kelt exploration

ANNUAL REPORT
AS AT AND FOR THE YEAR ENDED
DECEMBER 31, 2013

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FINANCIAL AND OPERATIONAL HIGHLIGHTS

(CA$ thousands, except as otherwise indicated)	Three months ended December 31, 2013	Year ended December 31, 2013
FINANCIAL		
Revenue, before royalties and financial instruments	18,543	46,656
Funds from operations[1]	9,396	23,656
Basic ($/ common share)[1]	0.09	0.32
Diluted ($/ common share)[1]	0.09	0.32
Profit (loss)	(1,838)	(5,115)
Basic ($/ common share)	(0.02)	(0.07)
Diluted ($/ common share)	(0.02)	(0.07)
Capital expenditures, prior to completion of the Arrangement	(6)	23,247
Capital expenditures, subsequent to completion of the Arrangement	231,335	305,896
Total capital expenditures	231,329	329,143
Total assets	485,201	485,201
Bank debt	-	-
Working capital surplus	20,500	20,500
Shareholders' equity	392,872	392,872
Weighted average common shares outstanding (000's)		
Basic	99,244	74,554
Diluted	100,242	75,093
OPERATIONS		
Average daily production		
Oil (bbls/d)	809	516
NGLs (bbls/d)	487	297
Gas (mcf/d)	26,660	18,888
Combined (BOE/d)[2]	5,739	3,961
Production per million common shares (BOE/d)[1]	58	53
Average realized prices, after financial instruments		
Oil ($/bbl)	81.35	86.77
NGLs ($/bbl)	57.00	52.76
Gas ($/mcf)	3.97	3.51
Operating netbacks[1] ($/BOE)		
Oil and gas revenue	35.12	32.27
Cash premium on financial instruments	-	0.16
Realized loss on financial instruments	(0.38)	(0.40)
Average realized price, after financial instruments	34.74	32.03
Royalties	(4.71)	(4.37)
Production and transportation expense	(11.36)	(10.69)
Operating netback[1]	18.67	16.97
Drilling Activity		
Total wells	6	19
Working interest wells	4.2	12.2
Success rate on working interest wells	100%	100%
Undeveloped land		
Gross acres		299,142
Net acres		184,082
Reserves – proved plus probable		
Oil (mbbls)		11,808
NGLs (mbbls)		5,002
Gas (mmcf)		254,329
Combined (mBOE)		59,198

(1) Refer to advisory regarding non-GAAP measures

(2) Average daily production reported above is calculated over the 365 day period ended December 31, 2013. Production for the 308 day period following commencement of active operations on February 27, 2013, averaged 4,694 BOE per day.

MESSAGE TO SHAREHOLDERS

Kelt Exploration Ltd. ("Kelt" or the "Company") is pleased to report its fourth quarter interim results and full year results to shareholders for the period ended December 31, 2013.

Kelt was incorporated on October 11, 2012 for the purpose of participating in a Plan of Arrangement between ExxonMobil Canada Ltd., ExxonMobil Celtic ULC and Celtic Exploration Ltd. and Kelt (the "Arrangement"). The Arrangement was completed on February 26, 2013, at which time Kelt commenced active operations.

Kelt achieved production levels in 2013 that exceeded its public guidance. Average production for 2013 was 3,961 BOE per day (4,694 BOE per day for the 308 operating day period commencing on February 27, 2013). During the fourth quarter of 2013, production averaged 5,739 BOE per day, up 24% from average production of 4,636 BOE per day during the third quarter of 2013. After giving effect to the Pouce Coupe/Spirit River acquisition that was completed on December 20, 2013, exit 2013 production was approximately 9,800 BOE per day (29% oil and NGLs and 71% gas), representing a 173% increase from the average production of 3,588 BOE per day for the 33-day period ended March 31, 2013.

For the three months ended December 31, 2013, revenue was $18.5 million and funds from operations was $9.4 million. At December 31, 2013, Kelt did not have any outstanding bank debt on its $100.0 million demand loan facility, with a chartered bank in Canada. The working capital surplus position, including cash and cash equivalents, at the end of the fourth quarter was $20.5 million.

On December 3, 2013, the Company completed an equity financing issuing 12.4 million common shares at a price of $8.15 per share, resulting in aggregate gross proceeds of $101.1 million. Certain insiders participated in the private placement, acquiring 2.4 million of these common shares for an aggregate subscription price of $19.6 million.

On December 20, 2013, Kelt completed the acquisition of oil and gas assets located at Pouce Coupe/Spirit River, in close proximity to the city of Grande Prairie, Alberta. The Company paid $192.0 million, before closing adjustments, for approximately 4,800 BOE (40% oil and 60% gas) per day of production. Subsequently, on February 10, 2014, the Company disposed of approximately 210 barrels per day of oil production for proceeds of $20.0 million, before closing adjustments.

Kelt drilled 19 gross (12.2 net) wells during 2013, with a 100% success rate. The Company drilled 11 gross (4.4 net) wells at Inga, British Columbia. The target at Inga is condensate-rich natural gas in the Doig (8 gross/3.2 net wells) and Montney (3 gross/1.2 net wells) formations. The Company drilled 6 gross (5.8 net) wells at Karr targeting the Montney oil formation. In addition, Kelt drilled a Wilrich/Falher test at Chicken/Grande Cache and an exploration test in west central Alberta, both at 100% working interest.

On March 5, 2014, Kelt entered into an agreement with a syndicate of underwriters to issue, on a private placement basis, 8.5 million common shares at a price of $11.60 per common share and 1.53 million common shares on a "flow-through" basis in respect of Canadian development expenses at a price of $12.75 per flow-through common share. In addition, certain directors, officers and employees of the Company subscribed to 1.105 million flow-through common shares or 10% of the total offering. The private placements will result in aggregate gross proceeds of $132.2 million and are expected to close on or about March 25, 2014. The underwriters have been granted an over-allotment option, exercisable for a 30 day period following closing, to purchase an additional 1.275 million common shares at the same offering price of $11.60 per common share, which would result in additional gross proceeds of $14.8 million if exercised. The proceeds of the private placements will be used to partially fund the Company's $250.0 million capital expenditure program, and for general working capital purposes.

As at March 10, 2014, the Company has 110.0 million common shares issued and outstanding. Directors and officers of Kelt own (including shares that they exercise control or direction over) 23.3 million common shares or 21.2% of the total shares outstanding.

Entering 2014, Kelt is well positioned financially and expects that it will have sufficient financial flexibility to carry out its operations during the year and pursue new opportunities as they arise. Management is excited about the Company's prospects and looks forward to updating shareholders with further results in the near future.

On behalf of the Board of Directors,

[signed]

David J. Wilson
President and Chief Executive Officer
March 10, 2014

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 west central Alberta and northeastern British Columbia. Common shares of the Company are listed and posted for trading on the Toronto Stock Exchange ("TSX") under the symbol "KEL". The head office of Kelt 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.

This Management's Discussion and Analysis ("MD&A") is dated March 10, 2014 and should be read in conjunction with the Company's audited annual financial statements and related notes as at and for the year ended December 31, 2013. 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, such as Kelt, are required to apply such standards. The Company's Board of Directors approved and authorized the financial statements for issue on March 10, 2014.

The Company was incorporated under the *Business Corporations Act* (Alberta) on October 11, 2012 as 1705972 Alberta Ltd. On October 19, 2012, Articles of Amendment were filed to change the name of the Company to Kelt Exploration Ltd. The Company was incorporated as a wholly owned subsidiary of Celtic Exploration Ltd. ("Celtic"), for the purposes of participating in a Plan of Arrangement (the "Arrangement") between ExxonMobil Canada Ltd. ("ExxonMobil Canada"), ExxonMobil Celtic ULC (formerly 1690731 Alberta ULC) (the "Purchaser"), Celtic and Kelt. Pursuant to the Arrangement, the Purchaser purchased all of Celtic's outstanding common shares ("Celtic Shares"), including Celtic Shares issued upon conversion of Celtic's 5% convertible debentures, at a cash price of $24.50 per Celtic Share. Additionally, Celtic shareholders received one-half (1/2) of a share of Kelt for each Celtic Share.

Pursuant to the Arrangement and a conveyance agreement (the "Conveyance Agreement") entered into by Celtic and Kelt upon closing of the Arrangement on February 26, 2013, Celtic transferred certain petroleum and natural gas assets (the "Acquired Assets") to Kelt (the "Acquisition") in exchange for $142.0 million of common share consideration. The Acquired Assets included all of Celtic's rights, title, estate and interest in the petroleum, natural gas and related hydrocarbon rights and related personal property interests within, upon or under the lands and leases, including:

- a liquids-rich gas property in the Inga area of northeastern British Columbia;
- a gas property in the Grande Cache area of Alberta; and
- an oil prospect in the Karr area of west central Alberta.

Prior to completion of the Arrangement, the Company did not have any assets, liabilities, or operations. The Company commenced active operations on February 27, 2013 following completion of the Arrangement and the Acquisition on February 26, 2013.

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 concerning the expected closing of the March 2014 Private Placements (as more particularly described under the heading of *Subsequent Events*), the timing of future development capital expenditures and the extent of the size of Kelt's reserves. Statements relating to "reserves" or "resources" are deemed to be forward looking statements as they involve the implied assessment, based on current estimates and assumptions that the reserves and resources can be profitably produced in the future.

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.

NON-GAAP MEASURES

This document contains certain financial measures, as described below, which do not have standardized meanings prescribed by GAAP. As these measures 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.

“Operating income” is calculated by deducting royalties, production expenses and transportation expenses from oil and gas revenue, after realized financial instruments and cash premiums. The Company refers to operating income expressed per unit of production as an “Operating netback”. “Funds from operations” is calculated by adding back settlement of decommissioning obligations and change in non-cash operating working capital to cash provided by operating activities. 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. 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 demonstrates the calculation of operating income derived from the individual financial statement line items in accordance with GAAP:

(CA$ thousands, except as otherwise indicated)	Three months ended December 31, 2013	Year ended December 31, 2013
Oil and gas revenue	18,543	46,656
Cash premium on financial instruments	-	228
Realized loss on financial instruments	(201)	(579)
Royalties	(2,486)	(6,321)
Production expenses	(4,988)	(11,358)
Transportation expenses	(1,005)	(4,090)
Operating income	9,863	24,536
Production (mBOE)	528	1,446
Operating netback ($/BOE)	18.67	16.97

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

(CA$ thousands)	Three months ended December 31, 2013	Year ended December 31, 2013
Cash provided by operating activities	13,866	26,891
Settlement of decommissioning obligations	-	-
Change in non-cash working capital	(4,470)	(3,235)
Funds from operations	9,396	23,656

"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 value of petroleum and natural gas reserves, undeveloped land, working capital surplus and proceeds from exercise of stock options, and dividing by the fully diluted number of common shares outstanding.

OTHER MEASUREMENTS

All dollar amounts are referenced in thousands of Canadian dollars, except when noted otherwise. Where amounts are expressed on a barrel of oil equivalent ("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. References to oil in this discussion include crude oil and field condensate. References to natural gas liquids ("NGLs") include, pentane, butane, propane, and ethane. References to gas in this discussion include natural gas and sulphur.

SIGNIFICANT JUDGMENTS AND ESTIMATES

The significant accounting policies used by the Company are disclosed in note 2 of the audited annual financial statements as at and for the year ended December 31, 2013. Certain accounting policies require that management make judgments regarding the selection and application of such policies, and to make appropriate decisions with respect to formulation of estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Actual results may differ materially from these estimates. The following discussion identifies the critical accounting policies and practices of the Company and helps assess the likelihood of materially different results being reported.

Common control transaction

In connection with the Arrangement and pursuant to the terms of the Conveyance Agreement between Celtic and Kelt, the Acquired Assets were transferred from Celtic to Kelt and Kelt assumed certain obligations and liabilities of Celtic. Kelt was a wholly owned subsidiary of Celtic immediately preceding closing of the Arrangement and immediately subsequent to closing, Kelt was controlled by the same shareholders as Celtic; consequently, the entities were under common control at the time of the Acquisition. 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 is recorded as a reserve from common control transaction in shareholders' equity.

Assets held for sale

The decision to classify a non-current asset or disposal group as held for sale requires judgment to determine if the carrying amount will be recovered through a sale transaction rather than through continuing use. In order to draw this conclusion, management must assert that the asset or disposal group is available for immediate sale in its present condition and believe that it is highly probable that a sale transaction will be completed within one year of designating the asset as held for sale. All as more particularly described in note 5 of the annual financial statements, estimates and assumptions are also required to measure the assets held for sale at their fair value less costs of disposal.

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 year-end oil and gas prices and reservoir performance. Such revisions can be either positive or negative.

Changes in reserve estimates impact the financial results of the Company as reserves and estimated future development costs are used to calculate depletion and are also used in measuring fair value less costs of disposal of property, plant and equipment ("PP&E") for impairment calculations and business combinations.

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.

Impairment of non-financial assets

Significant judgment is required to assess the Company's non-financial assets, namely PP&E and E&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. If significant indicators of impairment are identified, the Company must perform a formal impairment test and calculate the recoverable amount. Based on a detailed assessment of each CGU as at December 31, 2013, management concluded that there were no significant indicators of impairment and accordingly, that preparation of a formal impairment test was not required.

Significant judgment and estimates are also required to calculate the recoverable amount in an impairment test. However, given that were no significant indicators of impairment and that an impairment test was not required, the Company was not required to exercise these judgments as at December 31, 2013. 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. Commodity price changes impact the expected future cash flows which may require a material adjustment to the carrying value of non-financial assets.

Exploration and evaluation assets ("E&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. Judgment is also required to determine the level at which E&E is assessed for impairment; for Kelt, the recoverable amount of E&E assets is assessed at the operating segment level. Management assessed the carrying value of E&E for impairment as at December 31, 2013, and prior to transferring any E&E assets to PP&E. Given that were no significant indicators of impairment, the Company was not required to exercise judgment nor apply estimates to calculate the recoverable amount because an impairment test was not required as at December 31, 2013.

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.

Kelt estimates abandonment and reclamation costs based on a combination of publically available industry benchmarks and internal site specific information. The expected timing of settlement is estimated based on the proved plus probable period to abandonment for each field, as per the independent reserve evaluation, unless the timing to abandon and reclaim a specific well site or facility is known based on budgeted expenditures.

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.

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. 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; this assessment requires significant judgment. The provision for deferred income taxes also includes the following significant judgments of management:

- 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 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 unrecognized deferred income tax asset that arose on the common control transaction is being amortized based on the corporate weighted average depletion factor for the period.

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 10 of the annual financial statements.

The fair value of restricted share units is estimated based on the volume weighted average trading price 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. The assumptions used by the Company are discussed in note 10 of the 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. The two most common methods are the residual method and the relative fair value method. The Company has applied the residual method to appropriately reflect the substance transaction. Under the residual 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 as 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.

Determination of the fair value of ordinary shares requires judgment. Typically, it is based on the share price at the time the parties agree to the transaction, which is generally at a date earlier than closing. If there are significant changes in the share price between the date the parties agree to the offering and closing, additional judgment may be required.

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

DISCLOSURE CONTROLS AND PROCEDURES

The Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO") have designed, or caused to be designed under their supervision, disclosure controls and procedures as defined in National Instrument 52-109 of the Canadian Securities Administrators, to provide reasonable assurance that: (i) material information relating to the Company is made known to the CEO and the CFO by others, particularly during the period in which the 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, 2013 and have concluded that such disclosure controls and procedures are effective.

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, 2013 to December 31, 2013.

The CEO and the CFO have evaluated the effectiveness of Kelt's internal controls over financial reporting as at December 31, 2013 and have concluded that such internal controls over financial reporting are effective.

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.

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 seeks to identify and acquire strategic oil and gas properties where it believes further exploitation, development and exploration opportunities exist. In addition, Kelt has implemented a full cycle exploration program, resulting in exploration and development drilling based on opportunities generated internally.

