing emissions offset credits from non-regulated emitters (generated through activities that result in emissions reductions in accordance with established protocols), (3) purchasing emissions performance credits from other Regulated Emitters that earned credits through the reduction of their emissions below the 100,000 tonne threshold, (4) cogeneration compliance adjustments, and (5) by contributing to the Climate Change and Emissions Management Fund (the "Fund"). Contributions to the Fund are made at a rate of $15 per tonne of GHG emissions, increasing to a rate of $20 per tonne of GHG emissions in 2016 and $30 per tonne of GHG emissions in 2017. Proceeds from the Fund are directed at testing and implementing new technologies for greening energy production.

Alberta Climate Leadership Plan

In November 2015, the Alberta government announced its climate leadership plan (the "CLP"). On June 7, 2016, the *Climate Leadership Implementation Act* ("CLIA") was passed into law. The CLIA enacted the *Climate Leadership Act* ("CLA") introducing a carbon tax on all sources of GHG emissions, subject to certain exemptions. An initial economy-wide levy of $20 per tonne was implemented on January 1, 2017, increasing to $30 per tonne in January 2018. All fuel consumption, including gasoline and natural gas, will be subject to the levy, with certain exemptions, and directors of a corporation may be held jointly and severally liable with a corporation when the corporation fails to remit an owed carbon levy. Regulated Emitters will remain subject to the SGER framework until the end of 2017; upon the expiry of the SGER, the Government of Alberta intends to transition to a proposed Carbon Competitiveness Regulation, in which sector specific output-based carbon allocations will be used to ensure competitiveness. A 100 megatonne per year limit for GHG emissions was implemented for oil sands operations, which currently emit roughly 70 megatonnes per year. This cap exempts new upgrading and cogeneration facilities, which are allocated a separate 10 megatonne limit.

There are certain exemptions to the carbon levy imposed by the CLA. Until 2023, fuels consumed, flared or vented in a production process by conventional oil and gas producers will be exempt from the carbon levy. An exemption also applies for biofuels and fuels sold for export. In addition, marked fuels used in farming operations as well as personal and band uses by First Nations are exempt. As activities integral to oil and gas production processes are exempt until 2023, Kelt expects our operations to have minimal direct carbon levy exposure until 2023. Kelt has applied for and obtained its Alberta Carbon Levy Exemption Certificate. If, when, the exemption certificate expiries in 2023, the Company would expect the cost of operating its Alberta properties to increase under the CLA.

The passing of the CLIA is the first step towards executing the CLP (other legislation is still pending). In addition to enacting the CLA, the CLIA also enacted the *Energy Efficiency Alberta Act*, which enables the creation of Energy Efficiency Alberta, a new Crown corporation to support and promote energy efficiency programs and services for homes and businesses.

The Government of Alberta also signaled its intention through its CLP to implement regulations that would lower methane emissions by 45 percent by 2025. Regulations are planned to take effect in 2020 to ensure the 2025 target is met.

OUTLOOK AND GUIDANCE

Oil and gas prices have bounced back from the lows experienced earlier in 2016, however, our industry continues to operate in a challenging commodity price environment. Due to market instability and volatile commodity prices that have trended lower over the past two years, many oil and gas companies have reduced their capital spending plans. Ultimately, lower capital investment in oil and gas drilling can be expected to balance the supply and demand ratio. Kelt continues to be optimistic about the long-term outlook for oil and gas commodity prices.

Kelt has taken advantage of the current business environment and the recent downturn by adding opportunities at a reasonable cost. The cost to acquire land at Crown sales in the Company's core operating areas dropped significantly and service related costs to drill and complete wells also declined substantially. In order to capitalize on opportunities in the current energy business environment, Kelt was active at Crown land sales and has transitioned to development pad drilling in order to take advantage of lower oilfield related service costs.

Kelt's Board of Directors approved the Company's 2017 capital expenditure budget $144.6 million, of which approximately 72% will be incurred on drilling and completing wells. Approximately $58.0 million (40% of total budget) is expected to be incurred in the first quarter of 2017. A portion of the capital budget will be used for facilities, whereby Kelt expects to increase both compression and pipeline gathering capacity in its core producing areas to accommodate production additions. After giving effect to the Karr Property Disposition, net capital spending in 2017 is expected to be approximately $42.0 million.

Kelt expects to drill 20 gross (17.8 net) wells in 2017, however, the Company expects to complete 26 gross (23.8 net) wells in 2017, as there are 6 gross (6.0 net) drilled but un-completed ("DUC") wells from 2016.

The table below outlines Kelt's forecasted financial and operating guidance for 2017, after giving effect to the Karr Property Disposition. The guidance set-out in the table below was previously announced in the Company's press release dated January 4, 2017.

(CA$ millions, except as otherwise indicated)	**2017 Forecast**
Average Production	
Oil (bbls/d)	**6,700**
NGLs (bbls/d)	**2,500**
Gas (mmcf/d)	**82,800**
Combined (BOE/d)	**23,000**
Production per million common shares (BOE/d) (1)	**131**
Forecasted Average Commodity Prices	
WTI oil price (USD/bbl)	**52.00**
Canadian Light Sweet ($/bbl)	**65.24**
NYMEX natural gas price (USD/MMBtu)	**3.05**
AECO natural gas price ($/GJ)	**2.95**
Forecasted Average Exchange Rate (US$/CA$)	**0.749**
Capital Expenditures	
Drilling & completions	**104.6**
Facilities, pipeline & well equipment	**32.0**
Land and seismic & property acquisitions (net of dispositions)	**(94.6)**
Total capital expenditures, net of dispositions	**42.0**
Adjusted funds from operations (1)	**128.0**
Per common share, diluted (1)	**0.73**
Bank debt, net of working capital, at year-end (1)(2)	**222.0**
Net bank debt to trailing annual adjusted funds from operations ratio (1)	**0.4 x**
Weighted average common shares outstanding (millions)	**175.7**
Common shares issued and outstanding (millions)	**175.7**

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

(2) 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.

The Company is forecasting WTI crude oil prices to average US$52.00 per barrel in 2017, up 20% from an estimated average price of US$43.25 per barrel in 2016. AECO natural gas prices are forecasted to average $2.95 per GJ in 2017, up 45% from an estimated average price of $2.04 per GJ in 2016.

Forecast average production of 23,000 BOE per day in 2017 represents a 10% increase from forecast average production of 21,000 BOE per day in 2016 and is estimated to be weighted 40% to oil and NGLs and 60% to gas. However, based on the Company's forecasted commodity prices for 2017, 69% of forecasted operating income in 2017 is expected to be generated from oil and NGLs versus 31% from gas. Kelt exited 2016 with approximately 20,000 BOE per day of production. Pad drilling production additions in 2017 from Inga/Fireweed in BC are anticipated to occur in the later part of 2017 and therefore are not fully reflected in the average production forecast for 2017.

However, the Company expects 2017 exit production to be approximately 25% higher than 2016 exit production.

After giving effect to the aforementioned production estimates, commodity price assumptions, estimated expenses and the Karr property disposition: Adjusted funds from operations for 2017 is forecasted to be approximately $128.0 million or $0.73 per common share, diluted; Kelt estimates that the Company's bank debt, net of working capital, will be approximately $52.0 million as at December 31, 2017; Royalties are expected to average 11.2% of oil and gas sales in 2017; During 2017, combined production and transportation expense is estimated to be $11.59 per BOE ($8.88 per BOE and $2.71 per BOE respectively); G&A expense is estimated to be $0.91 per BOE; and interest expense is forecasted at $0.83 per BOE.

