



**SECOND QUARTER REPORT  
AS AT AND FOR THE THREE AND SIX MONTHS ENDED  
JUNE 30, 2017**

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FINANCIAL AND OPERATIONAL HIGHLIGHTS (CA\$ thousands, except as otherwise indicated)	Three months ended June 30			Six months ended June 30		
	2017	2016	%	2017	2016	%
<b>FINANCIAL</b>						
Revenue, before royalties and financial instruments	60,072	40,718	48	120,297	81,116	48
Adjusted funds from operations <sup>(1)</sup>	25,333	11,671	117	52,156	17,622	196
Basic (\$/ common share) <sup>(1)</sup>	0.14	0.07	100	0.30	0.10	200
Diluted (\$/ common share) <sup>(1)</sup>	0.14	0.07	100	0.29	0.10	190
Loss and comprehensive loss	(4,869)	(20,413)	-76	(7,136)	(46,331)	-85
Basic (\$/ common share)	(0.03)	(0.12)	-75	(0.04)	(0.27)	-85
Diluted (\$/ common share)	(0.03)	(0.12)	-75	(0.04)	(0.27)	-85
Total capital expenditures, net of dispositions	31,630	25,908	22	(3,734)	49,313	-108
Total assets	1,203,174	1,260,245	-5	1,203,174	1,260,245	-5
Bank debt, net of working capital <sup>(1)</sup>	80,618	139,080	-42	80,618	139,080	-42
Convertible debentures	72,685	69,320	5	72,685	69,320	5
Shareholders' equity	839,485	835,241	1	839,485	835,241	1
Weighted average shares outstanding (000s)						
Basic	175,894	173,818	1	175,805	171,321	3
Diluted	177,316	173,972	2	177,093	171,444	3
<b>OPERATIONS</b>						
Average daily production						
Oil (bbls/d)	5,929	5,066	17	5,863	5,469	7
NGLs (bbls/d)	1,967	2,632	-25	2,162	2,686	-20
Gas (mcf/d)	76,730	75,060	2	74,525	81,577	-9
Combined (BOE/d)	20,684	20,208	2	20,446	21,751	-6
Production per million common shares (BOE/d) <sup>(1)</sup>	118	116	2	116	127	-9
Average realized prices, before financial instruments						
Oil (\$/bbl)	56.80	49.76	14	58.48	41.30	42
NGLs (\$/bbl)	29.04	18.21	59	28.36	16.19	75
Gas (\$/mcf)	3.47	1.97	76	3.50	2.16	62
Operating netbacks (\$/BOE) <sup>(1)</sup>						
Petroleum and natural gas revenue	31.91	22.14	44	32.50	20.49	59
Realized gain (loss) on financial instruments	(0.21)	(0.01)	2000	(0.10)	(0.01)	900
Average realized price, after financial instruments	31.70	22.13	43	32.40	20.48	58
Royalties	(2.47)	(1.65)	50	(3.04)	(1.49)	104
Production expense	(10.27)	(8.87)	16	(9.94)	(9.61)	3
Transportation expense	(3.47)	(2.89)	20	(3.36)	(2.79)	20
Operating netback <sup>(1)</sup>	15.49	8.72	78	16.06	6.59	144
Undeveloped land						
Gross acres	777,550	665,010	17	777,550	665,010	17
Net acres	658,538	543,530	21	658,538	543,530	21

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

## **MESSAGE TO SHAREHOLDERS**

Kelt Exploration Ltd. (“Kelt” or the “Company”) reports its financial and operating results to shareholders for the second quarter ended June 30, 2017.

Average production for the three months ended June 30, 2017 was 20,684 BOE per day, up 2% compared to average production of 20,208 BOE per day during the second quarter of 2016. Production during the second quarter of 2017 reflects the disposition of the majority of the Company’s oil and gas assets at Karr which included approximately 1,300 BOE per day of production. The Karr disposition was completed on January 18, 2017.

The Company’s average production during the second quarter of 2017 was below original estimates as third party outages and downtime exceeded expectations. The following downtime and outages negatively affected 2017 second quarter production: TransCanada Pipeline Ltd. restricted a portion of firm service production on the NGTL pipeline system upstream of the James River receipt area in June for approximately two weeks; turnaround operations at the McMahan Gas Plant lasted longer than originally expected; compression downtime on the Westcoast pipeline system during the McMahan plant outage resulted in partial outages at the West Stoddart Gas Plant, where the majority of the Company’s gas in British Columbia is processed; an outage at the Younger Gas Plant in British Columbia, where repairs were conducted, reduced the amount of NGL recoveries that Kelt normally realizes during the period of repairs; in June 2017, the Alliance Pipeline system declared a force majeure resulting from excavation and inspection of the upper and lower sections of its pipeline segment in the area of the slope movement near the Wapiti River requiring Kelt to shut-in significant volumes of production in both British Columbia and Alberta; and at Spirit River, the Company was required to also shut-in approximately 400 BOE per day of production that flowed through a third party gathering system. The owner of the pipeline gathering system does not intend to complete the repairs required to bring the system back to operation at this time. Kelt is currently reviewing alternative options to bring that production back on stream.

Initial production rates from recent drilling results in both British Columbia and Alberta have exceeded the Company’s estimates. As a result, despite the lower second quarter production, Kelt has not changed its full year guidance of average daily production of 23,500 BOE per day. The Company intends to review its production guidance again in September and will provide updated information at that time.

At La Glace, Alberta, the Company drilled and completed two wells in the Middle Montney. The wells were completed using gelled-water with 36 fracture stages and approximately 40 tonnes of proppant per stage. The well located at 02/13-33-074-08W6 had an IP30 rate (gross estimated sales) of 790 BOE per day of which 90% was oil and NGLs. The second well located at 02/04-23-074-08W6 had an IP30 rate (gross estimated sales) of 888 BOE per day of which 69% was oil and NGLs. Given the lower capital expenditures per well and the resulting quick payback on these wells, at under six months in the current commodity price environment, Kelt has drilled two additional wells at La Glace in July 2017.

At Inga, British Columbia, the Company drilled its third Middle Montney well on its large contiguous land block. The well was completed using slick-water with 46 fracture stages and approximately 70 tonnes of proppant per stage. The well located at 02/15-33-087-23W6 had an IP24 rate (gross estimated sales) of 2,157 BOE per day, of which 81% was oil and NGLs. This is the highest Middle Montney initial production rate recorded to date at Inga/Fireweed. In the current commodity price environment, given the high oil content of the initial production, this well is expected to payback in approximately six months. With success to date in the Middle Montney, Kelt expects to drill additional Middle Montney wells at Inga during the second half of 2017 and 2018.

At Pipestone/Wembley, Alberta where the Company has recently increased its land position to 59,080 acres (92 sections) of lands with Montney rights, Kelt has drilled its first horizontal exploratory well located at 00/04-01-072-08W6. This well has now been completed using slick-water with 50 fracture stages and approximately 70 tonnes of proppant per stage. Initial production results are expected to be available in September 2017.

At Inga/Stoddart, British Columbia where the Company has 104,862 acres (164 sections) of lands with Baldonnel rights, Kelt has drilled its first horizontal exploratory well located at 00/13-29-087-21W6. This well is currently being completed using slick-water with 30 planned fracture stages and approximately 26 tonnes of proppant per stage.

Commodity prices have improved from 2016 levels and have shown significant gains in the second quarter of 2017 compared to the second quarter of 2016. Kelt’s realized average oil price during the second quarter of 2017 was \$56.80 per barrel, up 14% from \$49.76 per barrel in the second quarter of 2016. The realized average NGLs price during the second quarter of 2017 was \$29.04 per barrel, up 59% from \$18.21 per barrel in the corresponding quarter of 2016. Kelt’s realized average gas price for the second quarter of 2017 was \$3.47 per MCF, up 76% from \$1.97 per MCF in the second quarter of the previous year.

The Company continues to realize higher average gas prices compared to the AECO index price through its gas market diversification strategy. In British Columbia, where there have been gas egress congestion and bottlenecks in the past, for the upcoming gas year (November 1, 2017 to October 31, 2018), Kelt has contracted service for approximately

## MESSAGE TO SHAREHOLDERS

25,000 MMBtu per day of gas sales for its British Columbia production. Approximately 15,000 MMBtu per day will be delivered to the Station 2 Hub and Kelt will receive the Sumas Hub USD Monthly Index price less US\$0.695 per MMBtu. Approximately 10,000 MMBtu per day will be delivered to an Alliance pipeline receipt point and Kelt will receive the Chicago Hub Gas Daily Index price less transportation charges. As a result, Kelt will have minimal to no exposure to Station 2 pricing in its British Columbia gas market portfolio. In Alberta, the Company has contracts in place to sell 15,000 MMBtu per day of gas at NIT and to receive the Malin Hub USD Index price less US\$0.70 per MMBtu (November 1, 2017 to October 31, 2020) and 23,700 MMBtu per day of gas at the Dawn hub in southern Ontario less transportation charges (November 1, 2017 to October 31, 2020). These contracts provide Kelt with gas market diversification and ensure that the Company's future gas sales revenue is not subject to the risks associated with a single market.

