



**SECOND QUARTER REPORT**  
**AS AT AND FOR THE THREE AND SIX MONTHS ENDED**  
**JUNE 30, 2016**

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**FINANCIAL AND OPERATIONAL HIGHLIGHTS**

<i>(CA\$ thousands, except as otherwise indicated)</i>	Three months ended June 30			Six months ended June 30		
	2016	2015 <sup>(2)</sup>	%	2016	2015 <sup>(2)</sup>	%
<b>FINANCIAL</b>						
Revenue, before royalties and financial instruments	<b>40,718</b>	52,131	-22	<b>81,116</b>	91,514	-11
Funds from operations <sup>(1)</sup>	<b>11,671</b>	14,701	-21	<b>17,622</b>	28,681	-39
Basic (\$/ common share) <sup>(1)</sup>	<b>0.07</b>	0.10	-30	<b>0.10</b>	0.20	-50
Diluted (\$/ common share) <sup>(1)</sup>	<b>0.07</b>	0.09	-22	<b>0.10</b>	0.20	-50
Loss and comprehensive loss	<b>(20,413)</b>	(9,971)	105	<b>(46,331)</b>	(26,495)	75
Basic (\$/ common share)	<b>(0.12)</b>	(0.06)	100	<b>(0.27)</b>	(0.19)	42
Diluted (\$/ common share)	<b>(0.12)</b>	(0.06)	100	<b>(0.27)</b>	(0.19)	42
Total capital expenditures, net of dispositions	<b>25,908</b>	343,105	-92	<b>49,313</b>	420,805	-88
Total assets	<b>1,260,245</b>	1,364,810	-8	<b>1,260,245</b>	1,364,810	-8
Bank debt, net of working capital <sup>(1)</sup>	<b>139,080</b>	251,887	-45	<b>138,080</b>	251,887	-45
Convertible debentures	<b>69,320</b>	-	-	<b>69,320</b>	-	-
Shareholders' equity	<b>835,241</b>	870,083	-4	<b>835,241</b>	870,083	-4
Weighted average shares outstanding (000s)						
Basic	<b>173,818</b>	153,990	13	<b>171,321</b>	141,163	21
Diluted	<b>173,972</b>	155,300	12	<b>171,444</b>	142,212	21
<b>OPERATIONS</b>						
Average daily production						
Oil (bbls/d)	<b>5,066</b>	5,419	-7	<b>5,469</b>	5,189	5
NGLs (bbls/d)	<b>2,632</b>	1,494	76	<b>2,686</b>	1,437	87
Gas (mcf/d)	<b>75,060</b>	75,362	0	<b>81,577</b>	66,737	22
Combined (BOE/d)	<b>20,208</b>	19,473	4	<b>21,751</b>	17,749	23
Production per million common shares (BOE/d) <sup>(1)</sup>	<b>116</b>	126	-8	<b>127</b>	126	1
Average realized prices, before financial instruments						
Oil (\$/bbl)	<b>49.76</b>	59.02	-16	<b>41.30</b>	52.58	-21
NGLs (\$/bbl)	<b>18.21</b>	25.43	-28	<b>16.19</b>	25.57	-37
Gas (\$/mcf)	<b>1.97</b>	2.85	-31	<b>2.16</b>	2.94	-27
Operating netbacks <sup>(1)</sup> (\$/BOE)						
Oil and gas revenue	<b>22.14</b>	29.42	-25	<b>20.49</b>	28.49	-28
Realized gain (loss) on financial instruments	<b>(0.01)</b>	0.15	-107	<b>(0.01)</b>	0.65	-102
Average realized price, after financial instruments	<b>22.13</b>	29.57	-25	<b>20.48</b>	29.14	-30
Royalties	<b>(1.65)</b>	(2.91)	-43	<b>(1.49)</b>	(3.07)	-51
Production expense	<b>(8.87)</b>	(13.95)	-36	<b>(9.61)</b>	(13.05)	-26
Transportation expense	<b>(2.89)</b>	(2.48)	17	<b>(2.79)</b>	(2.54)	10
Operating netback <sup>(1)</sup>	<b>8.72</b>	10.23	-15	<b>6.59</b>	10.48	-37
Drilling activity						
Total wells	-	-	-	<b>3</b>	7	-57
Working interest wells	-	-	-	<b>2.5</b>	5.5	-55
Success rate on working interest wells	-	-	-	<b>100%</b>	100%	0
Undeveloped land						
Gross acres	<b>665,010</b>	661,304	1	<b>665,010</b>	661,304	1
Net acres	<b>543,530</b>	532,538	2	<b>543,530</b>	532,538	2

(1) Refer to advisory regarding non-GAAP measures.

(2) Certain comparative information has been revised, refer to information under the heading of "Capital Expenditures".

## **MESSAGE TO SHAREHOLDERS**

Kelt Exploration Ltd. (“Kelt” or the “Company”) reports its financial and operating results to shareholders for the second quarter and six months ended June 30, 2016.

Average production for the three months ended June 30, 2016 was 20,208 BOE per day, up 4% compared to average production of 19,473 BOE per day during the second quarter of 2015. Daily average production in the second quarter of 2016 was 13% lower than average production of 23,295 BOE per day in the first quarter of 2016, primarily due to a planned two week facility turnaround operation in Progress, Alberta. Production was also temporarily shut-in as a precautionary measure due to forest fires near gas processing facilities in the Stoddart area of British Columbia. Production downtime resulted in shut-ins of approximately 1,700 BOE per day average during the second quarter of 2016.

Kelt’s realized average oil price was \$49.76 per barrel, up 46% from \$34.01 per barrel in the first quarter of 2016 and down 16% from \$59.02 per barrel in the second quarter of 2015. The realized average NGLs price during the second quarter of 2016 was \$18.21 per barrel, up 28% from \$14.24 per barrel in the first quarter of 2016 and down 28% from \$25.43 per barrel in the corresponding period of 2015. The realized average gas price was \$1.97 per MCF, down 15% from \$2.33 per MCF in the first quarter of 2016 and down 31% from the realized average gas price of \$2.85 per MCF in the second quarter of the previous year.

For the three months ended June 30, 2016, revenue was \$40.7 million and funds from operations was \$11.7 million (\$0.07 per share, diluted), compared to revenue of \$52.1 million and funds from operations of \$14.7 million (\$0.09 per share, diluted) in the second quarter of 2015. At June 30, 2016, bank debt, net of working capital was \$139.1 million, down 45% from \$251.9 million at June 30, 2015. Production expenses of \$8.87 per BOE continue to improve and were 36% lower compared to \$13.95 per BOE in the second quarter of 2015.

Net capital expenditures incurred during the three months ended June 30, 2016 were \$25.9 million, of which \$18.9 million was for a property acquisition in Kelt’s core operating area at Progress, Alberta. The balance of capital spending during the second quarter of 2016 was primarily for land acquisition and infrastructure construction.

During the second quarter of 2016, Kelt took measures to improve financial liquidity. On April 7, 2016, the Company closed a private placement of 4.7 million common shares on a “CDE flow-through” basis at a price of \$4.70 per share, resulting in net proceeds of \$22.0 million. On May 3, 2016, Kelt closed the issuance of \$90.0 million principal amount of 5.0% convertible unsecured subordinated debentures, resulting in net proceeds of approximately \$86.4 million.

Kelt has revised its 2016 outlook and guidance to reflect changes to forecasted commodity prices as follows:

- Average production of 21,500 BOE per day, unchanged from previous guidance;
- 2016 production mix is expected to be weighted 37% to oil & NGLs and 63% to gas;
- 2016 operating income is expected to be derived 82% from oil & NGLs and 18% from gas;
- Average WTI price of US\$41.85 per barrel, down 3% from previous forecast;
- Average AECO gas price of \$2.10 per GJ, up 11% from previous forecast;
- Capital expenditures, including acquisitions, of \$87.0 million, up 5% from previous guidance;
- Funds from operations of \$54.0 million (\$0.31 per share, diluted), up 8% from previous guidance; and
- Bank debt, net of working capital of \$137.0 million (2.5 x trailing funds from operations), unchanged from previous guidance.

In July 2016, the Government of Alberta released further details with respect to the Alberta Modernized Royalty Framework (“MRF”), now providing companies with the ability to apply for early adoption by drilling wells in 2016 and still qualifying for royalties under MRF. Kelt expects to take advantage of this early adoption on certain wells and has increased its capital spending plans in Alberta for 2016 and reallocated funds within the budget.

After delineating four of its Montney oil plays in Alberta, Kelt is now in a position to commence full development on two of these plays and at the same time, taking advantage of both the early adoption of MRF, as well as the current low cost service sector environment. As a result, Kelt expects to commence pad drilling at Pouce Coupe and Karr in the second half of 2016. The Company plans to drill two wells at Pouce Coupe and two wells at Karr, with further

plans to drill additional wells from the same pads in both areas in early 2017. Completions of these wells are planned prior to spring break-up in 2017.

At Inga, British Columbia, Kelt put on production two wells that were recently drilled and completed on the eastern part of its contiguous Montney land block. Both these wells were completed in the Upper Montney. The well located at 07-12-088-23W6 flowed high volumes of field condensate with an IP30 rate (gross sales) of 648 BOE per day of which condensate and liquids was 379 barrels per day (58%). The well located at 05-07-088-22W6 had an IP30 rate (gross sales) of 1,130 BOE per day of which condensate and liquids was 592 barrels per day (52%). The Company is excited with these results as it extends the Montney resource play further to the east significantly adding to its future drilling inventory.

In the Inga/Fireweed/Stoddart area, Kelt will defer drilling and completing a previously planned Upper Montney well to 2017, leaving two wells to be drilled in the second half of 2016. The Company expects to drill and complete a Middle Montney well in the central part of its land block at Inga and to drill an Upper Montney well in the northeast part of its land block at Fireweed. Kelt expects to complete this well in early 2017 and to drill and complete the deferred Upper Montney well, also in early 2017. At this stage, the Company will have obtained sufficient information from delineation drilling and expects to commence full development in the Upper Montney in British Columbia by switching to pad drilling which should result in significant savings in per well capital expenditures, as well as lower per unit operating expenses when the wells are brought on production.

In light of the current energy business environment with much lower oil and gas prices year-to-date in 2016, compared to 2015, Kelt is optimistic that it can continue to take advantage of the current downturn with its strategy of low-cost land accumulation in its core operating areas, during the remainder of 2016. In July, Kelt completed an acquisition of 18 sections of land in British Columbia, which brings the Company's Montney land holdings in the Inga/Fireweed/Stoddart area to 180 contiguous net sections. The Upper Montney well that was deferred from 2016 capital spending plans is now expected to be drilled on these newly acquired lands during the first quarter of 2017. Kelt believes that these lands will be prospective in both the Upper and Middle Montney formations.

Management looks forward to updating shareholders with 2016 third quarter results on or about November 10, 2016.

On behalf of the Board of Directors,

*[signed]*

David J. Wilson  
President and Chief Executive Officer  
August 9, 2016

## **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. The Company's common shares and 5% convertible debentures are listed on the Toronto Stock Exchange ("TSX") under the symbol "KEL" and "KEL.DB", respectively. The head office of Kelt is located at Suite 300, 311 - 6<sup>th</sup> Avenue S.W., Calgary, Alberta T2P 3H2.

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

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

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

This Management's Discussion and Analysis ("MD&A") is dated August 9, 2016 and should be read in conjunction with the Company's unaudited condensed consolidated interim financial statements and related notes as at and for the three and six months ended June 30, 2016 and its audited consolidated annual financial statements and MD&A as at and for the year ended December 31, 2015. The accompanying financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") as set out in the *CPA Canada Handbook - Accounting* ("CPA Handbook"). The CPA Handbook incorporates International Financial Reporting Standards ("IFRS") and publicly accountable enterprises, including Kelt, are required to apply such standards. The Company's Board of Directors approved and authorized the condensed consolidated interim financial statements for issue on August 9, 2016.

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

This MD&A contains forward-looking statements and forward-looking information within the meaning of applicable securities laws. The use of any of the words "expect", "anticipate", "continue", "estimate", "objective", "ongoing", "may", "will", "project", "should", "believe", "plans", "intends" and similar expressions are intended to identify forward-looking information or statements. In particular, this MD&A contains forward-looking statements pertaining to the following: the anticipated continued reduction in production and transportation expenses resulting from operational initiatives and expenditures on infrastructure; the expectation that firm service gas transportation contracts will continue to alleviate production disruptions and discounted realized gas prices; the potential impact of the Modernized Royalty Framework ("MRF") on the Company's Alberta oil and gas assets and the expectation that Kelt will early adopt the MRF for certain wells drilled during the second half of 2016; the Company's ability to continue accumulating land at a low-cost in its core operating areas; and the Company's expected future financial position and operating results, as well as the amount and timing of future development capital expenditures. Statements relating to "reserves" or "resources" are deemed to be forward looking statements, as they involve the implied assessment, based on certain estimates and assumptions, that the reserves described exist in the quantities predicted or estimated and that the reserves can be profitably produced in the future.

Although Kelt believes that the expectations and assumptions on which the forward-looking statements are based are reasonable, undue reliance should not be placed on the forward-looking statements because Kelt cannot give any assurance that they will prove to be correct. Since forward-looking statements address future events and conditions, by their very nature they involve inherent risks and uncertainties. Actual results could differ materially from those currently anticipated due to a number of factors and risks. These include, but are not limited to, the risks associated

with the oil and gas industry in general (e.g., operational risks in development, exploration and production; delays or changes in plans with respect to exploration or development projects or capital expenditures; the uncertainty of reserve estimates; the uncertainty of estimates and projections relating to production, costs and expenses; failure to obtain necessary regulatory approvals for planned operations; health, safety and environmental risks; uncertainties resulting from potential delays or changes in plans with respect to exploration or development projects or capital expenditures; volatility of commodity prices, currency exchange rate fluctuations; imprecision of reserve estimates; and competition from other explorers) as well as general economic conditions, stock market volatility; and the ability to access sufficient capital. We caution that the foregoing list of risks and uncertainties is not exhaustive.

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

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

## **GROWTH STRATEGY**

The business plan of Kelt is to create sustainable and profitable growth as a participant in the oil and gas industry in Canada. Kelt seeks to identify and acquire strategic oil and gas properties where it believes further exploitation, development and exploration opportunities exist. From time to time, Kelt may acquire a corporate entity in order to accomplish its oil and gas property acquisition strategy. In addition, Kelt implements a full cycle exploration program, resulting in exploration and development drilling based on opportunities generated internally.

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

## **SECOND QUARTER FINANCIAL AND OPERATING HIGHLIGHTS**

- Kelt reported average production of 20,208 BOE per day for the three month period ended June 30, 2016, up 4% from 19,473 BOE per day in the same period of 2015. Average production during the second quarter of 2016 was impacted by approximately 1,700 BOE per day of downtime for planned facility turnaround operations and production disruptions due to forest fires near Fort St. John, BC.
- The Company generated funds from operations of \$11.7 million (\$0.07 per common share, diluted) during the second quarter of 2016, down 21% from \$14.7 million (\$0.10 per common share, diluted) in the second quarter of 2015, reflecting significantly lower realized oil and gas prices.
- Corporate royalty rates averaged 7.5% of revenue during the second quarter of 2016, down from 9.8% in the second quarter of 2015.
- Production expenses averaged \$8.87 per BOE during the three months ended June 30, 2016, down 36% from \$13.95 per BOE in the second quarter of 2015 reflecting the Company’s operational initiatives.
- Kelt continues to incur below industry average general and administrative (“G&A”) expenses, which averaged \$0.86 per BOE in the second quarter of 2016 in comparison to \$0.94 per BOE for the same quarter of 2015. G&A expense is reported net of standard overhead recoveries. Kelt does not capitalize any direct G&A expenses.
- The Company incurred capital expenditures, before acquisitions, of \$7.0 million during the quarter ended June 30, 2016, down 63% from \$19.1 million in the same quarter 2015. Kelt did not drill any wells through spring break up during the second quarter and capital expenditures were incurred primarily on land and infrastructure.