Kelt expects to keep three rigs active in its core Montney operating areas of BC and Alberta during the first quarter of 2017. At spring break-up, the Company will re-evaluate its spending plans for the remainder of 2017. With continued improvement in oil and gas prices, Kelt may consider increasing its capital program for the balance of 2017 at that time.

Changes in forecasted commodity prices and variances in production estimates can have a significant impact on estimated adjusted 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 2017. Readers are cautioned that this financial outlook may not be appropriate for other purposes.

ADDITIONAL INFORMATION

Additional information relating to Kelt is filed on SEDAR and can be viewed on their website at www.sedar.com. In addition, the Company's Annual Information Form ("AIF") for the year ended December 31, 2016, will be filed on SEDAR on or about March 10, 2017. 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.

On behalf of the Board of Directors,

[signed]

David J. Wilson
President and Chief Executive Officer
March 7, 2017

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 7, 2017

[signed]

Sadiq H. Lalani
Vice President and Chief Financial Officer
March 7, 2017

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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, 2016 and December 31, 2015 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, 2016 and December 31, 2015 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 7, 2017

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KELT EXPLORATION LTD.
CONSOLIDATED STATEMENT OF FINANCIAL POSITION
AS AT DECEMBER 31, 2016 AND DECEMBER 31, 2015

(CA$ thousands)	[Notes]	**December 31, 2016**	December 31, 2015 Revised [note 5]
ASSETS			
Current assets			
Cash and cash equivalents		**560**	870
Accounts receivable and accrued revenue	[15]	**30,406**	27,266
Prepaid expenses and deposits		**1,191**	2,129
Total current assets		**32,157**	30,265
Assets held for sale	[4]	**105,458**	-
Exploration and evaluation assets	[8]	**120,166**	124,305
Property, plant and equipment	[9]	**998,177**	1,124,905
Total assets		**1,255,958**	1,279,475
LIABILITIES			
Current liabilities			
Accounts payable and accrued liabilities		**55,659**	64,931
Derivative financial instruments	[15]	**599**	230
Deferred premium on flow-through shares	[13]	**798**	-
Decommissioning obligations	[12]	**1,450**	493
Total current liabilities		**58,506**	65,654
Decommissioning obligations held for sale	[4]	**2,532**	-
Bank debt	[10]	**111,693**	177,570
Convertible debentures	[11]	**70,978**	-
Decommissioning obligations	[12]	**126,597**	142,308
Deferred income tax liability	[14]	**42,351**	47,189
Total liabilities		**412,657**	432,721
SHAREHOLDERS' EQUITY			
Shareholders' capital	[13]	**1,055,959**	1,022,115
Reserve from common control transaction		**(57,668)**	(57,668)
Equity component of convertible debentures	[11]	**12,856**	-
Contributed surplus		**17,454**	17,833
Retained earnings (deficit)		**(185,300)**	(135,526)
Total shareholders' equity		**843,301**	846,754
Total liabilities and shareholders' equity		**1,255,958**	1,279,475

Commitments [17]
Subsequent Events [21]

The accompanying notes form an integral part of these consolidated 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, 2016 AND DECEMBER 31, 2015

		Year ended December 31	
(CA$ thousands, except per share amounts)	[Notes]	**2016**	2015
			Revised [note 5]
Revenue			
Oil and gas sales		**184,613**	179,326
Royalties		**(15,911)**	(19,033)
		168,702	160,293
Expenses			
Production	[19]	**71,204**	76,914
Transportation	[19]	**21,943**	14,192
Financing	[16]	**15,253**	9,400
General and administrative		**6,994**	5,200
Provision for potential credit losses	[15]	**309**	611
Share based compensation	[13]	**5,865**	8,372
Exploration and evaluation	[8]	**4,260**	10,474
Depletion, depreciation and impairment	[9]	**113,906**	205,204
Impairment of goodwill	[9]	**-**	18,206
		239,734	348,573
Loss before other items and taxes		**(71,032)**	(188,280)
Loss on derivative financial instruments	[15]	**(259)**	(2,861)
Premium on flow-through shares	[13]	**3,305**	3,564
Gain on acquisition	[5]	**-**	15,910
Gain on sale of assets	[7]	**8,746**	190
Transaction costs	[5,6]	**(23)**	(2,409)
Loss before taxes		**(59,263)**	(173,886)
Deferred income tax recovery	[14]	**(9,489)**	(32,847)
Loss and comprehensive loss		**(49,774)**	(141,039)
Loss per common share			
Basic	[13]	**(0.29)**	(0.91)
Diluted	[13]	**(0.29)**	(0.91)

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, 2016 AND DECEMBER 31, 2015

		Shareholders' capital						
(CA$ thousands)	[Notes]	Number of Shares (000s)	Amount ($ thousands)	Reserve	Convertible debentures – equity portion	Contributed surplus	Retained earnings (deficit)	Total shareholders' equity
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:								
Private placements	[13]	6,085	31,690	-	-	-	-	31,690
Deferred premium on flow-through shares	[13]	-	(4,103)	-	-	-	-	(4,103)
Share issue costs, net of tax	[13]	-	(280)	-	-	-	-	(280)
Issuance of convertible debentures	[11]	-	-	-	12,856	-	-	12,856
Exercise of stock options	[13]	67	384	-	-	(91)	-	293
Vesting of restricted share units	[13]	852	6,153	-	-	(6,153)	-	-
Share based compensation	[13]	-	-	-	-	5,865	-	5,865
Balance at December 31, 2016		**175,672**	**1,055,959**	**(57,668)**	**12,856**	**17,454**	**(185,300)**	**843,301**

Balance at December 31, 2014		126,934	657,102	(57,668)	-	14,692	5,513	619,639
Loss and comprehensive loss			-	-	-	-	(141,039)	(141,039)
Common shares issued:								-
Common share offerings	[13]	14,056	123,429	-	-	-	-	123,429
Deferred premium on flow-through shares	[13]	-	(2,872)	-	-	-	-	(2,872)
Corporate acquisition	[5]	26,900	242,641	-	-	-	-	242,641
Share issue costs, net of tax	[13]	-	(3,416)	-	-	-	-	(3,416)
Vesting of restricted share units	[13]	778	5,231	-	-	(5,231)	-	-
Share based compensation	[13]	-	-	-	-	8,372	-	8,372
Balance at December 31, 2015		168,668	1,022,115	(57,668)	-	17,833	(135,526)	846,754

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, 2016 AND DECEMBER 31, 2015