For the three months ended June 30, 2017, revenue was \$60.1 million and adjusted funds from operations was \$25.3 million (\$0.14 per share, diluted), compared to \$40.7 million and \$11.7 million (\$0.07 per share, diluted) respectively, in the second quarter of 2016. At June 30, 2017, bank debt, net of working capital was \$80.6 million, down 42% from \$139.1 million at June 30, 2016.

Capital expenditures incurred during the three months ended June 30, 2017, prior to property dispositions, were \$35.0 million. The Company spent \$19.6 million (56%) on drilling and completion operations, \$14.1 million (40%) on facilities, pipelines and equipment and \$1.2 million (4%) on land and seismic. In addition, during the second quarter of 2017, Kelt received cash proceeds of \$3.3 million from minor property dispositions.

Kelt has recently moved to development drilling from multi-well pads as part of its future development plan for its vast corporate Montney acreage. Capital efficiencies gained from pad drilling and improved completion results with increased fracture stages, greater proppant tonnage and high intensity pump rates have resulted in short payback periods in the current commodity price environment. The tables below show the estimated payback of capital incurred to drill and complete all new Montney wells that the Company has brought on production in 2017 (except the Inga 00/14-24-087-23W6 well which was brought on production on December 12, 2016). Two Montney wells drilled at Progress are not included in Table 1 as these wells are currently in the process of being brought on stream.

**Table 1 – Paybacks for 2017 Montney Development Wells:**

Well	Drill & Complete Cost (\$ MM) [1]	Initial Test Date	Production Start Date [2]	Actual Cumulative to May 31, 2017 [3]			Remaining to Payback [4]		Payback Period (years)	Last Month's Production Rate at Payback (BOE/d)
				Production (MBOE)	Operating Income (\$ MM)	Operating Netback (\$/BOE)	Production Estimate (MBOE)	Operating Income Estimate (\$ MM)		
Pouce Coupe 02/06-18-078-11W6	4.8	2017-01-26	2017-01-26	150.7	4.8	31.90	22.8	0.5	0.4	761
Pouce Coupe 03/07-18-078-11W6	4.1	2017-01-26	2017-01-26	125.4	4.0	31.84	23.8	0.6	0.4	792
Pouce Coupe 04/07-18-078-11W6	5.0	2017-01-24	2017-03-03	101.4	3.0	30.00	83.8	2.2	0.7	440
Pouce Coupe 05/07-18-078-11W6	4.3	2017-01-23	2017-03-08	105.0	3.2	30.08	40.2	1.2	0.4	578
Pouce Coupe 00/01-09-078-11W6	5.0	2017-02-21	2017-03-11	89.8	3.0	33.50	70.3	2.1	0.6	450
Pouce Coupe 03/16-25-077-13W6	5.8	2017-02-25	2017-06-19	26.5	0.4	13.83	426.1	5.8	0.8	1,061
La Glace 02/13-33-074-08W6	3.8	2017-04-01	2017-04-01	42.8	1.8	42.86	56.0	2.1	0.5	406
La Glace 02/04-23-074-08W6	4.0	2017-05-26	2017-05-26	2.1	0.1	26.88	131.8	4.2	0.7	347

Notes: Refer to explanatory notes provided under Table 2.

## MESSAGE TO SHAREHOLDERS

In addition to favourable economic results from its Montney development drilling program, the Company expects to achieve short paybacks on its capital incurred on Montney delineation and step-out wells. A move to pad drilling on these newly de-risked lands should result in further improvements in capital efficiencies in the future.

**Table 2 – Paybacks for 2017 Montney Delineation/Step-out Wells:**

Well	Drill & Complete Cost (\$ MM) [1]	Initial Test Date	Production Start Date [2]	Actual Cumulative to May 31, 2017 [3]			Remaining to Payback [4]		Payback Period (years)	Last Month's Production Rate at Payback (BOE/d)
				Production (MBOE)	Operating Income (\$ MM)	Operating Netback (\$/BOE)	Production Estimate (MBOE)	Operating Income Estimate (\$ MM)		
Inga 00/14-24-087-23W6 [ Middle Montney ]	6.5	2016-12-12	2016-12-12	135.6	4.6	34.17	58.2	2.0	0.8	449
Fireweed C-31-I/94-A-12 [ Upper Montney ]	6.9	2017-01-16	2017-01-16	142.9	3.6	25.13	151.5	3.3	1.4	313
Stoddart 00/08-17-087-22W6 [ Upper Montney ]	7.4 [5]	2017-03-22	2017-04-25	32.6	0.9	28.02	259.6	6.5	2.6	177
Inga 02/15-33-087-23W6 [ Middle Montney ]	5.5	2017-07-06	2017-07-13	-	-	-	193.7	5.7	0.5	656

**Notes:**

[1] Half-cycle capital – equipment and tie-in costs for delineation/step-out wells are not included in the payback period calculation, as the initial tie-in costs for single wells will eventually benefit additional wells drilled from the same pad. Equipment and tie-in costs for pad wells are on average an incremental \$300,000 per well and are included in the payback period calculation for development wells.

[2] Production Start Date is the date when the well commenced steady production after tie-in operations were completed. The payback period is calculated from this date.

[3] Actual production and operating income cumulative to date is up to May 31, 2017 and includes any production and operating income generated during the test period, prior to the Production Start Date.

[4] Estimated operating income required to payback is calculated based on actual sales prices received to date. Estimated future production is calculated based on internally generated production forecasts/decline curves for each respective well. Actual production for June and July 2017, based on field estimates, is included in estimated future production.

[5] During completion operations, the Stoddart 8-17 well experienced fracking and drill-out problems which added approximately \$1.0 million to the completion costs.

The Company's Board of Directors has agreed to increase the 2017 capital expenditure budget by a net \$10.0 million. Total exploration and development capital expenditures planned for 2017 are \$191.0 million (previously \$173.0 million) and proceeds from property dispositions are expected to be \$111.0 million (previously \$103.0 million), resulting in a net capital expenditure budget of \$80.0 million (previously \$70.0 million). The increase in the capital expenditure budget reflects an additional \$18.0 million for infrastructure expenditures and additional proceeds from minor property dispositions in the amount of \$8.0 million (\$3.3 million of which was already completed at June 30, 2017 and the balance is an estimate for further transactions expected to occur in the second half of 2017).

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

Kelt has also commenced installation of blending facilities at its three main oil terminals located at Inga, La Glace and Progress, which are now pipeline connected to oil sales and water injection. These new facilities are expected to provide the Company with higher price realizations for its oil and butane sales in each of these areas and are anticipated to be completed prior to year-end.

## **MESSAGE TO SHAREHOLDERS**

The Company is well positioned financially to execute its capital program during the remainder of 2017 and expects to enter 2018 with strong operational momentum.

Management looks forward to updating shareholders with 2017 third quarter results on or about November 9, 2017.

On behalf of the Board of Directors,

*[signed]*

David J. Wilson  
President and Chief Executive Officer  
August 8, 2017

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

### **INTRODUCTION**

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

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

This Management's Discussion and Analysis ("MD&A") is dated August 8, 2017 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, 2017 and its audited consolidated annual financial statements and MD&A as at and for the year ended December 31, 2016. The accompanying financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") as set out in the *CPA Canada Handbook - Accounting* ("CPA Handbook"). The CPA Handbook incorporates International Financial Reporting Standards ("IFRS") and publicly accountable enterprises, including Kelt, are required to apply such standards. The Company's Board of Directors approved and authorized the condensed consolidated interim financial statements for issue on August 8, 2017.

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

This MD&A contains forward-looking statements and forward-looking information within the meaning of applicable securities laws. The use of any of the words "expect", "anticipate", "continue", "estimate", "objective", "ongoing", "may", "will", "project", "should", "believe", "plans", "intends" and similar expressions are intended to identify forward-looking information or statements. In particular, this MD&A contains forward-looking statements pertaining to the following: the expectation that the Company's new firm service gas transportation contracts will limit exposure to discounted Station 2 pricing for its operations in northeastern BC; the anticipated improvement in Kelt's price realizations for its oil and butane sales following the installation of blending facilities at the Company's three main oil terminals, which are expected to be completed prior to December 31, 2017; the expectation that the recent purchase of a major infrastructure package in northeastern BC (refer to additional information under the heading of "*Subsequent Events*") will reduce the Company's production expenses in the future; the Company's ability to continue accumulating land at a low-cost in its core operating areas and potentially monetize non-core assets; and the Company's expected future financial position and operating results, as well as the amount and timing of future development capital expenditures. Statements relating to "reserves" or "resources" are deemed to be forward looking statements, as they involve the implied assessment, based on certain estimates and assumptions, that the reserves described exist in the quantities predicted or estimated and that the reserves can be profitably produced in the future. Actual reserves may be greater than or less than the estimates provided herein.