- On April 28, 2016, the Company completed a strategic acquisition of assets in its core area at Progress, Alberta, for cash consideration of \$18.9 million, after closing adjustments. The acquisition includes approximately 600 BOE per day of current production (60% light oil), 4,135 net acres of land, and infrastructure that is an integral part of Kelt's existing light oil play at Progress.
- During the second quarter ended June 30, 2016, Kelt reduced its bank debt, net of working capital, by \$91.2 million and strengthened its liquidity and financial position through the completion of strategic financing transactions:
  - On April 7, 2016, the Company closed a private placement of 4.7 million common shares for gross proceeds of \$22.1 million. The common shares were issued on a "flow-through" basis in respect of Canadian development expenses at a price of \$4.70 per share.
  - On May 3, 2016, the Company issued \$90.0 million principal amount of 5% convertible unsecured subordinated debentures with a maturity date of May 31, 2021.
- As at June 30, 2016, the Company had drawn \$127.0 million on its \$185.0 million bank credit facility. Kelt is well positioned to execute on its capital expenditure program during the second half of 2016 and has sufficient financial flexibility to take advantage of opportunities as they arise.

## PRODUCTION AND REVENUE

<i>(CA\$ thousands, except as otherwise indicated)</i>	Three months ended June 30			Six months ended June 30		
	2016	2015	%	2016	2015	%
Average daily production:						
Oil (bbls/d)	5,066	5,419	-7	5,469	5,189	5
NGLs (bbls/d)	2,632	1,494	76	2,686	1,437	87
Gas (mcf/d)	75,060	75,362	0	81,577	66,737	22
Combined (BOE/d)	20,208	19,473	4	21,751	17,749	23
Average realized prices, before financial instruments:						
Oil (\$/bbl)	49.76	59.02	-16	41.30	52.58	-21
NGLs (\$/bbl)	18.21	25.43	-28	16.19	25.57	-37
Gas (\$/mcf)	1.97	2.85	-31	2.16	2.94	-27
Combined (\$/BOE)	22.14	29.42	-25	20.49	28.49	-28
Average realized prices, after financial instruments:						
Oil (\$/bbl)	49.76	59.54	-16	41.30	52.84	-22
NGLs (\$/bbl)	18.21	25.43	-28	16.19	32.63	-50
Gas (\$/mcf)	1.97	2.85	-31	2.16	2.94	-27
Combined (\$/BOE)	22.13	29.57	-25	20.48	29.14	-30
Revenue, before royalties and financial instruments:						
Oil	22,937	29,105	-21	41,112	49,383	-17
NGLs	4,362	3,457	26	7,913	6,650	19
Gas	13,419	19,569	-31	32,091	35,481	-10
Total revenue, before royalties and financial instruments	40,718	52,131	-22	81,116	91,514	-11

The Company reported average production of 21,751 BOE per day for the six months ended June 30, 2016, up 23% from 17,749 BOE for the first six months of 2015. The increase in average daily production reflects the Company's successful drilling program and strategic acquisitions, partly offset by corporate declines. The Artek Acquisition, which closed on April 16, 2015, added approximately 5,400 BOE per day of production at the time of the acquisition and contributed to the significant increase in NGLs production.



Average production of 20,208 BOE per day reported for the second quarter of 2016 declined 13% compared to record production of 23,295 BOE per day achieved during the first quarter of 2016. The decrease reflects planned turnaround maintenance at the Progress Gas Plant completed over a two week period in June, along with the temporary shut-in of the West Stoddart Gas Plant and other intermittent production disruptions as a result of forest fires in the vicinity of Fort St. John, BC, during April and May. Kelt was able to mitigate certain production losses by diverting approximately 50% of its BC gas production to the McMahon Gas Plant. The Company estimates that downtime reduced production by approximately 1,700 BOE per day, on average, during the second quarter of 2016.

The Company earned revenue before royalties and financial instruments of \$40.7 million and \$81.1 million during the three and six month periods ended June 30, 2016, respectively. Despite an increase in production volumes, revenues are down by 22% and 11%, respectively, relative to the corresponding three and six month periods of 2015 due to significantly lower commodity prices in 2016 compared to 2015.

During the second quarter ended June 30, 2016, Kelt's combined average realized price was \$22.14 per BOE, up 16% from \$19.06 per BOE during the first quarter ended March 31, 2016. The increase is due to improved realized oil and NGLs pricing, which more than offset lower realized gas prices.

## OIL OPERATIONS

<i>(CA\$ thousands, except as otherwise indicated)</i>	Three months ended June 30			Six months ended June 30		
	2016	2015	%	2016	2015	%
Oil revenue	<b>22,937</b>	29,105	-21	<b>41,112</b>	49,383	-17
Oil royalties	<b>(2,946)</b>	(3,654)	-19	<b>(5,318)</b>	(7,309)	-27
Oil revenue, after royalties	<b>19,991</b>	25,451	-21	<b>35,794</b>	42,074	-15
Average realized price, before financial instruments (\$/bbl)	<b>49.76</b>	59.02	-16	<b>41.30</b>	52.58	-21
Realized gain (loss) on financial instruments (\$/bbl)	-	0.52	-	-	0.26	-
Average realized price, after financial instruments (\$/bbl)	<b>49.76</b>	59.54	-16	<b>41.30</b>	52.84	-22
Benchmark oil prices:						
WTI Cushing Oklahoma (US\$/bbl) <sup>(1)</sup>	<b>45.59</b>	57.94	-21	<b>39.52</b>	53.29	-26
WTI Cushing Oklahoma (CA\$/bbl) <sup>(2)</sup>	<b>58.74</b>	71.20	-18	<b>52.29</b>	65.77	-20
Canadian Light Sweet ("CLS") (\$/bbl) <sup>(1)</sup>	<b>55.01</b>	68.88	-20	<b>48.11</b>	61.08	-21
CLS % of CA\$WTI	<b>94%</b>	97%	-3	<b>92%</b>	93%	-1
Average exchange rate (CA\$/US\$) <sup>(1)</sup>	<b>1.2882</b>	1.2289	5	<b>1.3289</b>	1.2344	8

(1) Source: Sproule Associates Limited.

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

Kelt realized an average price of \$49.76 per barrel for oil sales during the second quarter ended June 30, 2016, up 46% from \$34.01 per barrel during the first quarter ended March 31, 2016. Compared to the second quarter of 2015, Kelt's realized oil price decreased by 16% from \$59.02 per barrel. The variance in Kelt's realized oil price generally reflects the change in benchmark oil prices, which fell significantly from 2015 as global crude oil supplies surpassed demand. In addition, the Company's realized oil price is discounted to benchmark oil prices as the base price paid by purchasers is adjusted for quality and is net of all applicable fees and deductions, including pipeline tariffs or location differentials. These tariffs and differentials vary depending on the delivery point, but do not fluctuate with oil prices.

The average discount of Kelt's realized oil price relative to the CLS reference price was \$5.25 per barrel during the second quarter of 2016, compared to a discount of \$7.21 per barrel in the first quarter of 2016 and \$9.86 per barrel in the second quarter of 2015. The decrease in discount during the quarter ended June 30, 2016 reflects an improvement in contract pricing for the Company's oil production at Karr, Alberta. In addition, Kelt's realized price on its BC oil production improved due to lower pipeline tariffs. As a result of capacity constraints on the BC Light pipeline, Kelt trucked a portion of its BC production volumes to terminals in Alberta with significantly lower pipeline tariffs.

During the first six months of 2016, oil royalties averaged 12.9% of oil revenue, down from 14.8% of oil revenue in the same period of 2015. The decrease in Kelt's average oil royalty rate is primarily due to lower oil prices.

## NGL OPERATIONS

<i>(CA\$ thousands, except as otherwise indicated)</i>	Three months ended June 30			Six months ended June 30		
	2016	2015	%	2016	2015	%
NGLs revenue	<b>4,362</b>	3,457	26	<b>7,913</b>	6,650	19
NGLs royalties	<b>(51)</b>	(342)	-85	<b>(197)</b>	(702)	-72
NGLs revenue, after royalties	<b>4,311</b>	3,115	38	<b>7,716</b>	5,948	30
Average realized price, before financial instruments (\$/bbl)	<b>18.21</b>	25.43	-28	<b>16.19</b>	25.57	-37
Realized gain (loss) on financial instruments (\$/bbl) <sup>(1)</sup>	-	-	-	-	7.06	-
Average realized price, after financial instruments (\$/bbl)	<b>18.21</b>	25.43	-28	<b>16.19</b>	32.63	-50
Benchmark NGLs prices <sup>(2)</sup> :						
Edmonton Pentane (CA\$/bbl)	<b>55.81</b>	71.26	-22	<b>50.58</b>	64.16	-21
Edmonton Butane (CA\$/bbl)	<b>32.39</b>	36.77	-12	<b>30.86</b>	40.07	-23
Edmonton Propane (CA\$/bbl)	<b>9.96</b>	1.99	401	<b>8.55</b>	6.21	38
Edmonton Ethane (CA\$/bbl)	<b>3.92</b>	7.41	-47	<b>4.50</b>	7.51	-40
Weighted average NGLs benchmark price (\$/bbl) <sup>(3)</sup>	<b>27.08</b>	37.36	-28	<b>25.09</b>	36.32	-31

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

(2) Source: Sproule Associates Limited.

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

During the quarter ended June 30, 2016, the Company realized an average price for NGL sales of \$18.21 per barrel, down 28% from \$25.43 per barrel in the corresponding quarter of 2015. Kelt's realized price for NGL sales is reported net of deductions, primarily transportation and fractionation charges, which are generally a fixed dollar amount per unit under the NGLs purchase contracts, depending on the point of delivery. As these charges do not fluctuate with NGL prices, the impact of lower benchmark prices for NGLs on Kelt's average realized price is more pervasive.

Kelt's NGL sales volumes were weighted 27% pentane, 26% butane, 30% propane and 18% ethane for the second quarter of 2016. By comparison, NGL sales volumes were weighted 34% pentane, 32% butane, 28% propane and 5% ethane during the same period in 2015. The change in NGLs product mix is primarily attributable to a new marketing arrangement that came into effect in November 2015, resulting in higher total NGL recoveries on Company's production originating from the West Stoddart Gas Plant in northeastern BC. The arrangement results in a higher shrink of its BC gas production, however, the price realized on additional NGL barrels extracted is at a premium to the Station 2 gas price.

NGL royalties averaged 2.5% during the six months ended June 30, 2016, down from 10.6% during the same period of 2015. NGL royalties are reduced by the pro-rata amount of gas cost allowance credits allocated to NGLs production, which do not fluctuate with NGL prices.

## GAS OPERATIONS

<i>(CA\$ thousands, except as otherwise indicated)</i>	Three months ended June 30			Six months ended June 30		
	2016	2015	%	2016	2015	%
Gas revenue	13,419	19,569	-31	32,091	35,481	-10
Gas royalties	(37)	(1,132)	-97	(378)	(1,860)	-80
Gas revenue, after royalties	13,382	18,437	-27	31,713	33,621	-6
Average realized price, before financial instruments (\$/MCF)	1.97	2.85	-31	2.16	2.94	-27
Realized gain (loss) on financial instruments (\$/MCF)	-	-	-	-	-	-
Average realized price, after financial instruments (\$/MCF)	1.97	2.85	-31	2.16	2.94	-27
Benchmark natural gas prices:						
NYMEX Henry Hub (US\$/mmbtu) <sup>(1)</sup>	1.95	2.67	-27	2.00	2.82	-29
AECO 5A (CA\$/GJ) <sup>(2)</sup>	1.33	2.52	-47	1.53	2.56	-40
NGX Station #2 Day Ahead Index (CA\$/GJ) <sup>(3)</sup>	1.13	2.01	-44	1.23	2.02	-39
% of AECO 5A (CA\$/GJ)	85%	80%	6	80%	79%	1
Platts Chicago City-Gates (US\$/mmbtu) <sup>(4)</sup>	2.09	n/a	n/a	2.06	n/a	n/a
Platts Chicago City-Gates (CA\$/mmbtu) <sup>(4)</sup>	2.69	n/a	n/a	2.75	n/a	n/a
% of AECO 5A (CA\$/mmbtu)	202%	n/a	n/a	180%	n/a	n/a

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

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

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

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

The Company realized an average gas sales price of \$1.97 per MCF during the quarter ended June 30, 2016, down 31% from \$2.85 per MCF during the quarter ended June 30, 2015. By comparison, the AECO 5A gas index price fell by 47% over the same period, and averaged \$1.33 per GJ during the second quarter of 2016. Kelt receives a premium to the AECO 5A gas index price due to the higher heat content of its gas production, and has marketing arrangements in place whereby the Company receives Chicago City-Gates pricing on a portion of its gas sales volumes.

Effective December 1, 2015, Kelt entered into gas sales agreements in BC and Alberta with 22,803 MMBTU per day of firm transportation on the Alliance pipeline, pursuant to which, Kelt receives Chicago City-Gates pricing (additional information is provided under the heading of “*Contractual Obligations*”). The Canadian dollar equivalent Chicago City-Gates price averaged \$2.75 per MMBTU for the first six months of 2016, representing a significant premium to AECO 5A and Station 2 prices. Approximately two-thirds of the Company’s gas production from its Inga-Fireweed-Stoddart assets was sold under these contracts during the first half of 2016, resulting in stronger realized prices compared to previous periods in which the majority of Kelt’s BC gas production was sold at Station 2 or CREC prices. The impact of the higher realized gas price on Kelt’s funds from operations is partially offset by higher tolls on the Alliance pipeline, which are included in transportation expenses.

Gas royalties were nominal for the second quarter ended of 2016 compared to 5.8% during the previous quarter ended June 30, 2015. Lower gas royalties reflect the significant decrease in gas reference prices as well as gas cost allowance credits which do not fluctuate with gas prices.

## PRODUCTION EXPENSES

<i>(CA\$ thousands, unless otherwise indicated)</i>	Three months ended June 30			Six months ended June 30		
	2016	2015 <sup>(1)</sup>	%	2016	2015 <sup>(1)</sup>	%
Production expense	16,324	24,738	-34	38,036	41,922	-9
\$ per BOE	8.87	13.95	-36	9.61	13.05	-26

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

Kelt achieved a 36% reduction in per unit production expenses of \$8.87 per BOE in the second quarter of 2016, compared to \$13.95 per BOE for the second quarter of 2015. Production expenses during the second quarter ended June 30, 2015 were impacted by high initial integration costs associated with the Artek Acquisition. The decrease in total and per unit production expenses reflects Kelt's operational initiatives and previous expenditures to construct and acquire strategic infrastructure.

## TRANSPORTATION EXPENSES

(CA\$ thousands, unless otherwise indicated)	Three months ended June 30			Six months ended June 30		
	2016	2015 <sup>(1)</sup>	%	2016	2015 <sup>(1)</sup>	%
Transportation expense	5,316	4,387	21	11,055	8,140	36
\$ per BOE	2.89	2.48	17	2.79	2.54	10

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

The Company's per unit transportation expenses averaged \$2.89 per BOE in the second quarter of 2016, up 17% from \$2.48 per BOE in the same quarter of the previous year. Higher gas transportation costs more than offset lower oil transportation expenses.

Kelt has invested in infrastructure in its core areas and entered into oil marketing and transportation arrangements to pipeline connect the majority of the Company's oil production, reducing reliance on trucking. This has resulted in significant savings, as oil trucking has historically been unpredictable and expensive due to long wait times. The Company's oil transportation expenses averaged \$2.00 per barrel for the quarter ended June 30, 2016, down 56% from \$4.51 per barrel during the quarter ended June 30, 2015. Average oil transportation expenses increased 16% from \$1.73 per barrel reported for the first quarter of 2016, as the Company was temporarily required to truck a portion of its BC oil production due to capacity constraints on the BC Light pipeline during the second quarter of 2016. The impact of higher oil trucking expenses on operating netbacks was relatively neutral as Kelt realized higher oil prices due to lower pipeline tariffs.