		Year ended December 31	
(CA$ thousands)	[Notes]	**2016**	2015
Operating activities			
Loss and comprehensive loss		**(49,774)**	(141,039)
Items not affecting cash:			
Accretion of convertible debentures	[11,16]	**2,145**	-
Accretion of decommissioning obligations	[12,16]	**2,817**	2,816
Share based compensation		**5,865**	8,372
Exploration and evaluation		**4,260**	10,474
Depletion, depreciation and impairment		**113,906**	205,204
Impairment of goodwill		**-**	18,206
Unrealized loss (gain) on derivative financial instruments	[15]	**(91)**	1,975
Premium on flow-through shares		**(3,305)**	(3,564)
Gain on acquisition		**-**	(15,910)
Gain on sale of assets		**(8,746)**	(190)
Deferred income tax recovery		**(9,489)**	(32,847)
Cash premiums on derivatives	[15]	**460**	-
Settlement of decommissioning obligations	[12]	**(782)**	(383)
Change in non-cash operating working capital	[18]	**(12,546)**	9,896
Cash provided by operating activities		**44,720**	63,010
Financing activities			
Increase (decrease) in bank debt		**(65,877)**	130,641
Issue of common shares, net of costs	[13]	**31,307**	118,755
Proceeds on exercise of stock options	[13]	**293**	-
Issue of convertible debentures, net of costs	[11]	**86,443**	-
Cash provided by financing activities		**52,166**	249,396
Investing activities			
Exploration and evaluation assets		**(35,575)**	(43,555)
Property, plant and equipment		**(50,072)**	(123,050)
Property acquisitions	[6]	**(18,512)**	(16,350)
Property dispositions	[7]	**5,891**	-
Corporate acquisition	[5]	**-**	(95,839)
Change in non-cash investing working capital	[18]	**1,072**	(33,791)
Cash used in investing activities		**(97,196)**	(312,585)
Net change in cash and cash equivalents		**(310)**	(179)
Cash and cash equivalents, beginning of year		**870**	1,049
Cash and cash equivalents, end of year		**560**	870

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

(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. 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 Company was incorporated under the *Business Corporations Act* (Alberta) on October 11, 2012 as 1705972 Alberta Ltd. and was inactive until February 26, 2013. On October 19, 2012, Articles of Amendment were filed to change the name of the Company to Kelt Exploration Ltd. 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.

On April 16, 2015, the Company completed the acquisition of Artek Exploration Ltd. ("Artek") by acquiring all of the issued and outstanding common shares of Artek pursuant to a statutory plan of arrangement under the *Business Corporations Act* (Alberta) (the "Artek Acquisition"). Pursuant to the arrangement, Artek common shares were delisted from the TSX and Artek became a wholly-owned subsidiary of Kelt. Immediately following the Artek Acquisition, Articles of Amendment were filed to change the name of Artek to Kelt Exploration (LNG) Ltd. ("Kelt LNG"). Kelt has transferred all of its British Columbia ("BC") assets to Kelt LNG and at the same time, Kelt LNG has transferred all of its Alberta assets to Kelt. Kelt LNG operates in BC as a wholly-owned subsidiary of Kelt.

The head office of Kelt and Kelt LNG 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.

2. BASIS OF PRESENTATION

a) Statement of compliance

These audited consolidated annual 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, such as Kelt, are required to apply such standards.

The Company's Board of Directors approved and authorized these audited consolidated annual financial statements for issue on March 7, 2017.

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 15 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 current production forecasts, prices and economic conditions. As circumstances change and additional data becomes available, reserve estimates also change. Estimates made are reviewed and revised, either upward or downward, as warranted by 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 (“PP&E”) 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 (“E&E”) 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, 2016, 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, 2015.

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 the significant decrease in forecast oil and natural gas prices, an indication of potential impairment was identified for all CGUs and an impairment test was performed for PP&E at December 31, 2016. 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 9 of the consolidated 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, 2016 and 2015 in notes 5 and 6 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 12 of the consolidated 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.

Convertible debentures

On May 3, 2016, the Company issued $90.0 million principal amount of 5% convertible unsecured subordinated debentures (the “Debentures”). Refer to note 11 for additional information regarding the Debentures. Calculation of the fair value of the liability component of the Debentures requires significant judgement with respect to the determination of a market interest rate for similar debt instruments without a conversion option. A change in the market rate of interest would impact the fair value allocated to the liability and equity components on initial recognition, deferred income taxes, and subsequent finance expense related to the accretion of the liability component recorded in profit or loss.

The Company’s calculation of the fair value of the liability component assumes a market interest rate of 10.5%. If the estimated market interest rate increased (decreased) by 0.5% the fair value of the liability component would decrease (increase) by approximately $1.5 million and the value of the equity component, net of deferred taxes, would increase (decrease) by approximately $1.1 million.

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, 2016, the Company has a consolidated deferred income tax liability of $42.4 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 $76.1 million related to non-capital losses which are estimated to be approximately $286.2 million at December 31, 2016. The Company’s non-capital losses expire in years 2023 to 2036. 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 13 of the consolidated 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 13 of the consolidated 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 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, 2016, 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 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 Statement of Financial Position, except for any portion expected to be realized or paid beyond twelve months of the 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 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.

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).

Such costs are not subject to depletion or depreciation until they are reclassified from E&E to PP&E.

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 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 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 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.

Accounting standards issued but not yet effective

IFRS 15 *Revenue from Contracts with Customers*, is intended to replace IAS 18 *Revenue*, IAS 11 *Construction Contracts*, and related interpretations. IFRS 15 provides clarification for recognizing revenue from contracts with customers and establishes a single revenue recognition and measurement framework that applies to contracts with customers. The new standard is effective for annual periods beginning on or after January 1, 2018, with early adoption permitted. The evaluation of all potential measurement and disclosure impacts is ongoing.

IFRS 9 *Financial Instruments*, is intended to replace IAS 39 *Financial Instruments: Recognition and Measurement* and uses a single approach to determine whether a financial asset is measured at amortized cost or fair value, replacing the multiple rules in IAS 39. For financial liabilities designated at fair value through profit or loss, a company can recognize the portion of the change in fair value related to the change in the company's own credit risk through other comprehensive income rather than profit or loss. The new standard also requires a single impairment method to be used, replacing the multiple impairment methods in IAS 39, and incorporates new hedge accounting requirements. The new standard is effective for annual periods beginning on or after January 1, 2018, with early adoption permitted. Based on the nature of the Company's existing financial assets and liabilities, management does not expect the adoption of IFRS 9 to have a material impact on the consolidated financial statements, however, 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 evaluating the potential impact of IFRS 16 on the consolidated financial statements.

4. ASSETS HELD FOR SALE

On December 13, 2016, the Company executed a letter of intent accepting a third party's offer to purchase the majority of Kelt's 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 and closed on January 18, 2017.

The assets and liabilities disposed subsequent to the end of the reporting period were classified as held for sale as at December 31, 2016.

Gross purchase price	100,000
Estimated closing adjustments (1)	2,926
Fair value of consideration (1)	**102,926**
Exploration and evaluation assets	4,377
Property, plant and equipment, net (2)	101,081
Assets held for sale	105,458
Decommissioning obligations held for sale (3)	(2,532)
Net assets held for sale	**102,926**

(1) Closing adjustments include estimates for certain capital expenditures and operating income between the effective and closing date of the disposition. At the time of preparation of the consolidated annual financial statements, closing adjustments are estimated to be approximately $2.9 million. The total amount of adjustments will not be known until completion of the final statement of adjustments and as a result, the fair value of consideration may differ from this estimate.

(2) Cost of $163.2 million, net of accumulated depletion and depreciation of $48.1 million and accumulated impairment of $14.0 million (net of impairment reversal).

(3) 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 estimated undiscounted cash flows required to settle the obligations are approximately $2.7 million.

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 previous year ended December 31, 2015. As at December 31, 2016, the impairment loss has been partially reversed by $32.2 million based on the fair value of consideration in excess of the carrying amount.

5. CORPORATE ACQUISITION

Acquisition of Artek Exploration Ltd.

On April 16, 2015, the Company closed the Artek Acquisition by acquiring all of the issued and outstanding common shares of Artek on the basis of 0.34 of a Kelt common share for each Artek common share, resulting in the issuance of 26,900,375 common shares of Kelt to the former shareholders of Artek. The acquisition of Artek consolidated the majority of Kelt's land acreage in its Inga-Fireweed-Stoddart, BC core area to 100% working interest and resulted in 100% ownership by Kelt in key infrastructure including compression facilities and pipelines in northeastern BC.