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



and competition from other explorers) as well as general economic conditions, stock market volatility; and the ability to access sufficient capital. We caution that the foregoing list of risks and uncertainties is not exhaustive.

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

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

## **GROWTH STRATEGY**

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

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

## **RESULTS OF OPERATIONS**

*On January 18, 2017, Kelt completed the disposition of the majority of its oil and gas assets in the Karr area of Alberta (the “Karr Property Disposition”) for cash proceeds of \$103.1 million after closing adjustments. At the time of the disposition, the assets were producing approximately 1,300 BOE per day (50% oil and NGLs). The Company’s operating results for the six months ended June 30, 2017 include production and operating income from the assets disposed for the 17 day period prior to closing on January 18, 2017. Additional information regarding the Karr Property Disposition is provided under the heading of “Capital Expenditures” in this MD&A.*

- Production averaged 20,684 BOE per day during the second quarter of 2017, up 2% from 20,204 BOE per day in the first quarter of 2017 and up 2% from 20,208 BOE per day during the second quarter of 2016.
- Revenue for the quarter ended June 30, 2017 was \$60.1 million, up 48% from the same quarter of 2016 on the recovery of commodity prices. The Company’s combined realized price averaged \$31.91 per BOE during the second quarter of 2017, compared to \$22.14 per BOE in the second quarter of 2016.
- During the three months ended June 30, 2017, corporate royalty rates averaged 7.7% of revenue, production expense averaged \$10.27 per BOE, transportation expenses were \$3.47 per BOE, interest expense was \$0.98 per BOE and G&A expense was \$1.06 per BOE.
- Kelt’s operating netback was \$15.49 per BOE for the quarter ended June 30, 2017, up 78% from \$8.72 per BOE during the quarter ended June 30, 2016.
- Adjusted funds from operations of \$25.3 million (\$0.14 per common share, diluted) during the second quarter of 2017 increased by 117% from \$11.7 million (\$0.07 per common share, diluted) in the second quarter of 2016.
- Capital expenditures, net of proceeds from dispositions, were \$31.6 million during the second quarter of 2017, of which Kelt spent \$1.2 million on land, \$19.6 million drilling and completing wells, and \$14.1 million on facilities, pipelines and equipment. Kelt received cash proceeds of \$3.3 million from minor property dispositions completed during the quarter ended June 30, 2017.
- Kelt’s bank debt, net of working capital was \$80.6 million at June 30, 2017, down 42% from \$139.1 million at June 30, 2016. As at June 30, 2017, the Company had drawn \$64.6 million on its revolving bank credit facility

with an authorized borrowing amount of \$185.0 million. Kelt is well positioned to execute on its capital expenditure program for the second half of 2017 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		
	2017	2016	%	2017	2016	%
Average daily production:						
Oil (bbls/d)	5,929	5,066	17	5,863	5,469	7
NGLs (bbls/d)	1,967	2,632	-25	2,162	2,686	-20
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Combined (BOE/d)	20,684	20,208	2	20,446	21,751	-6
Average realized prices, before financial instruments:						
Oil (\$/bbl)	56.80	49.76	14	58.48	41.30	42
NGLs (\$/bbl)	29.04	18.21	59	28.36	16.19	75
Gas (\$/mcf)	3.47	1.97	76	3.50	2.16	62
Combined (\$/BOE)	31.91	22.14	44	32.50	20.49	59
Revenue, before royalties and financial instruments:						
Oil	30,646	22,937	34	62,053	41,112	51
NGLs	5,199	4,362	19	11,097	7,913	40
Gas	24,227	13,419	81	47,147	32,091	47
Revenue, before royalties and financial instruments	60,072	40,718	48	120,297	81,116	48

Production averaged 20,684 BOE per day during the second quarter of 2017, up 2% from 20,204 BOE per day in the first quarter of 2017 and up 2% from the second quarter of 2016. The Company's average production for the first six months of 2017 of 20,446 BOE per day is down 6% or 1,305 BOE per day compared to the same period of 2016, reflecting the Karr Property Disposition which closed on January 18, 2017. Average production during the six months ended June 30, 2016 included approximately 1,800 BOE per day of production from the assets disposed at Karr, which were producing approximately 1,300 BOE per day (50% oil and NGLs) at the time of the disposition.

Notwithstanding the Karr Property Disposition, Kelt has significantly increased its corporate average oil production from wells recently drilled in its core areas. The Company has reported prolific initial results from its five-well pad at Pouce Coupe, Alberta, which was tested in the first quarter and on stream during the quarter ended June 30, 2017. In addition, two Montney oil wells that were drilled in the first quarter at La Glace were also brought on production during the second quarter 2017.

The following downtime and outages negatively affected 2017 second quarter production: TransCanada Pipeline Ltd. restricted a portion of firm service production on the NGTL pipeline system upstream of the James River receipt area in June for approximately two weeks; turnaround operations at the McMahan Gas Plant lasted longer than originally expected; compression downtime on the Westcoast pipeline system during the McMahan plant outage resulted in partial outages at the West Stoddart Gas Plant, where the majority of the Company's gas in BC is processed; an outage at the Younger Gas Plant in BC, where repairs were conducted, reduced the amount of NGL recoveries that Kelt normally realizes during the period of repairs; in June 2017, the Alliance Pipeline system declared a force majeure resulting from excavation and inspection of the upper and lower sections of its pipeline segment in the area of the slope movement near the Wapiti River requiring Kelt to shut-in significant volumes of production in both BC and Alberta; and at Spirit River, the Company was required to also shut-in approximately 400 BOE per day of production that flowed through a third party gathering system. The owner of the pipeline gathering system does not intend to complete the repairs required to bring the system back to operation at this time. Kelt is currently reviewing alternative options to bring that production back on stream.

Revenue for the second quarter of 2017 was \$60.1 million, up 48% from \$40.7 million during the second quarter of 2016. Year-to-date revenue of \$120.3 million is also up 48% despite production volumes being 6% lower, as realized commodity prices have recovered significantly from the historical lows during the first half of 2016. The Company's combined average sales price was \$32.50 per BOE for the six month period ended June 30, 2017, 59% higher than the average realized price of \$20.49 per BOE during the six month period ended June 30, 2016. Kelt's average realized price of \$31.91 per BOE during the second quarter of 2017 fell slightly from \$33.12 per BOE during the first quarter of 2017, primarily due the pullback in global oil prices partly offset by realizing a higher average price on NGLs.

## OIL OPERATIONS

References to "oil" in this discussion includes crude oil and field condensate (see "Other Measurements" for additional references).

(CA\$ thousands, except as otherwise indicated)	Three months ended June 30			Six months ended June 30		
	2017	2016	%	2017	2016	%
Oil production (bbls per day)	5,929	5,066	17	5,863	5,469	7
Oil revenue, before royalties and financial instruments	30,646	22,937	34	62,053	41,112	51
Average realized oil prices (\$/bbl):						
Before financial instruments	56.80	49.76	14	58.48	41.30	42
Realized gain (loss) on financial instruments	-	-	-	-	-	-
After financial instruments	56.80	49.76	14	58.48	41.30	42
Average realized price, percentage of CLS	95%	90%		94%	86%	
Benchmark oil prices:						
WTI Cushing Oklahoma (US\$/bbl) <sup>(1)</sup>	48.28	45.59	6	50.10	39.52	27
WTI Cushing Oklahoma (CA\$/bbl) <sup>(2)</sup>	64.91	58.74	11	66.79	52.29	28
Canadian Light Sweet ("CLS") (\$/bbl) <sup>(1)</sup>	59.72	55.01	9	62.28	48.11	29
CLS % of CA\$WTI	92%	94%	-2	93%	92%	1
Average exchange rate (CA\$/US\$) <sup>(1)</sup>	1.3440	1.2882	4	1.3335	1.3289	0

(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.

The Company's oil revenue for the first six months of 2017 is up 51% from the comparative period of 2016, driven by higher oil prices and the increase in oil production. Global crude oil prices have recovered significantly from the historical lows during the first half of 2016, in which WTI bottomed with a low average price of US\$30.62 (CA\$42.22) per barrel during February 2016. In February 2017, WTI averaged US\$53.46 (CA\$70.09) per barrel, its highest level over the past 24 month period. WTI averaged US\$48.28 (CA\$64.91) per barrel during the second quarter of 2017, 7% lower than the first quarter of 2017, as WTI retreated to US\$45.17 per barrel in June.