The Company's firm commitments for gas transportation on the Alliance pipeline came into effect December 1, 2015. Kelt incurs higher transportation expenses on these volumes, however, the tolls are more than offset by higher realized gas prices as Kelt receives Chicago City-Gates pricing, providing a premium to the gas price previously realized at CREC and Station 2.

## FINANCING EXPENSES

(CA\$ thousands, unless otherwise indicated)	Three months ended June 30			Six months ended June 30		
	2016	2015	%	2016	2015	%
Interest and fees on bank debt	2,056	1,978	4	4,292	2,851	51
Interest on convertible debentures	715	-	-	715	-	-
Accretion of convertible debentures	487	-	-	487	-	-
Accretion of decommissioning obligations	744	707	5	1,503	1,249	20
Financing expenses	4,002	2,685	49	6,997	4,100	71
Average bank debt outstanding	153,147	208,044	-26	174,707	143,083	22
Average interest rate on bank indebtedness	4.5%	3.4%	32	4.2%	3.4%	24
Interest expense per BOE <sup>(1)</sup>	1.51	1.12	35	1.26	0.89	42

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

The Company's financing expenses increased due to higher total debt levels in 2016, partly attributed to the assumption of corporate indebtedness on the Artek Acquisition, compounded by the rapid decline in commodity prices.

During the second quarter of 2016, Kelt reduced borrowings under its revolving bank credit facility using the net proceeds of the offering of \$90.0 million principal amount of convertible unsecured subordinated debentures (the

“Debentures”). The Debentures mature on May 31, 2021 and bear interest at 5.0% per annum, payable semi-annually on May 31<sup>st</sup> and November 30<sup>th</sup>, commencing November 30, 2016. Financing expense for the quarter ended June 30, 2016 includes \$0.7 million of accrued cash interest and \$0.5 million of non-cash accretion expense. The carrying value allocated to the liability component of the Debentures is accreted to its principal amount of \$90.0 million over the five year term to maturity, using the effective interest rate method.

The Company has a revolving committed term credit facility (the “Credit Facility”) with a syndicate of financial intuitions. During the six months ended June 30, 2016, amounts drawn under the Credit Facility were primarily in the form of bankers’ acceptances (“BAs”). Kelt’s average interest rate on outstanding bank indebtedness increased in 2016 as higher stamping fees on BAs more than offset the decrease in the Canadian Dollar Offered Rate (“CDOR”) compared to 2015. Under the Credit Facility, BA stamping fees fluctuate based on a pricing grid and range from 2.0% to 3.5%, depending upon the Company’s debt to cash flow ratio of between less than one and one tenth times to greater than three times. Fees on bank debt include commitment fees and standby charges on the undrawn facility.

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

Accretion expense on decommissioning obligations is a measure of the increase in the present value of the decommissioning obligation due to the passage of time. The increase in accretion expense for the six month period ended June 30, 2016 relative to the same period of 2015, is primarily due to the increase in the carrying value of decommissioning obligations related to the Artek Acquisition.

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

<i>(CA\$ thousands, unless otherwise indicated)</i>	Three months ended June 30			Six months ended June 30		
	2016	2015	%	2016	2015	%
Salaries and benefits	1,659	1,531	8	3,286	2,626	25
Other G&A expenses	784	844	-7	1,946	1,645	18
Gross G&A expenses	2,443	2,375	3	5,232	4,271	20
Overhead recoveries	(863)	(706)	22	(1,765)	(1,929)	-9
G&A expense, net of recoveries	1,580	1,669	-5	3,467	2,342	48
Gross G&A (\$ per BOE)	1.33	1.34	0	1.32	1.33	0
Net G&A (\$ per BOE)	0.86	0.94	-9	0.88	0.73	21

The Company incurred total G&A expenses, before recoveries, of \$5.2 million during the first six months of 2016, up 20% from the same period of 2015, in conjunction with the Company’s significant growth. On a per unit basis, gross G&A expenses are relatively unchanged at \$1.32 per BOE (before recoveries) due to management’s continued efforts to maintain a low cost structure.

G&A expenses are reported net of overhead recoveries, however, Kelt does not capitalize any direct G&A expenses. On a per unit basis, net G&A expense was \$0.86 per BOE for the quarter ended June 30, 2016, down 9% from the second quarter of 2015 as a result of higher operating overhead recoveries. Kelt earned lower capital overhead recoveries in the current year due to significantly lower capital expenditures resulting in an increase in net G&A expenses per BOE during the six month period ended June 30, 2016.

#### SHARE BASED COMPENSATION (“SBC”)

<i>(CA\$ thousands, unless otherwise indicated)</i>	Three months ended June 30			Six months ended June 30		
	2016	2015	%	2016	2015	%
Stock options	807	1,004	-20	1,672	2,335	-28
Restricted share units (“RSUs”)	341	870	-61	869	2,045	-58
Total SBC expense	1,148	1,874	-39	2,541	4,380	-42
\$ per BOE	0.62	1.06	-42	0.64	1.36	-53

Total SBC expense decreased in the three and six month periods ended June 30, 2016, as the fair value of new stock options and RSUs granted is lower than previous periods. The significant decrease in SBC expense on a per unit basis reflects management's objective to provide long term incentives to employees and grow production, while minimizing the dilutive impact to shareholders. As at June 30, 2016, stock options and RSUs outstanding represent 5.1% of total shares outstanding (4.7% of total shares outstanding at December 31, 2015).

## EXPLORATION AND EVALUATION

<i>(CA\$ thousands, unless otherwise indicated)</i>	Three months ended June 30			Six months ended June 30		
	2016	2015	%	2016	2015	%
Expired mineral leases	2,198	947	132	2,827	1,424	99
\$ per BOE	1.20	0.53	126	0.71	0.44	61

Exploration and evaluation expenses relate to the expiry of non-core land holdings as the Company focuses on the development of its core areas. The majority of the mineral leases expired during the six months ended June 30, 2016, were acquired through corporate acquisitions.

## DEPLETION AND DEPRECIATION

<i>(CA\$ thousands, unless otherwise indicated)</i>	Three months ended June 30			Six months ended June 30		
	2016	2015	%	2016	2015	%
Depletion of development and production assets	34,799	37,452	-7	75,516	65,322	16
Depreciation of corporate assets	183	253	-28	396	416	-5
Total depletion and depreciation	34,982	37,705	-7	75,912	65,738	15
\$ per BOE	19.02	21.28	-11	19.18	20.46	-6

The Company calculates depletion of development and production ("D&P") assets based on production relative to total proved reserves, for each depletion unit. The increase in the absolute level of depletion expense for the six months ended June 30, 2016 is due to an increase in the carrying value of assets subject to depletion, resulting from capital expenditures and acquisitions, in particular, the Artek Acquisition on April 16, 2015. The decrease in depletion expense per BOE is attributed an impairment of PP&E at December 31, 2015 which reduced the carrying value of D&P assets subject to depletion by \$64.1 million. The impairment was a result of lower commodity prices, however, Kelt's total proved reserves volumes increased year over year.

## GAIN ON SALE OF ASSETS

On March 31, 2016, the Company completed a disposition of certain non-core assets located at Boundary Lake in northwestern Alberta, for cash consideration of \$1.1 million (before closing adjustments) and reported a gain of \$2.1 million. The carrying amount of decommissioning obligations disposed was \$2.4 million, which exceeded the \$1.4 million combined carrying amount of the E&E and D&P assets. At the time of disposition, production from the assets was approximately 16 BOE per day.

## DERIVATIVE FINANCIAL INSTRUMENTS

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

(CA\$ thousands, unless otherwise indicated)	Three months ended June 30			Six months ended June 30		
	2016	2015	%	2016	2015	%
Realized gain (loss)	(22)	258	-109	(36)	2,081	-102
Unrealized gain (loss)	128	361	-65	251	(1,673)	-115
Gain on derivative financial instruments	106	619	-83	215	408	-47
\$ per BOE	0.06	0.35	-83	0.05	0.13	-62

### Interest rate contracts

The Company has an interest rate swap fixing the CDOR rate at 0.925% on a notional \$100.0 million per month from July 2015 to June 2017. The CDOR rate averaged 0.918% during the second quarter of 2016, resulting in a nominal realized loss in the period.

At June 30, 2016, Kelt had the following interest rate risk management contract outstanding:

Contract Type	Notional Amount	Reference Price	Fixed Contract Price	Remaining Term	Fair value Asset (Liability)
Interest Rate Swap	\$100,000,000	CDOR	0.925%	July 1, 2016 to June 30, 2017	(67)

If the CDOR rate increases (decreases) by 10 basis points, the fair market value of the interest rate swap contract would increase (decrease) by approximately \$0.1 million.

### Natural gas contracts

During the quarter ended June 30, 2016, the Company entered into a financial derivative contract to fix the basis differential between the Chicago Monthly Index and AECO 7A at US\$0.96 per MMBTU on a notional of 10,000 MMBTU per day for the period from June to October 2016. The actual differential was US\$0.91 per MMBTU for the June contract month, which resulted in a nominal realized loss recognized in the second quarter of 2016.

At June 30, 2016, Kelt had the following natural gas price risk management contracts outstanding:

Remaining Term	Notional Volume	Reference Prices	Fixed Contract Price	Fair value Asset (Liability)
July to October 2016	10,000 MMBTU/d	Chicago Monthly Index AECO 7A	Chicago Monthly Index minus US\$0.96 per MMBTU	99
September to October 2016	30,000 MMBTU/d	NYMEX Henry Hub AECO 5A	NYMEX Henry Hub minus US\$0.94 per MMBTU	(11)

The fair values of these derivative contracts are sensitive to changes in the natural gas reference prices:

- If the Chicago-AECO 7A basis differential increased (decreased) by \$0.10/MMBTU, the fair market value of contract would increase (decrease) by approximately \$0.1 million.
- If the NYMEX-AECO 5A basis differential increased (decreased) by \$0.10/MMBTU, the fair market value of contract would increase (decrease) by approximately \$0.2 million.

### Foreign exchange contracts

Subsequent to the quarter ended June 30, 2016, the Company entered a forward foreign exchange swaption contract whereby the counterparty has the right, if exercised on December 30, 2016, to enter a series of forward foreign exchange transactions fixing the exchange rate at CA\$/US\$1.33 from January to December 2017, on a notional amount of US\$1.0 million per month. In consideration for the swaption, Kelt received a cash premium of \$0.255 million at the time of entering into the contract.

## INCOME TAXES

Kelt was not required to pay income taxes in the current or prior periods as the Company had sufficient income tax deductions available to shelter taxable income. Tax deductions available as of June 30, 2016 are estimated to be approximately \$994.3 million (December 31, 2015 - \$958.0 million).

<i>(CA\$ thousands, unless otherwise indicated)</i>	Three months ended June 30			Six months ended June 30		
	2016	2015	%	2016	2015	%
Deferred income tax recovery	<b>(7,594)</b>	(2,046)	271	<b>(17,179)</b>	(3,646)	371
Loss before income taxes	<b>(28,007)</b>	(12,017)	133	<b>(63,510)</b>	(30,141)	111
Effective tax rate	<b>27%</b>	17%	59	<b>27%</b>	12%	125

The consolidated combined federal and provincial statutory tax rate averaged 26.6% during the first six months of 2016, up from 26.0% during the six month ended June 30, 2015. Effective July 1, 2015, the Alberta government increased the general corporate tax rate from 10% to 12%. The impact of the increase in future tax rates was recognized during the second quarter ended June 30, 2015, resulting in a \$4.5 million reduction in the deferred tax recovery, partly contributing to the low effective tax recovery rate in the comparative periods. A detailed analysis of the provision for deferred income taxes is included in note 13 of the consolidated interim financial statements, which includes a reconciliation of the difference between the deferred income tax recovery reported relative to expected recovery calculated based on the statutory tax rate.

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

Kelt reported a loss of \$20.4 million for the second quarter ended June 30, 2016. By comparison, Kelt reported a loss of \$10.0 million in the corresponding period of 2015, which includes a \$15.9 million gain on acquisition and \$2.3 million of transaction costs related to the acquisition of Artek in April of 2015.

<i>(CA\$ thousands, unless otherwise indicated)</i>	Three months ended June 30			Six months ended June 30		
	2016	2015	%	2016	2015	%
Loss and comprehensive loss	<b>(20,413)</b>	(9,971)	105	<b>(46,331)</b>	(26,495)	75
Weighted avg. shares outstanding, basic (000s)	<b>173,818</b>	153,990	13	<b>171,321</b>	141,163	21
Weighted avg. shares outstanding, diluted (000s) <sup>(1)(2)</sup>	<b>173,818</b>	153,990	13	<b>171,321</b>	141,163	21
\$ per common share, basic	<b>(0.12)</b>	(0.06)	100	<b>(0.27)</b>	(0.19)	42
\$ per common share, diluted <sup>(1)(2)</sup>	<b>(0.12)</b>	(0.06)	100	<b>(0.27)</b>	(0.19)	42
\$ per BOE	<b>(11.10)</b>	(5.63)	97	<b>(11.70)</b>	(8.25)	42

(1) The Company uses the treasury stock method to determine the dilutive effect of stock options and RSUs. Under this method, only "in-the-money" dilutive instruments impact the calculation of diluted profit per common share. In computing the diluted loss per common share for the three and six month periods ended June 30, 2016 and 2015, the Company excluded the effect of stock options and RSUs as they were anti-dilutive. Therefore, the diluted weighted average is equal to the basic weighted average shares outstanding.

(2) The common shares potentially issuable on conversion of the Debentures are excluded from the calculation of diluted weighted average shares outstanding as they were anti-dilutive for the three and six months ended June 30, 2016.

## FUNDS FROM OPERATIONS

The Company generated funds from operations of \$11.7 million (\$0.07 per common share, diluted) during the second quarter of 2016, down from \$14.7 million (\$0.09 per common share, diluted) in the same quarter of 2015. The significant decline in commodity prices resulted in lower revenues during the three and six month periods ended June 30, 2016. However, Kelt's realized prices for oil and gas strengthened, on a relative basis, compared to the CLS and AECO reference prices in the period. The Company mitigated the continued weakness in commodity prices with a \$5.08 per BOE reduction in production expenses, reflecting the Company's ongoing cost savings initiatives, and also benefited from a \$1.26 per BOE reduction in royalties.



<b>Three months ended June 30</b> <i>(CA\$ thousands, unless otherwise indicated)</i>	<b>2016</b>		<b>2015</b>	
	<b>Amount</b>	<b>\$/BOE</b>	<b>Amount</b>	<b>\$/BOE</b>
Oil and gas revenue	<b>40,718</b>	<b>22.14</b>	52,131	29.42
Realized gain (loss) on financial instruments <sup>(1)</sup>	<b>(21)</b>	<b>(0.01)</b>	258	0.15
Royalties	<b>(3,034)</b>	<b>(1.65)</b>	(5,128)	(2.91)
Production expense	<b>(16,324)</b>	<b>(8.87)</b>	(24,738)	(13.95)
Transportation expense	<b>(5,316)</b>	<b>(2.89)</b>	(4,387)	(2.48)
Operating income <sup>(2)</sup>	<b>16,023</b>	<b>8.72</b>	18,136	10.23
Financing expense <sup>(3)</sup>	<b>(2,771)</b>	<b>(1.51)</b>	(1,978)	(1.12)
G&A expense	<b>(1,580)</b>	<b>(0.86)</b>	(1,669)	(0.94)
Other income	-	-	212	0.12
Realized gain (loss) on financial instruments <sup>(4)</sup>	<b>(1)</b>	-	-	-
<b>Funds from operations<sup>(5)</sup></b>	<b>11,671</b>	<b>6.35</b>	14,701	8.29
Basic (\$ per common share) <sup>(6)</sup>	<b>0.07</b>		0.10	
Diluted (\$ per common share) <sup>(6)</sup>	<b>0.07</b>		0.09	
Common shares outstanding (000s):				
Basic, weighted average	<b>173,818</b>		153,990	
Diluted, weighted average	<b>173,972</b>		155,300	

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

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

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

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

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

(6) 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 for the six months ended June 30, 2016 was \$17.6 million (\$0.10 per common share, diluted), compared to \$28.7 million (\$0.20 per common share, diluted) for the first six months of 2015. Oil and gas revenues declined to \$81.1 million for the six months ended June 30, 2016 resulting from a 28% decrease in per unit revenues.