The Artek Acquisition was accounted for as a business combination using the acquisition method of accounting, whereby the assets acquired and the liabilities assumed were recorded at the fair value on the acquisition date of April 16, 2015. The following table summarizes the acquisition date fair value of the consideration paid and the final allocation of the purchase price:

Number of Kelt common shares issued (thousands)	26,900
Fair value of Kelt common shares ($/share)(1)	9.02
Fair value of common share consideration(1)	242,641
Settlement of pre-existing relationship(2)	(4,760)
Net consideration	**237,881**
Bank debt, net of working capital(3)	(101,185)
Exploration and evaluation assets	52,340
Property, plant and equipment	346,014
Decommissioning obligations	(11,966)
Deferred income tax liability	(31,412)
Fair value of net assets acquired	**253,791**
Gain on acquisition(4)	**15,910**

(1) Pursuant to IFRS 3, the fair value of common share consideration is measured based on the share price on the closing date of the acquisition. The share exchange ratio of 0.34 was negotiated based on the volume weighted average trading price of Kelt common shares that traded on the TSX during the five day period ended February 20, 2015 of $8.10 per share. If the negotiated price of $8.10 per share was used, the common share consideration would be valued at $217.9 million.

(2) Artek and Kelt were partners in joint operations. The settlement of the pre-existing relationship relates to $6.6 million of accounts payable by Kelt to Artek, net of $1.9 million of accounts receivable by Kelt from Artek, which were extinguished upon completion of the arrangement.

(3) The net working capital deficit includes $7.0 million of accounts receivable and accrued revenue, $0.4 million of deposits, $12.8 million of accounts payable and accrued liabilities (includes $0.9 million of additional royalties payable resulting from the BC Royalty Audit) and $13.7 million of bank overdraft. Pursuant to the change in control provisions in Artek's credit agreement, Artek's demand loan credit facility, on which $82.1 million was outstanding as of the closing date, was repaid and terminated by Kelt at closing using borrowings available under Kelt's Credit Facility.

(4) The Company recognized a gain on the acquisition of Artek as the total fair value of net assets acquired exceeds the fair value of the consideration paid for Artek's shares by $15.9 million The gain has been revised from $16.8 million previously reported in the Company's consolidated annual financial statements as at and for the year ended December 31, 2015, as a result of the BC Royalty Audit.

Transaction costs of approximately $2.4 million were recognized as an expense during the year ended December 31, 2015. In addition, $0.2 million of transaction costs directly attributable to the issuance of common share consideration were charged to equity, net of deferred taxes.

In March 2016, the British Columbia Ministry of Energy and Mining ("BC Ministry") completed a petroleum and natural gas by-products royalty audit, focused on natural gas liquids ("NGLs") and Sulphur Crown royalties, for the years 2011 to 2014 (the "BC Royalty Audit"). As a result of the BC Royalty Audit, it was determined that Artek's share of Crown royalties were miscalculated and underpaid by Artek for the years 2011 to 2014, resulting in a net settlement of approximately $0.9 million payable to the BC Ministry. If known at the time of acquisition, the additional royalties payable to the BC Ministry would have resulted in the recognition of additional liabilities as at April 16, 2015 and a reduction in the gain recorded on acquisition of Artek by approximately $0.9 million for the year ended December 31, 2015. Accordingly, comparative period amounts previously reported for the Artek Acquisition were revised to reflect the final allocation of the purchase price as at April 16, 2015.

The effect of the revision to the Company's consolidated annual financial statements as at and for the year ended December 31, 2015 is summarized in the table below.

As at and for the year ended December 31, 2015	**Previously Reported**	**Revision**	**Revised Comparative**
Gain on acquisition	16,774	(864)	**15,910**
Loss and comprehensive loss	(140,175)	(864)	**(141,039)**
Loss per common share, basic and diluted	(0.91)	-	**(0.91)**
Cash provided by operating activities	63,010	-	**63,010**
Accounts payable and accrued liabilities	64,067	864	**64,931**
Retained earnings (deficit)	(134,662)	(864)	**(135,526)**
Working capital deficiency	34,525	864	**35,389**
Bank debt, net of working capital	212,095	864	**212,959**

The Consolidated Statement of Profit (Loss) and Comprehensive Income (Loss) includes the results of operations for the period following closing of the Artek Acquisition on April 16, 2015. Specifically, Kelt's profit (loss) for year ended December 31, 2015 includes approximately $24.7 million of revenue and $7.8 million of operating income generated from the acquired interest in the properties subsequent to closing. If the acquisition had occurred on January 1, 2015, pro-forma revenue and operating income is estimated to be approximately $38.2 million and $9.3 million, respectively, for the year ended December 31, 2015. Operating income is defined as revenue, net of royalties, less production and transportation expenses. This pro-forma information is not necessarily indicative of the results of operations that would have resulted had the acquisition been effected on the dates indicated, or the results that may be obtained in the future.

6. PROPERTY ACQUISITIONS

On April 28, 2016, the Company acquired oil and gas assets in its core area at Progress, Alberta, for cash consideration of $18.0 million, before closing adjustments. The purchase price was adjusted for the results of operations between the effective date of January 1, 2016 and closing of the acquisition. The transaction has been accounted for as a business combination using the acquisition method whereby the net assets acquired and the liabilities assumed are recorded at fair value.

During the previous year ended December 31, 2015, Kelt completed several minor property acquisitions in its core areas. The following table summarizes the aggregate fair value of net assets acquired pursuant to property acquisitions completed during the years ended December 31, 2016 and 2015:

	December 31, 2016	December 31, 2015
Exploration and evaluation assets	**252**	264
Property, plant and equipment	**18,538**	16,714
Decommissioning obligations	**(278)**	(628)
Fair value of net assets acquired	**18,512**	16,350
Cash consideration, after closing adjustments	**18,512**	16,350

7. PROPERTY DISPOSITIONS

During the year ended December 31, 2016, Kelt completed dispositions of certain non-core assets for cash proceeds of $5.9 million, after closing adjustment and costs of disposal. The carrying values of the assets and associated decommissioning obligations disposed, as well as the resulting gain on sale, are summarized below.

	December 31, 2016	December 31, 2015
Exploration and evaluation assets	**2,575**	-
Property, plant and equipment	**6,257**	-
Decommissioning obligations	**(11,687)**	(190)
Carrying value of net assets (liabilities) disposed	**(2,855)**	(190)
Cash proceeds, after closing adjustments	**5,891**	-
Gain on sale of assets	**8,746**	190

8. EXPLORATION AND EVALUATION ASSETS

Exploration and evaluation 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 or charged to exploration and evaluation expense.

The following table reconciles movements of exploration and evaluation assets:

	December 31, 2016	December 31, 2015
Balance, beginning of year	**124,305**	79,294
Additions	**35,575**	43,555
Corporate acquisition [note 5]	**-**	52,340
Property acquisitions [note 6]	**252**	264
Property dispositions [note 7]	**(2,575)**	-
Transfers to property, plant and equipment	**(28,754)**	(40,674)
Expired mineral leases	**(4,260)**	(3,117)
Impairments	**-**	(7,357)
Reclassification – Assets held for sale [note 4]	**(4,377)**	-
Balance, end of year	**120,166**	124,305

The Company reviewed its E&E assets for indicators of potential impairment as at December 31, 2016. Except for $4.3 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, 2016.