Kelt realized an average price for its oil sales of \$56.80 per barrel during the three months ended June 30, 2017, up from \$49.76 per barrel during the quarter ended June 30, 2016. The 14% increase in Kelt's average realized oil price reflects the recovery of global crude oil prices as well as an improvement in the Company's internal oil price realization relative to benchmark prices.

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

The average discount of Kelt's realized oil price relative to the CLS reference price was \$2.92 per barrel (5% of CLS) during the second quarter of 2017, compared to a discount of \$5.25 per barrel (10% of CLS) in the second quarter of 2016. The decrease in Kelt's oil price discount reflects improved contract pricing. In addition, as benchmark oil prices are higher in 2017, the fixed deductions represent a lower percentage of the base price.

## NGL OPERATIONS

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

(CA\$ thousands, except as otherwise indicated)	Three months ended June 30			Six months ended June 30		
	2017	2016	%	2017	2016	%
NGLs production (bbls per day)	1,967	2,632	-25	2,162	2,686	-20
NGLs barrels per MMCF of natural gas sales	26	35	-26	29	33	-12
NGLs revenue, before royalties and financial instruments	5,199	4,362	19	11,097	7,913	40
Average realized NGLs price (\$/bbl):						
Before financial instruments	29.04	18.21	59	28.36	16.19	75
Realized gain (loss) on financial instruments	(0.19)	-	-	(0.10)	-	-
After financial instruments	28.85	18.21	58	28.26	16.19	75
Average realized price, percentage of CA\$WTI <sup>(1)</sup>	45%	31%		42%	31%	
Benchmark NGLs prices <sup>(2)</sup> (\$/bbl):						
Edmonton Pentane	64.40	55.81	15	66.84	50.58	32
% of CA\$WTI	99%	95%	4	100%	97%	3
Edmonton Butane	38.68	32.39	19	41.61	30.86	35
% of CA\$WTI	60%	55%	9	62%	59%	5
Edmonton Propane	19.21	9.96	93	24.01	8.55	181
% of CA\$WTI	30%	17%	76	36%	16%	125
Edmonton Ethane	7.73	3.92	97	7.59	4.50	69
% of CA\$WTI	12%	7%	71	11%	9%	22

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

(2) Source: Sproule Associates Limited.

Kelt realized an average price for its NGL sales of \$28.36 per barrel during first half of 2017, up 75% from \$16.19 per barrel during the same period of 2016. The increase in NGL prices is primarily attributed to the underlying recovery of WTI crude oil prices, as well as the dramatic recovery of propane prices. In addition, the Company's NGLs marketing contracts were renegotiated effective April 1, 2017 under favorable terms, including significantly lower fixed deductions. The positive impact of the new marketing arrangements is highlighted by Kelt's realized NGLs price during the second quarter of 2017 of \$29.04 per barrel (45% of CA\$WTI), which is up 4% from \$27.79 per barrel (40% of CA\$WTI) during the first quarter of 2017, despite the average CA\$WTI price falling 5% quarter-over-quarter.

The Company reported an increase in NGLs revenue for both the three and six month periods ended June 30, 2017, relative to the comparative periods of 2016, as the significant improvement in realized NGLs prices more than offset lower NGLs production. NGLs production has decreased during 2017 as a result of lower gas production and a decrease in Kelt's corporate average NGLs yield. Production from the Company's liquids-rich gas properties in BC is lower in 2017 as Kelt's 2016 drilling program was targeted primarily to its Alberta properties. In addition, production downtime resulting from gas plant and facility outages in northeastern BC further contributed to the lower average yield during the second quarter of 2017. While the Company's BC properties yield more NGLs barrels per MMCF of natural gas, the NGLs extracted in Kelt's Alberta operations attract a higher average price (approximately 45% NGLs barrels produced in Alberta are C5/C5+).

In January 2017, Kelt entered into a financial derivative contract to lock-in the stronger propane price and reduce the Company's downside price risk on a notional 500 barrels per day of propane at 50% of US\$WTI, for the period from February 1 to December 31, 2017. The OPIS-Conway propane price settled higher than the contract price in three of the first five months the contract was outstanding, resulting in a net realized loss of \$40 thousand (\$0.10 per NGLs barrel) during the period ended June 30, 2017.

## GAS OPERATIONS

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

(CA\$ thousands, except as otherwise indicated)	Three months ended June 30			Six months ended June 30		
	2017	2016	%	2017	2016	%
Gas production (MCF per day)	<b>76,730</b>	75,060	2	<b>74,525</b>	81,577	-9
Gas revenue, before royalties and financial instruments	<b>24,227</b>	13,419	81	<b>47,147</b>	32,091	47
Average realized gas price (\$/MCF):						
Before financial instruments	<b>3.47</b>	1.97	76	<b>3.50</b>	2.16	62
Realized gain (loss) on financial instruments	<b>(0.05)</b>	-	-	<b>(0.03)</b>	-	-
After financial instruments	<b>3.42</b>	1.97	74	<b>3.47</b>	2.16	61
Kelt average premium (discount) to AECO 5A <sup>(1)</sup>	<b>25%</b>	41%		<b>28%</b>	34%	
Benchmark gas prices:						
NYMEX Henry Hub (US\$/MMBtu) <sup>(2)</sup>	<b>3.13</b>	1.95	61	<b>3.19</b>	2.00	60
AECO 5A (CA\$/GJ) <sup>(3)</sup>	<b>2.64</b>	1.33	98	<b>2.60</b>	1.53	70
Spectra Station 2 Day Ahead Index (CA\$/GJ) <sup>(4)</sup>	<b>2.20</b>	1.13	95	<b>2.28</b>	1.23	85
Average discount to AECO 5A (CA\$/GJ)	<b>-16%</b>	-15%		<b>-12%</b>	-20%	
Sumas/Huntingdon ("Sumas") (CA\$/MMBtu) <sup>(5)</sup>	<b>3.34</b>	1.81	85	<b>3.88</b>	2.31	68
Average premium to Station 2 (CA\$/MMBtu)	<b>46%</b>	52%		<b>61%</b>	78%	
Platts Chicago City-Gate (CA\$/MMBtu) <sup>(6)</sup>	<b>3.93</b>	2.69	46	<b>3.94</b>	2.75	43
Average premium to AECO 5A (CA\$/MMBtu)	<b>41%</b>	92%		<b>44%</b>	70%	

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

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

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

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

(5) Source: Canadian Gas Price Reporter (Sumas/Huntingdon (US\$/MMBtu). The Canadian dollar equivalent Sumas price is calculated based on monthly average US\$ price and the monthly average CA\$/US\$ exchange rate.

(6) Source: Platts Chicago City-Gate (US\$/MMBtu) per Tidal Energy Marketing Inc. The Canadian dollar equivalent Chicago City-Gate price is calculated based on monthly average US\$ price and the monthly average CA\$/US\$ exchange rate.

The Company realized an average gas sales price of \$3.47 per MCF during the quarter ended June 30, 2017, up 76% from \$1.97 per MCF during the quarter ended June 30, 2016. By comparison, the AECO 5A gas reference price averaged \$2.64 per GJ during the second quarter of 2017, up 98% from \$1.33 per GJ the same quarter of 2016. Kelt receives a premium to the AECO 5A gas price due to the higher heat content of its gas production as well as various gas marketing arrangements that the Company has in place to diversify and gain exposure to alternative markets. As the AECO gas market recovered significantly during 2017, the discount to the Chicago City-Gate and Sumas markets narrowed, contributing the decrease in Kelt's average realized premium relative to AECO 5A compared to 2016.

The Company currently receives Chicago City-Gate pricing on 25% to 30% of its gas sales volumes. The Canadian dollar equivalent Chicago City-Gate price averaged \$3.93 per MMBtu during the second quarter of 2017, a premium of 41% above the equivalent AECO 5A price per MMBtu, down from the average premium of 92% during the second quarter of 2016. The impact of the higher realized gas price on Kelt's funds from operations is partially offset by higher tolls on the Alliance pipeline, which are included in transportation expenses.

Effective November 1, 2016, a portion of the Company's BC gas production which was previously sold at discounted Station 2 prices, now receives Sumas pricing less a fixed differential. In January 2017, Sumas peaked at \$6.15 per MMBtu or 2.3 times the Station 2 price of \$2.66 per MMBtu during the month. On average during the quarter ended June 30, 2017, Sumas was a 46% premium to Station 2, compared to an average premium of 76% during the first quarter ended March 31, 2017.