Kelt is optimistic about its future prospects. The Company 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 west central 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

- On February 27, 2013, the Company commenced active operations following completion of the Arrangement and the Acquisition on February 26, 2013; prior thereto, the Company did not have any assets, liabilities, or operations;
- The Company reported daily average production of 3,961 BOE per day for the year ended December 31, 2013. During the fourth quarter ended December 31, 2013, production averaged 5,739 BOE per day, up 24% from 4,636 BOE per day during the third quarter ended September 30, 2013;
- The Company generated funds from operations in the amount of $23.7 million ($0.32 per common share, basic and diluted) during the year ended December 31, 2013. Funds from operations increased from $5.5 million ($0.06 per common share, basic and diluted) during the third quarter of 2013 to $9.4 million ($0.09 per common share, basic and diluted) during the fourth quarter of 2013. This equates to an absolute increase of 70% quarter over quarter, or a 50% increase in funds from operations per common share;
- During 2013, corporate royalty rates averaged 13.5% of revenue; production and transportation expense, combined, averaged $10.69 per BOE; and G&A expense averaged $1.15 per BOE;
- Drilled 19 (12.2 net working interest) wells during 2013 resulting in 13 (6.4 net) gas wells and 6 (5.8 net) oil wells, for an overall success rate of 100%;
- Reported proved plus probable reserves of 59.2 million BOE with and average reserve life index of 13.9 years as of December 31, 2013. The weighting of proved plus probable reserves is 20% oil, 8% NGLs and 72% gas;
- Reported finding, development and acquisition costs (including future development capital expenditures) of $13.23 per BOE resulting in a recycle ratio of 1.8 times based on proved plus probable reserves;
- Reported net asset value at December 31, 2013 of $5.61 per common share, up 142% from $2.32 per common share per common share at February 26, 2013, at the time of the Arrangement;
- The Company raised gross proceeds of $320.9 million through private placement equity offerings, by issuing a total of 48.9 million common shares (of which 2.0 million shares were issued on a “flow-through” basis) at a weighted average price of $6.56 per common share. Certain officers, directors and employees of the Company purchased 14.4 million of the 48.9 million common shares issued during the year. As at December 31, 2013, insiders own or control 23.3 million common shares outstanding, or 21.2% of the total shares outstanding;
- On August 9, 2013, the Company acquired natural gas assets at Fireweed, adjacent to the Company’s core producing area at Inga, in northeastern British Columbia, for cash consideration of $15.5 million, before closing adjustments. Daily average production from the Fireweed assets for the period from closing of the acquisition on August 9, 2013 to December 31, 2013 was approximately 600 BOE per day; and
- On December 20, 2013, the Company acquired certain crude oil and natural gas assets located at Pouce Coupe/Spirit River, in close proximity to the Company’s core producing areas at Grande Cache and Karr in west central Alberta, for cash consideration of $192.0 million, before closing adjustments. Production from the Pouce Coupe/Spirit River assets averaged approximately 4,800 BOE per day over the 12 day period following closing of the acquisition on December 20, 2013 to December 31, 2013.

REVENUE

(CA$ thousands, unless otherwise indicated)	Three months ended December 31, 2013	Year ended December 31, 2013
Average daily production:		
Oil (bbls/d)	809	516
NGLs (bbls/d)	487	297
Gas (mcf/d)	26,660	18,888
Combined (BOE/d)	5,739	3,961
Average realized prices, before financial instruments:		
Oil ($/bbl)	84.02	88.62
NGLs ($/bbl)	57.00	52.76
Gas ($/mcf)	3.97	3.51
Combined ($/BOE)	35.12	32.27
Average realized prices, after financial instruments:		
Oil ($/bbl)	81.35	86.77
NGLs ($/bbl)	57.00	52.76
Gas ($/mcf)	3.97	3.51
Combined ($/BOE)	34.74	32.03
Revenue, before royalties and financial instruments:		
Oil	6,252	16,687
NGLs	2,554	5,721
Gas	9,737	24,248
Total revenue, before royalties and financial instruments	18,543	46,656

The Company commenced active operations on February 27, 2013 following the completion of the Arrangement and conveyance of the Acquired Assets from Celtic to Kelt on February 26, 2013. Production averaged 3,961 BOE per day over the twelve month period ended December 31, 2013, or 4,694 BOE per day calculated over the 308 day period of active operations following completion of the Arrangement.

During the fourth quarter of 2013, production averaged 5,739 BOE per day, an increase of 24% from 4,636 BOE per day during the third quarter of 2013. The increase in production quarter of quarter is primarily attributable to the following:

- On August 9, 2013, the Company acquired approximately 600 BOE per day of liquids-rich natural gas production at Fireweed, British Columbia. The acquisition contributed to an increase in daily average production by approximately 250 BOE per day in the fourth quarter relative to the third quarter as the results of the Fireweed operations are now included for a full quarter;
- On December 20, 2013, the Company acquired approximately 4,800 BOE per day of production in the Pouce Coupe/Spirit River area of west central Alberta (approximately 40% oil and NGLs, 60% gas). The acquisition contributed to an increase in daily average production by approximately 615 BOE per day in the fourth quarter relative to the third quarter; and
- The Company also has an active drilling program at Inga, Grande Cache and Karr. The remaining increase in daily average production of approximately 235 BOE per day is a result of incremental production from new wells tied-in during the fourth quarter, partially offset by corporate declines and declines on new drills brought on stream earlier in the year.

The Company realized a combined average sales price of $35.12 per BOE ($34.74 after financial instruments) during the three month period ended December 31, 2013, resulting in revenue before royalties and financial instruments of $18.5 million. The Company generated $46.7 million of revenue before royalties and financial instruments, based on a combined average sales price of $32.27 per BOE ($32.03 after financial instruments) during the twelve month period ended December 31, 2013. The increase in the average realized sales price in the fourth quarter relative to the annual average is due to a combination of higher natural gas prices and an increase in the proportion of total production being more heavily weighted to oil and NGLs during the fourth quarter.

BENCHMARK COMMODITY PRICES

The following table summarizes average historical benchmark commodity prices for the periods indicated, which represent the periods over which Kelt had active operations:

	March 2013	Q2 2013	Q3 2013	Q4 2013	Mar-Dec 2013	% Change Q4 vs YTD
WTI Cushing Oklahoma (US$/bbl)(1)	93.24	94.29	105.83	97.46	98.60	(1%)
Average FX rate (US$/CA$)(1)	0.9759	0.9774	0.9629	0.9528	0.9655	(1%)
WTI Cushing Oklahoma (CA$/bbl)(2)	95.54	96.48	109.91	102.29	102.16	0%
Edm. Light Par 40 API (CA$/bbl)(1)	89.53	92.94	105.17	86.26	94.26	(8%)
Pentane (CA$/bbl)(1)	105.76	103.74	108.80	98.77	103.97	(5%)
Butane (CA$/bbl)(1)	74.28	66.48	72.14	70.40	70.13	0%
Propane (CA$/bbl)(1)	32.28	29.57	37.31	57.65	40.58	42%
NYMEX Henry Hub (US$/mmbtu)(3)	3.38	4.09	3.60	3.63	3.73	(3%)
AECO 5A (CA$/GJ)(4)	3.29	3.35	2.31	3.35	3.03	11%

(1) Source: Sproule Associates Limited
(2) Source: Sproule Associates Limited, Canadian dollar equivalent price WTI price is calculated based on monthly average US$WTI price and the monthly average US$/CA$ exchange rate
(3) Source: Canadian Gas Price Reporter (Henry Hub 3-Day Average Close)
(4) Source: Canadian Gas Price Reporter (NGX AB-NIT Same Day Index 5A)

OIL OPERATIONS

(CA$/bbl)		Three months ended December 31, 2013		Year ended December 31, 2013
Oil revenue		84.02		88.62
Cash premium on financial instruments		-		1.21
Realized loss on financial instruments		(2.67)		(3.06)
Average realized price, after financial instruments		81.35		86.77
Royalties *(% of oil revenue)*	*24.6%*	(20.63)	*22.5%*	(19.92)
Production and transportation expense		(12.87)		(14.63)
Operating netback		47.85		52.22

The Company realized an average price, before financial instruments, of $84.02 per barrel and $88.62 per barrel during the three and twelve month periods ended December 31, 2013, respectively. The WTI index oil price averaged US$97.46 per barrel during the fourth quarter of 2013 and US$98.60 per barrel from March to December 2013, which approximates the period in which the Company had active operations. The average price realized by the Company for oil sales reflects a discount of 17.9% and 13.2% relative to the Canadian dollar equivalent WTI price in each corresponding period. During the fourth quarter 2013, the market experienced a widening discount of both the Edmonton Light Par crude oil price and Condensate Par price, relative to WTI.

The Company uses derivative financial instruments from time to time in order to manage commodity price risk. In May 2013, the Company sold a WTI US$95.00 call swaption on 500 barrels of oil per day for a premium of US$2.89 per barrel, resulting in cash proceeds of $0.2 million. The swaption was exercised by the counterparty on July 31, 2013; consequently, the Company entered into a commodity swap contract for 500 barrels of oil per day at a fixed price of WTI CA$98.00 per barrel, effective for the period from August 1, 2013 to December 31, 2013. The commodity swap contract resulted in a realized loss on financial instruments of $2.67 per barrel during the fourth quarter of 2013 and a realized loss of $1.85 per barrel for the year ended December 31, 2013, after netting the loss against the initial cash premium on the swaption.

Royalties averaged 24.6% and 22.5% of oil revenue, respectively, during the three and twelve month periods ended December 31, 2013. The increase in average oil royalties during the fourth quarter relative to the annual average is primarily due to oil production from a producing horizontal well at Karr, which no longer qualifies for a lower 5% royalty pursuant to royalty incentive programs, as the maximum cumulative production volume has been surpassed.

Production and transportation expenses, combined, averaged $12.87 per barrel and $14.63 per barrel during the three and twelve month periods ended December 31, 2013, respectively. The decrease in per unit oil expenses is primarily due to lower transportation costs resulting from a significant reduction in rates for oil trucking. The impact of reduced transportation costs is partially offset by higher production expenses during the fourth quarter, resulting from integration of oil production from the Pouce Coupe/Spirit River properties, which were acquired on December 20, 2013.

NGL OPERATIONS

(CA$/bbl)		Three months ended December 31, 2013		Year ended December 31, 2013
NGLs revenue		57.00		52.76
Royalties *(% of NGLs revenue)*	*16.0%*	(9.14)	*15.9%*	(8.40)
Production and transportation expense		(11.59)		(12.17)
Operating netback		36.27		32.19

The Company realized an average price for NGL sales of $57.00 per barrel and $52.76 per barrel, respectively, during the three and twelve month periods ended December 31, 2013. The WTI index oil price averaged US$97.46 per barrel during the fourth quarter of 2013 and US$98.60 per barrel from March to December 2013. The average price realized by the Company for NGL sales reflects an average discount of 44.3% and 48.3% relative to the Canadian dollar equivalent WTI price in each corresponding period. The decrease in the average discount to WTI is primarily due to strengthening propane prices. Approximately 45% of the Company's total NGLs production is weighted to propane and the average propane price was 42% higher in the fourth quarter relative to the average propane price for the period from March to December 2013.

NGL royalties averaged 16.0% and 15.9% of NGLs revenue during the three and twelve month periods ended December 31, 2013, respectively.

Production and transportation expenses, combined, averaged $11.59 per barrel and $12.17 per barrel during the three and twelve month periods ended December 31, 2013. The decrease in per unit NGL expenses is primarily due to more favorable terms for NGLs transportation at Karr. The impact of reduced transportation costs is moderately offset by higher production expenses during the fourth quarter, resulting from integration of NGLs production from the Pouce Coupe/Spirit River properties, which were acquired on December 20, 2013.

GAS OPERATIONS

(CA$/mcf)		Three months ended December 31, 2013		Year ended December 31, 2013
Gas revenue		3.97		3.51
Realized loss on financial instruments		-		-
Average realized price, after financial instruments		3.97		3.51
Royalties *(% of gas revenue)*	*5.5%*	(0.22)	*6.8%*	(0.24)
Production and transportation expense		(1.84)		(1.65)
Operating netback		1.91		1.62
Barrel of oil equivalent netback ($/BOE)		11.46		9.72

The Company realized an average price for gas sales of $3.97 per MCF and $3.51 per MCF, respectively, during the three and twelve month periods ended December 31, 2013. During the fourth quarter of 2013, the Company benefited from a narrowing of the NYMEX-AECO basis differential relative to the summer months, resulting in higher realized gas prices. The AECO gas index price averaged $3.35 per GJ during the fourth quarter of 2013 and $3.03 per GJ from March to December 2013, which approximates the period in which the Company had active operations. The average gas price realized by the Company includes a heating value premium, earned primarily from gas produced at Inga/Fireweed.

As a result of a staggering increase in the NYMEX-AECO basis differential during the third quarter of 2013, the Company entered into a risk management contract to fix the NYMEX-AECO basis spread at US$0.47 per MMBTU on 15,000 MMBTU per day for November and December of 2013. The actual differential narrowed to US$0.36 per MMBTU in November and widened back to US$0.51 per MMBTU in December. Consequently, and in conjunction with a strengthening US dollar, the Company effectively broke even on this contract in Canadian dollars and the resulting realized loss on derivative financial instruments is nominal.

Gas royalties averaged 5.5% and 6.8% of gas revenue, respectively, during the three and twelve month periods ended December 31, 2013. The relatively low gas royalty rate reflects the benefits of production qualifying for various incentive programs. In addition, royalties are reduced by gas cost allowance credits which do not fluctuate with gas prices.

Production and transportation expenses, combined, averaged $1.84 per MCF and $1.65 per MCF during the three and twelve month periods ended December 31, 2013. The increase in per unit gas expenses during the fourth quarter is primarily due to equalizations resulting from higher production through-put levels relative to the Company's ownership interest in the Copton Gas Plant at Grande Cache. In addition, production expenses increased in conjunction with integration of gas production from the newly acquired Pouce Coupe/Spirit River properties.

FINANCING EXPENSES

(CA$ thousands, unless otherwise indicated)	Three months ended December 31, 2013	Year ended December 31, 2013
Interest and fees on bank debt	31	82
Accretion of decommissioning obligations	96	247
Financing expense	127	329
Average bank debt outstanding	-	-
Interest and fees on bank debt, $ per BOE	0.06	0.06

The Company has a revolving operating demand loan (the "Credit Facility") with a Canadian chartered bank (the "Lender"). On November 4, 2013, the Lender authorized an increase in the borrowing base from $56.0 million to $100.0 million, which came into effect upon closing of the Pouce Coupe/Spirit River acquisition on December 20, 2013. Interest is payable monthly for borrowings through direct advances. Interest rates fluctuate based on a pricing grid and range from bank prime plus 0.5% to bank prime plus 2.5%, depending upon Kelt's then current debt to cash flow ratio of between less than one times to greater than three times. Under the Credit Facility, borrowings through the use of bankers' acceptances are also available.

The Company did not draw on the Credit Facility during the year ended December 31, 2013, and therefore did not incur any interest charges. Amounts reported as interest and fees on bank debt in the table above relate primarily to standby charges on the undrawn facility. Standby charges increased during the fourth quarter of 2013 as a result of an increase in the authorized borrowing amount.

Accretion expense is a measure of the increase in the present value of the decommissioning obligation due to the passage of time.

GENERAL AND ADMINISTRATIVE (“G&A”) EXPENSES

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

(CA$ thousands, unless otherwise indicated)	Three months ended December 31, 2013	Year ended December 31, 2013
Salaries and benefits	408	1,254
Other G&A expenses	602	1,365
Gross G&A expenses	1,010	2,619
Recovery pursuant to the TSA	(1)	(133)
Overhead recoveries	(352)	(826)
Total G&A expenses, net of recoveries	657	1,660
Net G&A ($ per BOE)	1.24	1.15

Total G&A expenses, net of recoveries, averaged $1.24 per BOE and $1.15 per BOE, respectively, during the three and twelve month periods ended December 31, 2013. G&A expenses increased during the fourth quarter in conjunction with the Company’s growth. Although the Company is exiting 2013 with record production levels, the majority of new production was added late in the year; consequently, per unit G&A expenses reported for 2013 do not fully reflect the increase in absolute production levels. In addition, fourth quarter G&A expenses include fees for professional services including the year-end audit and reserve evaluation. Overhead recoveries increased in the fourth quarter due to higher capital spending.

Pursuant to the Arrangement, the Company entered into a transition services agreement (the “TSA”) with the Purchaser. Under the TSA, Kelt employees provide contract services to the Purchaser as needed. The total recovery earned under the TSA was $0.1 million during the year ended December 31, 2013, which was earned primarily during the first and second quarters of 2013. The recovery earned through the TSA is presented as a reduction of gross G&A expenses. Under the TSA, the Purchaser granted a sublease to Kelt for office space during the transition period, the cost of which is included in other G&A expenses.

SHARE BASED COMPENSATION

(CA$ thousands, unless otherwise indicated)	Three months ended December 31, 2013	Year ended December 31, 2013
Stock options	824	2,593
Restricted share units	1,011	3,186
Total share based compensation expense	1,835	5,779
$ per BOE	3.48	4.00

Pursuant to Kelt’s Incentive Stock Option Plan, during 2013, the Company granted 2,420,500 stock options to officers, directors, and employees, at a weighted average exercise price of $6.84 per share. The weighted average fair value of stock options granted during the year, as determined by the Black-Scholes option pricing model, is $2.61 per common share. The total fair value is recognized as an expense over the vesting period using graded amortization, commencing on the grant date.

In addition, pursuant to Kelt’s Restricted Share Unit Plan, the Company granted 1,622,500 restricted share units to officers and employees during the year. The total fair value, which is based on the market price of Kelt shares at the time of grant, is recognized as an expense over the vesting period using graded amortization.

DEPLETION AND DEPRECIATION

(CA$ thousands, unless otherwise indicated)	Three months ended December 31, 2013	Year ended December 31, 2013
Depletion of development and production assets	8,216	23,232
Depreciation of corporate assets	55	105
Total depletion and depreciation	8,271	23,337
$ per BOE	15.66	16.14

The Company calculates depletion of development and production assets based on production relative to total proved reserves, for each property. Future development costs required to develop proved reserves in the amount of $219.6 million are included in the carrying value subject to depletion.

EXPLORATION AND EVALUATION

During the year ended December 31, 2013, the Company expensed $0.1 million of costs associated with expired mineral leases. There were no expiries of mineral leases during the fourth quarter of 2013.