As at December 31, 2015, the Company concluded that approximately $7.4 million of exploratory drilling costs were impaired. The exploratory drilling costs were charged to exploration and evaluation expense, along with $3.1 million of costs associated with mineral leases that expired during the year ended December 31, 2015.

9. PROPERTY, PLANT AND EQUIPMENT

Net carrying value	December 31, 2016	December 31, 2015
Development and production ("D&P") assets	**997,646**	1,124,180
Corporate assets	**531**	725
Total net carrying value of property, plant and equipment	**998,177**	1,124,905

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, 2014	899,407	1,028	900,435
Additions	122,240	810	123,050
Corporate acquisition [note 5]	346,014	-	346,014
Property acquisitions [note 6]	16,714	-	16,714
Decommissioning costs	33,173	-	33,173
Transfers from E&E	40,674	-	40,674
Balance at December 31, 2015	**1,458,222**	**1,838**	**1,460,060**
Additions	**49,436**	**636**	**50,072**
Property acquisitions [note 6]	**18,538**	**-**	**18,538**
Property dispositions [note 7]	**(11,520)**	**-**	**(11,520)**
Decommissioning costs	**(2,848)**	**-**	**(2,848)**
Transfers from E&E	**28,754**	**-**	**28,754**
Reclassification – Assets held for sale [note 4]	**(163,166)**	**-**	**(163,166)**
Balance at December 31, 2016	**1,377,416**	**2,474**	**1,379,890**

Accumulated depletion, depreciation and impairment	D&P Assets	Corporate Assets	Total PP&E
Balance at December 31, 2014	129,456	495	129,951
Depletion and depreciation expense	140,518	618	141,136
Impairments	64,068	-	64,068
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)**
Property dispositions [note 7]	**(5,263)**	**-**	**(5,263)**
Reclassification – Assets held for sale [note 4]	**(62,085)**	**-**	**(62,085)**
Balance at December 31, 2016	**379,770**	**1,943**	**381,713**

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 $588.5 million (December 31, 2015 - $531.2 million) are included in the depletion calculation for development and production assets.

As a result of the significant decrease in forecast oil and natural gas prices as at December 31, 2016, an indication of potential impairment was identified for all CGUs. Recoverable amounts for the Company's CGUs were estimated based on FVLCD methodology. With the exception of the Karr assets classified as held for sale at December 31, 2016 (note 4), 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, 2016. The projected cash flows used in the FVLCD calculation reflect current market assessments of key assumptions, 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, 2016 ranged from 9% to 12%, depending on the risks specific to the assets in the CGU. Based on the FVLCD calculation, the carrying value of the Leduc-Woodbend CGU was in excess of the recoverable amount, resulting in an impairment loss of $6.0 million as at December 31, 2016.

During the previous year ended December 31, 2015, recoverable amounts for each CGU were estimated based on after-tax discount rates between 9% to 10%. Based on the FVLCD calculation as at December 31, 2015, the carrying value of each of the Company's Alberta CGUs was in excess of the recoverable amount, resulting in an impairment of PP&E of $64.1 million and an impairment of goodwill allocated to the Grande Prairie CGU of $18.2 million.

Of the total PP&E impairment loss recognized at December 31, 2015, $48.5 million related to the Karr CGU. As more particularly described in note 4, the majority of the assets included in the Karr CGU were classified as held for sale as at December 31, 2016 and subsequently disposed on January 18, 2017. As at December 31, 2016, the impairment of the Karr CGU 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 (note 21).

The recoverable amounts calculated for each CGU as at December 31, 2016 are highly sensitive to the discount rate and forecast future commodity prices used in the FVLCD calculation. Holding all other variables constant:

- if the discount rate applied to all CGUs increased (decreased) by 1%, the impairment of the Leduc-Woodbend CGU would increase (decrease) by approximately $0.5 million; and
- if the forecast combined average realized price increased (decreased) by 5%, the impairment of the Leduc-Woodbend CGU would decrease (increase) by approximately $1.0 million.

A 1% increase in the discount rate or 5% decrease in the forecast combined average realized price would not trigger an impairment of the Company's other CGUs as at December 31, 2016. Similarly, a 1% decrease in the discount rate or 5% increase in the forecast combined average realized price would not trigger a reversal of impairment of the Company's other CGUs.

Forecast future prices used in the impairment evaluations as at December 31, 2016 and 2015, 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.

As at December 31, 2016	**2017**	**2018**	**2019**	**2020**	**2021(1)**
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

As at December 31, 2015	2016	2017	2018	2019	2020(1)
WTI Cushing Oklahoma (US$/bbl)	45.00	60.00	70.00	80.00	81.20
Canadian Light Sweet 40 API ($/bbl)	55.20	69.00	78.43	89.41	91.71
NYMEX Henry Hub (US$/MMBtu)	2.25	3.00	3.50	4.00	4.25
AECO-C Spot ($/MMBtu)	2.13	2.80	3.24	3.71	3.98
Exchange rate (CA$/US$)	1.3333	1.2500	1.2048	1.1765	1.1765

(1) Prices escalate at 1.5% thereafter

10. BANK DEBT

	December 31, 2016	December 31, 2015
Bank loan	**82,100**	5,800
Bankers' acceptances	**30,000**	172,800
Unamortized financing fees (1)	**(407)**	(1,030)
Bank debt	**111,693**	177,570

(1) Includes $0.1 million of prepaid interest and stamping fees on bankers' acceptances as at December 31, 2016 ($0.6 million as at December 31, 2015).

The Company has a revolving committed term credit facility ("the Credit Facility") with a syndicate of financial institutions. As at December 31, 2016, the authorized borrowing amount available under the Credit Facility was $185.0 million. The Credit Facility is available for a revolving period of 364 days, maturing on April 29, 2017, and may be extended for an additional 364 days at the discretion of the lenders, with a term-out to April 27, 2018 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 15), 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.

Subsequent to December 31, 2016, Kelt completed the Karr Property Disposition and received unanimous consent of the lenders to keep the authorized borrowing amount under the Credit Facility unchanged at $185.0 million. Refer to note 21 *Subsequent Events* for additional information.

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.

11. 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	**-**	**2,145**	**-**
Balance at December 31, 2016	**90,000**	**70,978**	**12,856**

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 31st and November 30th, 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.

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 liability component of the Debentures was recognized initially at the fair value of a similar liability that does not have an equity conversion option, which was calculated based on a market interest rate of 10.5%. The difference between the $90.0 million principal amount of the Debentures and the fair value of the liability component was recognized in shareholders' equity, net of deferred income taxes. Total transaction costs directly attributable to the offering of $3.6 million were allocated to the liability and equity components of the Debentures proportionately.

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 16). At December 31, 2016, the fair value of the Debentures was $130.5 million (note 15).

12. 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, 2016	December 31, 2015
Balance, beginning of year	**142,801**	94,791
Obligations incurred	**1,233**	1,807
Obligations acquired [note 5, 6]	**278**	12,594
Obligations disposed [note 7]	**(11,687)**	(190)
Obligations settled	**(782)**	(383)
Changes in discount rate	**(8,502)**	33,664
Revisions to estimates	**4,421**	(2,298)
Accretion expense	**2,817**	2,816
Reclassification – Decommissioning obligations held for sale [note 4]	**(2,532)**	-
Balance, end of year	**128,047**	142,801
Decommissioning obligations – current	**1,450**	493
Decommissioning obligations – non-current	**126,597**	142,308

As at December 31, 2016, the key assumptions on which the carrying amount of the decommissioning obligations is based include a risk-free rate of 2.3% (December 31, 2015 – 2.2%) and an inflation rate of 2.0% (December 31, 2015 – 2.0%).