## ROYALTIES

<i>(CA\$ thousands, except as otherwise indicated)</i>	Three months ended June 30			Six months ended June 30		
	2017	2016	%	2017	2016	%
Royalties, before Crown Cost Allowances:						
Oil	4,196	2,946	42	8,865	5,318	67
NGLs	826	1,039	-21	2,067	1,713	21
Gas	1,097	938	17	3,209	2,352	36
Total, before Crown Cost Allowances	6,119	4,923	24	14,141	9,383	51
Crown Cost Allowances <sup>(1)</sup>	(1,477)	(1,889)	-22	(2,876)	(3,490)	-18
Royalties	4,642	3,034	53	11,265	5,893	91
Royalties, before Crown Cost Allowances:						
Oil (% of oil revenue)	13.7%	12.8%	7	14.3%	12.9%	11
NGLs (% of NGLs revenue)	15.9%	23.8%	-33	18.6%	21.6%	-13
Gas (% of gas revenue)	4.5%	7.0%	-36	6.8%	7.3%	-7
Total, before Crown Cost Allowances (% of revenue)	10.2%	12.1%	-16	11.8%	11.6%	2
Crown Cost Allowances (% of total revenue)	-2.5%	-4.6%	-46	-2.4%	-4.3%	-44
Royalties (% of total revenue)	7.7%	7.5%	3	9.4%	7.3%	29

(1) "Crown Cost Allowances" include Alberta Crown Gas Cost Allowance ("GCA") and BC Producer Cost of Service ("PCOS").

Kelt's corporate average royalty rate was 7.7% during the second quarter of 2017, up from 7.5% during the same quarter of 2016. Year-to-date in 2017, royalties averaged 9.4% of revenue compared to 7.3% in the same period of 2016. The increase in Kelt's corporate average royalty rate is primarily driven by higher commodity prices, the higher proportion of oil production, and the decrease in Crown Cost Allowances. Crown royalties are reduced by Crown Cost Allowances including BC Producer Cost of Service ("PCOS") and Alberta Gas Cost Allowance ("GCA") credits which do not fluctuate with gas prices. The Company has estimated total GCA and PCOS credits of \$2.9 million for the first six months of 2017, down compared to \$3.5 million estimated during the comparative six month period of 2016. There are numerous factors that impact the amount of PCOS and GCA, however, the decrease in total estimated Crown Cost Allowances is primarily due to the Karr Property Disposition.

Oil royalties averaged 13.7% of oil revenue during the quarter ended June 30, 2017, up from 12.8% in the comparative quarter of 2016. The increase is primarily due to higher oil prices, partly offset by lower royalties on new production that qualifies for various royalty incentives, including favorable treatment under the Alberta Modernized Royalty Framework ("MRF") which came into effect January 1, 2017. The increase in oil production from wells recently drilled in Alberta that were brought on production during the second quarter of 2017, contributed the decrease in corporate average oil royalty rate compared to the first quarter of 2017, in which oil royalties averaged 14.9%.

NGL royalties averaged 15.9% of NGLs revenue during the second quarter of 2017 compared to 23.8% in the second quarter of 2016. NGLs royalty rates do not fluctuate with NGLs prices, but are reduced by certain drilling incentive credits. In addition, Kelt's corporate average NGLs royalty rate is impacted by the relative weighting of NGLs royalties in BC and Alberta. During the first half of 2017, a higher proportion of NGLs royalties were paid (or payable) in Alberta.

Gas royalties (before Crown Cost Allowances) averaged 6.8% of gas revenue during the six month period ended June 30, 2017, down from 7.3% in the comparative period of 2016. The impact of higher natural gas prices on the royalty rate was more than offset by royalty incentives on new gas production.

## PRODUCTION EXPENSES

<i>(CA\$ thousands, unless otherwise indicated)</i>	Three months ended June 30			Six months ended June 30		
	2017	2016	%	2017	2016	%
Production expense	19,325	16,324	18	36,791	38,036	-3
\$ per BOE	10.27	8.87	16	9.94	9.61	3

Production expenses averaged \$9.94 per BOE during the first six months of 2017, compared to \$9.61 per BOE in the same period of 2016. The Company performed various maintenance operations and production optimization workovers during the first and second quarters of 2017.

Kelt incurred higher total production expenses during the second quarter of 2017 as its field operations were mobilized to handle the anticipated increase in production. However, Kelt was unable to produce volumes at its full capability during the second quarter of 2017 due to numerous production disruptions, including constrained pipeline capacity and unplanned facility downtime. In addition, a scheduled turnaround of the McMahon Gas Plant was completed in June 2017. As a result, per unit production expenses during the second quarter of 2017 were higher.

Additional information regarding production downtime is provided under the heading of “*Production and Revenue*”.

## TRANSPORTATION EXPENSES

<i>(CA\$ thousands, unless otherwise indicated)</i>	Three months ended June 30			Six months ended June 30		
	2017	2016	%	2017	2016	%
Transportation expense <sup>(1)</sup>	6,529	5,316	23	12,438	11,055	13
\$ per BOE	3.47	2.89	20	3.36	2.79	20

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

During the six month period ended June 30, 2017, Kelt incurred transportation expenses of \$12.4 million (\$3.36 per BOE), up from \$11.1 million (\$2.79 per BOE) in the same period of 2016. The increase in both total and average per unit transportation expenses is driven by significantly higher oil transportation costs. The impact is marginally offset by lower total gas transportation expenses resulting from lower gas production, however per unit gas transportation costs are relatively unchanged over the periods.

Oil transportation expenses increased in conjunction with higher oil production (up 17% in the second quarter and up 7% year-to date in 2017, compared to 2016), but primarily due to the increase in oil transportation expenses per barrel. During the first half of 2017, oil transportation averaged \$3.33 per barrel compared to \$1.85 per barrel in the first half of 2016. In Alberta, the Company incurred high trucking costs in March and April to handle new oil production from its five-well pad at Pouce Coupe, prior to completing construction of the pipeline connection from Kelt's Pouce facility located at 6-33 to the sales line at Progress 6-19. Third-party pipeline outages also caused trucking rates to increase due to high demand and long wait times. In addition, although Kelt's BC oil production is pipeline connected, at certain times the Company may truck BC volumes to terminals in Alberta. Kelt incurs higher transportation expense on these trucked volumes, but the impact on operating netbacks is relatively neutral as Kelt reports a higher realized oil price due to significantly lower pipeline tariffs, equivalent to approximately \$5 per barrel (see footnote 1 regarding the presentation of pipeline tariffs).

## FINANCING EXPENSES

<i>(CA\$ thousands, unless otherwise indicated)</i>	Three months ended June 30			Six months ended June 30		
	2017	2016	%	2017	2016	%
Interest and fees on bank debt	720	2,056	-65	1,393	4,292	-68
Interest on convertible debentures	1,122	715	57	2,232	715	212
Total interest expense	1,842	2,771	-34	3,625	5,007	-28
Accretion of convertible debentures	875	487	80	1,707	487	251
Accretion of decommissioning obligations	743	744	0	1,464	1,503	-3
Total financing expense	3,460	4,002	-14	6,796	6,997	-3
Interest expense per BOE <sup>(1)</sup>	0.98	1.51	-35	0.98	1.26	-22
Average principal amount outstanding during period:						
Bank debt	55,508	153,147	-64	47,745	174,707	-73
Convertible debentures	90,000	58,352	54	90,000	29,176	208
Average total principal amount of debt outstanding	145,508	211,499	-31	137,745	203,883	-32

(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 total interest expense paid or payable in cash of \$1.8 million (\$0.98 per BOE) for the quarter ended June 30, 2017 is down 34% from the comparative quarter due to the significant decrease in average total debt outstanding following completion of the Karr Property Disposition, and on improved commodity prices compared to the first half of 2016.

On May 3, 2016, Kelt reduced borrowings under its revolving bank credit facility using the net proceeds of the offering of \$90.0 million principal amount of convertible unsecured subordinated debentures (the "Debentures"). The Debentures mature on May 31, 2021 and bear interest at 5.0% per annum, payable semi-annually on May 31<sup>st</sup> and November 30<sup>th</sup>. Financing expense for the quarter ended June 30, 2017 includes \$1.1 million of accrued cash interest and \$0.9 million of non-cash accretion expense. The Debentures are convertible into common shares of the Company at a conversion price of \$5.50 per share. Based on the closing price of Kelt common shares on the TSX of \$6.28 per share on June 30, 2017, the Debentures are "in-the-money".