OTHER INCOME AND EXPENSES

Interest income

The Company earned $0.5 million ($0.86 per BOE) and $1.1 million ($0.76 per BOE) of interest on cash and cash equivalents during the three and twelve month periods ended December 31, 2013, respectively.

Transaction costs

During the fourth quarter of 2013, the Company incurred approximately $0.2 million of transaction costs associated with the Pouce Coupe/Spirit River property acquisition. The transaction costs primarily relate to professional fees for an independent reserve evaluation, audit and legal fees, as well as fees for regulatory filings under the *Competition Act* (Canada).

Premium on flow-through shares

On August 27, 2013, the Company issued 2.0 million flow-through shares at a price of $9.80 per flow-through share. The implied premium on the flow-through shares was determined to be $3.6 million or $1.80 per flow-through share, in context of Kelt's concurrent private placement of common shares which was completed at a price of $8.00 per ordinary common share. During the period from closing of the offering on August 27, 2013 to December 31, 2013, the Company incurred approximately $13.2 million of Qualifying Expenditures, representing 67.2% of the $19.6 million total commitment. The deferred premium on flow-through shares was drawn down in proportion to the Qualifying Expenditures incurred in the period, resulting in $2.4 million being recognized as other income during the year ended December 31, 2013. The Company expects to incur the remaining commitment of $6.4 million of Qualifying Expenditures in the allowable period prior to December 31, 2014.

Loss on derivative financial instruments

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

(CA$ thousands, unless otherwise indicated)	Three months ended December 31, 2013	Year ended December 31, 2013
Realized loss	(201)	(579)
Unrealized loss	(277)	(304)
Loss on derivative financial instruments	(478)	(883)

Additional information with respect to the Company's risk management contracts that give rise to gains or losses on financial instruments is provided under the heading of *Future Commitments – Derivative Financial Instruments*.

Fair value accounting for derivative financial instruments may cause significant fluctuations in unrealized gains (losses) due to the volatility of commodity prices, interest and foreign exchange rates. In addition, the fair value of derivative financial instruments as at the Statement of Financial Position date may change in the future as a result of changes in these economic benchmarks upon which the fair value is primarily based, and therefore the amount actually realized from financial instruments may vary from such fair value.

INCOME TAXES

During the three and twelve month periods ended December 31, 2013, the Company recognized deferred income tax expense in the amount of $3.2 million and $1.2 million, respectively. This amount differs from the expected expense (recovery) of income taxes calculated based on the statutory tax rate due to non-deductible share based compensation expense, recognition of the unrecognized deferred income tax asset resulting from the common control transaction, and the impact of flow-through shares. In addition, a deferred income tax recovery in the amount of $3.1 million was charged directly to equity in respect of share issue costs incurred in the period. An analysis of the provision for deferred income taxes is included in note 11 of the annual financial statements.

For the three and twelve month periods ended December 31, 2013, the Company was not required to pay current income taxes as it had sufficient income tax deductions available to shelter taxable income. Tax deductions available as of December 31, 2013 are estimated to be approximately $447.0 million, as outlined further in the table below.

(CA$ thousands, unless otherwise indicated)	Amount	% of Total	Rate
Canadian oil and gas property expenses	259,625	58%	10%
Canadian development expenses	33,339	8%	30%
Canadian exploration expenses	18,399	4%	100%
Undepreciated capital cost(1)	98,424	22%	25%
Share and debt issue costs	10,575	2%	5 years
Non-capital losses(2)	26,630	6%	100%
Estimated tax deductions available as at December 31, 2013	446,992	100%	

(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 will expire in 20 years.

PROFIT (LOSS) AND COMPREHENSIVE INCOME (LOSS)

(CA$ thousands, unless otherwise indicated)	Three months ended December 31, 2013	Year ended December 31, 2013
Profit (loss) and comprehensive income (loss)	(1,838)	(5,115)
Weighted average common shares outstanding, basic (000's)	99,244	74,554
Weighted average common shares outstanding, diluted (000's)	100,242	75,093
$ per common share, basic	(0.02)	(0.07)
$ per common share, diluted	(0.02)	(0.07)
$ per BOE	(3.48)	(3.54)

The Company recorded operating income of $9.9 million and $24.5 million, respectively, during the three and twelve month periods ended December 31, 2013. The term "operating income" is a non-GAAP measure which is calculated by deducting royalties, production expenses and transportation expenses from oil and gas revenue, after realized financial instruments and cash premiums. The net loss reported by the Company, as determined in accordance with GAAP, includes the provision for significant non-cash items such as depletion and depreciation and share based compensation expense.

FUNDS FROM OPERATIONS

(CA$ thousands, unless otherwise indicated)	Three months ended December 31, 2013	Year ended December 31, 2013
Funds from operations[1]	9,396	23,656
Weighted average common shares outstanding, basic (000's)	99,244	74,554
Weighted average common shares outstanding, diluted (000's)	100,242	75,093
$ per common share, basic[2]	0.09	0.32
$ per common share, diluted[2]	0.09	0.32
$ per BOE	17.80	16.36

(1) Funds from operations is a non-GAAP measure which is calculated as cash provided by operating activities, before settlement of decommissioning obligations and change in non-cash operating working capital.
(2) 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.

During the fourth quarter of 2013, the Company generated funds from operations in the amount of $9.4 million ($0.09 per common share, basic and diluted). During the year ended December 31, 2013, the Company generated funds from operations in the amount of $23.7 million ($0.32 per common share, basic and diluted). Funds from operations per BOE increased in the fourth quarter, relative to the 2013 average, primarily due to higher average realized prices, partially offset by higher per unit production expenses.

INVESTMENT AND INVESTMENT EFFICIENCIES

CAPITAL EXPENDITURES

Kelt is committed to future growth through its strategy to implement a full-cycle exploration and development program. In addition, Kelt seeks to identify and acquire strategic oil and gas properties where it believes further exploitation, development and exploration opportunities exist.

The Company's total capital expenditures, including those incurred prior to completion of the Arrangement and property acquisitions, are summarized in the following table:

(CA$ thousands)	Prior to February 26, 2013	Subsequent to February 26, 2013	Total capital expenditures
Capital expenditures:			
Lease acquisition and retention	6,194	6,753	12,947
Geological and geophysical	-	3,033	3,033
Drilling and completion of wells	13,833	70,418	84,251
Facilities, pipeline and well equipment	3,220	15,834	19,054
Corporate assets	-	414	414
	23,247	96,452	119,699
Property acquisitions	-	209,444	209,444
Total capital expenditures	**23,247**	**305,896**	**329,143**

Common control transaction

Pursuant to the Arrangement and the Conveyance Agreement, Celtic transferred certain petroleum and natural gas assets to Kelt in exchange for $142.0 million of common share consideration on February 26, 2013. Celtic incurred $23.2 million of capital costs on behalf of Kelt prior to closing of the Arrangement, which were incremental to the value of common share consideration. Accordingly, the additional costs are included in the Company's total capital expenditures for the year ended December 31, 2013, as more particularly outlined in the table above.

Fireweed property acquisition

On August 9, 2013, the Company acquired natural gas assets at Fireweed, adjacent to the Company's core producing area at Inga, in northeastern British Columbia, for cash consideration of $15.5 million, before closing adjustments. The acquisition had an effective date of April 1, 2013 and the purchase price was adjusted for the results of operations between the effective date and closing of the transaction, which resulted in a reduction in the purchase price by approximately $1.3 million. Daily average production from the Fireweed assets for the period from closing of the acquisition on August 9, 2013 to December 31, 2013 was approximately 600 BOE per day (76% natural gas and 24% natural gas liquids).

Kelt acquired a 50% working interest in the Fireweed assets and its partner and the operator at Inga, also acquired a 50% working interest in the assets. The assets acquired include a compression and dehydration facility with approximately 16 MMCF per day of gross natural gas capacity and 25 kilometres of pipeline that adds to the Company's infrastructure in the area. The Fireweed assets are a complementary fit with a contiguous land position adjacent to Kelt's Inga exploration and development core area, including 11,227 net acres (15.8 net sections) of land (6,299 net acres with Doig mineral rights and 7,097 net acres with Montney mineral rights).

Pouce Coupe/Spirit River property acquisition

On December 20, 2013, the Company acquired certain crude oil and natural gas assets located at Pouce Coupe/Spirit River, for cash consideration of $192.0 million, before closing adjustments. The acquisition had an effective date of October 1, 2013 and the purchase price was adjusted for the results of operations between the effective date and closing of the transaction, which resulted in a reduction in the purchase price by approximately $1.3 million. Production from the Pouce Coupe/Spirit River assets averaged approximately 4,800 BOE per day over the 12 day period following closing of the acquisition on December 20, 2013 to December 31, 2013.

The acquisition included an established field office located in the city of Grande Prairie, Alberta which has now become Kelt's main field operating base for all of the Company's operated properties in the newly acquired Pouce Coupe/Spirit River area and in the Company's existing areas at Karr and Grande Cache. The Pouce Coupe/Spirit River assets included an extensive land position that is a complementary fit geographically to Kelt's existing core areas at Karr and Grande Cache and are located 20 and 40 miles north of Karr and Grande Cache respectively. The acquisition included 256,345 gross acres (400 gross sections) and 103,303 net acres (161 net sections) of land. The acquisition also included a major infrastructure component with interests in major oil and gas facilities including a 20.2% ownership interest in a 140 MMCF per day gas processing plant, varying ownership interests in gas compressors and oil batteries, as well as an extensive network of oil and gas gathering pipelines that will be accessible for transportation of oil and gas resulting from future drilling.

Refer to additional information under the heading of *Subsequent Events* for details regarding the subsequent disposition of certain minor non-core assets acquired.

LAND HOLDINGS

As at December 31, 2013, the Company owned 184,082 net acres of undeveloped land. Based on an internal evaluation of the fair market value of its land holdings at December 31, 2013, Kelt estimates the fair market value of its undeveloped land at $63.4 million. This implies an average fair value of $213 per acre.

Kelt continued to expand its prospect inventory in its core areas. In 2013, the Company expended approximately $9.8 million at Crown land sales acquiring 77,583 net acres of petroleum and natural gas rights at an average bonus cost of $127 per acre, compared to an industry average of $160 per acre (being the combined average of Alberta and British Columbia 2013 land sales).

Kelt's ongoing land acquisition strategy is focused on building a significant land base of high working interest, internally generated prospects, complemented by third party farm-in arrangements in core exploration areas. The Company will continue building a significant base of high working interest operated prospects, ensuring that the Company is in a position to control its capital expenditure program.

The following table summarizes the Company's land holdings as at December 31, 2013:

LAND HOLDINGS	Gross Acres	Net Acres
Developed	255,320	113,273
Undeveloped	299,142	184,082
Total	554,462	297,355
Average working interest		54%

DRILLING

During the year ended December 31, 2013, the Company drilled 19 (12.2 net) wells, with an overall success rate of 100% on net wells drilled. The Company's average working interest in wells drilled during 2013 was 64%. In 2013, Kelt's active horizontal drilling program resulted in an average measured depth of net wells drilled of 3,725 metres. The Company drilled a total of 45,255 net metres during the year.

The following table summarizes the Company's drilling activity during the year ended December 31, 2013:

DRILLING ACTIVITY	Three months ended December 31, 2013		Year ended December 31, 2013	
	Gross	Net	Gross	Net
Gas	4	2.2	13	6.4
Oil	2	2.0	6	5.8
Dry	-	-	-	-
Total	6	4.2	19	12.2
Success rate		100%		100%

RESERVES

Kelt retained Sproule Associates Limited ("Sproule"), an independent qualified reserve evaluator to prepare a report on 100% of its oil and gas reserves (the "Sproule Report"). The Company has a Reserves Committee which oversees the selection, qualifications and reporting procedures of the independent engineering consultants. Reserves as at December 31, 2013 were determined using the guidelines and definitions set out under National Instrument 51-101 ("NI 51-101").

At December 31, 2013, Kelt's proved plus probable reserves were 59.2 million BOE. The Company's net present value of proved plus probable reserves at December 31, 2013, discounted at 10% before tax, was $557.4 million. Forecasted commodity prices for 2014 used to determine the present value of the Company's reserves were US$94.65/bbl for WTI oil and CA$3.79/GJ for AECO gas.

The reserve life index for proved plus probable reserves was 13.9 years. At December 31, 2013, the weighting of proved plus probable reserves was 20% oil, 8% NGLs and 72% gas.

The following table outlines a summary of the Company's reserves at December 31, 2013:

SUMMARY OF RESERVE VOLUMES (1)	Oil (mbbls)	NGLs (mbbls)	Gas (mmcf)	Combined (mBOE)	FDC Costs ($ thousands)
Proved developed producing	4,500	1,082	75,873	18,228	-
Proved developed non-producing	180	28	966	369	1,327
Proved undeveloped	1,990	1,531	78,857	16,664	218,273
Total Proved	**6,670**	**2,641**	**155,696**	**35,260**	**219,600**
Probable additional	5,138	2,361	98,633	23,938	111,700
Total Proved plus Probable	**11,808**	**5,002**	**254,329**	**59,198**	**331,300**

(1) Reserve volumes include Company gross working interest share of remaining reserves, as determined in accordance with NI 51-101, plus reserve volumes in which the Company has a royalty interest and sulphur. The inclusion of royalty interests and sulphur resulted in an increase in the amount reported for proved plus probable gas reserves by 995 mmcf or 166 mBOE.

Future development capital ("FDC") expenditures of $219.6 million included in the reserve evaluation for total proved reserves are expected to be spent as follows: $64.2 million in 2014, $89.5 million in 2015 and $41.9 million in 2016 and $24.0 million thereafter. FDC of $331.3 million included for proved plus probable reserves are expected to be spent as follows: $114.1 million in 2014, $108.9 million in 2015, $75.4 million in 2016 and $32.9 million thereafter.

The following table outlines FDC expenditures by major prospect included in the December 31, 2013 reserve evaluation, for proved plus probable ("2P") reserves:

FDC EXPENDITURES	2P FDC ($M)	2P Gross Drills	2P Net Drills
Inga/Fireweed – Doig/Montney	142,318	50	21.3
Karr – Montney	60,869	8	8.0
Pouce Coupe – Montney	113,210	15	15.0
Spirit River – Charlie Lake	9,080	2	2.0
Other costs	5,823	-	-
Total FDC Expenditures – 2P	**331,300**	**75**	**46.3**

The following tables reconcile the change in total proved reserves during the year:

RESERVES RECONCILIATION **TOTAL PROVED**	Oil (mbbls)	NGLs (mbbls)	Gas (mmcf)	Combined (mBOE)
Balance, December 31, 2012	-	-	-	-
Extensions	1,180	742	19,094	5,104
Infill drilling	179	171	4,463	1,094
Discoveries	82	20	348	160
Technical revisions	-	-	-	-
Economic factors	-	-	-	-
Acquisitions	5,417	1,816	138,685	30,347
Dispositions	-	-	-	-
Net additions	6,858	2,749	162,590	36,705
2013 Production	(188)	(108)	(6,894)	(1,445)
Balance, December 31, 2013	**6,670**	**2,641**	**155,696**	**35,260**

The following tables reconcile the change in total proved plus probable reserves during the year:

RESERVES RECONCILIATION **TOTAL PROVED PLUS PROBABLE**	Oil (mbbls)	NGLs (mbbls)	Gas (mmcf)	Combined (mBOE)
Balance, December 31, 2012	-	-	-	-
Extensions	3,996	2,058	49,616	14,323
Infill drilling	234	220	5,755	1,413
Discoveries	113	28	480	221
Technical revisions	-	-	-	-
Economic factors	-	-	-	-
Acquisitions	7,653	2,804	205,372	44,686
Dispositions	-	-	-	-
Net additions	11,996	5,110	261,223	60,643
2013 Production	(188)	(108)	(6,894)	(1,445)
Balance, December 31, 2013	**11,808**	**5,002**	**254,329**	**59,198**

Kelt does not have any opening reserves dated as of December 31, 2012 as Kelt was not engaged in "oil and gas activities" within the meaning of NI-51-101 as of December 31, 2012 and therefore Kelt did not have any reserves data or report thereon as of that date.

The WTI oil price during the years 2011 to 2013 was range bound averaging between US$94.19 and US$97.98 per barrel. After a precipitous decline in natural gas prices in 2012 during which AECO-C averaged $2.30 per GJ, prices increased to average $2.97 per GJ in 2013. Significantly higher prices have been realized to date in 2014.

Sproule is forecasting WTI oil prices to average US$91.95 per barrel over the next five years, 7% higher than the average price of US$85.65 per barrel over the past five years. For natural gas, AECO-C natural gas prices are forecasted to average $4.16 per GJ over the 2014 to 2018 period, an increase of 25% from the average price of $3.34 per GJ during the 2009 to 2013 period.