<b>Six months ended June 30</b> <i>(CA\$ thousands, unless otherwise indicated)</i>	<b>2016</b>		<b>2015</b>	
	<b>Amount</b>	<b>\$/BOE</b>	<b>Amount</b>	<b>\$/BOE</b>
Oil and gas revenue	<b>81,116</b>	<b>20.49</b>	91,514	28.49
Realized gain (loss) on financial instruments <sup>(1)</sup>	<b>(21)</b>	<b>(0.01)</b>	2,081	0.65
Royalties	<b>(5,893)</b>	<b>(1.49)</b>	(9,871)	(3.07)
Production expense	<b>(38,036)</b>	<b>(9.61)</b>	(41,922)	(13.05)
Transportation expense	<b>(11,055)</b>	<b>(2.79)</b>	(8,140)	(2.54)
Operating income <sup>(2)</sup>	<b>26,111</b>	<b>6.59</b>	33,662	10.48
Financing expense <sup>(3)</sup>	<b>(5,007)</b>	<b>(1.26)</b>	(2,851)	(0.89)
G&A expense	<b>(3,467)</b>	<b>(0.88)</b>	(2,342)	(0.73)
Other income	-	-	212	0.07
Realized gain (loss) on financial instruments <sup>(4)</sup>	<b>(15)</b>	-	-	-
<b>Funds from operations<sup>(5)</sup></b>	<b>17,622</b>	<b>4.45</b>	28,681	8.93
Basic (\$ per common share) <sup>(6)</sup>	<b>0.10</b>		0.20	
Diluted (\$ per common share) <sup>(6)</sup>	<b>0.10</b>		0.20	
Common shares outstanding (000s):				
Basic, weighted average	<b>171,321</b>		141,163	
Diluted, weighted average	<b>171,444</b>		142,212	

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

(2) "Operating income" is a non-GAAP measure which is calculated by deducting royalties, production expenses and transportation expenses from oil

and gas revenue, after realized gains or losses on associated financial instruments.

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

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

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

(6) 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.

## 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 capital expenditures, including acquisitions and dispositions ("A&D"), are summarized in the following table:

<i>(CA\$ thousands, unless otherwise indicated)</i>	Three months ended June 30			Six months ended June 30		
	2016	2015	%	2016	2015	%
Capital expenditures:						
Lease acquisition and retention	1,245	684	82	1,985	6,098	-67
Geological and geophysical	160	1,065	-85	160	1,072	-85
Drilling and completion of wells	999	5,855	-83	14,330	43,447	-67
Facilities, pipeline and well equipment	4,500	11,054	-59	14,973	40,399	-63
Corporate assets	120	455	-74	128	530	-76
Capital expenditures, before A&D	7,024	19,113	-63	31,576	91,546	-66
Property acquisitions	18,884	9,674	95	18,921	14,941	27
Property dispositions	-	-	-	(1,184)	-	-
Corporate acquisition	-	314,318	-	-	314,318	-
Total capital expenditures, net of dispositions	25,908	343,105	-92	49,313	420,805	-88

The Company incurred capital expenditures, before A&D, of \$7.0 million during the quarter ended June 30, 2016, down 63% from \$19.1 million in the same quarter 2015. Kelt did not drill any wells through spring break up during the second quarter and capital expenditures were allocated primarily to land and infrastructure. Capital expenditures include costs for the scheduled turnaround of the non-operated Progress Gas Plant, as well as the expansion of the Company's facilities at Karr, including natural gas refrigeration and construction of a fuel gas supply line to a third party power generation plant in the Karr area. The Company continues to be active at land sales and spent \$1.2 million on Crown lease acquisitions during the quarter ended June 30, 2016.

### *Property acquisitions*

On April 28, 2016, the Company closed an acquisition of oil and gas assets in its core area at Progress, Alberta, for cash consideration of \$18.9 million, after closing adjustments. The acquisition includes approximately 600 BOE per day of current production (60% light oil), 4,135 net acres of land, and infrastructure that is an integral part of Kelt's existing light oil play at Progress. Further information on the Progress acquisition is contained in note 5 to the condensed interim financial statements for the period ended June 30, 2016.

### *Acquisition of Artek Exploration Ltd.*

On April 16, 2015, the Company closed the acquisition of Artek by acquiring all of the issued and outstanding common shares of Artek on the basis of 0.34 of a Kelt common share for each Artek common share, resulting in the issuance of 26,900,375 common shares of Kelt to the former shareholders of Artek. The Artek Acquisition was completed by way of a statutory plan of arrangement under the *Business Corporations Act* (Alberta), pursuant to which, Artek common shares were delisted from the TSX and Artek became a wholly-owned subsidiary of Kelt. Immediately following the Arrangement, a name change was effected to change the name of Artek to Kelt Exploration (LNG) Ltd. The acquisition of Artek consolidated the majority of Kelt's land acreage in its Inga-Fireweed-Stoddart,

British Columbia core area to 100% working interest and is consistent with the Company's strategy to operate and control all of its major core exploration and development prospects. In addition, Kelt's acquisition of Artek resulted in 100% ownership by Kelt in key infrastructure including compression facilities and pipelines in northeastern BC.

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

*(CA\$ thousands, unless otherwise indicated)*

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

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

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

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

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

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

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

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

### **CAPITAL RESOURCES AND LIQUIDITY**

Kelt's capital management objective is to maintain a flexible capital structure to allow the Company to execute on its capital investment program and strategic growth plan, which may include opportunistic acquisitions if significant upside potential exists. The Company strives to actively manage its capital structure in response to changes in economic conditions and the risk characteristics of its underlying oil and natural gas assets. As at June 30, 2016, Kelt's capital structure was comprised of shareholders' capital, convertible debentures, bank debt and working capital.

The Board of Directors approves an annual capital expenditures 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. The Company's capital expenditures in the first six months of 2016 were funded by cash provided by operating activities, the net proceeds of an equity private placement, and bank debt. Future capital expenditures are expected to be funded through a combination of cash flow from operations and bank debt, supplemented with new equity or debt offerings if required.

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

	<b>June 30, 2016</b>	December 31, 2015
Bank debt <sup>(1)</sup>	<b>126,993</b>	177,570
Working capital deficiency <sup>(1)(2)</sup>	<b>12,087</b>	35,389
Bank debt, net of working capital <sup>(2)</sup>	<b>139,080</b>	212,959
Trailing funds from operations <sup>(3)(4)</sup>	<b>46,684</b>	44,688
Net bank debt to trailing funds from operations ratio <sup>(2)</sup>	<b>3.0</b>	4.8

(1) The current portion of bank debt of \$10.0 million is included in "Bank debt" and excluded from the "Working capital deficiency",

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

(3) Funds from operations is a non-GAAP measure which is calculated as cash provided by operating activities, before transaction costs, provisions for potential credit losses, settlement of decommissioning obligations and changes in non-cash operating working capital.

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

Kelt targets a net bank debt to trailing funds from operations ratio of less than 2.0 times, however, during periods of low commodity prices, the Company may exceed this target. Despite the continued weakness in commodity prices through the first half of 2016, Kelt reduced its net bank debt to trailing funds from operations ratio from 4.8 times at December 31, 2015 to 3.0 times as at June 30, 2016. The reduction in net bank debt was achieved through the completion of strategic financing transactions including the issuance of \$90.0 million principal amount of convertible unsecured subordinated debentures with a maturity date of May 31, 2021. In addition, the Company closed a private placement of 4.7 million common shares for gross proceeds of \$22.1 million on April 7, 2016. The common shares were issued on a "flow-through" basis in respect of Canadian development expenses at a price of \$4.70 per share.

In response to the current business environment of low commodity prices, Kelt has taken action to preserve its balance sheet and maintain liquidity over the long-term. In particular, the Company has moderated the pace of capital spending and short-term growth trajectory (compared to historical levels). Kelt's management and employees continue to focus on cost saving initiatives, both corporately and at the field level. The Company expects its net bank debt to trailing funds from operations ratio will decrease to 2.5 times at December 31, 2016 (assumes \$54 million of funds from operations for 2016 and net bank debt of \$137 million at December 31, 2016). Refer to additional information under the heading of "Outlook and Guidance" and to advisories regarding forward-looking statements.

The capital intensive nature of Kelt's operations may create a working capital deficiency position during periods with high levels of capital investment. However, during such periods, the Company strives to maintain sufficient unused bank credit lines to satisfy such working capital deficiencies. As at June 30, 2016, the Company's working capital deficit, excluding current bank debt, of \$12.1 million combined with outstanding bank debt of \$127.0 million, represented 75% of the authorized borrowing amount available under the Credit Facility of \$185.0 million.

### **Credit Facility**

At June 30, 2016, the Company has a revolving committed term credit facility with a syndicate of financial institutions. As at June 30, 2016, the authorized borrowing amount available under the Credit Facility was \$185.0 million. As part of the semi-annual borrowing base review completed on May 31, 2016, all of the lenders, other than a single lender representing \$10.0 million of the total commitment amount (the "Term Lender"), agreed to extend the revolving period to April 29, 2017. The Company is obligated to pay out the Term Lender in full on April 28, 2017. The Credit Facility is available for a revolving period of 364 days, maturing on April 29, 2017, and may be extended for an additional 364 days at the discretion of the lenders, with a term-out to April 27, 2018 if not renewed.

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

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

### **Convertible debentures**

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

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

40 days prior notice at a redemption price equal to their principal amount plus accrued and unpaid interest, if any, up to but excluding the date set for redemption.

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

The liability component of the Debentures was recognized initially at the fair value of a similar liability that does not have an equity conversion option, which was calculated based on a market interest rate of 10.5%. The difference between the \$90.0 million principal amount of the Debentures and the fair value of the liability component was recognized in shareholders' equity, net of deferred income taxes. Transaction costs directly attributable to the offering of \$3.6 million were allocated to the liability and equity components of the Debentures proportionately at \$2.8 and \$0.7 million, respectively. The liability component of the Debentures is measured at amortized cost using the effective interest method and is accreted each period, such that the carrying value will equal the principal amount outstanding on the Maturity Date. The equity component is not re-measured subsequent to initial recognition. The carrying amounts of the liability and equity components of the Debentures are reclassified to shareholders' capital on conversion to common shares.

The Debentures trade on the TSX under the symbol "KEL.DB".

### Shareholder's capital

The Company is authorized to issue an unlimited number of common shares and an unlimited number of preferred shares. As at June 30, 2016 there were 174.2 million common shares issued and outstanding (as at August 9, 2016, there are 174.2 million common shares outstanding). There are no preferred shares issued or outstanding.

As at June 30, 2016, officers, directors, and employees have been granted options to purchase 8.2 million common shares of the Company at an average exercise price of \$6.64 per common share. In addition, there are 0.7 million RSUs outstanding. Options and RSUs outstanding at June 30, 2016 represented 5.1% of total common shares issued and outstanding. Additional information regarding the Company's stock options and RSUs is included in note 12 of the consolidated interim financial statements.

The Company's common shares trade on the TSX under the symbol "KEL".

### CONTRACTUAL OBLIGATIONS

As of June 30, 2016, the Company is committed to future payments under the following agreements:

<i>(CA\$ thousands)</i>	2016	2017	2018	2019	2020	Thereafter
Operating lease - office buildings	666	1,347	563	108	18	-
Operating lease - vehicles	110	178	93	13	-	-
Flow-through shares	22,090	-	-	-	-	-
Firm processing commitments	3,309	4,519	-	-	-	-
Firm transportation commitments <sup>(1)</sup>	8,963	17,396	8,866	6,582	3,606	17,579
<b>Total annual commitments</b>	<b>35,138</b>	<b>23,440</b>	<b>9,522</b>	<b>6,703</b>	<b>3,624</b>	<b>17,579</b>

(1) A portion of Kelt's commitments on the Alliance pipeline are denominated in US dollars. The volumes committed vary over the term of the contracts, which are effective until October 31, 2017, however, the maximum US denominated commitment in a given month does not exceed US\$0.31 million. Amounts are translated to Canadian dollars at the spot rate on June 30, 2016 of CA\$/US\$1.2917.

The Company has firm commitments for oil and gas transportation on major pipelines in Alberta and British Columbia. For periods subsequent to 2020, Kelt has an annual commitment of \$1.5 million for gas transportation until March 31, 2026 and an annual commitment of \$1.5 million for oil transportation until June 30, 2027.

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

## RELATED PARTY TRANSACTIONS

A director of the Company is also a partner at a law firm which Kelt has engaged to provide legal services. During the first six months ended June 30, 2016, the Company incurred \$0.5 million (2015 - \$0.4 million) in legal fees and disbursements, of which, nil is payable at June 30, 2016 (\$0.1 million at December 31, 2015). The Company expects to continue using the services of this law firm from time to time.

## OFF-BALANCE SHEET TRANSACTIONS

The Company did not engage in any off-balance sheet transactions during the periods ended June 30, 2016 and 2015.

## SUMMARY OF QUARTERLY RESULTS

<i>(CA\$ thousands, except as otherwise indicated)</i>	<b>Q2 2016</b>	Q1 2016	Q4 2015	Q3 2015
Revenue, before royalties and financial instruments	<b>40,718</b>	40,398	42,797	45,015
Funds from operations	<b>11,671</b>	5,951	11,172	16,601
Per share - basic (\$/common share)	<b>0.07</b>	0.04	0.07	0.10
Per share - diluted (\$/common share)	<b>0.07</b>	0.04	0.07	0.10
Profit (loss) and comprehensive income (loss)	<b>(20,413)</b>	(25,918)	(92,123) <sup>(1)</sup>	(21,557) <sup>(1)</sup>
Per share - basic (\$/common share)	<b>(0.12)</b>	(0.15)	(0.55) <sup>(1)</sup>	(0.13) <sup>(1)</sup>
Per share - diluted (\$/common share)	<b>(0.12)</b>	(0.15)	(0.55) <sup>(1)</sup>	(0.13) <sup>(1)</sup>
Total assets	<b>1,260,245</b>	1,268,268	1,279,475	1,362,757 <sup>(1)</sup>
Bank debt	<b>126,993</b>	214,360	177,570	147,801
Working capital deficiency <sup>(2)</sup>	<b>12,087</b>	15,930	35,389 <sup>(1)</sup>	35,320 <sup>(1)</sup>
Shareholders' equity	<b>835,241</b>	822,229	846,754 <sup>(1)</sup>	937,658 <sup>(1)</sup>
Average daily production (BOE/d)	<b>20,208</b>	23,295	20,086	18,695
Average realized price, after financial instruments (\$/BOE)	<b>22.13</b>	19.06	22.01	25.71
Operating netback (\$/BOE)	<b>8.72</b>	4.76	8.05	11.52
Netback as a percentage of revenue	<b>39%</b>	25%	37%	45%

	Q2 2015	Q1 2015	Q4 2014	Q3 2014
Revenue, before royalties and financial instruments	52,131	39,383	54,396	61,136
Funds from operations	14,701	13,980	29,668	31,984
Per share - basic (\$/common share)	0.10	0.11	0.23	0.25
Per share - diluted (\$/common share)	0.09	0.11	0.23	0.25
Profit (loss) and comprehensive income (loss)	(9,971) <sup>(1)</sup>	(16,524)	1,256	1,185
Per share - basic (\$/common share)	(0.06) <sup>(1)</sup>	(0.13)	0.01	0.01
Per share - diluted (\$/common share)	(0.06) <sup>(1)</sup>	(0.13)	0.01	0.01
Total assets	1,364,810 <sup>(1)</sup>	966,613	908,709	820,241
Bank debt	224,221	105,117	46,929	-
Working capital deficiency	27,666 <sup>(1)</sup>	33,633	57,501	37,219
Shareholders' equity	870,083 <sup>(1)</sup>	635,708	619,639	614,384
Average daily production (BOE/d)	19,473	16,005	15,559	13,872
Average realized price, after financial instruments (\$/BOE)	29.57	28.61	39.96	47.49
Operating netback (\$/BOE)	10.23	10.78	21.55	25.81
Netback as a percentage of revenue	35%	38%	54%	54%

(1) Certain comparative information has been revised, refer to information under the heading of "Capital Expenditures".