The Company has a revolving committed term credit facility (the "Credit Facility") with a syndicate of financial institutions. Amounts drawn under the Credit Facility are primarily in the form of bankers' acceptances ("BAs"). Stamping fees on BAs fluctuate based on a pricing grid and range from 2.0% to 3.5%, depending upon the Company's quarter-end debt to cash flow ratio of between less than one and one tenth times to greater than three times. The Company's debt to cash flow ratio has improved significantly and Kelt realized a 150 basis point decrease in the applicable margin under the Credit Facility compared to the second quarter of 2016. The impact of lower interest and stamping fees is partly offset by higher standby charges on the undrawn portion of the Credit Facility.

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



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

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

<i>(CA\$ thousands, unless otherwise indicated)</i>	Three months ended June 30			Six months ended June 30		
	2017	2016	%	2017	2016	%
Salaries and benefits	2,074	1,659	25	4,090	3,286	24
Other G&A expenses	988	784	26	2,026	1,946	4
Gross G&A expenses	3,062	2,443	25	6,116	5,232	17
Overhead recoveries	(1,057)	(863)	22	(2,465)	(1,765)	40
G&A expense, net of recoveries	2,005	1,580	27	3,651	3,467	5
Gross G&A (\$ per BOE)	1.63	1.33	23	1.65	1.32	25
Net G&A (\$ per BOE)	1.06	0.86	23	0.99	0.88	13

The Company incurred \$3.7 million of G&A expenses during the first six months of 2017, up 5% from \$3.5 million during the same period of 2016. The increase in gross G&A expenses (before recoveries), which averaged \$1.65 per BOE year-to-date during 2017, is primarily driven by the increase in total salaries and benefits as Kelt has hired new employees and consultants to support the Company’s growth. Executive salaries continue to be below median levels in the industry. Net G&A expense averaged \$0.99 per BOE for the six month period ended June 30, 2017.

G&A expenses are reported net of overhead recoveries, however, Kelt does not capitalize any direct G&A expenses. Total overhead recoveries are higher in 2017 in conjunction with the significant increase in capital expenditures (before proceeds from dispositions) compared to 2016. Capital overhead recoveries are lower in the second quarter of 2017, relative to the first quarter of 2017, in proportion to the decline in capital spending through spring break up. As a result, net G&A of \$1.06 per BOE during the second quarter ended June 30, 2017 is higher than net G&A of \$0.91 per BOE reported for the first quarter ended March 31, 2017, although gross G&A expenses per BOE are relatively unchanged.

## SHARE BASED COMPENSATION (“SBC”)

<i>(CA\$ thousands, unless otherwise indicated)</i>	Three months ended June 30			Six months ended June 30		
	2017	2016	%	2017	2016	%
Stock options	860	807	7	1,756	1,672	5
Restricted share units (“RSUs”)	439	341	29	793	869	-9
Total SBC expense	1,299	1,148	13	2,549	2,541	0
\$ per BOE	0.69	0.62	11	0.69	0.64	8

Share based compensation is expensed using graded amortization over the three year vesting period. The fair value of new stock options and RSUs granted during the first half of 2017 increased, primarily due to appreciation of Kelt’s share price compared to 2016. During the period ended June 30, 2017, SBC expense average \$0.69 per BOE, reflecting management’s efforts to provide long term incentives to employees while minimizing the dilutive impact to shareholders. As at June 30, 2017, stock options and RSUs outstanding represent 5% of total shares outstanding (5% of total shares outstanding at December 31, 2016).

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

<i>(CA\$ thousands, unless otherwise indicated)</i>	Three months ended June 30			Six months ended June 30		
	2017	2016	%	2017	2016	%
Expired mineral leases	464	2,198	-79	527	2,827	-81
\$ per BOE	0.25	1.20	-79	0.14	0.71	-80

The Company expensed \$0.5 million of costs related to the expiry of non-core land holdings during the quarter ended June 30, 2017. The majority of the mineral leases expired during 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		
	2017	2016	%	2017	2016	%
Depletion of D&P assets	30,271	34,799	-13	57,296	75,516	-24
Depreciation of corporate assets	269	183	47	471	396	19
Total depletion and depreciation	30,540	34,982	-13	57,767	75,912	-24
Depletion and depreciation (\$/BOE)	16.22	19.02	-15	15.60	19.18	-19

The Company calculates depletion of development and production (“D&P”) assets based on production relative to total proved reserves, for each depletion unit. Depletion expense of \$57.3 million for the first half of 2017 is down by 24% or \$18.2 million from the comparative period, of which, approximately \$7.6 million is attributed to the Karr Property Disposition. In addition, while the decrease in depletion is partly due to lower production volumes year-to-date in 2017 compared to 2016, the significant decrease of depletion expense per BOE reflects the Company’s improving capital efficiencies. In particular, Kelt has added proved reserves at lower than historical finding and development capital costs.

Depletion and depreciation expense of \$16.22 per BOE reported for quarter ended June 30, 2017, increased from \$14.97 per BOE during first quarter ended March 31, 2017. During the second quarter of 2017, the Company brought new Montney oil wells on production in its core areas. High initial or “flush” production rates on these wells resulted in a high depletion factor for the second quarter, driving the increase in corporate total and per unit depletion expense during the three month period ended June 30, 2017, compared to the quarter ended March 31, 2017.

## GAIN ON SALE OF ASSETS

<i>(CA\$ thousands, unless otherwise indicated)</i>	Three months ended June 30			Six months ended June 30		
	2017	2016	%	2017	2016	%
Gain on sale of assets	1,584	-	-	1,563	2,134	-27

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

On June 20, 2017, the Company disposed of certain non-core assets located near Grande Cache, Alberta, for net proceeds of \$3.1 million and reported a gain of \$1.6 million. Production associated with those assets was approximately 140 BOE per day.

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

## DERIVATIVE FINANCIAL INSTRUMENTS

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

(CA\$ thousands, unless otherwise indicated)	Three months ended June 30			Six months ended June 30		
	2017	2016	%	2017	2016	%
Realized gain (loss)	(396)	(22)	1700	(371)	(36)	931
Unrealized gain (loss)	184	128	44	421	251	68
Gain (loss) on derivative financial instruments	(212)	106	-300	50	215	-77
\$ per BOE	(0.11)	0.06	-283	0.01	0.05	-80

### Interest rate risk management contracts

The Company is exposed to interest rate risk to the extent that changes in market interest rates will impact the Company's Credit Facility which is subject to a floating interest rate. Based on average bank debt outstanding of \$47.7 million during the first half of 2017, an increase (decrease) in the market rate of interest by 25 basis points would have increased (decreased) interest expense by \$0.1 million. During the previous year ended December 31, 2016, Kelt had an interest rate swap fixing CDOR at 0.925% on a notional amount of \$100 million until June 30, 2017. In January 2017, in conjunction with the Karr Property Disposition and resulting reduction in bank debt, the interest rate swap was unwound and terminated for proceeds of \$10 thousand.

### Commodity price risk management contracts

As at June 30, 2017, the following commodity price risk management contracts are outstanding:

Contract Type	Notional Volume	Reference Prices	Fixed Contract Price	Remaining Term	Fair value Asset (Liability)
Financial Swap Natural Gas	10,000 MMBtu/d	SoCAL Border Avg. NYMEX Henry Hub	SoCAL Border Avg. plus US\$0.055 per MMBtu	July to October 2017	(198) <sup>(1)</sup>
Financial Swap Propane	500 bbls/d	OPIS-Conway propane WTI Cushing Oklahoma	50% of US\$WTI	July to December 2017	(190) <sup>(2)</sup>

(1) The fair value is sensitive to changes in natural gas reference prices. If the Southern California Border Average ("SoCAL Border Avg.") - NYMEX basis differential increased (decreased) by \$0.10/MMBtu, the fair market value of the contract would decrease (increase) by approximately \$0.2 million.

(2) The fair value is sensitive to changes in propane reference prices. If the OPIS-Conway propane price increased (decreased) by 5% relative to the fixed contract price, the fair market value of the contract would decrease (increase) by approximately \$0.1 million.

### Foreign exchange risk management contracts

As at June 30, 2017, the following foreign exchange risk management contract was outstanding:

Contract Type	Notional Amount per month	Fixed Contract Price	Remaining Term	Fair value Asset (Liability)
FX swap <sup>(1)</sup>	US\$1,000,000	CA\$/US\$ 1.3300	July to December 2017	210 <sup>(2)</sup>

(1) The FX swap outstanding at June 30, 2017 resulted from an FX swaption contract which was exercised by the counterparty on December 30, 2016. Kelt received a cash premium of \$0.255 million at the time of entering into the contract on July 11, 2016.

(2) The fair value of the contract is sensitive to changes in the exchange rate. If the CA\$/US\$ exchange rate increased (decreased) by \$0.05, the fair market value of the contract would decrease (increase) by approximately \$0.3 million.