The following table outlines forecasted future prices that Sproule has used in their evaluation of the Company's reserves at December 31, 2013:

FUTURE COMMODITY PRICE FORECAST	WTI Cushing Oklahoma US$/bbl	Edmonton Light Par CA$/bbl	NYMEX Henry Hub US$/mmbtu	AECO-C Spot CA$/GJ	USD/CAD Exchange US$/CA$
2014	94.65	92.64	4.17	3.79	0.94
2015	88.37	89.31	4.15	3.78	0.94
2016	84.25	89.63	4.17	3.79	0.94
2017	95.52	101.62	5.04	4.67	0.94
2018	96.96	103.14	5.12	4.75	0.94
Five year average	**91.95**	**95.27**	**4.53**	**4.16**	**0.94**

The Company's net present value of proved plus probable reserves, discounted at 10% before tax, was $557.4 million as of December 31, 2013. The undiscounted future net cash flow, before tax, was $1.1 billion. The following table summarizes the net present value of the Company's reserves (before tax) as at December 31, 2013:

NET PRESENT VALUE (BEFORE TAX)

(CA$ thousands)	Undiscounted	NPV 5% BT	NPV 8% BT	NPV 10% BT
Proved developed producing	379,455	306,367	275,300	258,152
Proved developed non-producing	8,789	7,460	6,835	6,473
Proved undeveloped	196,563	115,027	83,865	67,589
Total Proved	**584,807**	**428,854**	**366,000**	**332,214**
Probable additional	512,833	321,060	256,900	225,147
Total Proved plus Probable	**1,097,640**	**749,914**	**622,900**	**557,361**

The Company's net present value of proved plus probable reserves, discounted at 10% after tax, was $437.2 million as of December 31, 2013. The undiscounted future net cash flow, after tax, was $860.3 million. The following table summarizes the net present value of the Company's reserves (after tax) as at December 31, 2013:

NET PRESENT VALUE (AFTER TAX)

(CA$ thousands)	Undiscounted	NPV 5% AT	NPV 8% AT	NPV 10% AT
Proved developed producing	323,689	265,704	240,800	226,993
Proved developed non-producing	6,573	5,555	5,083	4,811
Proved undeveloped	147,391	80,554	54,917	41,572
Total Proved	**477,653**	**351,813**	**300,800**	**273,376**
Probable additional	382,669	237,018	188,100	163,787
Total Proved plus Probable	**860,322**	**588,831**	**488,900**	**437,163**

During 2013, the Company's capital expenditures, including acquisitions, resulted in proved plus probable reserve additions of 60.6 million BOE, resulting in FD&A costs of $13.23 per BOE, including FDC costs. Proved reserve additions in 2013 were 36.7 million BOE, resulting in FD&A costs of $18.82 per BOE, including FDC costs.

During its first year of operations, Kelt has successfully added high quality reserves at a low FD&A cost per BOE. This has been primarily a result of the Company's successful exploration and development drilling programs at Karr in Alberta and Inga in British Columbia. At Karr, the Company is at an early stage in the delineation and de-risking of a potential Montney oil (with associated gas) multi-year development play.

At Inga, Kelt has participated with its partner in developing a condensate-rich natural gas Doig resource play, and with recent success, it appears to have extended the size of the resource on the Company's southern land block. Also at Inga, Kelt, along with its partner, has commenced exploration drilling on its Montney lands where initial results have been encouraging.

In addition to its drilling program, Kelt completed a significant acquisition in the Pouce Coupe/Spirit River area of Alberta. The acquisition was completed on December 20, 2013 and the Company has identified 136 gross (112 net) horizontal drilling locations primarily targeting the Montney, Doig and Charlie Lake formations. In the December 31, 2013 reserve evaluation, 17 gross (17 net) horizontal locations are included in future development capital in this area, leaving the Company with a significant inventory of potential un-booked reserves.

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 that years' reserve FD&A cost per BOE. Using the operating netback for the December 20th to 31st, 2013 period, which would include operations from the assets acquired at Pouce Coupe and Spirit River on December 20, 2013, the proved plus probable recycle ratio was 1.8 times. As the Company commences development of these acquired assets, it expects to have a future recycle ratio in excess of 2.0 times.

The following table provides detailed calculations relating to FD&A costs and recycle ratios for 2013:

FINDING, DEVELOPMENT & ACQUISITION COSTS *(CA$ thousands, except as otherwise noted)*	Proved Reserves	Proved plus Probable Reserves
Capital expenditures	329,143	329,143
Value of assets conveyed from Celtic Exploration Ltd.	141,961	141,961
Change in FDC costs required to develop reserves	219,600	331,300
Total capital costs	690,704	802,404
Reserve additions, net (mBOE)	36,705	60,643
FD&A cost, before FDC ($/BOE)	8.97	5.43
FD&A cost, including FDC ($/BOE)	**18.82**	**13.23**
Operating netback ($/BOE)(1)	23.74	23.74
Recycle ratio	**1.3 x**	**1.8 x**

(1) Operating netback is for the period from December 20, 2013 to December 31, 2013, as this period reflects production from the Pouce Coupe/Spirit River acquisition that was completed on December 20, 2013.

In calculating finding and development ("F&D") costs, NI 51-101 requires that exploration and development costs incurred in the year and the change in FDC be aggregated and divided by reserve additions in the year. Under NI 51-101, the F&D calculation expressly excludes acquisitions. The Company believes that by excluding the effect of acquisitions, the provisions of NI 51-101 do not fully reflect Kelt's ongoing reserve replacement costs. Since acquisitions can have a significant impact on annual reserve replacement costs, the Company believes that excluding acquisitions could result in an inaccurate representation of Kelt's cost structure. It is further noted that, for the year ended December 31, 2013, the assets conveyed from Celtic to Kelt pursuant to the Arrangement are reflected as an acquisition in the Sproule Report, therefore it is impracticable to calculate F&D for the current year. Accordingly, the Company presents its finding and development costs, inclusive of acquisitions, as shown in the table above.

Kelt's 2013 capital investment program resulted in net reserve additions that replaced 2013 production by a factor of 25.4 times on a proved basis and 42.0 times on a proved plus probable basis.

The tables below summarize production replacement for 2013:

PRODUCTION REPLACEMENT **TOTAL PROVED RESERVES**	Oil (mbbls)	NGLs (mbbls)	Gas (mmcf)	Combined (mBOE)
Reserve additions, including revisions	6,858	2,749	162,590	36,705
2013 Production	188	108	6,894	1,445
Production replacement ratio	**36.5 x**	**25.5 x**	**23.6 x**	**25.4 x**

PRODUCTION REPLACEMENT **TOTAL PROVED PLUS PROBABLE RESERVES**	Oil (mbbls)	NGLs (mbbls)	Gas (mmcf)	Combined (mBOE)
Reserve additions, including revisions	11,996	5,110	261,223	60,643
2013 Production	188	108	6,894	1,445
Production replacement ratio	**63.8 x**	**47.3 x**	**37.9 x**	**42.0 x**

NET ASSET VALUE

As at December 31, 2013, the Company estimates its net asset value per common share to be $6.18 (P&NG reserves discounted at 8% before tax) and $5.61 (P&NG reserves discounted at 10% before tax). This represents an increase of 167% and 142%, respectively, compared to the net asset value of $2.32 per common share on February 26, 2013, at the time of completion of the Arrangement. The present value of petroleum and natural gas ("P&NG") reserves was determined by Sproule in their year-end evaluation report.

The components of net asset value are summarized in the table below. The present value of P&NG reserves is determined using proved plus probable reserves at discount rates of 8% and 10% before tax. Undeveloped land at December 31, 2013 was internally valued at an average price of $213 per acre. Proceeds from exercise of stock options are based on an average exercise price of $6.84 per share at December 31, 2013. The fully diluted number of common shares outstanding assumes 100% of stock options and RSUs are outstanding, not just those that are vested and in-the-money.

NET ASSET VALUE *(CA$ thousands, except per share amounts)*	NPV discounted @ 8% BT	NPV discounted @ 10% BT
Present value of P&NG reserves, before tax(1)	622,900	557,361
Undeveloped land	63,384	63,384
Working capital surplus(2)	2,578	2,578
Proceeds from exercise of stock options	16,545	16,545
Net asset value	705,407	639,868
Fully diluted common shares outstanding (000's)	114,070	114,070
Net asset value ($ per common share)	**6.18**	**5.61**

(1) The Sproule Report only includes abandonment and disconnect costs for future undrilled locations. As a result, abandonment and reclamation obligations and potential salvage value recoveries associated with existing wells and facilities are not factored into the present value of P&NG reserves.

(2) The working capital surplus excludes assets held for sale and non-cash items including the derivative financial instrument liability and deferred premium on flow-through shares.

CAPITAL RESOURCES AND LIQUIDITY

MARKET CAPITALIZATION

The Company's total capitalization was $1.1 billion as of December 31, 2013. The market value of common shares, based on the closing share price on the TSX, represented 96% of the total capitalization.

The following table summarizes the Company's capitalization:

CAPITALIZATION

(CA$ thousands, except per share amounts)	Amount	% of total
Common shares outstanding (000's)	110,026	
Share price (last price traded at in the year)	$9.40	
Market capitalization	1,034,244	96%
Bank debt	-	0%
Working capital surplus(1)	(2,578)	0%
Decommissioning obligations	46,857	4%
Deferred income tax asset	(1,957)	0%
Total capitalization	1,076,566	100%

(1) The working capital surplus excludes assets held for sale and non-cash items including the derivative financial instrument liability and deferred premium on flow-through shares.

SOURCE OF FUNDS

The Company has a revolving operating demand loan (the "Credit Facility"). On November 4, 2013, the Lender authorized an increase in the borrowing base from $56.0 million to $100.0 million, which came into effect upon closing of the Pouce Coupe/Spirit River acquisition on December 20, 2013. Repayments of principal are not required provided that the borrowings under the Credit Facility do not exceed the authorized borrowing amount and the Company is in compliance with all covenants, representations and warranties. The Company is not subject to any financial covenants under the Credit Facility. The Company did not draw any amounts on the Credit Facility during the period and as at December 31, 2013, the Credit Facility remains undrawn.

On February 26, 2013, concurrent with the closing of the Arrangement, Kelt completed the private placement of 6.0 million common shares at a price of $2.32 per share for aggregate gross proceeds of $13.92 million.

On April 5, 2013, Kelt completed brokered and non-brokered equity financings for aggregate gross proceeds of $94.35 million. Pursuant to an agreement with a syndicate of underwriters, the underwriters agreed to purchase for resale to the public, on a bought deal private placement basis, 11.0 million common shares at a price of $5.55 per common share, resulting in gross proceeds to the Company of $61.05 million. In conjunction with the brokered private placement, Kelt agreed to issue to certain directors, officers and employees of the Company, on a non-brokered basis, an additional 6.0 million common shares at a price of $5.55 per common share, resulting in additional gross proceeds of $33.3 million.

On August 27, 2013, Kelt completed bought deal private placement equity offering, pursuant to which the Company issued 11.5 million common shares at a price of $8.00 per common share (which includes the exercise, in full, of the over-allotment option to purchase 1.5 million common shares) and issued 2.0 million common shares on a "flow-through" basis at a price of $9.80 per flow-through share. In aggregate, the offering resulted in gross proceeds of $111.6 million.

On December 3, 2013, Kelt raised aggregate gross proceeds of $101.06 million through a brokered and non-brokered subscription receipt equity financing. Pursuant to an agreement with a syndicate of underwriters, on a bought deal private placement basis, the Company issued 10.0 million subscription receipts of Kelt at a price of $8.15 per subscription receipt, resulting in gross proceeds of $81.5 million. Certain officers and directors of the Company purchased an additional 2.4 million subscriptions receipts at a price of $8.15 per subscription receipt, on a non-brokered private placement basis, providing additional gross proceeds of $19.56 million. The subscription receipts were converted into common shares of the Company on December 20, 2013, at no additional cost, following successful completion of the Pouce Coupe/Spirit River acquisition. Concurrently, the aggregate gross proceeds of the subscription receipt financings were released by the escrow agent to the account of Kelt. The common shares issued in connection with the December 3, 2013 private placements are subject to a statutory hold period of four months plus one day from the date of completion of the private placement, in accordance with applicable securities legislation.

Kelt expects to fund future capital expenditures through the use of a combination of cash provided by operating activities and bank debt, supplemented by new equity or debt offerings, as necessary. Refer to additional information under the heading of *Subsequent Events* regarding a $132.2 million equity financing announced subsequent to December 31, 2013.

WORKING CAPITAL

As at December 31, 2013, the Company has a working capital surplus of $20.5 million and the Company's $100.0 million Credit Facility is undrawn.

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. 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. At December 31, 2013, 90% of accounts receivable are current and all balances outstanding are expected to be fully collectable.

Accounts payable consists of amounts payable to suppliers relating to head office and field operating and investing activities. These invoices are processed within the Company's normal payment period.

LIQUIDITY

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 and bank debt (as at December 31, 2013, bank debt outstanding is nil). 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. Kelt targets a relatively low net debt to trailing 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. Kelt actively manages the pace of its capital spending program by monitoring forecasted production and commodity prices and resulting cash flows. 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.

The Company's $100.0 million Credit Facility, which is undrawn at December 31, 2013, is structured as a revolving operating demand loan. Repayments of principal are not required provided that the borrowings under the Credit Facility do not exceed the authorized borrowing amount and the Company is in compliance with all covenants, representations and warranties. As at December 31, 2013, the Company is in compliance with all covenants. The Credit Facility is subject to review by the Lender on or before May 1, 2014. The continued availability of the Credit Facility is not guaranteed and is dependent on a number of factors, including, among other things, the overall state of credit markets and fluctuating commodity prices. However, the Company maintains good relationships with various financial institutions and expects to obtain credit, as required, in future periods.

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, 2013 there were 110.0 million common shares issued and outstanding (as at March 10, 2014, there were 110.0 million common shares outstanding). There are no preferred shares issued or outstanding.

As at December 31, 2013, officers, directors, and employees have been granted options to purchase 2,420,500 common shares of the Company at an average exercise price of $6.84 per common share. In addition, there are 1,622,500 restricted shares units outstanding. Additional information regarding the Company's stock options and restricted share units is included in note 10 to the annual financial statements.

The Company's common shares trade on the TSX under the symbol "KEL". During the period from listing of the shares on March 1, 2013 to December 31, 2013, 105.8 million shares traded on the TSX at a weighted average price of $6.80 per share.

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

SHARE TRADING ACTIVITY (KEL)	Q1	Q2	Q3	Q4	2013
High ($)	7.45	7.60	8.57	9.74	9.74
Low ($)	5.30	6.10	7.17	8.07	5.30
Close ($)	6.65	7.40	8.39	9.40	9.40
Volume traded (thousands)	57,809	17,154	14,283	16,592	105,838
Value traded ($ thousands)	336,364	120,161	115,978	147,402	719,905
Weighted average trading price ($)	5.82	7.00	8.12	8.88	6.80

FUTURE COMMITMENTS – 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.

The following table summarizes the Company's risk management contracts outstanding as of December 31, 2013:

Commodity	Notional volume	Pricing point	Contract Price	Remaining term	Fair value Asset (Liability)
Crude oil	500 bbls/d	NYMEX – WTI	CA$ 100.04/bbl	Jan 1 to Jun 30, 2014	(370)
Crude oil	500 bbls/d	NYMEX – WTI	CA$ 100.00/bbl	Jul 1 to Dec 31, 2014	(10)
Crude oil	500 bbls/d	NYMEX – WTI	CA$ 101.41/bbl	Jan 1 to Dec 31, 2014	(128)
Propane	150 bbls/d	OPIS-Conway	US$ 48.09/bbl	Jan 1 to Dec 31, 2014	(24)
Derivative financial instrument liability					**(532)**

Subsequent to December 31, 2013, the Company entered into an additional commodity swap contract for 500 barrels of crude oil per day at a fixed price of WTI CA$103.10 per barrel for the period from February 1 to December 31, 2014. As a result, the Company's combined average price is WTI CA$101.46 per barrel on a notional quantity of 532,000 barrels of crude oil for 2014, or 1,000 barrels per day for the January 1 to 31, 2014 period and 1,500 barrels per day for the February 1 to December 31, 2014 period.

The fair value of the derivative contracts is sensitive to changes in commodity prices. If the Canadian dollar equivalent WTI price increases (decreases) by $1.00 per bbl, the total fair market value of the crude oil contracts would decrease (increase) by $0.4 million. If the Canadian dollar equivalent OPIS-Conway propane price increases (decreases) by $1.00 per bbl, the fair market value of the propane contract would increase (decrease) by less than $0.1 million.

CONTRACTUAL OBLIGATIONS

The Company is committed to future payments under the following agreements:

(CA$ thousands)	2014	2015	2016	2017	2018	Thereafter
Transition services agreement	49	-	-	-	-	-
Operating lease – office buildings	610	761	738	747	249	-
Operating lease – vehicles	163	154	91	21	-	-
Flow-through shares	6,429	-	-	-	-	-
Firm transportation commitments	2,823	2,424	541	-	-	-
Total annual commitments	10,074	3,339	1,370	768	249	-

Pursuant to the Arrangement, the Company entered into a transition services agreement (the "TSA") with the Purchaser. Under the TSA, the Purchaser granted a sublease to Kelt for office space which terminates on February 26, 2014.

Payments under the office building operating lease relate to the Company's head office in Calgary, Alberta, and the field office in Grande Prairie, Alberta. The head office and field office leases expire on April 30, 2018 and April 30, 2015, respectively, if not extended.

The Company has a $100.0 million revolving operating demand loan which is undrawn at December 31, 2013. Repayments of principal are not required provided that the borrowings under the Credit Facility do not exceed the authorized borrowing amount and the Company is in compliance with all covenants, representations and warranties.