(2) The working capital deficiency excludes the current portion of bank debt.

Over the past two years, the Company has increased its production through the efficient execution of its capital program as well as by completing strategic acquisitions in its core areas, including the Artek Acquisition on April 16, 2015. In addition to cash provided by operating activities, the Company's capital expenditures were funded primarily through equity financings, and supplemented by bank debt. The fourth quarter of 2014 marked the beginning of the rapid, industry wide decline in commodity prices. The effect of which is clearly reflected in the Company's operating results and financial position in subsequent quarters. Notably, the loss reported in the fourth quarter of 2015 includes an impairment of PP&E of \$64.1 million and an impairment of goodwill of \$18.2 million, which were both triggered by the significant decrease in forecast commodity prices as at December 31, 2015. Refer to the "Results of Operations" section of this MD&A for further discussion. Additional information relating to Kelt, including the Company's MD&A for previous quarters, is filed on SEDAR and can be viewed at [www.sedar.com](http://www.sedar.com).

## 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 gains or losses on associated financial instruments. The Company refers to operating income expressed per unit of production as an "Operating netback". "Funds from operations" is calculated by adding back transaction costs associated with acquisitions and dispositions, provisions for potential credit losses, settlement of decommissioning obligations and the 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 reconciles cash provided by operating activities to funds from operations:

<i>(CA\$ thousands, except as otherwise indicated)</i>	Three months ended June 30			Six months ended June 30		
	2016	2015	%	2016	2015	%
Cash provided by operating activities	7,776	24,939	-69	7,649	37,296	-79
Transaction costs	19	2,305	-99	19	2,396	-99
Provision for potential credit losses	228	-	-	228	-	-
Settlement of decommissioning obligations	217	163	33	217	163	33
Change in non-cash working capital	3,431	(12,706)	-127	9,509	(11,174)	-185
Funds from operations	11,671	14,701	-21	17,622	28,681	-39

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

<i>(CA\$ thousands, except as otherwise indicated)</i>	Three months ended June 30			Six months ended June 30		
	2016	2015	%	2016	2015	%
Oil and gas revenue	40,718	52,131	-22	81,116	91,514	-11
Realized gain (loss) on financial instruments <sup>(1)</sup>	(21)	258	-108	(21)	2,081	-101
Royalties	(3,034)	(5,128)	-41	(5,893)	(9,871)	-40
Production expenses	(16,324)	(24,738)	-34	(38,036)	(41,922)	-9
Transportation expenses	(5,316)	(4,387)	-21	(11,055)	(8,140)	36
Operating income	16,023	18,136	-12	26,111	33,662	-22
Production (mBOE)	1,839	1,772	4	3,959	3,213	23
Operating netback (\$/BOE)	8.72	10.23	-15	6.59	10.48	-37

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



“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.

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

## **OTHER MEASUREMENTS**

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

## **SIGNIFICANT JUDGMENTS AND ESTIMATES**

The timely preparation of the financial statements requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amount of assets, liabilities, income and expenses. Actual results may differ materially from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are reviewed and for any future years affected. The significant judgments, estimates and assumptions made by management in the interim financial statements are outlined in note 2 of the December 31, 2015 annual financial statements. Except as outlined below, there have been no significant changes in the Company’s judgments and estimates applied during the interim period ended June 30, 2016 relative to those described in the most recent annual financial statements as at and for the year ended December 31, 2015.

### **Acquisition of Artek Exploration Ltd.**

In March of 2016, the British Columbia Ministry of Energy and Mining (“BC Ministry”) completed a petroleum and natural gas by-products royalty audit which resulted in Kelt recording a revision to previously reported amounts for the Artek Acquisition. Refer to the “*Capital Expenditures*” section of this MD&A for additional information regarding the revision recognized during the previous quarter ended March 31, 2016.

### **Convertible debentures**

During the quarter ended June 30, 2016, the Company issued \$90.0 million principal amount of convertible debentures that bear interest at a fixed rate of 5% per annum (refer to additional information regarding the Debentures under the heading of “*Capital Resources and Liquidity*”). Calculation of the fair value of the liability component of the Debentures requires significant judgement with respect to the determination of a market interest rate for similar debt instruments without a conversion option. A change in the market rate of interest would impact the fair value allocated to the liability and equity components on initial recognition, deferred income taxes, and subsequent finance expense related to the accretion of the liability component recorded in profit or loss. The Company’s calculation of the fair value of the liability component assumes a market interest rate of 10.5%. If the estimated market interest rate increased (decreased) by 0.5% the fair value of the liability component would decrease

(increase) by approximately \$1.5 million and the fair value of the equity component, net of deferred taxes, would increase (decrease) by approximately \$1.1 million.

## CHANGE IN CLASSIFICATION OF CERTAIN PRODUCTION AND TRANSPORTATION EXPENSES

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

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

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

## DISCLOSURE CONTROLS AND PROCEDURES

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

## 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 changes to the Company's internal controls over financial reporting during the interim period from April 1, 2016 to June 30, 2016 that have materially affected, or are reasonably likely to materially affect the Company's internal controls over financial reporting.

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

## **BUSINESS RISKS**

The business of exploration, development, production and acquisition of oil and gas reserves involves a number of uncertainties. As a result, the Company is exposed to certain business risks inherent in the oil and gas industry which may impact the Company's operations or financial results. A discussion of the significant risk factors affecting the Company is included in Kelt's Annual Information Form dated March 11, 2016 which can be found at [www.sedar.com](http://www.sedar.com).

## **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.

### **RECENT DEVELOPMENTS**

#### *Alberta Modernized Royalty Framework*

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

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

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

### **CURRENT ECONOMIC ENVIRONMENT**

The current economic environment in the energy industry continues to be volatile and uncertain. Global crude oil supplies and increasing inventories continue to exceed global demand and as a result, crude oil prices continue to be negatively affected. North American winter demand for natural gas relating to heating was lower this past winter due to milder than normal winter conditions caused by the weather pattern "El Nino" resulting in excess amounts of natural gas storage at the end of the winter. In addition, natural gas infrastructure and capacity constraints continue to impact commodity prices being realized in domestic markets relative to world markets. In addition, uncertainties

facing debt markets around the world could lead to tighter credit markets in the future. In this environment, Kelt continues to focus on maintaining a strong balance sheet, giving the Company the ability to take advantage of opportunities as they arise. The Company's capital expenditure program is also flexible, with the ability to defer expenditures into the future if the current economic environment deteriorates.

## OUTLOOK AND GUIDANCE

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

Kelt believes that the current business environment creates opportunities to add value at a reasonable cost. The cost to acquire land at Crown sales in the Company's core operating areas has dropped significantly and service related costs to drill and complete wells have also declined substantially. In order to capitalize on opportunities in the current energy business environment, Kelt expects to remain active at Crown land sales. The Company is opportunity driven and is confident that it can continue to build on its current inventory of development projects by adding new exploration prospects. As a result, the Company's Board of Directors, have increased Kelt's 2016 capital expenditures budget to \$87.0 million, up 5% from its previous budget of \$83.0 million.

The table below outlines the Company's forecasted financial and operating guidance for 2016, updated from guidance previously disclosed in the Company's interim MD&A dated May 10, 2016.

<i>(CA\$ millions, except as otherwise indicated)</i>	<b>Revised Guidance</b>	Previous Guidance	Change
Average Production			
Oil and NGLs (bbls/d)	<b>7,940</b>	7,950	0%
Gas (mmcf/d)	<b>81,360</b>	81,300	0%
Combined (BOE/d)	<b>21,500</b>	21,500	0%
Production per million common shares (BOE/d)	<b>124</b>	124	0%
Forecasted Average Commodity Prices			
WTI oil price (US\$/bbl)	<b>41.85</b>	43.25	-3%
Canadian Light Sweet (\$/bbl)	<b>50.73</b>	51.05	-1%
NYMEX natural gas price (US\$/MMBTU)	<b>2.50</b>	2.35	6%
AECO natural gas price (\$/GJ)	<b>2.10</b>	1.90	11%
Average Exchange Rate (US\$/CA\$)	<b>0.760</b>	0.772	-2%
Capital Expenditures			
Drilling & completions	<b>42.0</b>	41.0	2%
Facilities, pipeline & well equipment	<b>20.3</b>	15.0	35%
Land, seismic & property acquisitions (net of dispositions)	<b>24.7</b>	27.0	-9%
Total Capital Expenditures	<b>87.0</b>	83.0	5%
Funds from operations	<b>54.0</b>	50.0	8%
Per common share, diluted	<b>0.31</b>	0.29	7%
Bank debt, net of working capital, at year-end <sup>(1)</sup>	<b>137.0</b>	137.0	0%
Weighted average common shares outstanding (millions)	<b>172.8</b>	172.8	0%
Common shares issued and outstanding (millions)	<b>174.2</b>	174.2	0%

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

Forecast average production of 21,500 BOE per day in 2016 represents a 16% increase from average production of 18,577 BOE per day in 2015 and is estimated to be weighted 37% to oil and NGLs and 63% to gas. However, based on the Company's forecasted commodity prices for 2016, 82% of forecasted operating income in 2016 is expected to be generated from oil and NGLs versus 18% from gas.

During 2016, the Company is forecasting oil and gas prices to average WTI US\$41.85 per barrel and AECO \$2.10 per GJ, respectively. Sensitivities to changes in these prices are as follows: a 10% increase in the average WTI oil price forecast would increase funds from operations by \$7.0 million or 13%; a 10% decrease in the average WTI oil price forecast would decrease funds from operations by \$7.6 million or 14%; a 10% increase in the average AECO gas price forecast would increase funds from operations by \$7.5 million or 14%; and a 10% decrease in the average AECO gas price forecast would decrease funds from operations by \$7.8 million or 14%. The Company reviews its commodity price forecasts periodically and retains the flexibility to adjust its capital expenditure plans accordingly.

Royalties are expected to average 8.4% of oil and gas sales in 2016 (previously, 9.3%). During 2016, production and transportation expense (combined) is estimated to be \$12.62 per BOE (previously, \$12.74 per BOE), G&A expense is estimated to be \$0.89 per BOE (unchanged from previous guidance) and interest expense is forecasted at \$1.31 per BOE (unchanged from previous guidance).

After giving effect to the aforementioned production estimates, commodity price assumptions and estimated expenses: funds from operations for 2016 is forecasted to be approximately \$54.0 million or \$0.31 per common share, diluted. Kelt estimates that the Company's bank debt, net of working capital, will be approximately \$137.0 million as at December 31, 2016.

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

The information set out herein is "financial outlook" within the meaning of applicable securities laws. The purpose of this financial outlook is to provide readers with disclosure regarding Kelt's reasonable expectations as to the anticipated results of its proposed business activities for 2016. 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 11, 2016 is filed on SEDAR and can be viewed on their website at [www.sedar.com](http://www.sedar.com). Copies of the AIF can also be obtained by contacting Sadiq H. Lalani, Vice President and Chief Financial Officer at Kelt Exploration Ltd., Suite 300, 311 Sixth Avenue SW, Calgary, Alberta, Canada, T2P 3H2. Further information relating to the Company is also available on its website at [www.keltexploration.com](http://www.keltexploration.com).

On behalf of the Board of Directors,

*[signed]*

David J. Wilson  
President and Chief Executive Officer  
August 9, 2016

**KELT EXPLORATION LTD.**  
**CONSOLIDATED STATEMENT OF FINANCIAL POSITION**  
[Unaudited]

<i>(CA\$ thousands)</i>	[Notes]	<b>June 30, 2016</b>	December 31, 2015
			Revised [note 4]
<b>ASSETS</b>			
<b>Current assets</b>			
Cash and cash equivalents		<b>302</b>	870
Accounts receivable and accrued revenue	[14]	<b>24,713</b>	27,266
Prepaid expenses and deposits		<b>1,556</b>	2,129
Derivative financial instruments	[14]	<b>99</b>	-
<b>Total current assets</b>		<b>26,670</b>	30,265
Deferred income tax asset	[13]	<b>3,928</b>	-
Exploration and evaluation assets	[7]	<b>119,108</b>	124,305
Property, plant and equipment	[8]	<b>1,110,539</b>	1,124,905
<b>Total assets</b>		<b>1,260,245</b>	1,279,475
<b>LIABILITIES</b>			
<b>Current liabilities</b>			
Accounts payable and accrued liabilities		<b>35,549</b>	64,931
Derivative financial instruments	[14]	<b>78</b>	230
Deferred premium on flow-through shares	[12]	<b>2,585</b>	-
Bank debt	[9]	<b>10,000</b>	-
Decommissioning obligations	[11]	<b>545</b>	493
<b>Total current liabilities</b>		<b>48,757</b>	65,654
Bank debt	[9]	<b>116,993</b>	177,570
Convertible debentures	[10]	<b>69,320</b>	-
Decommissioning obligations	[11]	<b>151,271</b>	142,308
Deferred income tax liability	[13]	<b>38,663</b>	47,189
<b>Total liabilities</b>		<b>425,004</b>	432,721
<b>SHAREHOLDERS' EQUITY</b>			
Shareholders' capital	[12]	<b>1,047,016</b>	1,022,115
Reserve from common control transaction		<b>(57,668)</b>	(57,668)
Equity component of convertible debentures	[10]	<b>12,856</b>	-
Contributed surplus		<b>14,895</b>	17,833
Retained earnings (deficit)		<b>(181,858)</b>	(135,526)
<b>Total shareholders' equity</b>		<b>835,241</b>	846,754
<b>Total liabilities and shareholders' equity</b>		<b>1,260,245</b>	1,279,475

**Corporate Acquisition** [4]  
**Commitments** [16]

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

On behalf of the Board of Directors:

*[signed]*  
David J. Wilson, Director

*[signed]*  
Neil G. Sinclair, Director

**KELT EXPLORATION LTD.**  
**CONSOLIDATED STATEMENT OF PROFIT (LOSS) AND COMPREHENSIVE INCOME (LOSS)**  
[Unaudited]

(CA\$ thousands, except per share amounts)	[Notes]	Three months ended June 30		Six months ended June 30	
		2016	2015	2016	2015
			Revised [note 4]		Revised [note 4]
<b>Revenue</b>					
Oil and gas sales		<b>40,718</b>	52,131	<b>81,116</b>	91,514
Royalties		<b>(3,034)</b>	(5,128)	<b>(5,893)</b>	(9,871)
		<b>37,684</b>	47,003	<b>75,223</b>	81,643
<b>Expenses</b>					
Production	[18]	<b>16,324</b>	24,738	<b>38,036</b>	41,922
Transportation	[18]	<b>5,316</b>	4,387	<b>11,055</b>	8,140
Financing	[15]	<b>4,002</b>	2,685	<b>6,997</b>	4,100
General and administrative		<b>1,580</b>	1,669	<b>3,467</b>	2,342
Provision for potential credit losses	[14]	<b>228</b>	-	<b>228</b>	-
Share based compensation	[12]	<b>1,148</b>	1,874	<b>2,541</b>	4,380
Exploration and evaluation	[7]	<b>2,198</b>	947	<b>2,827</b>	1,424
Depletion and depreciation	[8]	<b>34,982</b>	37,705	<b>75,912</b>	65,738
		<b>65,778</b>	74,005	<b>141,063</b>	128,046
<b>Loss before other items and taxes</b>		<b>(28,094)</b>	(27,002)	<b>(65,840)</b>	(46,403)
Other income		-	212	-	212
Transaction costs	[4,5]	<b>(19)</b>	(2,305)	<b>(19)</b>	(2,396)
Premium on flow-through shares	[12]	-	359	-	1,938
Gain on derivative financial instruments	[14]	<b>106</b>	619	<b>215</b>	408
Gain on acquisition	[4]	-	15,910	-	15,910
Gain on sale of assets	[6]	-	190	<b>2,134</b>	190
<b>Loss before taxes</b>		<b>(28,007)</b>	(12,017)	<b>(63,510)</b>	(30,141)
Deferred income tax recovery	[13]	<b>(7,594)</b>	(2,046)	<b>(17,179)</b>	(3,646)
<b>Loss and comprehensive loss</b>		<b>(20,413)</b>	(9,971)	<b>(46,331)</b>	(26,495)
<b>Loss per common share</b>					
Basic	[12]	<b>(0.12)</b>	(0.06)	<b>(0.27)</b>	(0.19)
Diluted	[12]	<b>(0.12)</b>	(0.06)	<b>(0.27)</b>	(0.19)