Subsequent to the end of the reporting period, the forward exchange rate fell to CA\$/US\$ 1.25. On July 26, 2017, the Company unwound the FX swap for cash proceeds of \$0.4 million, extinguishing the contract for the remaining five month term from August to December 2017. Kelt realized a cumulative net cash gain of \$0.7 million under this contract, including the cash premium earned at inception.

In November 2016, Kelt received a cash premium of \$0.205 million for entering into a forward foreign exchange swaption contract whereby the counterparty had the right, if exercised on March 31, 2017, to enter a series of forward foreign exchange transactions fixing the exchange rate on a notional US\$1.0 million per month at CA\$/US\$ 1.3600 from April 2017 to March 2018. The swaption was not exercised on March 31, 2017 and Kelt has no further obligations under the contract.

## INCOME TAXES

<i>(CA\$ thousands, unless otherwise indicated)</i>	Three months ended June 30			Six months ended June 30		
	2017	2016	%	2017	2016	%
Deferred income tax recovery	<b>(1,313)</b>	(7,594)	-83	<b>(1,940)</b>	(17,179)	-89
Loss before taxes	<b>(6,182)</b>	(28,007)	-78	<b>(9,076)</b>	(63,510)	-86
Effective tax recovery rate	<b>21.2%</b>	27.1%	-22	<b>21.4%</b>	27.0%	-21

The consolidated combined federal and provincial statutory tax rate averaged 26.4% and 26.3% during the three and six months ended June 30, 2017, respectively, compared to 26.6% in each of the comparative periods of 2016.

A detailed analysis of the provision for deferred income taxes is included in note 12 of the interim financial statements, which includes a reconciliation of the difference between the deferred income tax recovery reported relative to expected recovery based on the statutory tax rate. The lower effective rate of tax recovery during 2017 is due to qualifying expenditures incurred and renounced in respect of flow-through shares.

On August 23, 2016, the Company raised gross proceeds of \$2.5 million by issuing 0.385 million FTS at a price of \$6.50 per FTS, resulting in a premium of \$0.6 million or \$1.66 per FTS. Pursuant to the private placement, the Company was obligated to incur eligible Canadian exploration expenses prior to December 31, 2017. As of June 30, 2017, the Company has incurred the required amount of qualifying expenditures and fully satisfied all FTS obligations. The expenditures were renounced to subscribers under the “look-back rule” with an effective date of December 31, 2016.

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

Kelt was not required to pay income taxes in the current or prior year as the Company had sufficient income tax deductions available to shelter taxable income. The Company’s consolidated tax pools are estimated to be approximately \$916.6 million as of June 30, 2017, down 6% from \$975.4 million at December 31, 2016. Proceeds from the Karr Property Disposition of \$100.0 million, before closing adjustments, reduced Kelt’s COGPE and UCC tax pools by \$80 million and \$20 million, respectively.

<i>(CA\$ thousands, unless otherwise indicated)</i>	Rate	June 30 2017	December 31 2016	% change
Canadian oil and gas property expenses (COGPE)	10%	<b>157,191</b>	248,468	-37
Canadian development expenses (CDE)	30%	<b>188,921</b>	154,830	22
Canadian exploration expenses (CEE)	100%	<b>98,870</b>	94,597	5
Undepreciated capital cost <sup>(1)</sup> (UCC)	25%	<b>164,314</b>	177,487	-7
Share and debt issue costs (SIC/DIC)	5 years	<b>10,621</b>	13,795	-23
Non-capital losses <sup>(2)</sup> (NCL)	100%	<b>296,726</b>	286,219	4
Estimated tax deductions available, end of year		<b>916,643</b>	975,396	-6

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

(2) The Company’s non-capital losses expire in years 2023 to 2036.

## ADJUSTED FUNDS FROM OPERATIONS

THREE MONTHS ENDED JUNE 30 <sup>TH</sup>	2017		2016		% change	
	Amount	\$/BOE	Amount	\$/BOE	Amount	\$/BOE
<i>(CA\$ thousands, unless otherwise indicated)</i>						
Petroleum and natural gas revenue	60,072	31.91	40,718	22.14	48	44
Realized gain (loss) on financial instruments <sup>(1)</sup>	(396)	(0.21)	(21)	(0.01)	1786	2000
Royalties	(4,642)	(2.47)	(3,034)	(1.65)	53	50
Revenue, after royalties and financial instruments	55,034	29.23	37,663	20.48	46	43
Production expense	(19,325)	(10.27)	(16,324)	(8.87)	18	16
Transportation expense	(6,529)	(3.47)	(5,316)	(2.89)	23	20
<b>Operating income</b> <sup>(2)</sup>	<b>29,180</b>	<b>15.49</b>	16,023	8.72	82	78
Financing expense <sup>(3)</sup>	(1,842)	(0.98)	(2,771)	(1.51)	-34	-35
G&A expense	(2,005)	(1.06)	(1,580)	(0.86)	27	23
Realized gain (loss) on financial instruments <sup>(4)</sup>	-	-	(1)	(0.00)	-100	0
<b>Adjusted funds from operations</b> <sup>(5)</sup>	<b>25,333</b>	<b>13.45</b>	11,671	6.35	117	112
Basic (\$ per common share) <sup>(6)</sup>	0.14		0.07		100	
Diluted (\$ per common share) <sup>(6)</sup>	0.14		0.07		100	
Common shares outstanding (000s):						
Basic, weighted average	175,894		173,818		1	
Diluted, weighted average	177,316		173,972		2	

SIX MONTHS ENDED JUNE 30 <sup>TH</sup>	2017		2016		% change	
	Amount	\$/BOE	Amount	\$/BOE	Amount	\$/BOE
<i>(CA\$ thousands, unless otherwise indicated)</i>						
Petroleum and natural gas revenue	120,297	32.50	81,116	20.49	48	59
Realized gain (loss) on financial instruments <sup>(1)</sup>	(381)	(0.10)	(21)	(0.01)	1714	900
Royalties	(11,265)	(3.04)	(5,893)	(1.49)	91	104
Revenue, after royalties and financial instruments	108,651	29.36	75,202	18.99	44	55
Production expense	(36,791)	(9.94)	(38,036)	(9.61)	-3	3
Transportation expense	(12,438)	(3.36)	(11,055)	(2.79)	13	20
<b>Operating income</b> <sup>(2)</sup>	<b>59,422</b>	<b>16.06</b>	26,111	6.59	128	144
Financing expense <sup>(3)</sup>	(3,625)	(0.98)	(5,007)	(1.26)	-28	-22
G&A expense	(3,651)	(0.99)	(3,467)	(0.88)	5	13
Realized gain (loss) on financial instruments <sup>(4)</sup>	10	0.00	(15)	(0.00)	-167	0
<b>Adjusted funds from operations</b> <sup>(5)</sup>	<b>52,156</b>	<b>14.09</b>	17,622	4.45	196	217
Basic (\$ per common share) <sup>(6)</sup>	0.30		0.10		200	
Diluted (\$ per common share) <sup>(6)</sup>	0.29		0.10		190	
Common shares outstanding (000s):						
Basic, weighted average	175,805		171,321		3	
Diluted, weighted average	177,093		171,444		3	

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

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

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

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

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

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

During the three months ended June 30, 2017, adjusted funds from operations was \$25.3 million (\$0.14 per common share, diluted), up 117% from \$11.7 million (\$0.07 per common share, diluted) in the second quarter of 2016. Year-to-date in 2017, adjusted funds from operations is up 196% to \$52.2 million (\$0.29 per common share, diluted) compared to \$17.6 million (\$0.10 per common share, diluted) in the same six month period of 2016.

The increase in adjusted funds from operations is primarily attributed the increase in revenues driven by the recovery of commodity prices, which more than offset the 6% decrease in average production volumes compared to the first half of 2016. While the Company incurred higher transportation expenses during 2017, a portion of the increase related to oil and gas marketing arrangements and firm pipeline commitments contributed to the increase in Kelt's realized prices, partly mitigating the impact on operating netbacks. The Company's operating netback averaged \$16.06 per BOE for the six month period ended June 30, 2017, up 144% compared to \$6.59 per BOE in the same period of 2016. The Company's low financing and G&A expenses result in the majority of operating income generated in the field contributing directly to Kelt's funds from operations.