On August 27, 2013, the Company issued 2.0 million flow-through shares at a price of $9.80 per flow-through share. Pursuant to the provisions in the *Income Tax Act* (Canada), the Company shall incur Canadian Exploration Expenses, including, if applicable, deemed Canadian Exploration Expenses, (the "Qualifying Expenditures") after August 27, 2013 and prior to December 31, 2014 in the aggregate amount of not less than $19.6 million. As of December 31, 2013, the Company had incurred $13.2 million of Qualifying Expenditures, leaving $6.4 million of Qualifying Expenditures to be incurred in 2014. Kelt shall renounce the Qualifying Expenditures so incurred to the subscribers' of the flow-through shares such that $9.80 per flow-through share shall be deductible against the subscribers' income for the fiscal year ended December 31, 2013.

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 2013, the Company incurred $0.6 million in legal fees and disbursements, of which, $0.2 million is payable at December 31, 2013. 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 during the year ended December 31, 2013:

(CA$ thousands)	Year ended December 31, 2013
Salaries, bonuses and other benefits	485
Share based compensation	3,392
Total compensation	3,877

During the year ended December 31, 2013, key management personnel were granted an aggregate of 789,000 restricted share units and 1,250,000 stock options with an exercise price of $6.47 per share.

In addition, the Acquisition is considered to be a related party transaction because Kelt was a wholly owned subsidiary of Celtic immediately prior to closing of the Arrangement. Refer to note 3 of the annual financial statements for information regarding the accounting treatment of the common control transaction.

OFF-BALANCE SHEET TRANSACTIONS

The Company did not engage in any off-balance sheet transactions during the period ended December 31, 2013.

SUBSEQUENT EVENTS

Non-core property disposition

On February 10, 2014, Kelt completed the disposition of certain non-core and non-operated assets in northwestern Alberta. These assets were part of the assets included in the Pouce Coupe/Spirit River acquisition that was completed on December 20, 2013. The Company received proceeds of $20.0 million, before closing adjustments. Current net production from these assets is estimated to be approximately 210 barrels per day of oil. Proved reserves, as at December 31, 2013, were 500,500 barrels and proved plus probable reserves were 635,100 barrels. Kelt had not assigned any future development capital or future potential drilling locations to these assets. The disposition did not result in a reduction of the authorized borrowing amount available under the Credit Facility.

Equity offerings

On March 5, 2014, the Company entered into an agreement with a syndicate of underwriters (collectively the “Underwriters”), pursuant to which the Underwriters have agreed to purchase for resale to the public, on a bought deal private placement basis, 8,500,000 common shares of Kelt at a price of $11.60 per common share, resulting in gross proceeds of $98.6 million and in addition, the Underwriters have agreed to sell to the public, on a guaranteed agency basis, 1,530,000 common shares of Kelt on a "flow-through" basis in respect of Canadian development expenses at a price of $12.75 per flow-through common share resulting in additional gross proceeds of $19.5 million.

Kelt has also granted the Underwriters an option, exercisable for a period commencing at closing of the offering and ending 30 days following closing of the offering, to purchase an additional 1,275,000 common shares at the same common share offering price of $11.60 per common share, which if exercised, would increase the common share offering gross proceeds by $14.8 million. The financing is expected to close on or around March 25, 2014.

In conjunction with the aforementioned brokered private placement, Kelt has agreed to issue to certain directors, officers and employees of the Company, on a non-brokered basis, an additional 1,105,000 common shares of Kelt on a "flow-through" basis in respect of Canadian development expenses at a price of $12.75 per flow-through common share, resulting in additional proceeds of $14.1 million. The non-brokered private placement will close concurrently with the closing of the brokered private placement on or around March 25, 2014.

The net proceeds from both the brokered private placement and non-brokered private placement equity offerings (collectively, the “March 2014 Private Placements”) will be used to partially finance the Company’s 2014 capital expenditure program and for general working capital purposes.

Kelt shall, pursuant to the provisions in the *Income Tax Act* (Canada), incur eligible Canadian development expenses, (the “Qualifying Expenditures”) after the closing date and prior to December 31, 2014 in the aggregate amount of not less than the total amount of the gross proceeds raised from the issue of flow-through common shares of $33.6 million. Kelt shall renounce the Qualifying Expenditures so incurred to the purchasers of the flow-through common shares in an amount equal to $12.75 per flow-through common share on or prior to December 31, 2014.

SELECTED ANNUAL INFORMATION

The following table summarizes key annual financial and operating information over the most recently completed financial years. The Company was incorporated on October 11, 2012 and did not have any assets, liabilities or active operations until February 27, 2013, following completion of the Arrangement.

(CA$ thousands, except as otherwise indicated)	December 31, 2013	December 31, 2012
Revenue, before royalties and financial instruments	46,656	-
Funds from operations	23,656	-
Per share – basic ($/common share)	0.32	-
Per share – diluted ($/common share)	0.32	-
Profit (loss)	(5,115)	-
Per share – basic ($/common share)	(0.07)	-
Per share – diluted ($/common share)	(0.07)	-
Total assets	485,201	-
Bank debt	-	-
Working capital surplus	20,500	-
Average daily production (BOE/d)	3,961	-
Average realized price, after financial instruments ($/BOE)	32.03	-
Operating netback ($/BOE)	16.97	-
Netback as a percentage of revenue	53%	-

SUMMARY OF QUARTERLY RESULTS

Comparative quarterly information is presented in the table below. The Company was incorporated on October 11, 2012 and did not have any assets, liabilities or active operations until February 27, 2013, following completion of the Arrangement.

(CA$ thousands, except as otherwise indicated)	Q4 2013	Q3 2013	Q2 2013	Q1 2013
Revenue, before royalties and financial instruments	18,543	12,388	11,860	3,865
Funds from operations	9,396	5,473	6,608	2,179
Per share – basic ($/common share)	0.09	0.06	0.08	0.09
Per share – diluted ($/common share)	0.09	0.06	0.08	0.09
Profit (loss)	(1,838)	(2,400)	(737)	(140)
Per share – basic ($/common share)	(0.02)	(0.03)	(0.01)	(0.01)
Per share – diluted ($/common share)	(0.02)	(0.03)	(0.01)	(0.01)
Total assets	485,201	333,832	229,370	141,834
Bank debt	-	-	-	-
Working capital surplus (deficiency)	20,500	123,774	58,058	(24,471)
Average daily production (BOE/d)	5,739	4,636	4,097	1,316
Average realized price, after financial instruments ($/BOE)	34.74	28.17	32.42	32.64
Operating netback ($/BOE)	18.67	12.94	18.42	19.28
Netback as a percentage of revenue	54%	46%	57%	59%

Inherent to the nature of the oil and gas industry, fluctuations can be expected quarter over quarter in the amount of revenue, funds from operations and/or profit (loss) generated by the Company. These fluctuations may be caused by, among other things, variations in production volumes, realized commodity prices and the related impact on royalties, changes in per unit expenses and provisions for deferred income taxes. Refer to the *Results of Operations* section of this MD&A for explanation of changes.

BUSINESS RISKS

The business of exploring for, developing and producing oil and natural gas reserves is inherently risky. The following information is a summary only of certain risk factors relating to the Company and should be read in conjunction with the Company's Annual Information Form dated March 28, 2013. In addition, the Company's Annual Information Form as at December 31, 2013, will be filed on or before March 31, 2014. 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.

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 ensure 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 additional information under the heading of *Insurance* below.

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. 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.

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.

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, noncore 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

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

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

Based on current funds available and expected funds generated from operations, Kelt believes it has sufficient funds available to fund its projected capital expenditures. However, if funds generated from operations are lower than expected or capital costs for these projects exceed current estimates, or if Kelt incurs major unanticipated expense related to development or maintenance of its existing properties, it may be required to seek additional capital to maintain its capital expenditures at planned levels. Failure to obtain any financing necessary for Kelt's capital expenditure plans may result in a delay in development or production on Kelt's properties.

Regulatory

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

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

Royalty Regimes

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

Insurance

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

Operational Dependence

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

Competition

The oil and gas industry is highly competitive. Kelt actively competes for reserve acquisitions, exploration leases, licenses 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.

Kelt and certain of its executive officers (namely, David J. Wilson, Sadiq H. Lalani, Alan G. Franks and Patrick Miles, and a part-time employee, namely, Michael R. Shea) are subject to the Non-Competition and Non-Solicitation Agreements for a period of one year following the completion of the Arrangement on February 26, 2013.

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. Implementation of strategies with respect to climate change and reducing greenhouse gases could have material impact on the nature of oil and natural gas operations, including those of Kelt. 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.

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.

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.

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 continues to be challenging and uncertain. Infrastructure and capacity constraints continue to impact commodity prices being realized in domestic markets relative to world markets. Political upheaval in the Middle East remains a wild card and could hamper world economic recovery if oil supply is negatively affected. Inflation around the world could also have an impact on economic recovery which would ultimately affect the demand for energy in high growth countries such as India and China. Also, uncertainties facing debt markets in Europe could lead to tighter credit markets in the future.

In this environment, Kelt is focused 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.

2014 GUIDANCE

Kelt remains optimistic about its future prospects. The Company 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 costs. In addition, the Company will focus its exploration efforts in areas of multi-zone hydrocarbon potential, primarily in west central Alberta and northeastern British Columbia.

Kelt's Board of Directors has approved a 2014 capital expenditure budget of $250.0 million, net of dispositions (previously $130.0 million). In aggregate, the Company expects to spend $198.0 million on drilling and completing wells, $34.5 million on facilities, equipment and pipelines, and $30.0 million on land and seismic. Proceeds from dispositions, net of acquisitions, are expected to be $12.5 million.

Kelt expects production in 2014 to average approximately 11,000 (previously 10,500) BOE per day. Production is expected to be weighted 20% oil, 8% NGLs, and 72% gas; however, operating income in 2014 is expected to be derived 41% from oil production, 12% from NGLs production, and 47% from gas production.

The Company's average commodity price assumptions for 2014 are US$90.00 (previously US$87.50) per barrel for WTI oil, US$4.65 (previously US$3.95) per MMBTU for NYMEX natural gas, $4.50 (previously $3.50) per GJ for AECO natural gas and a US/Canadian dollar exchange rate of US$0.920 (previously US$0.952). These prices compare to average calendar 2013 prices of US$97.98 per barrel for WTI oil, US$3.68 per MMBTU for NYMEX natural gas, $2.97 per GJ for AECO natural gas and a US/Canadian dollar exchange rate of US$0.971. After giving effect to the aforementioned production and commodity price assumptions as well as the increased capital expenditure budget and the March 2014 Private Placements (described under the heading of *Subsequent Events*), funds from operations for 2014 is forecasted to be approximately $102.0 million or $0.85 per common share, diluted (previously $78.0 million or $0.69 per common share, diluted).

Kelt estimates that the Company's bank indebtedness, net of working capital, will be approximately $17.9 million (previously $52.0 million) at December 31, 2014, after giving effect to proceeds from dispositions realized in February 2014 as well as proceeds from the March 2014 Private Placements (not including the over-allotment option). Kelt has established a demand operating loan facility with a Canadian chartered bank with an authorized borrowing limit of $100.0 million.

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

The information set out herein under the heading "2014 Guidance" 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 2014. Readers are cautioned that this financial outlook may not be appropriate for other purposes.

ADDITIONAL INFORMATION

Additional information relating to Kelt, including the Company's Annual Information Form ("AIF") dated March 28, 2013, is filed on SEDAR and can be viewed on their website at www.sedar.com. The Company's Annual Information Form as at December 31, 2013, will be filed on or before March 31, 2014. Copies of the AIF can also be obtained by contacting Sadiq H. Lalani, Vice President, Finance and Chief Financial Officer at Kelt Exploration Ltd., Suite 300, 311 Sixth Avenue SW, Calgary, Alberta, Canada, T2P 3H2. Further information relating to the Company 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 10, 2014

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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 Accountants, has been engaged, as approved by the then sole shareholder 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 10, 2014

[signed]

Sadiq H. Lalani
Vice President, Finance, and Chief Financial Officer
March 10, 2014

INDEPENDENT AUDITOR'S REPORT

March 10, 2014

To the Shareholders of Kelt Exploration Ltd.

We have audited the accompanying financial statements of Kelt Exploration Ltd. (the "Company"), which comprise the statements of financial position as at December 31, 2013 and December 31, 2012 and the statements of profit (loss) and comprehensive income (loss), statements of changes in shareholders' equity and statements of cash flows for the year ended December 31, 2013 and the period from October 11, 2012 through December 31, 2012, 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 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, 2013 and December 31, 2012 and its financial performance and its cash flows for the year ended December 31, 2013 and the period from October 11, 2012 through December 31, 2012 in accordance with International Financial Reporting Standards.

PricewaterhouseCoopers LLP

Chartered Accountants

PricewaterhouseCoopers LLP
111 5th Avenue SW, Suite 3100, Calgary, Alberta, Canada T2P 5L3
T: +1 403 509 7500, F:+1 403 781 1825, www.pwc.com/ca

KELT EXPLORATION LTD.
STATEMENT OF FINANCIAL POSITION

(CA$ thousands)	[Notes]	December 31, 2013	December 31, 2012
ASSETS			
Current assets			
Cash and cash equivalents		32,015	-
Accounts receivable and accrued revenue	[12]	13,082	-
Prepaid expenses and deposits		1,240	-
Assets held for sale	[5]	19,635	-
Total current assets		65,972	-
Deferred income tax asset	[11]	1,957	-
Exploration and evaluation assets	[6]	40,564	-
Property, plant and equipment	[7]	376,708	-
Total assets		485,201	-
LIABILITIES			
Current liabilities			
Accounts payable and accrued liabilities		43,447	-
Derivative financial instruments	[12]	532	-
Deferred premium on flow-through shares	[10]	1,181	-
Decommissioning obligations	[9]	312	
Bank debt	[8]	-	-
Total current liabilities		45,472	-
Decommissioning obligations	[9]	46,857	-
Total liabilities		92,329	-
SHAREHOLDERS' EQUITY			
Shareholders' capital	[10]	449,876	-
Reserve from common control transaction	[3]	(57,668)	-
Contributed surplus		5,779	-
Retained earnings (deficit)		(5,115)	-
Total shareholders' equity		392,872	-
Total liabilities and shareholders' equity		485,201	-

Common control transaction	[3]
Property acquisitions	[4]
Commitments	[14]
Subsequent events	[17]

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

On behalf of the Board of Directors:

[signed]
David J. Wilson, Director

[signed]
Neil G. Sinclair, Director

KELT EXPLORATION LTD.
STATEMENT OF PROFIT (LOSS) AND COMPREHENSIVE INCOME (LOSS)

(CA$ thousands, except per share amounts)	[Notes]	Year ended December 31, 2013	Period ended December 31, 2012
Revenue			
Oil and gas		46,656	-
Royalties		(6,321)	-
		40,335	-
Expenses			
Production		11,358	-
Transportation		4,090	-
Financing	[13]	329	-
General and administrative		1,660	-
Share based compensation	[10]	5,779	-
Depletion and depreciation		23,337	-
Exploration and evaluation	[6]	114	-
		46,667	-
Profit (loss) before other items and taxes		(6,332)	-
Interest income		1,095	-
Transaction costs	[4]	(233)	-
Premium on flow-through shares		2,419	-
Loss on derivative financial instruments	[12]	(883)	-
Profit (loss) before taxes		(3,934)	-
Deferred income tax expense	[11]	1,181	-
Profit (loss) and comprehensive income (loss)		(5,115)	-
Profit (loss) per common share			
Basic	[10]	(0.07)	-
Diluted	[10]	(0.07)	-

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

KELT EXPLORATION LTD.
STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

(CA$ thousands)	[Notes]	Shareholders' capital	Reserve	Contributed surplus	Retained earnings (deficit)	Total shareholders' equity
Balance at December 31, 2012		-	-	-	-	-
Profit (loss) and comprehensive income (loss)					(5,115)	(5,115)
Common shares issued:						
Pursuant to the Arrangement	[3,10]	141,961	(57,668)			84,293
Private placements	[10]	301,330				301,330
Flow-through shares issued:						
Private placement	[10]	19,600				19,600
Less: deferred premium	[10]	(3,600)				(3,600)
Share issue costs, net of tax	[10]	(9,415)				(9,415)
Share based compensation	[10]			5,779		5,779
Balance at December 31, 2013		449,876	(57,668)	5,779	(5,115)	392,872

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

KELT EXPLORATION LTD.
STATEMENT OF CASH FLOWS

(CA$ thousands)	[Notes]	Year ended December 31, 2013	Period ended December 31, 2012
Operating activities			
Profit (loss)		(5,115)	-
Items not affecting cash:			
Accretion of decommissioning obligations	[9,13]	247	-
Share based compensation		5,779	-
Depletion and depreciation		23,337	-
Exploration and evaluation		114	-
Premium on flow-through shares		(2,419)	-
Unrealized loss on derivative financial instruments	[12]	304	-
Deferred income tax expense		1,181	-
Cash premiums on derivative financial instruments	[12]	228	-
Change in non-cash operating working capital	[15]	3,235	-
Cash provided by operating activities		26,891	-
Financing activities			
Issue of common shares	[10]	301,330	-
Issue of flow-through shares	[10]	19,600	-
Share issue costs		(12,553)	-
Cash provided by financing activities		308,377	-
Investing activities			
Pursuant to the Arrangement	[3]	(23,247)	-
Exploration and evaluation assets:			
Capital expenditures		(46,717)	-
Acquisitions	[4]	(11,355)	-
Property, plant and equipment:			
Capital expenditures		(49,735)	-
Acquisitions	[4]	(198,089)	-
Change in non-cash investing working capital	[15]	25,890	-
Cash used in investing activities		(303,253)	-
Net change in cash and cash equivalents		32,015	-
Cash and cash equivalents, beginning of period		-	-
Cash and cash equivalents, end of period		32,015	-

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

NOTES TO THE FINANCIAL STATEMENTS

As at and for the year ended December 31, 2013
(All tabular amounts in thousands of Canadian dollars, unless otherwise stated)

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 west central Alberta and northeastern British Columbia. Common shares of the Company are listed and posted for trading on the Toronto Stock Exchange ("TSX") under the symbol "KEL". The head office of Kelt 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.