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

**KELT EXPLORATION LTD.**  
**CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY**  
[Unaudited]

<i>(CA\$ thousands)</i>	[Notes]	Shareholders' capital		Reserve	Convertible debentures – equity portion	Contributed surplus	Retained earnings (deficit)	Total shareholders' equity
		Number of Shares (000s)	Amount (\$ thousands)					
Balance at December 31, 2015		168,668	1,022,115	(57,668)	-	17,833	(135,526)	846,754
Loss and comprehensive loss		-	-	-	-	-	(46,331)	(46,331)
Common shares issued:								
Private placements	[12]	4,700	22,090	-	-	-	-	22,090
Deferred premium on flow-through shares	[12]	-	(2,585)	-	-	-	-	(2,585)
Share issue costs, net of tax	[12]	-	(83)	-	-	-	-	(83)
Issuance of convertible debentures	[10]	-	-	-	12,856	-	-	12,856
Vesting of restricted share units	[12]	782	5,479	-	-	(5,479)	-	-
Share based compensation	[12]	-	-	-	-	2,541	-	2,541
<b>Balance at June 30, 2016</b>		<b>174,150</b>	<b>1,047,016</b>	<b>(57,668)</b>	<b>12,856</b>	<b>14,895</b>	<b>(181,858)</b>	<b>835,241</b>
Balance at December 31, 2014		126,934	657,102	(57,668)	-	14,692	5,513	619,639
Loss and comprehensive loss		-	-	-	-	-	(26,495)	(26,495)
Common shares issued:								
Private placements	[12]	3,881	33,380	-	-	-	-	33,380
Deferred premium on flow-through shares	[12]	-	(2,872)	-	-	-	-	(2,872)
Pursuant to corporate acquisition	[4]	26,900	242,641	-	-	-	-	242,641
Share issue costs, net of tax	[12]	-	(590)	-	-	-	-	(590)
Vesting of restricted share units	[12]	708	4,581	-	-	(4,581)	-	-
Share based compensation	[12]	-	-	-	-	4,380	-	4,380
Balance at June 30, 2015		158,423	934,242	(57,668)	-	14,491	(20,982)	870,083

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



**KELT EXPLORATION LTD.**  
**CONSOLIDATED STATEMENT OF CASH FLOWS**  
[Unaudited]

(CA\$ thousands)	[Notes]	Three months ended June 30		Six months ended June 30	
		2016	2015	2016	2015
<b>Operating activities</b>					
Loss and comprehensive loss		(20,413)	(9,971)	(46,331)	(26,495)
Items not affecting cash:					
Accretion of convertible debentures	[10,15]	487	-	487	-
Accretion of decommissioning obligations	[11,15]	744	707	1,503	1,249
Share based compensation		1,148	1,874	2,541	4,380
Exploration and evaluation		2,198	947	2,827	1,424
Depletion and depreciation		34,982	37,705	75,912	65,738
Premium on flow-through shares		-	(359)	-	(1,938)
Unrealized (gain) loss on derivative financial instruments	[14]	(128)	(361)	(251)	1,673
Gain on acquisition	[4]	-	(15,910)	-	(15,910)
Gain on sale of assets		-	(190)	(2,134)	(190)
Deferred income tax recovery		(7,594)	(2,046)	(17,179)	(3,646)
Settlement of decommissioning obligations		(217)	(163)	(217)	(163)
Change in non-cash operating working capital	[17]	(3,431)	12,706	(9,509)	11,174
<b>Cash provided by operating activities</b>		<b>7,776</b>	<b>24,939</b>	<b>7,649</b>	<b>37,296</b>
<b>Financing activities</b>					
Increase (decrease) in bank debt		(87,367)	119,104	(50,577)	177,292
Issue of common shares, net of costs	[12]	21,976	(243)	21,976	32,575
Issue of convertible debentures, net of costs	[10]	86,444	-	86,444	-
<b>Cash provided by financing activities</b>		<b>21,053</b>	<b>118,861</b>	<b>57,843</b>	<b>209,867</b>
<b>Investing activities</b>					
Exploration and evaluation assets		(1,405)	(1,752)	(11,189)	(16,539)
Property, plant and equipment		(5,619)	(17,361)	(20,387)	(75,007)
Property acquisitions	[5]	(18,884)	(9,674)	(18,921)	(14,941)
Property dispositions	[6]	-	-	1,184	-
Corporate acquisition	[4]	-	(95,839)	-	(95,839)
Change in non-cash investing working capital	[17]	(2,916)	(18,538)	(16,747)	(44,561)
<b>Cash used in investing activities</b>		<b>(28,824)</b>	<b>(143,164)</b>	<b>(66,060)</b>	<b>(246,887)</b>
<b>Net change in cash and cash equivalents</b>		<b>5</b>	<b>636</b>	<b>(568)</b>	<b>276</b>
<b>Cash and cash equivalents, beginning of period</b>		<b>297</b>	<b>689</b>	<b>870</b>	<b>1,049</b>
<b>Cash and cash equivalents, end of period</b>		<b>302</b>	<b>1,325</b>	<b>302</b>	<b>1,325</b>

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

**KELT EXPLORATION LTD.**  
**NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS**  
**AS AT AND FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2016**  
[Unaudited]

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

**1. DESCRIPTION OF THE BUSINESS**

Kelt Exploration Ltd. (“Kelt” or the “Company”) is an oil and gas company based in Calgary, Alberta, focused on the exploration, development and production of crude oil and natural gas resources, primarily in west central Alberta and northeastern British Columbia. The Company was incorporated under the *Business Corporations Act* (Alberta) on October 11, 2012 as 1705972 Alberta Ltd. and was inactive until February 26, 2013. On October 19, 2012, Articles of Amendment were filed to change the name of the Company to Kelt Exploration Ltd. The Company’s common shares and 5% convertible debentures are listed on the Toronto Stock Exchange (“TSX”) under the symbol “KEL” and “KEL.DB”, respectively.

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

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

**2. BASIS OF PRESENTATION**

These condensed consolidated interim financial statements were approved and authorized for issue by the Company’s Board of Directors on August 9, 2016.

**a) Statement of compliance**

The Company prepares its financial statements in accordance with Canadian generally accepted accounting principles (“GAAP”) as set out in the *CPA Canada Handbook - Accounting*. These condensed consolidated interim financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”), as issued by the International Accounting Standards Board (“IASB”), applicable to the preparation of interim financial statements, including IAS 34 Interim Financial Reporting. Certain disclosures included in the notes to the annual financial statements have been condensed in the following note disclosures or have been disclosed on an annual basis only. Accordingly, these condensed consolidated interim financial statements should be read in conjunction with the audited consolidated annual financial statements as at and for the year ended December 31, 2015.

**b) Basis of measurement**

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

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 14 of these financial statements.

**c) Significant judgments and estimates**

The timely preparation of the financial statements requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amount of assets, liabilities, income and expenses. Actual results may differ materially from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are reviewed and for any future years affected. Significant judgments, estimates and assumptions made by management in these financial statements are outlined in note 2 of the December 31, 2015 consolidated annual financial statements. Except as outlined below, there have been no significant changes in the Company's judgments and estimates applied during the interim period ended June 30, 2016 relative to those described in the most recent annual financial statements as at and for the year ended December 31, 2015.

#### **Acquisition of Artek Exploration Ltd.**

In March of 2016, the British Columbia Ministry of Energy and Mining ("BC Ministry") completed a petroleum and natural gas by-products royalty audit which resulted in Kelt recording a revision to previously reported amounts for the Artek Acquisition. Refer to note 4 for additional information regarding the revision recognized during the previous quarter ended March 31, 2016.

#### **Convertible debentures**

During the quarter ended June 30, 2016, the Company issued \$90.0 million principal amount of 5% convertible unsecured subordinated debentures (the "Debentures"). Calculation of the fair value of the liability component of the Debentures requires significant judgement with respect to the determination of a market interest rate for similar debt instruments without a conversion option. A change in the market rate of interest would impact the fair value allocated to the liability and equity components on initial recognition, deferred income taxes, and subsequent finance expense related to the accretion of the liability component recorded in profit or loss. Further details on the Debentures are contained in note 10.

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

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

The significant accounting policies applied by the Company are described in note 3 of the December 31, 2015 consolidated annual financial statements. Except as outlined below, these condensed consolidated interim financial statements have been prepared following the same accounting policies and methods of computation as the most recent consolidated annual financial statements as at and for the year ended December 31, 2015.

Income tax expense for an interim period is based on an estimated average annual effective income tax rate.

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

The IASB has issued accounting standards that are not yet effective, including: IFRS 15 *Revenue from Contracts with Customers*; IFRS 9 *Financial Instruments*; and IFRS 16 *Leases*. Details of the foregoing are outlined in note 3 of the December 31, 2015 consolidated annual financial statements. There have been no changes as of the date of these condensed interim financial statements. The evaluation of all potential measurement and disclosure impacts is ongoing.

#### 4. CORPORATE ACQUISITION

##### *Acquisition of Artek Exploration Ltd.*

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

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

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

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

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

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

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

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

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

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

Comparative figures have been revised to reflect all measurement period adjustments as at the acquisition date of April 16, 2015. Accordingly, the gain on acquisition previously reported for the three and six months ended June 30, 2015 has been reduced by \$2.6 million of cumulative adjustments to the allocation of the purchase price.

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

## 5. PROPERTY ACQUISITIONS

The following table summarizes the aggregate fair value of net assets acquired pursuant to property acquisitions completed during the interim period ended June 30, 2016 and the previous year ended December 31, 2015:

	<b>June 30, 2016</b>	December 31, 2015
Exploration and evaluation assets	<b>252</b>	264
Property, plant and equipment	<b>18,916</b>	16,714
Decommissioning obligations	<b>(247)</b>	(628)
<b>Fair value of net assets acquired<sup>(1)</sup></b>	<b>18,921</b>	16,350
<b>Cash consideration, after closing adjustments<sup>(1)</sup></b>	<b>18,921</b>	16,350

(1) The fair values allocated to the net assets acquired were estimated based on information available at the time of preparation of these interim financial statements. The amount of cash consideration, after closing adjustments, was estimated based on an interim statement of adjustments. The actual amounts ultimately recognized by the Company upon finalizing the accounting for the property acquisition may differ from these estimates.

On April 28, 2016, the Company closed the acquisition of oil and gas assets in its core area at Progress, Alberta, for cash consideration of \$18.9 million, after closing adjustments. The purchase price was adjusted for the results of operations between the effective date of January 1, 2016 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.

## 6. PROPERTY DISPOSITIONS

On March 31, 2016, Kelt completed a minor disposition of certain non-core assets located in northwestern Alberta for cash proceeds of \$1.1 million, before closing adjustments, resulting in a gain on sale of approximately \$2.1 million.

The carrying value of assets and associated decommissioning obligations disposed during the six month period ended June 30, 2016 and previous year ended December 31, 2015, are summarized below.

	June 30, 2016	December 31, 2015
Exploration and evaluation assets	(21)	-
Property, plant and equipment	(1,367)	-
Decommissioning obligations	2,338	190
<b>Carrying value of net (assets) liabilities disposed</b>	<b>950</b>	<b>190</b>
<b>Cash proceeds, after closing adjustments<sup>(1)</sup></b>	<b>1,184</b>	<b>-</b>
<b>Gain on sale of assets<sup>(1)</sup></b>	<b>2,134</b>	<b>190</b>

(1) The amounts reported in the table above were estimated based on information available at the time of preparation of these interim financial statements. In particular, closing adjustments were estimated based on an interim statement of adjustments. The actual gain on sale of assets ultimately recognized by the Company upon determination of final closing adjustments may differ from this estimate.

## 7. EXPLORATION AND EVALUATION ASSETS

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

The following table reconciles movements of exploration and evaluation assets:

	June 30, 2016	December 31, 2015
Balance, beginning of year	124,305	79,294
Additions	11,189	43,555
Corporate acquisition [note 4]	-	52,340
Property acquisitions [note 5]	252	264
Property dispositions [note 6]	(21)	-
Transfers to property, plant and equipment	(13,790)	(40,674)
Expired mineral leases	(2,827)	(3,117)
Impairments	-	(7,357)
<b>Balance, end of period</b>	<b>119,108</b>	<b>124,305</b>

The Company reviewed its E&E assets for indicators of potential impairment as at June 30, 2016. Except for \$2.8 million of costs associated with the expiry of mineral leases which have been recognized as an expense during the six months ended June 30, 2016, the Company concluded that there are no indicators of potential impairment of its E&E assets at June 30, 2016.

## 8. PROPERTY, PLANT AND EQUIPMENT

	June 30, 2016	December 31, 2015
Net carrying value		
Development and production (“D&P”) assets	1,110,082	1,124,180
Corporate assets	457	725
<b>Total net carrying value of property, plant and equipment</b>	<b>1,110,539</b>	<b>1,124,905</b>

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

Property, plant and equipment, at cost	D&P Assets	Corporate Assets	Total PP&E
Balance at December 31, 2014	899,407	1,028	900,435
Additions	122,240	810	123,050
Corporate acquisition [note 4]	346,014	-	346,014
Property acquisitions [note 5]	16,714	-	16,714
Decommissioning costs	33,173	-	33,173
Transfers from E&E	40,674	-	40,674
<b>Balance at December 31, 2015</b>	<b>1,458,222</b>	<b>1,838</b>	<b>1,460,060</b>
Additions	20,259	128	20,387
Property acquisitions [note 5]	18,916	-	18,916
Property dispositions [note 6]	(4,748)	-	(4,748)
Decommissioning costs	9,820	-	9,820
Transfers from E&E	13,790	-	13,790
<b>Balance at June 30, 2016</b>	<b>1,516,259</b>	<b>1,966</b>	<b>1,518,225</b>

Accumulated depletion, depreciation and impairment	D&P Assets	Corporate Assets	Total PP&E
Balance at December 31, 2014	129,456	495	129,951
Depletion and depreciation expense	140,518	618	141,136
Impairments	64,068	-	64,068
<b>Balance at December 31, 2015</b>	<b>334,042</b>	<b>1,113</b>	<b>335,155</b>
Depletion and depreciation expense	75,516	396	75,912
Property dispositions [note 6]	(3,381)	-	(3,381)
<b>Balance at June 30, 2016</b>	<b>406,177</b>	<b>1,509</b>	<b>407,686</b>

There were no borrowing costs capitalized in the current or prior year, as the Company did not have any qualifying assets. Future capital costs required to develop proved reserves in the amount of \$545.1 million (December 31, 2015 - \$531.2 million) are included in the depletion calculation for development and production assets.

As a result of the significant decrease in forecast oil and natural gas prices during the previous year, the Company completed an impairment test for all cash generating units (“CGUs”) as at December 31, 2015 and recognized an impairment of PP&E of \$64.1 million and an impairment of the full goodwill balance of \$18.2 million. As at June 30, 2016, the Company reviewed each CGU for indicators of possible impairment and concluded that there were no indicators of impairment during the interim reporting period.