The underlying cost estimates are derived from a combination of published industry benchmarks as well as site specific information. As at December 31, 2016, the undiscounted amount of the estimated cash flows required to settle the obligation is $145.8 million (December 31, 2015 – $150.6 million), and is expected to be incurred over the next 50 years.

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 16).

13. 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, 2016 (December 31, 2015 – nil).

	Number of Shares (000s)	Amount ($ thousands)
Balance at December 31, 2014	126,934	657,102
Issued for cash through common share offerings	14,056	123,429
Deferred premium on flow-through shares	-	(2,872)
Issued pursuant to Artek Acquisition [note 5]	26,900	242,641
Released upon vesting of restricted share units	778	5,231
Share issue costs, net of deferred income taxes ($1,258)	-	(3,416)
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 ($103)	**-**	**(280)**
Balance at December 31, 2016	**175,672**	**1,055,959**

Common share offerings

On July 7, 2015, the Company issued 9.775 million common shares by way of a short-form prospectus and 0.4 million common shares on a non-brokered basis to certain directors and officers of the Company and their associates, at a price of $8.85 per share, providing gross proceeds of $90.0 million.

Private placements of flow-through common shares

The table below summarizes flow-through common shares (“FTS”) issued pursuant to private placements for the period from January 1, 2015 to December 31, 2016, the amount of qualifying expenditures incurred and the Company’s outstanding commitments to incur eligible expenditures as at the end of the current reporting period.

(CA$ thousands, except as otherwise indicated)					Eligible Expenditures (1)			Expenditure Period End / Effective date of Renunciation
Closing Dates	# of FTS	Price per FTS	Gross Proceeds	Deferred Premium	Type	As at December 31, 2016		
						Incurred	Remaining	
First quarter of 2015	3.881 million	$8.60	33,380	2,872	CDE	33,380	-	December 31, 2015 December 31, 2015
April 7, 2016	**4.7 million**	**$4.70**	**22,090**	**2,585**	**CDE**	**22,090**	**-**	**December 31, 2016 December 31, 2016**
August 23, 2016	**0.385 million**	**$6.50**	**2,500**	**638**	**CEE**	**-**	**2,500**	**December 31, 2017 December 31, 2016**
November 2, 2016	**1.0 million**	**$7.10**	**7,100**	**880**	**CDE**	**5,812**	**1,258**	**March 31, 2017 March 31, 2017**

(1) Pursuant to the provisions of the *Income Tax Act* (Canada), the Company shall incur eligible Canadian development expenses ("CDE") or Canadian exploration expenses ("CEE") as required under the respective subscription agreements.

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, 2014	4,927	8.38
Granted	1,845	4.85
Forfeited	(82)	9.32
Balance at December 31, 2015	**6,690**	**7.40**
Granted	**2,533**	**4.71**
Exercised (1)	**(67)**	**4.38**
Forfeited	**(780)**	**7.85**
Balance at December 31, 2016	**8,376**	**6.57**

(1) The weighted average share price on the date of exercise for stock options exercised in 2016 was $5.25 per common share.

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	
	2016	2015
Risk free interest rate	**0.6%**	0.7%
Expected life (years)	**3.5**	3.5
Expected volatility (1)	**52.6%**	44.5%
Expected dividend yield	**0.0%**	0.0%
Expected forfeiture rate	**2.4%**	1.4%
Fair value of options granted during the year ($/share)	**1.76**	1.56

(1) The expected volatility for options granted during the nine months ended December 31, 2016 was estimated based on Kelt's historical volatility. The expected volatility for options granted during the nine months ended December 31, 2015 was estimated based on Kelt's historical volatility and a peer group average for junior/intermediate oil and gas companies, given there was no stock price history for the Company prior to the listing of KEL shares on March 1, 2013.

The following table summarizes information regarding stock options outstanding at December 31, 2016:

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	3,748	4.2	4.50	539	4.40
$5.01 to $10.00	3,567	2.1	6.95	2,836	6.95
$10.01 to $15.00	1,001	2.3	12.40	674	12.38
$15.01 to $20.00	60	2.5	15.40	40	15.40
Total	**8,376**	**3.1**	**6.57**	**4,089**	**7.59**

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, 2014	1,762
Granted	247
Released upon vesting	(778)
Forfeited	(27)
Balance at December 31, 2015	**1,204**
Granted	**439**
Released upon vesting	**(852)**
Forfeited	**(71)**
Balance at December 31, 2016	**720**

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	
	2016	2015
Stock options	**4,099**	4,472
Restricted share units	**1,766**	3,900
Total share based compensation expense	**5,865**	8,372

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)	**2016**	2015
Weighted average common shares outstanding, basic	**173,076**	154,829
Effect of stock options and RSUs	**339**	1,107
Effect of convertible debentures	**-**	-
Weighted average common shares outstanding, diluted	**173,415**	155,936

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, 2016 and 2015, 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 were determined to be anti-dilutive.

14. 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, 2016 are estimated to be approximately $975.4 million (2015 – $957.9 million).

The following table reconciles income taxes calculated at the 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	
	2016	2015
Loss before income taxes	**(59,263)**	(173,022)
Canadian statutory tax rate	**26.4%**	26.0%
Expected income tax recovery	**(15,645)**	(44,986)
Increase (decrease) resulting from:		
Non-deductible expenses (1)	**1,599**	2,810
Recognition of unrecognized deferred tax asset	**(2,055)**	(1,979)
Qualifying expenditures on flow-through shares	**7,434**	9,553
Premium on flow-through shares	**(892)**	(927)
Change in tax rates (2)	**-**	2,247
True-up of tax pools	**70**	63
Impairment of goodwill	**-**	4,734
Gain on acquisition	**-**	(4,362)
Deferred income tax recovery	**(9,489)**	(32,847)

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

(2) Includes a deferred tax recovery of approximately $0.8 million representing the consolidated net tax benefit of intercompany transactions between Kelt and Kelt LNG during the year ended December 31, 2015.

The Canadian statutory tax rate per the rate reconciliation above represents the 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. Effective July 1, 2015, the Alberta government increased the general corporate tax rate from 10% to 12%, resulting in an average tax rate of 11% for Alberta for the year ended December 31, 2016. The increase in Alberta's corporate tax rate resulted in an increase in Kelt's deferred tax liability and a reduction of the deferred tax recovery by approximately $3.0 million during the year ended December 31, 2015.

During the year ended December 31, 2016, the Company renounced tax pools in the amount of $27.9 million related to qualifying expenditures incurred pursuant to flow-through share offerings. The Company renounced $35.4 million of tax pools to the subscribers of flow-through shares during the previous year ended December 31, 2015.

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, 2015	Recognized in profit and CI[(1)]	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[(2)] and other[(3)]	55,954	20,358	-	**76,312**
	(47,189)	9,489	(4,651)	**(42,351)**

Deferred income tax asset (liability)	Balance at December 31, 2014	Recognized in profit and CI[(1)]	Recognized in balance sheet	Balance at December 31, 2015
Derivative financial instruments	(438)	500	-	62
PP&E and E&E	(78,194)	(855)	(57,367)	(136,416)
Decommissioning obligations	23,786	11,183	3,046	38,015
Share and debt issue costs	3,283	(1,280)	2,361	4,364
Reserve from common control transaction	(10,430)	1,262	-	(9,168)
Non-capital losses[(2)] and other[(3)]	12,111	22,037	21,806	55,954
	(49,882)	32,847	(30,154)	(47,189)

(1) Comprehensive income has been abbreviated as "CI".
(2) The Company's non-capital losses expire in years 2023 to 2036.
(3) Includes a deferred tax asset of $0.2 million related to a portion of the provision for potential credit losses as at December 31, 2016 (2015 – $0.1 million).