1. BACKGROUND AND BASIS OF PRESENTATION

a) Background

The Company was incorporated under the *Business Corporations Act* (Alberta) on October 11, 2012 as 1705972 Alberta Ltd. On October 19, 2012, Articles of Amendment were filed to change the name of the Company to Kelt Exploration Ltd. The Company was incorporated as a wholly owned subsidiary of Celtic Exploration Ltd. ("Celtic"), for the purposes of participating in a Plan of Arrangement (the "Arrangement") between ExxonMobil Canada Ltd. ("ExxonMobil Canada"), ExxonMobil Celtic ULC (formerly 1690731 Alberta ULC) (the "Purchaser"), Celtic and Kelt. Pursuant to the Arrangement, the Purchaser purchased all of Celtic's outstanding common shares ("Celtic Shares"), including Celtic Shares issued upon conversion of Celtic's 5% convertible debentures, at a cash price of $24.50 per Celtic Share. Additionally, Celtic shareholders received one-half (1/2) of a share of Kelt for each Celtic Share.

Pursuant to the Arrangement and a conveyance agreement (the "Conveyance Agreement") entered into by Celtic and Kelt upon closing of the Arrangement on February 26, 2013, Celtic transferred certain petroleum and natural gas assets (the "Acquired Assets") to Kelt (the "Acquisition") in exchange for $142.0 million of common share consideration. The Acquired Assets included all of Celtic's rights, title, estate and interest in the petroleum, natural gas and related hydrocarbon rights and related personal property interests within, upon or under the lands and leases, including:

- a liquids-rich gas property in the Inga area of northeastern British Columbia;
- a gas property in the Grande Cache area of Alberta; and
- an oil prospect in the Karr area of west central Alberta.

Prior to completion of the Arrangement, the Company did not have any assets, liabilities, or operations. The Company commenced active operations on February 27, 2013 following completion of the Arrangement and the Acquisition on February 26, 2013. Refer to note 3 *Common Control Transaction* for additional information.

b) Statement of compliance

These audited 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.

These audited annual financial statements were approved and authorized for issue by the Company's Board of Directors on March 10, 2014.

c) Basis of measurement

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

During the prior period ended December 31, 2012, the Company issued one common share in exchange for $1 of consideration upon incorporation of the Company on October 11, 2012. As the financial statements are rounded to thousands of dollars, the amounts reported for the December 31, 2012 comparative period are presented as nil.

These 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 12 of these financial statements. The Acquisition has been accounted for using the predecessor values from date of transaction method; refer to note 3 *Common Control Transaction* for additional information.

d) Significant judgments and estimates

The significant accounting policies used by the Company are disclosed in note 2. Certain accounting policies require that management make judgments regarding the selection and application of such policies, and to make appropriate decisions with respect to formulation of estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Actual results may differ materially from these estimates. The following discussion identifies the critical accounting policies and practices of the Company and helps assess the likelihood of materially different results being reported.

Common control transaction

In connection with the Arrangement and pursuant to the terms of the Conveyance Agreement between Celtic and Kelt, the Acquired Assets were transferred from Celtic to Kelt and Kelt assumed certain obligations and liabilities of Celtic. Kelt was a wholly owned subsidiary of Celtic immediately preceding closing of the Arrangement and immediately subsequent to closing, Kelt was controlled by the same shareholders as Celtic; consequently, the entities were under common control at the time of the Acquisition. 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 is recorded as a reserve from common control transaction in shareholders' equity.

Assets held for sale

The decision to classify a non-current asset or disposal group as held for sale requires judgment to determine if the carrying amount will be recovered through a sale transaction rather than through continuing use. In order to draw this conclusion, management must assert that the asset or disposal group is available for immediate sale in its present condition and believe that it is highly probable that a sale transaction will be completed within one year of designating the asset as held for sale. All as more particularly described in note 5, estimates and assumptions are also required to measure the assets held for sale at their fair value less costs of disposal.

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 year-end oil and gas prices and reservoir performance. Such revisions can be either positive or negative.

Changes in reserve estimates impact the financial results of the Company as reserves and estimated future development costs are used to calculate depletion and are also used in measuring fair value less costs of disposal of property, plant and equipment (“PP&E”) for impairment calculations and business combinations.

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.

Impairment of non-financial assets

Significant judgment is required to assess the Company’s non-financial assets, namely PP&E and E&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. If significant indicators of impairment are identified, the Company must perform a formal impairment test and calculate the recoverable amount. Based on a detailed assessment of each CGU as at December 31, 2013, management concluded that there were no significant indicators of impairment and accordingly, that preparation of a formal impairment test was not required.

Significant judgment and estimates are also required to calculate the recoverable amount in an impairment test. However, given that were no significant indicators of impairment and that an impairment test was not required, the Company was not required to exercise these judgments as at December 31, 2013. 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. Commodity price changes impact the expected future cash flows which may require a material adjustment to the carrying value of non-financial assets.

Exploration and evaluation assets (“E&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. Judgment is also required to determine the level at which E&E is assessed for impairment; for Kelt, the recoverable amount of E&E assets is assessed at the operating segment level. Management assessed the carrying value of E&E for impairment as at December 31, 2013, and prior to transferring any E&E assets to PP&E. Given that were no significant indicators of impairment, the Company was not required to exercise judgment nor apply estimates to calculate the recoverable amount because an impairment test was not required as at December 31, 2013.

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.

Kelt estimates abandonment and reclamation costs based on a combination of publically available industry benchmarks and internal site specific information. The expected timing of settlement is estimated based on the proved plus probable period to abandonment for each field, as per the independent reserve evaluation, unless the timing to abandon and reclaim a specific well site or facility is known based on budgeted expenditures.

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.

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. 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; this assessment requires significant judgment. The provision for deferred income taxes also includes the following significant judgments of management:

- 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 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 unrecognized deferred income tax asset that arose on the common control transaction is being amortized based on the corporate weighted average depletion factor for the period.

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 10.

The fair value of restricted share units is estimated based on the volume weighted average trading price 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. The assumptions used by the Company are discussed in note 10.

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. The two most common methods are the residual method and the relative fair value method. The Company has applied the residual method to appropriately reflect the substance transaction. Under the residual 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 as 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.

Determination of the fair value of ordinary shares requires judgment. Typically, it is based on the share price at the time the parties agree to the transaction, which is generally at a date earlier than closing. If there are significant changes in the share price between the date the parties agree to the offering and closing, additional judgment may be required.

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.

2. 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 Statement of Profit and Comprehensive Income.

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 Statement of Profit and Comprehensive Income. Transaction costs associated with the acquisition are expensed when incurred.

Common control transaction

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.

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 Statement of Profit and Comprehensive Income. 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 Statement of Profit and Comprehensive Income.

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 Statement of Profit and Comprehensive Income. 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 or production 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, other than E&E assets and deferred tax assets, at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. E&E assets are assessed for impairment prior to being reclassified to PP&E, and also if facts and circumstances suggest that the carrying value exceeds the recoverable amount.

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 fair value less costs of disposal ("FVLCD"). E&E assets are assessed for impairment at the operating segment level.

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 Statement of Profit and Comprehensive Income. 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.

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 Statement of Profit and Comprehensive Income 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 Statement of Profit and Comprehensive Income 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.

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 Statement of Profit and Comprehensive Income 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 Statement of Profit and Comprehensive Income, 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 (hereinafter 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 Statement of Profit and Comprehensive Income. 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.

New or amended IFRSs effective January 1, 2013

During the reporting period, the Company adopted the following new IFRSs: IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements*, IFRS 12 *Disclosure of Interests in Other Entities*, IFRS 13 *Fair Value Measurement*, and IAS 27 *Separate Financial Statements*. In addition, the Company adopted the amendments to the following standards: IFRS 7 *Financial Instruments: Disclosures*, IAS 1 *Presentation of Financial Statements*, IAS 16 *Property, Plant and Equipment*, IAS 19R *Employee Benefits*, IAS 28R *Investments in Associates and Joint Ventures*, IAS 32 *Financial Instruments: Presentation*, and IAS 34 *Interim Financial Reporting*. The Company is a single reporting entity does not have any subsidiaries or joint ventures. Adoption of the new and amended standards did not have a significant impact the Company.

Future accounting changes

The IASB has issued IFRS 9 *Financial Instruments*, which is effective for annual periods beginning on or after January 1, 2015 with early adoption permitted. IFRS 9 is the first step to replace IAS 39 Financial Instruments: Recognition and Measurement. IFRS 9 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. The approach in IFRS 9 is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of the financial assets. The new standard also requires a single impairment method to be used, replacing the multiple impairment methods in IAS 39. Based on the nature of the Company's financial instruments outstanding as at December 31, 2013, the impact of adopting IFRS 9 on January 1, 2015, is not expected to be significant.

3. COMMON CONTROL TRANSACTION

The Company commenced active operations on February 27, 2013 following the completion of the Arrangement and conveyance of the Acquired Assets from Celtic to Kelt on February 26, 2013. Prior to closing of the Arrangement, Kelt was a wholly owned subsidiary of Celtic and immediately subsequent to closing, Kelt was controlled by the same shareholders as Celtic; consequently, the entities were under common control at the time of the Acquisition. The Acquisition has been accounted for using the predecessor values from the date of transaction method, whereby the Acquired Assets are transferred to Kelt based on the historical carrying value carved-out of Celtic.

The following table summarizes the carrying value of the net assets transferred as of February 26, 2013:

Exploration and evaluation assets		12,785
Property, plant and equipment		
Cost	126,062	
Accumulated depletion and depreciation	(22,218)	103,844
Decommissioning obligations		(9,089)
Net working capital		(23,247)
Carrying value of net assets transferred		84,293

The difference between the common share consideration of $142.0 million and the carrying value of Acquired Assets is recognized as a reserve from common control transaction in shareholders' equity, as follows:

Common shares	[note 10]	141,961
Carrying value of net assets transferred		(84,293)
Reserve from common control transaction		57,668

The amounts reported above are estimates, which were made by management using information available at the time of preparation of the financial statements. Final closing adjustments, if any, will result in an adjustment to the carrying amounts of assets and liabilities reported above.

Pursuant to the Conveyance Agreement, Celtic incurred certain costs on behalf of Kelt prior to closing of the Arrangement. These costs relate primarily to capital expenditures in respect of the Acquired Assets. Accordingly, net working capital in the amount of $23.2 million is presented as a reduction of the carrying value of the net assets transferred.

Under the terms of the Arrangement, the Company earned tax pools in the amount of $165.2 million relating to the Acquired Assets. The Company has not recognized a deferred income tax asset of $14.4 million related to the excess of tax pools acquired relative to the carrying value of the net assets transferred because the common control transaction is not a business combination and is therefore subject to the initial recognition exemption under IAS 12 *Income taxes*. Refer to note 11 for additional information.

4. PROPERTY ACQUISITIONS

Fireweed property acquisition

On August 9, 2013, the Company acquired natural gas assets at Fireweed, adjacent to the Company's core producing area at Inga, in northeastern British Columbia, for cash consideration of $15.5 million, before closing adjustments. The acquisition had an effective date of April 1, 2013 and the purchase price was adjusted for the results of operations between the effective date and closing of the transaction.

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.

The following table summarizes the fair value of net assets acquired pursuant to the Fireweed acquisition:

Exploration and evaluation assets	1,045
Property, plant and equipment	13,718
Decommissioning obligations	(585)
Fair value of net assets acquired	**14,178**
Purchase price	15,500
Closing adjustments	(1,322)
Net consideration	**14,178**

Management reviewed the purchase and sale agreement to ensure that all identifiable assets acquired and liabilities assumed have been recognized, and that the fair values assigned are appropriate based on current information. The above amounts are estimates, which were made by management at the time of the preparation of the financial statements based on information then available.

The Statement of Profit and Comprehensive Income includes the results of operations for the period following closing of the transaction on August 9, 2013. Specifically, Kelt's profit for the year ended December 31, 2013 includes approximately $3.1 million of revenue and $1.6 million of operating income generated from the Fireweed property subsequent to August 9, 2013. Operating income is defined as revenue, net of royalties, less production and transportation expenses.

Assuming the acquisition had occurred on January 1, 2013, pro-forma revenue and operating income in respect of the Fireweed property is estimated to be approximately $6.9 million and $3.9 million, respectively, for the year ended December 31, 2013. 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.

Pouce Coupe/Spirit River property acquisition

On December 20, 2013, the Company acquired certain crude oil and natural gas assets located at Pouce Coupe/Spirit River, for cash consideration of $192.0 million, before closing adjustments. The acquisition had an effective date of October 1, 2013 and the purchase price was adjusted for the results of operations between the effective date and closing of the transaction, which resulted in a reduction in the purchase price by approximately $1.3 million.

The acquisition included an established field office located in the city of Grande Prairie, Alberta which has now become Kelt's main field operating base for all of the Company's operated properties in the newly acquired Pouce Coupe/Spirit River area and in the Company's existing areas at Karr and Grande Cache. The Pouce Coupe/Spirit River assets included an extensive land position that is a complementary fit geographically to Kelt's existing core areas at Karr and Grande Cache. The acquisition also included a major infrastructure component with interests in major oil and gas facilities including gas processing plants, gas compressors and oil batteries, as well as an extensive network of oil and gas gathering pipelines that will be accessible for transportation of oil and gas resulting from future drilling.

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.

The following table summarizes the fair value of net assets acquired pursuant to the Pouce Coupe/Spirit River acquisition:

Exploration and evaluation assets	8,682
Property, plant and equipment[1]	197,592
Decommissioning obligations[2]	(15,533)
Fair value of net assets acquired	**190,741**
Purchase price	192,000
Closing adjustments	(1,259)
Net consideration	**190,741**

(1) Includes $20.6 million of property, plant and equipment classified as held for sale
(2) Includes $1.0 million of decommissioning obligations associated with property, plant and equipment classified as held for sale

Management reviewed the purchase and sale agreement to ensure that all identifiable assets acquired and liabilities assumed have been recognized, and that the fair values assigned are appropriate based on current information. The above amounts are estimates, which were made by management at the time of the preparation of the financial statements based on information then available.

Prior to closing of the Pouce Coupe/Spirit River acquisition on December 20, 2013, management entered into negotiations with an independent private oil and gas company to subsequently sell a group of minor non-core assets being acquired for proceeds of $20.0 million, before closing adjustments. As more particularly described in note 5, the assets being sold are collectively referred to as the “Assets Held for Sale”. The acquired assets classified as held for sale were designated as such on the acquisition date.

The Statement of Profit and Comprehensive Income includes the results of operations for the period following closing of the transaction on December 20, 2013. Specifically, Kelt’s profit for the year ended December 31, 2013 includes approximately $2.6 million of revenue and $1.3 million of operating income generated from the Pouce Coupe/Spirit River properties for the 12 day period following closing. Operating income is defined as revenue, net of royalties, less production and transportation expenses. Transaction costs associated with the acquisition of approximately $0.2 million were recognized as an expense.

Pro-forma revenue and operating income in respect of the Pouce Coupe/Spirit River properties for the year ended December 31, 2013, is outlined in the table below:

	Pro-forma Revenue	Pro-forma Operating Income
Pouce Coupe/Spirit River properties	85,959	45,900
Less: Assets Held for Sale	(6,183)	(4,243)
Pro-forma revenue and operating income	**79,776**	**41,657**

The above pro-forma information assumes the acquisition had occurred on January 1, 2013, and excludes pro-forma revenue and operating income associated with the Assets Held for Sale. 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.

Other acquisitions

Kelt completed a series of minor property acquisitions during the year, with an aggregate cost of approximately $4.5 million, after closing adjustments. The total cash consideration, which approximates the fair values on the respective acquisition dates, was allocated as follows:

Exploration and evaluation assets	1,628
Property, plant and equipment	3,010
Decommissioning obligations	(113)
Fair value of net assets acquired	**4,525**

5. ASSETS HELD FOR SALE

Subsequent to the end of the reporting period, on February 10, 2014, Kelt completed the disposition of certain non-core and non-operated assets located in northwestern Alberta (collectively referenced herein as the “Assets Held for Sale”). The Company received proceeds of $20.0 million, before closing adjustments.