## 9. BANK DEBT

	June 30, 2016	December 31, 2015
Bank loan	8,700	5,800
Bankers’ acceptances	119,300	172,800
Unamortized financing fees <sup>(1)</sup>	(1,007)	(1,030)
<b>Bank debt</b>	<b>126,993</b>	<b>177,570</b>
Bank debt – current	10,000	-
Bank debt – non-current	116,993	177,570

(1) Includes \$0.5 million of prepaid interest and stamping fees on bankers’ acceptances as at June 30, 2016 (\$0.6 million as at December 31, 2015).

The Company has a revolving committed term credit facility (“the Credit Facility”) with a syndicate of financial institutions. As at June 30, 2016, the authorized borrowing amount available under the Credit Facility was \$185.0 million. As part of the semi-annual borrowing base review completed on May 31, 2016, all of the lenders, other than a single lender representing \$10.0 million of the total commitment amount (the “Term Lender”), agreed to extend the revolving period to April 29, 2017. The Company is obligated to pay out the Term Lender in full on April 28, 2017. The Credit Facility is available for a revolving period of 364 days, maturing on April 29, 2017, and may be extended for an additional 364 days at the discretion of the lenders, with a term-out to April 27, 2018 if not renewed.

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

There are no financial covenants under the Credit Facility and Kelt is in compliance with all other covenants. Covenants include industry standard positive and negative covenants including reporting requirements, permitted indebtedness, permitted dispositions (to a maximum in each calendar year which are in the aggregate not more than 5% of the borrowing base then in effect), permitted risk management activities (as more particularly described in note 14), permitted encumbrances and other standard business operating covenants. Security is provided for by a first fixed and floating charge debenture over all assets in the amount of \$800.0 million and general assignment of book debts.

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

#### 10. CONVERTIBLE DEBENTURES

	Number of convertible debentures	Liability component (\$ thousands)	Equity Component (\$ thousands)
Balance at December 31, 2015	-	-	-
Issuance of convertible debentures	<b>90,000</b>	<b>71,665</b>	<b>18,335</b>
Issue costs	-	<b>(2,832)</b>	<b>(724)</b>
Deferred income tax liability	-	-	<b>(4,755)</b>
Accretion of discount	-	<b>487</b>	-
<b>Balance at June 30, 2016</b>	<b>90,000</b>	<b>69,320</b>	<b>12,856</b>

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

The Debentures are redeemable by the Company after May 31, 2019 and prior to May 31, 2020, in whole or in part, from time to time, on not more than 60 days and not less than 40 days prior notice at a redemption price equal to their principal amount plus accrued and unpaid interest, if any, up to but excluding the date set for redemption, provided



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

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

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

Accretion of the liability component and accrued interest payable on the Debentures are included in financing expenses in the Statement of Profit (Loss) and Comprehensive Income (Loss) (note 15). At June 30, 2016, the fair value of the Debentures was \$102.8 million (note 14).

## 11. 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:

	June 30, 2016	December 31, 2015
Balance, beginning of year	142,801	94,791
Obligations incurred	254	1,807
Obligations acquired <sup>(1)</sup> [note 4,5]	247	12,594
Obligations disposed [note 6]	(2,338)	(190)
Obligations settled	(217)	(383)
Changes in discount rate <sup>(1)</sup>	9,360	33,664
Revisions to estimates	206	(2,298)
Accretion expense	1,503	2,816
Balance, end of period	151,816	142,801
Decommissioning obligations – current	545	493
Decommissioning obligations – non-current	151,271	142,308

(1) Decommissioning obligations acquired as part of a business combination are initially measured at fair value using a credit-adjusted risk-free rate to discount estimated future cash outflows. The revaluation of obligations acquired using the risk-free rate at the end of the period results in an increase in the present value of the obligation reported in the Statement of Financial Position. Revaluation of the decommissioning obligations associated with the assets acquired at Progress, Alberta (note 5), resulted in a change in estimate of \$1.6 million recorded in the second quarter of 2016.

The key assumptions on which the carrying amount of the decommissioning obligations is based, include a risk-free rate of 2.0% (December 31, 2015 - 2.2%) and an inflation rate of 2.0% (December 31, 2015 - 2.0%). The underlying cost estimates are derived from a combination of published industry benchmarks as well as site specific information. As at June 30, 2016, the undiscounted amount of the estimated cash flows required to settle the obligation is \$150.4 million (December 31, 2015 - \$150.6 million), and is expected to be incurred over the next 50 years.

Accretion of the decommissioning obligation due to the passage of time is presented within financing expenses in the Statement of Profit (Loss) and Comprehensive Income (Loss) (note 15).

## 12. 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.

There are no preferred shares issued or outstanding as of June 30, 2016 (December 31, 2015 - nil).

### Common share offerings

During the second quarter of 2016, the Company completed non-brokered private placements of 4.7 million flow-through common shares at a price of \$4.70 per flow-through common share, resulting in gross proceeds of \$22.1 million. The implied premium on the flow-through shares was determined to be \$2.6 million or \$0.55 per flow-through share, assuming a market price of \$4.15 per ordinary common share. Certain directors and officers of the Company subscribed to purchase 0.2 million flow-through common shares for gross proceeds of \$0.9 million. Pursuant to the provisions of the *Income Tax Act* (Canada), the Company shall incur eligible Canadian development expenses (the "Qualifying Expenditures") after the respective closing dates and prior to December 31, 2016 in the aggregate amount of not less than the total gross proceeds raised from the offering. As of June 30, 2016, the Company had not incurred Qualifying Expenditures, leaving \$22.1 million of Qualifying Expenditures to be incurred in the balance of 2016.

During the first quarter of 2015, the Company completed non-brokered private placements of 3.881 million flow-through shares at a price of \$8.60 per flow-through share, resulting in aggregate gross proceeds of \$33.4 million. The implied premium on the flow-through shares was determined to be \$2.9 million or \$0.74 per flow-through share. Pursuant to the provisions of the *Income Tax Act* (Canada), the Company incurred eligible Canadian development expenses and renounced the qualifying expenditures to the subscribers of the flow-through shares on or before December 31, 2015, as required under the subscription agreements. The Company had fully satisfied its obligations and incurred the full commitment of \$33.4 million as of December 31, 2015.

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

### Stock options

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

The following table summarizes the change in stock options outstanding:

	Number of Options (000s)	Average Exercise Price (\$/share)
Balance at December 31, 2014	4,927	8.38
Granted	1,845	4.85
Forfeited	(82)	9.32
Balance at December 31, 2015	<b>6,690</b>	<b>7.40</b>
Granted	<b>2,083</b>	<b>4.56</b>
Forfeited	<b>(557)</b>	<b>7.94</b>
<b>Balance at June 30, 2016</b>	<b>8,216</b>	<b>6.64</b>

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

	Six months ended June 30	
	2016	2015
Risk free interest rate	<b>0.6%</b>	0.6%
Expected life (years)	<b>3.6</b>	3.0
Expected volatility <sup>(1)</sup>	<b>51.8%</b>	39.9%
Expected dividend yield	<b>0.0%</b>	0.0%
Expected forfeiture rate	<b>2.0%</b>	3.1%
Fair value of options granted during the year (\$/share)	<b>1.71</b>	2.26

(1) The expected volatility for options granted during the six months ended June 30, 2016 was estimated based on Kelt's historical volatility. The expected volatility for options granted during the six months ended June 30, 2015 was estimated based on Kelt's historical volatility and a peer group average for junior/intermediate oil and gas companies, given there was no stock price history for the Company prior to the listing of KEL shares on March 1, 2013.

The following table summarizes information regarding stock options outstanding at June 30, 2016:

Range of exercise prices per common share	Number of options outstanding (000s)	Weighted average remaining term (years)	Weighted average exercise price for options outstanding (\$/share)	Number of options exercisable (000s)	Weighted average exercise price for options exercisable (\$/share)
\$0.00 to \$5.00	3,605	4.7	4.48	33	4.38
\$5.01 to \$10.00	3,517	2.5	7.02	2,517	6.84
\$10.01 to \$15.00	1,034	2.8	12.39	686	12.39
\$15.01 to \$20.00	60	3.0	15.40	40	15.40
<b>Total</b>	<b>8,216</b>	<b>3.5</b>	<b>6.64</b>	<b>3,276</b>	<b>8.08</b>

### Restricted share units

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

The following table summarizes the change in RSUs outstanding:

	Number of RSUs (000s)
Balance at December 31, 2014	1,762
Granted	247
Released upon vesting	(778)
Forfeited	(27)
Balance at December 31, 2015	<b>1,204</b>
Granted	<b>301</b>
Released upon vesting	<b>(782)</b>
Forfeited	<b>(54)</b>
<b>Balance at June 30, 2016</b>	<b>669</b>

### Share based compensation expense

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

	Three months ended June 30		Six months ended June 30	
	2016	2015	2016	2015
Stock options	807	1,004	1,672	2,335
Restricted share units	341	870	869	2,045
Total share based compensation expense	1,148	1,874	2,541	4,380

### Per share amounts

The table below summarizes the weighted average number of common shares outstanding. The Company uses the treasury stock method to determine the dilutive effect of stock options and RSUs. Under this method, only “in-the-money” dilutive instruments impact the calculation of diluted profit per common share. Accordingly, in computing the diluted loss per common share for the each of the three and six month periods ended June 30, 2016 and 2015, respectively, the Company excluded the effect of stock options and RSUs as they were anti-dilutive.

<i>(000s of common shares)</i>	Three months ended June 30		Six months ended June 30	
	2016	2015	2016	2015
Weighted avg. common shares outstanding, basic	173,818	153,990	171,321	141,163
Effect of stock options and RSUs	154	1,310	123	1,049
Effect of convertible debentures	-	-	-	-
Weighted avg. common shares outstanding, diluted	173,972	155,300	171,444	142,212

The calculation of weighted average diluted common shares outstanding excludes the effect of potentially issuable common shares on conversion of the Debentures for the three and six months ended June 30, 2016.

### 13. INCOME TAXES

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 (Loss) and Comprehensive Income (Loss):

	Three months ended June 30		Six months ended June 30	
	2016	2015	2016	2015
Loss before income taxes	(28,007)	(12,017)	(63,510)	(30,141)
Canadian statutory tax rate <sup>(1)</sup>	26.6%	26.0%	26.6%	26.0%
Expected income tax recovery	(7,450)	(3,124)	(16,894)	(7,837)
Increase (decrease) resulting from:				
Non-deductible expenses <sup>(2)</sup>	317	1,110	695	1,764
Recognition of unrecognized deferred tax asset	(514)	(512)	(1,028)	(990)
Qualifying expenditures on flow-through shares	-	1,358	-	4,450
Premium on flow-through shares	-	(108)	-	(504)
Change in tax rates	-	4,516	-	4,697
True-up of tax pools	53	(1,149)	48	(1,090)
Gain on acquisition	-	(4,137)	-	(4,136)
Deferred income tax recovery	(7,594)	(2,046)	(17,179)	(3,646)

(1) The Canadian statutory tax rate used in the rate reconciliation represents the combined federal and provincial corporate tax rate. The federal corporate tax rate is 15.0% and the provincial tax rate is 11.0% in British Columbia. Effective July 1, 2015, the Alberta government increased the general corporate tax rate from 10% to 12%.

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

Kelt was not required to pay income taxes in the current or prior periods as the Company had sufficient income tax deductions available to shelter taxable income. Tax deductions available as of June 30, 2016 are estimated to be approximately \$994.3 million (December 31, 2015 - \$958.0 million).

	June 30, 2016	December 31, 2015
Deferred income tax asset	3,928	-
Deferred income tax liability	(38,663)	(47,189)
<b>Net deferred income tax asset (liability)</b>	<b>(34,735)</b>	<b>(47,189)</b>

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

	Balance at December 31, 2015	Recognized in profit and CI <sup>(1)</sup>	Recognized in balance sheet	Balance at June 30, 2016
Deferred income tax asset (liability)				
Derivative financial instruments	62	(68)	-	(6)
PP&E and E&E	(136,416)	(180)	-	(136,596)
Decommissioning obligations	38,015	2,393	-	40,408
Convertible debentures	-	36	(4,755)	(4,719)
Share and bank debt issue costs	4,364	(796)	30	3,598
Reserve from common control transaction	(9,168)	1,028	-	(8,140)
Non-capital losses <sup>(2)</sup>	55,954	14,766	-	70,720
	(47,189)	17,179	(4,725)	(34,735)

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

(2) The Company's non-capital losses expire in years 2023 to 2035.

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

#### 14. 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, Debentures, and bank debt. The Company is exposed to financial risks arising from its financial assets and liabilities that include credit and liquidity risk in addition to the market risks associated with commodity prices, and interest and foreign exchange rates. Profit (loss), cash flows and the fair value of financial assets and liabilities may fluctuate due to movement in market prices or as a result of the Company's exposure to credit and liquidity risks.

The Company uses derivative financial instruments from time to time in order to manage market risks. The objective of market risk management is to manage and control market risk exposures within acceptable limits, while maximizing long-term returns. All such transactions are conducted in accordance with the Company's established risk management policies that permit management to enter into commodity price agreements, provided that:

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

Gains (losses) on the Company's risk management contracts are summarized as follows:

	Three months ended June 30		Six months ended June 30	
	2016	2015	2016	2015
Realized gain (loss)	(22)	258	(36)	2,081
Unrealized gain (loss)	128	361	251	(1,673)
Gain on derivative financial instruments	106	619	215	408

### Commodity price risk management contracts

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

During the quarter ended June 30, 2016, the Company entered into financial derivative contracts to fix the basis differential between certain natural gas reference prices.

Remaining Term	Notional Volume	Reference Prices	Fixed Contract Price	Fair value Asset (Liability)
July to October 2016	10,000 MMBTU/d	Chicago Monthly Index AECO 7A	Chicago Monthly Index minus US\$0.96 per MMBTU	99
September to October 2016	30,000 MMBTU/d	NYMEX Henry Hub AECO 5A	NYMEX Henry Hub minus US\$0.94 per MMBTU	(11)

The fair values of these derivative contracts are sensitive to changes in the natural gas reference prices:

- If the Chicago-AECO 7A basis differential increased (decreased) by \$0.10/MMBTU, the fair market value of contract would increase (decrease) by approximately \$0.1 million.
- If the NYMEX-AECO 5A basis differential increased (decreased) by \$0.10/MMBTU, the fair market value of contract would increase (decrease) by approximately \$0.2 million.

### Interest rate risk management contracts

The Company is exposed to interest rate risk to the extent that changes in market interest rates will impact the Company's Credit Facility which is subject to a floating interest rate. Kelt had the following interest rate risk management contracts outstanding as of June 30, 2016:

Contract Type	Notional Amount	Reference Price	Fixed Contract Price	Remaining Term	Fair value Asset (Liability)
Interest Rate Swap	\$100,000,000	CDOR	0.925%	July 1, 2016 to June 30, 2017	(67)

The fair value of the interest rate swap is sensitive to changes in the Canadian Dollar Offered Rate ("CDOR"). If the CDOR rate increases (decreases) by 10 basis points, the fair market value of the contract would increase (decrease) by approximately \$0.1 million.

### Foreign exchange risk management contracts

Kelt is exposed to fluctuations of the Canadian to U.S. dollar exchange rate given realized pricing is directly influenced by U.S. dollar denominated benchmark pricing. The Company also has commitments for firm gas transportation service under contracts denominated in U.S. dollars as outlined in note 16. Exposure to foreign exchange rates is mitigating by entering U.S. dollar denominated commodity price or foreign exchange derivative financial instruments.

The Company did not have any U.S. dollar denominated commodity price contracts or foreign exchange contracts outstanding during the period ended or as at June 30, 2016.