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 $2.0 million of deferred income tax assets to be recovered related to temporary differences in respect of share and debt issue costs, provisions for potential credit losses and the derivative financial instrument liability. The Company does not expect any other deferred income tax assets or liabilities to reverse within the next twelve months.

15. 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.

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 management contracts

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 for oil and natural gas 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.

At December 31, 2016, the Company had financial derivative contracts to fix the basis differential between certain natural gas reference prices.

Remaining Term	Notional Volume	Reference Prices	Fixed Contract Price	Fair value Asset (Liability)
April 2017 to October 2017	10,000 MMBtu/d	Southern California Border Avg. NYMEX Henry Hub	Southern California Border Avg. plus US$0.055 per MMBtu	**(282)**

The fair value of the derivative contracts is sensitive to changes in the natural gas reference prices. If the Southern California Border Average-NYMEX basis differential increased (decreased) by $0.10/MMBtu, the fair market value of the contract would decrease (increase) by approximately $0.3 million.

Subsequent to the end of the reporting period, Kelt entered into a financial derivative to lock in stronger propane prices on notional contract volumes of 500 barrels per day from February 1, 2017 to December 31, 2017. Kelt will receive 50% of the average US$WTI oil price for the month and will pay a floating price referenced to the current month average OPIS-Conway propane price.

Interest rate risk management contracts

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 $149.6 million during 2016, an increase (decrease) in the market rate of interest by 25 basis points would have increased (decreased) interest expense by $0.4 million, before financial instruments. As at and during the year ended December 31, 2016, Kelt had an interest rate swap that fixed the Canadian Dollar Offered Rate ("CDOR") at 0.925% on a notional amount of $100 million until June 30, 2017. The fair value of the contract was a liability of $3 thousand as of December 31, 2016. 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 management contracts

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 entered in a natural gas marketing arrangement effective November 1, 2016 through October 31, 2017, whereby Kelt receives revenue on the firm contract volume of 4,739 MMBtu per day 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 17. Exposure to foreign exchange rates is mitigating by entering U.S. dollar denominated commodity price or foreign exchange derivative financial instruments.

As at December 31, 2016, the following foreign exchange risk management contracts were outstanding:

Contract Type	Notional Amount per month	Fixed Contract Price	Remaining Term	Fair value Asset (Liability)
FX swap(1)	$1,000,000	CA$/US$ 1.3300	January to December 2017	**(115)**

(1) The FX swap outstanding at December 31, 2016 resulted from an FX swaption contract which was exercised by the counterparty on December 30, 2016. Kelt received a cash premium of $0.255 million at the time of entering into the contract on July 11, 2016.

The fair value of the foreign exchange swap contract is sensitive to changes in the exchange rate. If the CA$/US$ exchange rate increased (decreased) by $0.05, the fair market value of the contract would decrease (increase) by approximately $0.6 million.

At December 31, 2016, the Company had a forward foreign exchange swaption contract whereby the counterparty has the right, if exercised on March 31, 2017, to enter a series of forward foreign exchange transactions fixing the exchange rate on a notional US$1.0 million per month at CA$/US$ 1.3600 from April 2017 to March 2018. In consideration for the swaption, Kelt received a cash premium of $0.205 million at the time of entering into the contract on November 11, 2016. The fair value of the forward foreign exchange swaption as at December 31, 2016, resulted in a derivative financial instrument liability of $0.2 million.

Gains and loss on risk management contracts

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

	Year ended December 31	
	2016	2015
Realized loss	**(350)**	(886)
Unrealized gain (loss)	**91**	(1,975)
Loss on derivative financial instruments	**(259)**	(2,861)

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, 2016:

	Carrying Value ("CV")			Fair Value		
	Gross	Netting[1]	Net CV	Level 1	Level 2	Level 3
Financial liabilities						
Derivative financial instruments	599	-	599	-	599	-
Convertible debentures[2]	70,978	-	70,978	130,500	-	-

(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, 2016, there are no offsetting derivative financial contracts.

(2) The fair value of the convertible debentures is based on the closing market price on the TSX of $145.00 per Debenture as at December 31, 2016, and represents the market value of the entire instrument.

Credit Risk

As at December 31, 2016, 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.

During the year ended December 31, 2016, sales to four oil and gas marketers each individually represented more than 10% of total revenue. Sales to these marketers account for approximately 37%, 23%, 13%, and 10% of total revenue, respectively. During the previous year ended December 31, 2015, sales to five oil and gas marketers accounted for approximately 23%, 17%, 15%, 13% and 11% of total revenue, respectively. Kelt has secured parental guarantees (with terms ranging from two to five years) or letters of credit covering approximately 90% of its monthly credit exposure from oil and gas marketers, calculated based on average sales by purchaser for the fourth quarter of 2016.

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

Accounts receivable and accrued revenue	**December 31, 2016**	December 31, 2015
Joint venture partners	**3,525**	5,154
Oil and gas marketers	**21,949**	16,085
GST input tax credits	**3,438**	4,773
Other	**1,494**	1,254
Accounts receivable and accrued revenue	**30,406**	27,266

Credit risk from 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 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 ageing of the Company's accounts receivable is summarized in the following table:

Accounts receivable and accrued revenue	Current	30-60 days	60-90 days	Over 90 days	Total
Balance at December 31, 2016	**28,657**	**539**	**253**	**957**	**30,406**
Balance at December 31, 2015	23,071	1,836	783	1,576	27,266

The balance of accounts receivable outstanding for more than 90 days relates primarily to receivables from the Company's joint venture partners. Due to the current business environment and low commodity prices, many oil and gas companies, including some of Kelt's partners, continue to face significant financial challenges. Management has reviewed past due accounts receivable balances as at December 31, 2016 and expects the accounts to be collectible, except for approximately $0.8 million of accounts receivable which are provided for in the allowance for doubtful accounts.

	December 31, 2016	December 31, 2015
Allowance for doubtful accounts, beginning of year	**1,002**	-
Provisions recognized in balance sheet	**-**	391
Direct write-off of amounts included in provision	**(522)**	-
Provisions for potential credit losses through profit or loss	**309**	611
Allowance for doubtful accounts, end of year	**789**	1,002

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 include accounts payable, derivative financial instruments, 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, 2016, the Company's working capital deficit of $26.3 million combined with outstanding bank debt of $111.7 million, represented 75% of the authorized borrowing amount available under the Credit Facility of $185.0 million. The Credit Facility is available for a revolving period of 364 days, maturing on April 29, 2017, and may be extended for an additional 364 days at the discretion of the lenders, with a term-out to April 27, 2018 if not renewed. 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, 2016:

	Within 1 Year	1 to 5 Years	More than 5 Years	Total
Accounts payable and accrued liabilities	55,659	-	-	55,659
Derivative financial instrument liability	599	-	-	599
Bank debt and estimated interest(1)	4,356	113,077	-	117,433
Convertible debentures(2)	4,500	105,744		110,244
Total	**65,114**	**218,821**	**-**	**283,935**

(1) Estimated interest for future periods related to the Credit Facility was calculated using the weighted average interest rate of 3.9% for the fourth quarter ended December 31, 2016, 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 27, 2018.