As discussed in note 4, the Assets Held for Sale were acquired on December 20, 2013, as part of the greater Pouce Coupe/Spirit River Acquisition. Management entered into negotiations to sell and received an initial offer to purchase the Assets Held for Sale, prior to closing of the acquisition. As of the acquisition date, it was considered highly probable that the disposition would be successfully completed. Accordingly, the acquired assets to be sold were classified as held for sale on the acquisition date and measured at their fair value less costs of disposal. The disposition had an effective date of January 1, 2014 and the fair value has been reduced by approximately $0.4 million in respect of estimated closing adjustments between the effective date and closing of the transaction.

The fair value of the property, plant and equipment held for sale, net of the fair value of associated decommissioning obligations, is outlined in the table below:

Property, plant and equipment	20,635
Decommissioning obligations	(1,000)
Assets held for sale	**19,635**

The fair value of the decommissioning obligations held for sale is estimated based on a credit-adjusted risk-free rate of 6.7% and an inflation rate of 2.0%. The undiscounted cash flows required to settle the obligation are estimated to be approximately $5.6 million.

In accordance with IFRS 5, the Company did not recognize depletion and depreciation expense on the assets held for sale because they were designated as held for sale on the acquisition date. Thus, the property, plant and equipment held for sale does not have any associated accumulated depletion and depreciation.

The Statement of Profit and Comprehensive Income for the year ended December 31, 2013 includes approximately $0.1 million of operating income in respect of the Assets Held for Sale for the 12 day period following the acquisition on December 20, 2013. There were no future development costs assigned to these assets. The disposition did not result in a reduction of the authorized borrowing amount available under the Credit Facility (note 8).

6. 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 commercial viable, which is generally the point at which proved reserves are discovered, the costs are transferred to property, plant, and equipment.

The following table reconciles movements of exploration and evaluation assets during the period:

	December 31, 2013	December 31, 2012
Balance, beginning of period	-	-
Common control transaction [note 3]	12,785	-
Additions	46,717	-
Acquisitions [note 4]	11,355	-
Transfers to property, plant and equipment	(30,179)	-
Expired mineral leases	(114)	-
Balance, end of period	40,564	-

The Company did not capitalize any general and administrative costs in respect of exploration activities during the current period.

During the year ended December 31, 2013, the Company transferred $30.2 million of costs from E&E to PP&E. The transfers primarily relate to costs associated with exploratory drilling of wells which were assigned proved reserves at year end. In addition, the Company transferred the cost of certain seismic data linked to locations in which proved reserves have been identified.

There were no indicators of impairment identified in respect of the Company's exploration and evaluation assets. Accordingly, there were no impairment losses recognized during the period ended December 31, 2013.

7. PROPERTY, PLANT AND EQUIPMENT

Net carrying value	December 31, 2013	December 31, 2012
Development and production assets	376,399	-
Corporate assets	309	-
Total net carrying value of property, plant and equipment	376,708	-

The following table reconciles movements of property, plant and equipment during the period:

Property, plant and equipment, at cost	D&P[1] Assets	Corporate Assets	Total PP&E
Balance at inception on October 11, 2012	-	-	-
Additions	-	-	-
Balance at December 31, 2012	-	-	-
Common control transaction [note 3]	126,062	-	126,062
Additions	49,321	414	49,735
Acquisitions [note 4]	198,089	-	198,089
Decommissioning costs	38,833	-	38,833
Transfers from E&E	30,179	-	30,179
Assets held for sale [note 5]	(20,635)	-	(20,635)
Balance at December 31, 2013	421,849	414	422,263

Accumulated depletion and depreciation	D&P[1] Assets	Corporate Assets	Total PP&E
Balance at inception on October 11, 2012	-	-	-
Depletion and depreciation expense	-	-	-
Balance at December 31, 2012	-	-	-
Common control transaction [note 3]	22,218	-	22,218
Depletion and depreciation expense	23,232	105	23,337
Balance at December 31, 2013	45,450	105	45,555

(1) Development and production assets have been abbreviated as "D&P assets"

The Company did not capitalize any general and administrative costs in respect of development and production activities during the current period. There were no borrowing costs capitalized in the current or prior period, as the Company did not have any qualifying assets nor did the Company draw on the Credit Facility.

Future capital costs required to develop proved reserves in the amount of $219.6 million are included in the depletion calculation for development and production assets.

There were no indicators of impairment identified in respect of the Company's property, plant and equipment. Accordingly, there were no impairment losses recognized during the period ended December 31, 2013.

8. BANK DEBT

The Company has a revolving operating demand loan (the "Credit Facility") with a Canadian chartered bank (the "Lender"). On November 4, 2013, the Lender authorized an increase in the borrowing base from $56.0 million to $100.0 million, which came into effect upon closing of the Pouce Coupe/Spirit River Acquisition on December 20, 2013. Repayments of principal are not required provided that the borrowings under the Credit Facility do not exceed the authorized borrowing amount and the Company is in compliance with all covenants, representations and warranties. Covenants include reporting requirements, permitted indebtedness, permitted asset dispositions, permitted risk management contracts and other standard business operating covenants; there are no financial covenants. Security is provided by a first fixed and floating charge debenture over all assets in the amount of $500.0 million. Interest is payable monthly for borrowings through direct advances. Interest rates fluctuate based on a pricing grid and range from bank prime plus 0.5% to bank prime plus 2.5%, depending upon Kelt's then current debt to cash flow ratio of between less than one times to greater than three times. Under the Credit Facility, borrowings through the use of bankers' acceptances are also available.

As at December 31, 2013, the Company is in compliance with all covenants. The Credit Facility is subject to review by the Lender on or before May 1, 2014. Although the continued availability of the Credit Facility is not guaranteed and is dependent on a number of factors, including, among other things, the overall state of credit markets and fluctuating commodity prices, the Company expects that the Credit Facility will continue to be available in future periods.

The Company did not draw any amounts on the Credit Facility during the period and as at December 31, 2013, the Credit Facility remains undrawn. Accordingly, issue costs in the amount of $0.2 million are deferred and included in prepaid expenses as at the Statement of Financial Position date. Going forward, issue costs will be presented as a reduction of the carrying value of bank debt and amortized upon utilization of the Credit Facility.

9. 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, 2013	December 31, 2012
Balance, beginning of period	-	-
Common control transaction [note 3]	9,089	-
Obligations incurred	1,698	-
Obligations acquired [note 4]	16,231	-
Changes in discount rate	21,491	-
Revisions to estimates	(587)	
Accretion expense	247	-
Balance, end of period	48,169	
Current portion of decommissioning obligations	(312)	
Obligations associated with assets held for sale [note 5]	(1,000)	-
Long-term portion of decommissioning obligations	46,857	-

The key assumptions, on which the carrying amount of the decommissioning obligations is based, include a risk-free rate of 3.2% and an inflation rate of 2.0%. The undiscounted amount of the estimated cash flows required to settle the obligations is $74.0 million (excluding approximately $5.6 million associated with assets held for sale), which will 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 Statement of Profit and Comprehensive Income (note 13).

The change in the present value of decommissioning obligations due to changes in discount rates is primarily due to obligations acquired through business combinations which are discounted at a credit-adjusted rate of 6.7% on the acquisition date and then revalued using the risk-free rate of 3.2% on the Statement of Financial Position date. The decrease in the discount rate resulted in an increase in the present value by approximately $21.5 million.

10. 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:

	Number of Shares (000's)	Amount ($ thousands)
Balance at inception on October 11, 2012	-	-
Common share issued on incorporation	-	-
Balance at December 31, 2012	-	-
Issued pursuant to the Arrangement [note 3]	61,126	141,961
Issued for cash through private placement offerings	46,900	301,330
Issued for cash through flow-through share offering	2,000	19,600
Deferred premium on flow-through shares	-	(3,600)
Share issue costs, net of deferred income taxes	-	(9,415)
Balance at December 31, 2013	110,026	449,876

There are no preferred shares issued or outstanding as of December 31, 2013 (2012 – nil).

i) Common share offerings

The Company issued one common share in exchange for $1 of consideration upon incorporation of the Company on October 11, 2012. Note that the amount is shown as nil in the table above due to rounding because the table is presented in thousands of common shares.

On February 26, 2013, the Arrangement described in note 1 was completed by way of a statutory plan of arrangement under Section 193 of the *Business Corporations Act* (Alberta). Pursuant to the Arrangement, the Purchaser acquired all of the issued and outstanding Celtic Shares, including Celtic Shares issued upon conversion of Celtic's 5% convertible debentures, for cash consideration of $24.50 per Celtic Share. In addition to the cash consideration, each Celtic shareholder received one-half (1/2) of a share of Kelt for each Celtic Share, resulting in the issuance of 61,126,119 Kelt common shares for consideration of $142.0 million. Concurrently with the closing of the Arrangement on February 26, 2013, Kelt also completed the private placement of 6.0 million common shares at a price of $2.32 per share for aggregate gross proceeds of approximately $13.92 million.

On April 5, 2013, Kelt completed brokered and non-brokered equity financings for aggregate gross proceeds of $94.35 million. Pursuant to an agreement with a syndicate of underwriters, the underwriters agreed to purchase for resale to the public, on a bought deal private placement basis, 11.0 million common shares at a price of $5.55 per common share, resulting in gross proceeds to the Company of $61.05 million. In conjunction with the brokered private placement, Kelt agreed to issue to certain directors, officers and employees of the Company, on a non-brokered basis, an additional 6.0 million common shares at a price of $5.55 per common share, resulting in additional gross proceeds of $33.3 million.

On August 27, 2013, the Company issued 11.5 million common shares at a price of $8.00 per common share (which includes the exercise in full of the over-allotment option to purchase 1.5 million common shares) and 2.0 million flow-through shares at a price of $9.80 per flow-through share, for total gross proceeds of $111.6 million. The implied premium on the flow-through shares was determined to be $3.6 million or $1.80 per flow-through share. Pursuant to the provisions in the *Income Tax Act* (Canada), the Company shall incur Canadian Exploration Expenses, including, if applicable, deemed Canadian Exploration Expenses, (the "Qualifying Expenditures") after August 27, 2013 and prior to December 31, 2014 in the aggregate amount of not less than $19.6 million. As of December 31, 2013, the Company had incurred approximately $13.2 million of Qualifying Expenditures, leaving $6.4 million of Qualifying Expenditures to be incurred in 2014. Kelt shall renounce the Qualifying Expenditures so incurred to the subscribers' of the flow-through shares such that $9.80 per flow-through share shall be deductible against the subscribers' income for the fiscal year ended December 31, 2013.

On December 3, 2013, Kelt raised aggregate gross proceeds of $101.06 million through a brokered and non-brokered subscription receipt equity financing. Pursuant to an agreement with a syndicate of underwriters, on a bought deal private placement basis, the Company issued 10.0 million subscription receipts of Kelt at a price of $8.15 per subscription receipt, resulting in gross proceeds of $81.5 million. Certain officers and directors of the Company purchased an additional 2.4 million subscriptions receipts at a price of $8.15 per subscription receipt, on a non-brokered private placement basis, providing additional gross proceeds of $19.56 million. The subscription receipts were converted into common shares of the Company on December 20, 2013, at no additional cost, following successful completion of the Pouce Coupe/Spirit River Acquisition. Concurrently, the aggregate gross proceeds of the subscription receipt financings were released by the escrow agent to the account of Kelt. The common shares issued in connection with the December 3, 2013 private placements are subject to a statutory hold period of four months plus one day from the date of completion of the private placement, in accordance with applicable securities legislation.

ii) 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 (000's)	Average Exercise Price ($/share)
Balance at December 31, 2012	-	-
Granted	2,421	6.84
Exercised	-	-
Forfeited/expired	-	-
Balance at December 31, 2013	**2,421**	**6.84**

During the year ended December 31, 2013, the Company granted 2,420,500 stock options to officers, directors, and employees at a weighted average exercise price of $6.84 per share. The average fair value of stock options granted, as determined by the Black-Scholes option pricing model, is $2.61 per common share. The total fair value will be recognized as an expense over the vesting period using graded amortization, commencing on the grant date.

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

Risk free interest rate	1.2%
Expected life (years)	3.6
Expected volatility[(1)]	51.6%
Expected dividend yield	0.0%
Expected forfeiture rate	0.4%
Fair value of options granted during the year ($/share)	2.61

(1) Given there is no stock price history for Kelt prior to the listing of shares on March 1, 2013, the volatility has been estimated using a junior oil and gas company peer group average, over the expected life of the option.

The following table summarizes information regarding stock options outstanding at December 31, 2013:

Range of exercise prices per common share	Number of options outstanding (000's)	Weighted average remaining term (years)	Weighted average exercise price for options outstanding ($/share)	Number of options exercisable (000's)	Weighted average exercise price for options exercisable ($/share)
$5.00 to $7.50	2,110	4.2	6.47	-	-
$7.51 to $10.00	311	5.0	9.32	-	-
Total	**2,421**	**4.3**	**6.84**	**-**	**-**

iii) 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 (000's)
Balance at December 31, 2012	-
Granted	1,623
Released	-
Forfeited	-
Balance at December 31, 2013	**1,623**

During the year ended December 31, 2013, the Company granted 1,622,500 restricted share units to officers and employees. The weighted average fair value of RSUs granted in the year is $6.74 per share, which based on the volume weighted average trading price on the TSX over three trading days immediately prior to the date of grant, for each grant. The Company has applied an estimated forfeiture rate to the fair value on the grant date. For officers and head office employees, the Company has applied a forfeiture rate of 0% on the assumption that all RSUs granted to these persons will ultimately vest. A forfeiture rate of 5% per year has been applied to the fair value of RSUs granted to field employees during the year. The total fair value, net of forfeitures, will be recognized as an expense over the vesting period using graded amortization, commencing on the grant date.

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, 2013	Period ended December 31, 2012
Weighted average common shares outstanding, basic	74,554	-
Effect of stock options and RSUs	539	-
Weighted average common shares outstanding, diluted	75,093	-

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 (loss) per common share. In computing the diluted loss per common share for the year ended December 31, 2013, the Company excluded the effect of stock options and RSUs as they were anti-dilutive.

11. INCOME TAXES

The Company's current and deferred income tax expense is outlined in the following table:

	Year ended December 31, 2013	Period ended December 31, 2012
Current income tax expense	-	-
Deferred income tax expense	1,181	-
Total income tax expense	1,181	-

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

	Year ended December 31, 2013	Period ended December 31, 2012
Profit (loss) before income taxes	(3,934)	-
Canadian statutory tax rate	25.0%	25.0%
Expected income tax expense (recovery)	(984)	-
Increase (decrease) resulting from:		
Non-deductible expenses[1]	1,449	-
Recognition of unrecognized deferred income tax asset	(1,972)	-
Qualifying Expenditures on flow-through shares	3,293	-
Premium on flow-through shares	(605)	-
Deferred income tax expense	1,181	-

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

The Canadian statutory tax rate per the rate reconciliation above represents the combined federal and provincial corporate tax rate. The enacted federal corporate tax rate is 15.0% and the provincial tax rate in both Alberta and British Columbia is 10.0%.

Under the terms of the Arrangement, the Company earned tax pools in the amount of $165.2 million relating to the Acquired Assets. The Company has not recognized a deferred income tax asset of $14.4 million related to the excess of tax pools acquired relative to the carrying value of the net assets transferred because the common control transaction is not a business combination and is therefore subject to the initial recognition exemption under IAS 12 *Income taxes*. The unrecognized deferred income tax asset is being amortized based on the corporate weighted average depletion factor for the period.

On August 27, 2013, the Company issued 2.0 million flow-through shares at a price of $9.80 per flow-through share. The Company shall incur Qualifying Expenditures after August 27, 2013 and prior to December 31, 2014 in the aggregate amount of not less than $19.6 million. As of December 31, 2013, the Company had incurred approximately $13.2 million of Qualifying Expenditures, leaving $6.4 million of Qualifying Expenditures to be incurred in 2014. Kelt shall renounce the Qualifying Expenditures so incurred to the subscribers' of the flow-through shares such that $9.80 per flow-through share shall be deductible against the subscribers' income for the fiscal year ended December 31, 2013.

The deferred premium on flow-through shares was drawn down in proportion to the Qualifying Expenditures incurred in the period, resulting in $2.4 million being recognized as other income during the year ended December 31, 2013.

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, 2012	Recognized in profit and CI[1]	Recognized directly in equity	Balance at December 31, 2013
Derivative financial instruments	-	133	-	133
PP&E and E&E	-	(6,780)	-	(6,780)
Decommissioning obligations	-	11,792	-	11,792
Share and debt issue costs	-	(539)	3,138	2,599
Reserve from common control transaction	-	(12,445)	-	(12,445)
Non-capital losses[2]	-	6,658	-	6,658
	-	(1,181)	3,138	1,957

(1) Comprehensive income has been abbreviated as "CI"
(2) The Company's non-capital losses expire in 20 years.

The amount and timing of reversals of temporary differences will be dependent upon a number of factors, including the Company's future operating results. The deferred income tax asset associated with derivative financial instruments is expected to reverse over the next twelve month period as it relates to short-term risk management contracts. The Company does not expect any other deferred income tax assets or liabilities to reverse within the next twelve months.