Subsequent to the quarter ended June 30, 2016, the Company entered a forward foreign exchange swaption contract whereby the counterparty has the right, if exercised on December 30, 2016, to enter a series of forward foreign exchange transactions fixing the exchange rate at CA\$/US\$1.33 from January to December 2017, on a notional amount of US\$1.0 million per month. In consideration for the swaption, Kelt received a cash premium of \$0.255 million at the time of entering into the contract.

### Fair value measurements

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

- Level 1 - Values are based on unadjusted quoted prices available in active markets for identical assets or liabilities as of the reporting date.
- Level 2 - Values are based on inputs, including quoted forward prices for commodities, time value and volatility factors, which can be substantially observed or corroborated in the marketplace. Prices in Level 2 are either directly or indirectly observable as of the reporting date.
- Level 3 - Values are based on prices or valuation techniques that are not based on observable market data.

Assessment of the significance of a particular input to the fair value measurement requires judgment and may affect the placement within the fair value hierarchy.

The fair value of cash and cash equivalents, accounts receivable and accrued revenue, deposits, accounts payable and accrued liabilities approximate their carrying value due to the short term to maturity of these instruments. Bank debt bears interest at a floating market rate and accordingly the fair market value of bank debt approximates the carrying amount.

The fair value of the convertible debentures is estimated using quoted market prices on the TSX as of the Statement of Financial Position date.

The fair value of financial assets and liabilities, excluding working capital, is attributable to the following fair value hierarchy levels at June 30, 2016:

	Carrying value ("CV")			Fair Value		
	Gross	Netting <sup>(1)</sup>	Net CV	Level 1	Level 2	Level 3
<b>Financial assets</b>						
Derivative financial instruments	99	-	99	-	99	-
<b>Financial liabilities</b>						
Derivative financial instruments	78	-	78	-	78	-
Convertible debentures <sup>(2)</sup>	69,320	-	69,320	102,753	-	-

(1) Financial assets and liabilities are only offset if the Company has the current legal right to offset and intends to settle on a net basis or settle the asset and liability simultaneously. Kelt offsets derivative contracts assets and liabilities when the counterparty, commodity, currency and timing of settlement are the same. As at June 30, 2016, there are no offsetting derivative financial contracts.

(2) The fair value of the convertible debentures is based on the closing market price on the TSX of 114.17 per debenture as at June 30, 2016, and represents the market value of the entire instrument.

### Credit Risk

As at June 30, 2016, the carrying amount of cash and cash equivalents, derivative financial instrument assets, accounts receivable and accrued revenue, and deposits represent the Company's maximum credit exposure. Cash and cash equivalents are held on deposit with a Canadian chartered bank. The Company's credit risk exposure arises primarily from receivables from oil and gas marketers and joint venture partners.

During the quarter ended June 30, 2016, sales to four oil and gas marketers each individually represented more than 10% of total revenue. Sales to these marketers account for approximately 40%, 18%, 11%, and 11% of total revenue, respectively. During the previous year ended December 31, 2015, sales to five oil and gas marketers accounted for approximately 23%, 17%, 15%, 13% and 11% of total revenue, respectively. Kelt has secured parental guarantees (with terms ranging from two to five years) or letters of credit covering approximately 75% its monthly credit exposure from oil and gas marketers, calculated based on average sales by purchaser for the second quarter of 2016.

Credit risk from joint venture receivables is mitigated by obtaining partner approval of significant capital expenditures prior to expenditure and in certain circumstances may require cash deposits in advance of incurring financial obligations on behalf of joint venture partners. The Company has the ability to withhold production from joint venture partners in the event of non-payment or may be able to register security on the assets of joint venture partners.

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

The ageing of the Company's accounts receivable is summarized in the following table:

Accounts receivable and accrued revenue	Current	30-60 days	60-90 days	Over 90 days	Total
<b>Balance at June 30, 2016</b>	<b>19,483</b>	<b>2,734</b>	<b>1,083</b>	<b>1,413</b>	<b>24,713</b>
Balance at December 31, 2015	23,071	1,836	783	1,576	27,266

The balance of accounts receivable outstanding for more than 90 days relates primarily to receivables from the Company's joint venture partners. Due to the current business environment and low commodity prices, many oil and gas companies, including some of Kelt's partners, are facing significant financial challenges. Management has reviewed past due accounts receivable balances as at June 30, 2016 and expects the accounts to be collectible, except for approximately \$1.2 million of accounts receivable which are provided for in the allowance for doubtful accounts.

	June 30, 2016	December 31, 2015
Allowance for doubtful accounts, beginning of year	1,002	-
Provisions recognized in balance sheet	-	391
Provisions for potential credit losses through profit or loss	228	611
Allowance for doubtful accounts, end of period	1,230	1,002

## Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they are due. The Company's financial liabilities include accounts payable, derivative financial instruments, bank debt and convertible debentures. The Company manages liquidity risk through prudent use of bank debt and an actively managed production and capital expenditure budgeting process.

The table below outlines a contractual maturity analysis for Kelt's financial liabilities as at June 30, 2016:

	Within 1 Year	1 to 5 Years	More than 5 Years	Total
Accounts payable and accrued liabilities	35,549	-	-	35,549
Derivative financial instrument liability	78	-	-	78
Bank debt and estimated interest <sup>(1)</sup>	15,682	122,379	-	138,061
Convertible debentures <sup>(2)</sup>	4,845	108,000	-	112,845
<b>Total</b>	<b>56,154</b>	<b>230,379</b>	<b>-</b>	<b>286,533</b>

(1) Estimated interest for future periods related to the Credit Facility was calculated using the weighted average interest rate of 4.5% for the second quarter ended June 30, 2016, applied to the principal balance outstanding as at that date. Principal repayment of \$10.0 million to the Term Lender under Credit Facility is assumed on April 28, 2017, with the remaining repayment assumed to occur on April 27, 2018.

(2) The contractual maturity analysis includes semi-annual cash interest payments at the fixed coupon rate of 5.0%, assuming that the \$90.0 million principal amount of the Debentures is outstanding for the full term to maturity on May 31, 2021, provided that: the equity conversion option is not first exercised by the holder; and that the Company does not elect to settle its financial obligation by issuing common shares instead of cash at redemption or maturity. Refer to additional information regarding the Debentures in note 10.



As at June 30, 2016, the Company's working capital deficit of \$12.1 million (excluding current bank debt) combined with outstanding bank debt of \$127.0 million, represented 75% of the authorized borrowing amount available under the Credit Facility of \$185.0 million. The Company is obligated to repay \$10.0 million to the Term Lender under the Credit Facility on April 28, 2017. The remaining \$117.0 million drawn on the Credit Facility is available for a revolving period of 364 days, maturing on April 29, 2017, and may be extended for an additional 364 days at the discretion of the lenders, with a term-out to April 27, 2018 if not renewed. The next semi-annual borrowing base review is scheduled to occur on or before November 30, 2016. In an event that the lenders reduce the borrowing base below the amount drawn at the time of the redetermination, the Company would have 60 days to eliminate any borrowing base shortfall by repaying the amount drawn in excess of a re-determined borrowing base or by providing additional security or other consideration satisfactory to the lenders. Although management expects that the Company will not have a borrowing base shortfall and that the lenders will extend the Credit Facility on or before November 30, 2016, there is no assurance that the financial institutions will choose to do so. Should the financial institutions not extend the loan, the Company would need to seek alternate sources of debt or equity financing.

### Capital Management

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

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

	June 30, 2016	December 31, 2015
Bank debt <sup>(1)</sup>	126,993	177,570
Working capital deficiency <sup>(1)(2)</sup>	12,087	35,389
Bank debt, net of working capital <sup>(2)</sup>	139,080	212,959
Trailing funds from operations <sup>(3)(4)</sup>	46,684	44,688
Net bank debt to trailing funds from operations ratio <sup>(2)</sup>	3.0	4.8

(1) The current portion of bank debt of \$10.0 million is included in "Bank debt" and excluded from the "Working capital deficiency".

(2) Comparative information for the year ended December 31, 2015 has been revised. Details regarding the revision are set-forth in note 4 of these interim financial statements. Kelt previously reported a debt to trailing funds from operation ratio of 4.7 times as at December 31, 2015.

(3) Funds from operations is a non-GAAP measure which is calculated as cash provided by operating activities, before transaction costs, provisions for potential credit losses, settlement of decommissioning obligations and changes in non-cash operating working capital.

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

Kelt targets a net bank 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.

The Company has reduced its net bank debt to trailing funds from operations ratio to 3.0 times as at June 30, 2016 from 4.8 times at December 31, 2015. On May 3, 2016, the Company significantly reduced the amount drawn under its revolving bank credit facility using net proceeds of the offering of \$90.0 million principal amount of convertible debentures that mature on May 31, 2021. In addition, the Company closed a private placement of 4.7 million common shares for gross proceeds of \$22.1 million on April 7, 2016.

As more particularly described in note 9, Kelt is subject to certain non-financial covenants under the Credit Facility agreement. As at June 30, 2016, the Company is in compliance with all covenants. The Company is not subject to any other externally imposed capital requirements.

## 15. FINANCING EXPENSES

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

	Three months ended June 30		Six months ended June 30	
	2016	2015	2016	2015
Interest and fees on bank debt	2,056	1,978	4,292	2,851
Interest on convertible debentures [note 10]	715	-	715	-
Accretion of convertible debentures [note 10]	487	-	487	-
Accretion of decommissioning obligations [note 11]	744	707	1,503	1,249
Financing expense	4,002	2,685	6,997	4,100

## 16. COMMITMENTS

As of June 30, 2016, the Company is committed to future payments under the following agreements:

<i>(CA\$ thousands)</i>	2016	2017	2018	2019	2020	Thereafter
Operating lease - office buildings	666	1,347	563	108	18	-
Operating lease - vehicles	110	178	93	13	-	-
Flow-through shares	22,090	-	-	-	-	-
Firm processing commitments	3,309	4,519	-	-	-	-
Firm transportation commitments <sup>(1)</sup>	8,963	17,396	8,866	6,582	3,606	17,579
<b>Total annual commitments</b>	<b>35,138</b>	<b>23,440</b>	<b>9,522</b>	<b>6,703</b>	<b>3,624</b>	<b>17,579</b>

(1) A portion of Kelt's commitments on the Alliance pipeline are denominated in US dollars. The volumes committed vary over the term of the contracts, which are effective until October 31, 2017, however, the maximum US denominated commitment in a given month does not exceed US\$0.31 million. Amounts are translated to Canadian dollars at the spot rate on June 30, 2016 of CA\$/US\$1.2917.

The Company has firm commitments for oil and gas transportation on major pipelines in Alberta and British Columbia. For periods subsequent to 2020, Kelt has an annual commitment of \$1.5 million for gas transportation until March 31, 2026 and an annual commitment of \$1.5 million for oil transportation until June 30, 2027.

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

## 17. SUPPLEMENTAL CASH FLOW INFORMATION

	Three months ended June 30		Six months ended June 30	
	2016	2015	2016	2015
Accounts receivable and accrued revenue	(1,132)	18,868	2,553	21,065
Prepaid expenses and deposits	404	803	573	953
Accounts payable and accrued liabilities	(5,619)	(25,503)	(29,382)	(55,405)
Change in non-cash working capital	(6,347)	(5,832)	(26,256)	(33,387)
Relating to:				
Operating activities	(3,431)	12,706	(9,509)	11,174
Investing activities	(2,916)	(18,538)	(16,747)	(44,561)
Change in non-cash working capital	(6,347)	(5,832)	(26,256)	(33,387)

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

	Three months ended June 30		Six months ended June 30	
	2016	2015	2016	2015
Interest and standby fees on bank debt	1,833	1,978	4,518	2,831
Taxes	-	-	-	-

## 18. CHANGE IN CLASSIFICATION OF CERTAIN PRODUCTION AND TRANSPORTATION EXPENSES

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

	Three months ended June 30, 2015	Six months ended June 30, 2015
Production expense	668	1,066
Transportation expense	(668)	(1,066)
Net impact on profit (loss) and comprehensive income (loss)	-	-
Net impact on cash flow provided by operating activities	-	-

## 19. RELATED PARTY TRANSACTIONS

A director of the Company is also a partner at a law firm which Kelt has engaged to provide legal services. During the first six months ended June 30, 2016, the Company incurred \$0.5 million (2015 - \$0.4 million) in legal fees and disbursements, of which, nil is payable at June 30, 2016 (\$0.1 million at December 31, 2015). The Company expects to continue using the services of this law firm from time to time.

## **ABBREVIATIONS**

bbls	barrels
mbbls	thousand barrels
bbls/d	barrels per day
BOE	barrels of oil equivalent
mBOE	thousand barrels of oil equivalent
BOE/d	barrels of oil equivalent per day
mcf	thousand cubic feet
mmcf	million cubic feet
bcf	billion cubic feet
mmcf/d	million cubic feet per day
mmbtu	million British Thermal Units
GJ	gigajoules
LT	long tonnes
AECO	Alberta Energy Company "C" Meter Station of the NOVA Pipeline System
WTI	West Texas Intermediate
NYMEX	New York Mercantile Exchange
CREC	Alliance Pipeline Canadian receipt location
Station 2	Spectra Energy receipt location
NGX	Natural Gas Exchange Inc. (Canada)
MD&A	Management's Discussion and Analysis
Q1	First quarter ended March 31 <sup>st</sup>
Q2	Second quarter ended June 30 <sup>th</sup>
Q3	Third quarter ended September 30 <sup>th</sup>
Q4	Fourth quarter ended December 31 <sup>st</sup>
YTD	Year to date
BT	Before income taxes
AT	After income taxes
1P	Proved reserves
2P	Proved plus probable reserves
BC	Province of British Columbia
CDE	Canadian development expenses
CGU	Cash generating unit
MRF	Modernized Royalty Framework (Alberta)

## **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** <sup>2, 3, 4, 6</sup>  
President, Valhalla Ventures Inc.

**William C. Guinan** <sup>1, 5</sup>  
Partner, Borden Ladner Gervais LLP

**Eldon A. McIntyre** <sup>2, 3, 4, 6</sup>  
President, Jarrod Oils Ltd.

**Neil G. Sinclair** <sup>2, 3, 4, 5, 6</sup>  
President, Sinson Investments Ltd.

**David J. Wilson** <sup>5</sup>  
President & Chief Executive Officer,  
Kelt Exploration Ltd.

1 chairman of the board

2 member of the audit committee

3 member of the reserves committee

4 member of the compensation committee

5 member of the health, safety and environment committee

6 member of the nominating committee

### **OFFICERS**

**David J. Wilson**  
President & Chief Executive Officer

**Sadiq H. Lalani**  
Vice President & Chief Financial Officer

**Douglas J. Errico**  
Vice President, Land

**Alan G. Franks**  
Vice President, Production

**Bruce D. Gigg**  
Vice President, Engineering

**Ashley D. Hohm**  
Vice President, Finance

**Douglas O. MacArthur**  
Vice President, Operations

**Patrick Miles**  
Vice President, Exploration

### **HEAD OFFICE**

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### **REGISTRAR AND TRANSFER AGENT**

Computershare  
6<sup>th</sup> Floor, 530 Eighth Avenue S.W.  
Calgary, Alberta T2P 3S8

### **LEGAL COUNSEL**

Borden Ladner Gervais LLP  
Centennial Place, East Tower,  
Suite 1900, 520 Third Avenue S.W.  
Calgary, Alberta T2P 0R3

### **BANKERS**

National Bank of Canada  
Suite 1800, 311 Sixth Avenue S.W.  
Calgary, Alberta T2P 3H2

### **AUDITORS**

PricewaterhouseCoopers LLP  
Suite 3100, 111 Fifth Avenue S.W.  
Calgary, Alberta T2P 5L3

### **EVALUATION ENGINEERS**

Sproule Associates Limited  
Suite 900, 140 Fourth Avenue S.W.  
Calgary, Alberta T2P 3N3

### **STOCK EXCHANGE LISTING**

Toronto Stock Exchange  
Common Shares "KEL"  
Convertible Debentures "KEL.DB"



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