(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 11.

Refer to note 21 *"Subsequent Events"* for information regarding the significant reduction in bank debt following completion of the Karr Property Disposition on January 18, 2017. Kelt received unanimous consent of the lenders to keep the authorized borrowing amount under the Credit Facility unchanged at $185.0 million.

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, 2016	December 31, 2015
Bank debt	**111,693**	177,570
Working capital deficiency (1)	**26,349**	35,389
Bank debt, net of working capital (1)	**138,042**	212,959
Trailing adjusted funds from operations (2)(3)	**92,400**	44,688
Net bank debt to trailing adjusted funds from operations ratio (1)	**1.5**	4.8

(1) Comparative information for the year ended December 31, 2015 has been revised (note 5). Kelt previously reported a debt to trailing funds from operation ratio of 4.7 times as at December 31, 2015.

(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: 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 has reduced its net bank debt to trailing adjusted funds from operations ratio to 1.5 times as at December 31, 2016 from 4.8 times at December 31, 2015. On May 3, 2016, the Company significantly reduced the amount drawn under its revolving bank credit facility using net proceeds of the offering of $90.0 million principal amount of convertible debentures that mature on May 31, 2021. In addition, the Company closed private placements of 6.1 million common shares for net proceeds of $31.3 million and received $5.9 million of proceeds on the disposition of non-core assets during the year ended December 31, 2016.

Subsequent to the end of the reporting period, Kelt completed the Karr Property Disposition for gross proceeds of $100 million, before closing adjustments (refer to note 21 *"Subsequent Events"*). The proceeds have been used initially to reduce indebtedness under the Credit facility, further strengthening the Company's financial position.

As more particularly described in note 10, Kelt is subject to certain non-financial covenants under the Credit Facility agreement. As at December 31, 2016, the Company is in compliance with all covenants. The Company is not subject to any other externally imposed capital requirements.

16. FINANCING EXPENSES

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

	Year ended December 31	
	2016	2015
Interest on bank debt	**7,308**	6,584
Interest on convertible debentures	**2,983**	-
Accretion of convertible debentures	**2,145**	-
Accretion of decommissioning obligations [note 12]	**2,817**	2,816
Financing expense	**15,253**	9,400

17. COMMITMENTS

As of December 31, 2016, the Company is committed to future payments under the following agreements:

(CA$ thousands)	2017	2018	2019	2020	2021	Thereafter
Operating lease - office buildings	1,334	559	108	18	-	-
Operating lease - vehicles	299	205	95	3	-	-
Flow-through shares	3,758	-	-	-	-	-
Firm processing commitments	10,304	3,881	-	-	-	-
Firm transportation commitments(1)	18,029	8,254	5,643	2,519	2,038	8,656
Total annual commitments	**33,724**	**12,899**	**5,846**	**2,540**	**2,038**	**8,656**

(1) 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, 2017, however, the maximum US denominated commitment in a given month does not exceed US$0.31 million. Amounts are translated to Canadian dollars at the spot rate on December 31, 2016 of CA$/US$1.3427.

The Company has firm commitments for oil and gas transportation on major pipelines in Alberta and British Columbia. For periods subsequent to 2021, Kelt has an annual commitment of $1.2 million for gas transportation until March 31, 2026 and an annual commitment of $0.6 million for oil transportation until June 30, 2027.

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, 2018, February 28, 2020, and November 30, 2018, respectively, if not extended.

18. SUPPLEMENTAL CASH FLOW INFORMATION

	Year ended December 31	
Changes in non-cash working capital	**2016**	2015
Accounts receivable and accrued revenue	**(3,140)**	21,413
Prepaid expenses and deposits	**938**	1,131
Accounts payable and accrued liabilities	**(9,272)**	(46,439)
Change in non-cash working capital	**(11,474)**	(23,895)
Relating to:		
Operating activities	**(12,546)**	9,896
Investing activities	**1,072**	(33,791)
Change in non-cash working capital	**(11,474)**	(23,895)

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

	Year ended December 31	
Cash outlays in respect of interest and taxes	**2016**	2015
Interest and standby fees on bank debt	**6,930**	6,921
Interest on convertible debentures	**2,601**	-
Taxes	**-**	-

19. CHANGE IN CLASSIFICATION OF CERTAIN PRODUCTION AND TRANSPORTATION EXPENSES

During the previous year ended December 31, 2015, the Company reclassified certain charges that were previously presented as transportation expenses to production expenses. The Company concluded that a portion of the charges being incurred pursuant to a firm transportation contract and a gas sales agreement related to upstream services, primarily gas gathering and processing fees, which are more appropriately presented as a production expense rather than transportation expense. The adjustment, which was recognized in the Company's financial statements during the fourth quarter of 2015, resulted in a total reclassification of production and transportation expenses previously reported by $1.8 million for the nine month period ended September 30, 2015. The reclassification had a net nil impact on cash flow provided by operating activities and profit (loss) and comprehensive income (loss) reported for the periods.

	Three months ended September 30, 2015	Nine months ended September 30, 2015
Production expense	733	1,799
Transportation expense	(733)	(1,799)
Net impact on profit (loss) and comprehensive income (loss)	-	-
Net impact on cash flow provided by operating activities	-	-

20. 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, 2016, the Company incurred $0.6 million (2015 – $0.6 million) in legal fees and disbursements, of which, less than $0.1 million is payable at December 31, 2016 ($0.1 million at December 31, 2015). 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	
	2016	2015
Salaries, bonuses and other benefits	**1,437**	958
Share based compensation	**3,339**	3,251
Total compensation	**4,776**	4,209

During the 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. During the previous year ended December 31, 2015, key management personnel were granted 87,684 RSUs and 750,000 stock options with an exercise price of $4.38 per share.

21. SUBSEQUENT EVENTS

Karr Property Disposition

On January 18, 2017, Kelt completed the Karr Property Disposition. The assets and associated decommissioning obligations disposed were classified as held for sale as at December 31, 2016 and the carrying amounts are disclosed in note 4. The Karr Property Disposition had an effective date of January 1, 2017. Kelt received gross proceeds, prior to adjustments at closing and following the waiver of certain preferential rights, in the amount of $100.0 million. Net proceeds have been 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.

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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-C	Alberta Energy Company "C" Meter Station of the Nova Pipeline System
WTI	West Texas Intermediate
NYMEX	New York Mercantile Exchange
CREC	Alliance Pipeline Canadian receipt location
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 31st
Q2	Second quarter ended June 30th
Q3	Third quarter ended September 30th
Q4	Fourth quarter ended December 31st
YTD	Year to date
BT	Before income taxes
AT	After income taxes
1P	Proved reserves
2P	Proved plus probable reserves
FD&A	Finding, development and acquisition costs
CGU	Cash generating unit
FVLCD	Fair value less costs of disposal

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)

CORPORATE INFORMATION

BOARD OF DIRECTORS

Robert J. Dales [2, 3, 4, 6]
President, Valhalla Ventures Inc.

William C. Guinan [1, 5]
Partner, Borden Ladner Gervais LLP

Eldon A. McIntyre [2, 3, 4, 6]
President, Jarrod Oils Ltd.

Neil G. Sinclair [2, 3, 4, 5, 6]
President, Sinson Investments Ltd.

David J. Wilson [5]
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

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AUDITORS

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Convertible Debentures “KEL.DB”

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