12. 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 and bank debt. Fair values of financial assets and liabilities, summarized information related to risk management positions, and discussion of risks associated with financial assets and liabilities are presented as follows:

Fair value of financial assets and liabilities	December 31, 2013		December 31, 2012	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Financial assets				
Cash and cash equivalents	32,015	32,015	-	-
Accounts receivable and accrued revenue	13,082	13,082	-	-
Deposits	545	545	-	-
Financial liabilities				
Accounts payable and accrued liabilities	43,447	43,447	-	-
Derivative financial instruments	532	532	-	-
Bank debt	-	-	-	-

The fair values of cash and cash equivalents, accounts receivable and accrued revenue, deposits, accounts payable and accrued liabilities, and bank debt, approximate their carrying value due to the short-term maturity of those instruments. The methodology used to determine the fair value for the Company's derivative financial instruments is described further in this note.

Offsetting of financial instruments

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, 2013, the Company does not have any offsetting derivative contract positions.

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 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 table below summarizes fair value measurements for each hierarchy level as at December 31, 2013:

	Level 1	Level 2	Level 3
Financial liabilities			
Derivative financial instruments	-	532	-

Risk Management Overview

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. This note presents information about the Company's exposure to each of the above risks, the Company's objectives, policies and processes for measuring and managing risk, and the Company's management of capital. Further quantitative disclosures are included throughout these financial statements.

The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework. The Company's management has implemented and continues to maintain and monitor risk management procedures for the benefit of the organization.

The Company's risk management policies are established to: i) identify and analyze the risks faced by the Company; ii) set appropriate risk limits and controls; and iii) monitor risks and consider the implications of market conditions in relation to the Company's activities.

Credit Risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations and arises primarily from Kelt's receivables from joint venture partners and oil and gas marketers. The composition of the Company's accounts receivable is set out in the following table:

Accounts receivable & accrued revenue	December 31, 2013	December 31, 2012
Joint venture partners	5,771	-
Oil and gas marketers	4,384	-
GST input tax credits	1,981	-
Interest receivable	33	-
Other	913	-
Accounts receivable & accrued revenue	13,082	-

During the year ended December 31, 2013, sales to two external customers each individually represented more than 10% of total revenue. Sales to these customers account for approximately 55% and 29% of total revenue, respectively.

The credit risk exposure for oil and gas marketers is mitigated through the use of approved credit policies governing the Company's credit portfolio and with credit practices that limit transactions according to counterparty credit quality as well as requiring collateral where deemed appropriate. The Company does not typically obtain collateral from its oil and gas marketers or joint venture partners.

The 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. However, the receivables are from participants in the oil and gas industry and collection of the outstanding balances is dependent on industry factors such as changes in commodity prices, escalating costs and the risk of unsuccessful drilling. In addition, further risk exists with joint venture partners from occasional contractual disputes that increase the potential for non-collection. The Company does have 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 balance of “other receivables” outstanding as of December 31, 2013, includes accrued receivables related to closing adjustments on property acquisitions completed during the year. It is customary in the industry for such adjustments to be settled within one year of completion of an acquisition.

The Company has an International Swaps and Derivatives Association ("ISDA") agreement with a Canadian chartered bank to address counterparty credit risk associated with derivative financial instruments. These agreements and confirmations provide some credit protection in that they generally allow parties to aggregate amounts owing to each other under all outstanding transactions and settle with a single net amount in the case of a credit event.

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. Management has reviewed past due accounts receivable balances and expects the accounts to be fully collectible.

The carrying amount of accounts receivable represents the Company’s maximum credit exposure. The ageing of the Company’s accounts receivable is summarized in the following table:

Accounts receivable & accrued revenue	Current	30-60 days	60-90 days	Over 90 days	Total
Balance at December 31, 2013	11,799	194	834	255	13,082
Balance at December 31, 2012	-	-	-	-	-

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 and bank debt. Kelt’s approach to managing liquidity is to ensure, as far as possible, that it will have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking harm to the Company’s reputation.

As at December 31, 2013, the Company has a working capital surplus of $20.5 million. However, the capital intensive nature of Kelt’s activities may create a working capital deficiency position during periods with high levels of capital investment. 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 net debt to trailing 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.

As discussed in note 8, Kelt has a $100.0 million revolving operating demand loan. Repayments of principal are not required provided that the borrowings under the Credit Facility do not exceed the authorized borrowing amount and the Company is in compliance with all covenants, representations and warranties. The Company is not subject to any financial covenants under the Credit Facility. As at December 31, 2013, the Credit Facility is undrawn. The Credit Facility is subject to review by the lender on or before May 1, 2014. The continued availability of the Credit Facility is not guaranteed and is dependent on a number of factors, including, among other things, the overall state of credit markets and fluctuating commodity prices. However, the Company expects to obtain credit, as required, in future periods.

During the year ended December 31, 2013, the Company raised total gross proceeds $320.9 million through equity financings. The equity financings and undrawn Credit Facility provide Kelt with significant financial flexibility to execute its 2014 capital expenditure program.

Market Risks

Market risk is the risk that changes in market prices, such as foreign exchange rates, commodity prices, and interest rates will affect the Company’s operations, net profit or the value of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable limits, while maximizing long-term returns.

The Company uses derivative financial instruments from time to time in order to manage market risks. All such transactions are conducted in accordance with the Company's established risk management procedures.

Commodity price risk

Inherent to the business of producing oil and gas, the Company's cash provided by operating activities is subject to commodity price risk. Commodity price risk is the risk that future cash flows will fluctuate as a result of changes in commodity prices. Commodity prices 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 United States dollar. The Company mitigates commodity price risk through the use of various derivative financial instruments.

The Company's current risk management policies permit management to enter into commodity agreements, provided that: i) the contracts are not entered into for speculative purposes; ii) that the notional quantity hedged, at the time of entering into the contract, does not exceed 75% of average daily production; and iii) that the term does not exceed 36 months.

In May 2013, the Company sold a WTI US$95.00 call swaption on 500 barrels of oil per day for a premium of US$2.89 per barrel, resulting in cash proceeds of $0.2 million. The swaption was exercised by the counterparty on July 31, 2013; consequently, the Company entered into a derivative financial contract for 500 barrels of oil per day at a fixed price of WTI CA$98.00 per barrel, effective for the period from August 1, 2013 to December 31, 2013. The contract resulted in a cumulative realized loss on financial instruments of $0.6 over the term of the contract (the cumulative loss is reduced to $0.4 million after considering the initial swaption premium of $0.2 million).

As a result of a staggering increase in the NYMEX-AECO basis differential during the third quarter of 2013, the Company entered into a risk management contract to fix the NYMEX-AECO basis spread at US$0.47 per MMBTU on 15,000 MMBTU per day for November and December of 2013. The actual differential narrowed to US$0.36 per MMBTU in November and widened back to US$0.51 per MMBTU in December. Consequently, and in conjunction with a strengthening US dollar, the Company effectively broke even on this contract in Canadian dollars and the resulting realized loss this derivative financial instrument is nominal.

The following table summarizes the Company's financial derivative risk management contracts outstanding as of December 31, 2013:

Commodity	Notional volume	Pricing point	Contract Price	Remaining term	Fair value Asset (Liability)
Crude oil	500 bbls/d	NYMEX – WTI	CA$ 100.04/bbl	Jan 1 to Jun 30, 2014	(370)
Crude oil	500 bbls/d	NYMEX – WTI	CA$ 100.00/bbl	Jul 1 to Dec 31, 2014	(10)
Crude oil	500 bbls/d	NYMEX – WTI	CA$ 101.41/bbl	Jan 1 to Dec 31, 2014	(128)
Propane	150 bbls/d	OPIS-Conway	US$ 48.09/bbl	Jan 1 to Dec 31, 2014	(24)
Derivative financial instrument liability					**(532)**

The fair value of the derivative contracts is sensitive to changes in commodity prices. If the Canadian dollar equivalent WTI price increases (decreases) by $1.00 per bbl, the total fair market value of the crude oil contracts would decrease (increase) by $0.4 million. If the Canadian dollar equivalent OPIS-Conway propane price increases (decreases) by $1.00 per bbl, the fair market value of the propane contract would increase (decrease) by less than $0.1 million.

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

	Year ended December 31, 2013	Period ended December 31, 2012
Realized loss	(579)	-
Unrealized loss	(304)	-
Loss on derivative financial instruments	(883)	-

Interest rate risk

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. 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.

As at December 31, 2013, the Credit Facility is undrawn therefore the Company's exposure to interest rate risk is limited. The Company did not have any interest rate risk management contracts in place during the current year.

Foreign exchange rate risk

Foreign exchange risk is the risk that future cash flows will fluctuate as a result of changes in foreign exchange rates. While substantially all of the Company's oil and natural gas sales are denominated in Canadian dollars, the Company is exposed to the risk of changes in the Canadian/U.S. dollar exchange rate on sales of commodities that are denominated in U.S. dollars or directly influenced by U.S. dollar benchmark prices. The effects of foreign exchange fluctuations are embedded in the Company's results and the total effect of foreign exchange fluctuations are not separately identifiable.

The Company had no foreign exchange rate contracts in place as at or during the period ended December 31, 2013.

In order to mitigate a portion of the risk relating to revenue that is subject to fluctuations in the exchange rate, the Company may enter into commodity swap transactions whereby commodity prices denominated in U.S. dollars are converted to Canadian dollars. Refer to the *Commodity price risk* section above for details of contracts in place as of December 31, 2013.

Capital Management

The Company's capital structure is comprised of shareholders' equity, 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 debt to trailing funds from operations ratio, which is a non-GAAP financial measure.

	December 31, 2013
Bank debt	-
Working capital deficiency (surplus)(1)	(22,213)
Net debt (surplus)	(22,213)
Trailing funds from operations(2)(3)	37,584
Net debt to trailing funds from operations ratio	N/A(4)

(1) Working capital excludes bank debt, derivative financial instruments assets and liabilities, and the deferred premium on flow-through shares.
(2) Funds from operations is a non-GAAP measure which is calculated as cash provided by operating activities, before settlement of decommissioning obligations and change in non-cash operating working capital.
(3) Trailing funds from operations is annualized based on the most recent quarter's funds from operations.
(4) The Company has a net surplus as at December 31, 2013, therefore the net debt to trailing funds from operations ratio is not applicable.

Kelt targets a net debt to trailing 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.

As described in note 8, Kelt is subject to certain non-financial covenants under the Credit Facility agreement. As at December 31, 2013, the Company is in compliance with all covenants. The Company is not subject to any other externally imposed capital requirements.

13. FINANCING EXPENSES

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

	Year ended December 31, 2013	Period ended December 31, 2012
Interest and fees on bank debt	82	-
Accretion of decommissioning obligations [note 9]	247	-
Financing expense	329	-

The Company did not draw on the Credit Facility during the period ended December 31, 2013 and therefore did not incur any interest charges. Amounts reported as interest and fees on bank debt in the table above relate to standby charges on the undrawn Credit Facility.

14. COMMITMENTS

The Company is committed to future payments under the following agreements:

(CA$ thousands)	2014	2015	2016	2017	2018	Thereafter
Transition services agreement	49	-	-	-	-	-
Operating lease – office buildings	610	761	738	747	249	-
Operating lease – vehicles	163	154	91	21	-	-
Flow-through shares	6,429	-	-	-	-	-
Firm transportation commitments	2,823	2,424	541	-	-	-
Total annual commitments	10,074	3,339	1,370	768	249	-

Pursuant to the Arrangement, the Company entered into a transition services agreement (the "TSA") with the Purchaser. Under the TSA, the Purchaser granted a sublease to Kelt for office space which terminates on February 26, 2014.

Payments under the office building operating lease relate to the Company's head office in Calgary, Alberta, and the field office in Grande Prairie, Alberta. The head office and field office leases expire on April 30, 2018 and April 30, 2015, if not extended.

The Company has a $100.0 million revolving operating demand loan which is undrawn at December 31, 2013. Repayments of principal are not required provided that the borrowings under the Credit Facility do not exceed the authorized borrowing amount and the Company is in compliance with all covenants, representations and warranties.

On August 27, 2013, the Company issued 2.0 million flow-through shares at a price of $9.80 per flow-through share. Pursuant to the provisions in the *Income Tax Act* (Canada), the Company shall incur Canadian Exploration Expenses, including, if applicable, deemed Canadian Exploration Expenses, (the "Qualifying Expenditures") after August 27, 2013 and prior to December 31, 2014 in the aggregate amount of not less than $19.6 million. As of December 31, 2013, the Company had incurred $13.2 million of Qualifying Expenditures, leaving $6.4 million of Qualifying Expenditures to be incurred in 2014. Kelt shall renounce the Qualifying Expenditures so incurred to the subscribers' of the flow-through shares such that $9.80 per flow-through share shall be deductible against the subscribers' income for the fiscal year ended December 31, 2013.

15. SUPPLEMENTAL CASH FLOW INFORMATION

Changes in non-cash working capital, excluding bank debt:

	Year ended December 31, 2013	Period ended December 31, 2012
Accounts receivable and accrued revenue	(13,082)	-
Prepaid expenses and deposits	(1,240)	-
Accounts payable and accrued liabilities	43,447	-
Change in non-cash working capital	29,125	-
Relating to:		
Operating activities	3,235	-
Investing activities	25,890	-
Change in non-cash working capital	29,125	-

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

	Year ended December 31, 2013	Period ended December 31, 2012
Interest and fees on bank debt	70	-
Taxes	-	-

16. 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 2013, the Company incurred $0.6 million in legal fees and disbursements, of which, $0.2 million is payable at December 31, 2013. 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:

(CA$ thousands)	Year ended December 31, 2013	Period ended December 31, 2012
Salaries, bonuses and other benefits	485	-
Share based compensation	3,392	-
Total compensation	3,877	-

During the year ended December 31, 2013, key management personnel were granted an aggregate of 789,000 restricted share units and 1,250,000 stock options with an exercise price of $6.47 per share.

In addition, the Acquisition is considered to be a related party transaction because Kelt was a wholly owned subsidiary of Celtic immediately prior to closing of the Arrangement. Refer to note 3 for additional information regarding accounting for the common control transaction.

17. SUBSEQUENT EVENTS

Non-core property disposition

As more particularly described in note 5, the Company had designated certain assets as held for sale at December 31, 2013. On February 10, 2014, Kelt completed the disposition of these non-core and non-operated assets located in northwestern Alberta. The Company received proceeds of $20.0 million, before closing adjustments. The disposition did not result in a reduction of the authorized borrowing amount available under the Credit Facility.

Equity offerings

On March 5, 2014, the Company entered into an agreement with a syndicate of underwriters (collectively the "Underwriters"), pursuant to which the Underwriters have agreed to purchase for resale to the public, on a bought deal private placement basis, 8,500,000 common shares of Kelt at a price of $11.60 per common share, resulting in gross proceeds of $98.6 million and in addition, the Underwriters have agreed to sell to the public, on a guaranteed agency basis, 1,530,000 common shares of Kelt on a "flow-through" basis in respect of Canadian development expenses at a price of $12.75 per flow-through common share resulting in additional gross proceeds of $19.5 million.

Kelt has also granted the Underwriters an option, exercisable for a period commencing at closing of the offering and ending 30 days following closing of the offering, to purchase an additional 1,275,000 common shares at the same common share offering price of $11.60 per common share, which if exercised, would increase the common share offering gross proceeds by $14.8 million. The financing is expected to close on or around March 25, 2014.

In conjunction with the aforementioned brokered private placement, Kelt has agreed to issue to certain directors, officers and employees of the Company, on a non-brokered basis, an additional 1,105,000 common shares of Kelt on a "flow-through" basis in respect of Canadian development expenses at a price of $12.75 per flow-through common share, resulting in additional proceeds of $14.1 million. The non-brokered private placement will close concurrently with the closing of the brokered private placement on or around March 25, 2014.

The net proceeds from both the brokered private placement and non-brokered private placement equity offerings (collectively, the "March 2014 Private Placements") will be used to partially finance the Company's 2014 capital expenditure program and for general working capital purposes.

Kelt shall, pursuant to the provisions in the *Income Tax Act* (Canada), incur eligible Canadian development expenses, (the "Qualifying Expenditures") after the closing date and prior to December 31, 2014 in the aggregate amount of not less than the total amount of the gross proceeds raised from the issue of flow-through common shares of $33.6 million. Kelt shall renounce the Qualifying Expenditures so incurred to the purchasers of the flow-through common shares in an amount equal to $12.75 per flow-through common share on or prior to December 31, 2014.

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
API	American Petroleum Institute
BT	Before income taxes
AT	After income taxes
1P	Proved reserves
2P	Proved plus probable reserves
FD&A	Finding, development & acquisition costs
CAGR	Compound annual growth rate
CICA	Canadian Institute of Chartered Accountants
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

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, 6]
Partner, Borden Ladner Gervais LLP

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

Neil G. Sinclair [2, 3, 4, 5]
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, Finance & Chief Financial Officer

Douglas J. Errico
Vice President, Land

Alan G. Franks
Vice President, Production

Douglas O. MacArthur
Vice President, Operations

Patrick Miles
Vice President, Exploration

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AUDITORS

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EVALUATION ENGINEERS

Sproule Associates Limited
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Common Shares “KEL”

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