## LOSS AND COMPREHENSIVE LOSS

<i>(CA\$ thousands, unless otherwise indicated)</i>	Three months ended June 30			Six months ended June 30		
	2017	2016	%	2017	2016	%
Loss and comprehensive loss	<b>(4,869)</b>	(20,413)	-76	<b>(7,136)</b>	(46,331)	-85
Wtd avg. shares outstanding, basic (000s)	<b>175,894</b>	173,818	1	<b>175,805</b>	171,321	3
Wtd avg. shares outstanding, diluted (000s) <sup>(1)(2)</sup>	<b>175,894</b>	173,818	1	<b>175,805</b>	171,321	3
\$ per common share, basic	<b>(0.03)</b>	(0.12)	-75	<b>(0.04)</b>	(0.27)	-85
\$ per common share, diluted <sup>(1)(2)</sup>	<b>(0.03)</b>	(0.12)	-75	<b>(0.04)</b>	(0.27)	-85
\$ per BOE	<b>(2.59)</b>	(11.10)	-77	<b>(1.93)</b>	(11.70)	-84

(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 months ended June 30, 2017 and 2016, the Company excluded the effect of stock options and RSUs as they were anti-dilutive. Therefore, the diluted weighted average is equal to the basic weighted average shares outstanding in each period.

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

Kelt reported a loss of \$4.9 million (\$0.03 per common share, diluted) for the second quarter of 2017, down 76% compared to the loss of \$20.4 million (\$0.12 per common share, diluted) in the second quarter of 2016. The decrease in loss is primarily due to the \$13.2 million increase in operating income and \$4.4 million decrease in depletion expense, partly offset by the corresponding reduction in the deferred income tax recovery.

Year-to-date in 2017, the loss reported of \$7.1 million (\$0.04 per common share, diluted) is 85% lower than the loss of \$46.3 million (\$0.27 per common share, diluted) in the corresponding period of 2016. Similarly, the decrease in loss was primarily driven by higher operating income and lower depletion, net of the change in deferred taxes.

## INVESTING ACTIVITIES

### CAPITAL EXPENDITURES

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

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

<i>(CA\$ thousands, unless otherwise indicated)</i>	Three months ended June 30			Six months ended June 30		
	2017	2016	%	2017	2016	%
Capital expenditures:						
Lease acquisition and retention	1,191	1,245	-4	3,403	1,985	71
Geological and geophysical	-	160	-100	280	160	75
Drilling and completion of wells	19,600	999	1862	69,093	14,330	382
Facilities, pipeline and well equipment	13,558	4,500	201	29,075	14,973	94
Corporate assets	622	120	418	732	128	472
Capital expenditures, before A&D	34,971	7,024	398	102,583	31,576	225
Property acquisitions	-	18,884	-100	-	18,921	-100
Property dispositions	(3,341)	-	-	(106,317)	(1,184)	8879
Total capital expenditures, net of dispositions	31,630	25,908	22	(3,734)	49,313	-108

#### *Minor Property Disposition*

On June 20, 2017, Kelt completed a disposition of certain non-core assets located near Grande Cache, Alberta, for cash proceeds of \$3.2 million before closing adjustments. The assets and associated decommissioning obligations disposed had a net carrying value of approximately \$1.5 million resulting in a gain on sale of \$1.6 million (after estimated closing adjustments). At the time of disposition, production from the assets was approximately 140 BOE per day (90% gas).

#### *Karr Property Disposition*

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

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

<b>Estimates as of:</b> (CA\$ thousands)	<b>June 30 2017</b>	December 31 2016	Change in Estimates
Gross purchase price	100,000	100,000	-
Estimated closing adjustments <sup>(1)</sup>	3,092	2,926	166
<b>Fair value of consideration <sup>(1)</sup></b>	<b>103,092</b>	<b>102,926</b>	<b>166</b>
Exploration and evaluation assets	4,377	4,377	-
Property, plant and equipment, net <sup>(2)</sup>	101,264	101,081	183
Assets held for sale and disposed	<b>105,641</b>	<b>105,458</b>	<b>183</b>
Decommissioning obligations held for sale and disposed <sup>(3)</sup>	(2,532)	(2,532)	-
<b>Net assets held for sale and disposed</b>	<b>103,109</b>	<b>102,926</b>	<b>183</b>

(1) At the time of preparation of the interim financial statements, closing adjustments are estimated to be approximately \$3.1 million and include estimates for certain capital expenditures and operating income between the effective and closing date of the disposition. The total amount of adjustments will not be known until completion of the final statement of adjustments and as a result, the fair value of consideration may differ from this estimate.

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

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

#### Key Attributes of the Karr Property Disposition:

- At December 31, 2016, as evaluated by Sproule, proved reserves were 7.7 million BOE (\$71.3 million of FDC required to develop proved reserves) and proved plus probable reserves were 13.5 million BOE (\$105.3 million of FDC required to develop proved plus probable reserves) of which 26% were oil, 21% were NGLs and 53% were gas;
- Average production for December 2016 was approximately 1,300 BOE per day (34% oil, 16% NGLs and 50% gas);
- Land holdings include 16,480 gross acres (25.7 sections) and 16,400 net acres (25.6 sections) of which 9,920 gross acres (15.5 sections) and 9,840 net acres (15.4 sections) included Montney rights. Approximately 79% of net land holdings were classified as undeveloped by Kelt; and
- Tangible equipment includes a 100% interest in the Kelt Karr 10-21-65-3W6 oil battery and a 2.26% interest in the CNRL Karr 10-10-65-2W6 gas plant.

Kelt retained certain non-operated interests at Karr with current production of approximately 120 BOE per day and a 1.0% interest in the CNRL Karr 10-10-65-2W6 gas plant. The Company may endeavour to divest of these minor interests in the future.

#### Property Acquisitions and Dispositions – Year ended December 31, 2016

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

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

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



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

## **CAPITAL RESOURCES AND LIQUIDITY**

Kelt's capital management objective is to maintain a flexible capital structure and sufficient liquidity to allow the Company to execute on its capital investment program and strategic growth plan. The Company strives to actively manage its capital structure in response to changes in economic conditions and the risk characteristics of its underlying oil and natural gas assets. As at June 30, 2017, Kelt's capital structure was comprised of shareholders' capital, convertible debentures, bank debt and working capital.

The capital intensive nature of Kelt's operations may create a working capital deficiency position during periods with high levels of capital investment. Kelt's working capital deficiency decreased at June 30, 2017 with lower capital spending through spring break-up during the second quarter. The Company maintains sufficient unused bank credit lines to satisfy such working capital deficiencies. As at June 30, 2017, the Company's working capital deficit of \$16.0 million combined with outstanding bank debt of \$64.6 million, represented 44% of the authorized borrowing amount available under the Credit Facility of \$185.0 million (down from 75% of the authorized borrowing amount at December 31, 2016).

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

	<b>June 30, 2017</b>	December 31, 2016
Bank debt	<b>64,575</b>	111,693
Working capital deficiency	<b>16,043</b>	26,349
Bank debt, net of working capital <sup>(1)</sup>	<b>80,618</b>	138,042
Trailing annualized adjusted funds from operations <sup>(2)(3)</sup>	<b>101,332</b>	92,400
Net bank debt to trailing adjusted funds from operations ratio <sup>(1)</sup>	<b>0.8</b>	1.5

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

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

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

The Company has reduced its net bank debt to trailing adjusted funds from operations ratio to 0.8 times as at June 30, 2017, from 1.5 times at December 31, 2016. The Karr Property Disposition was completed on January 18, 2017 for cash proceeds of \$103.1 million. The proceeds were used initially to reduce bank indebtedness under the Credit Facility and have been used, along with \$54.4 million of cash provided by operating activities, to fund exploration and development capital expenditures of \$102.6 million during the first half of 2017. Future capital expenditures are expected to be funded through a combination of cash flow from operations and bank debt, and may be supplemented by new equity or debt offerings.

## **CREDIT FACILITY**

The Company has a revolving committed term credit facility (the "Credit Facility") with a syndicate of financial institutions. As at June 30, 2017, the authorized borrowing amount available under the Credit Facility was \$185.0 million (unchanged from December 31, 2016). The Credit Facility is available for a revolving period of 364 days, maturing on April 28, 2018, and may be extended annually at Kelt's option and subject to lender approval, with a term-out to April 28, 2019 if not renewed. The Credit Facility is subject to semi-annual borrowing base reviews, occurring approximately in April and October of each year. In the event that the lenders reduced the borrowing base below the amount drawn at the time of the redetermination, the Company would have 60 days to eliminate any borrowing base shortfall by repaying the amount drawn in excess of the re-determined borrowing base or by

providing additional security or other consideration satisfactory to the lenders. Repayments of principal are not required provided that the borrowings under the facility do not exceed the authorized borrowing amount and the Company is in compliance with all covenants, representations and warranties.

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

## **CONVERTIBLE DEBENTURES**

On May 3, 2016, the Company issued \$90.0 million principal amount of convertible unsecured subordinated debentures (the "Debentures") for net proceeds of \$86.4 million. The Debentures mature on May 31, 2021 (the "Maturity Date") and bear interest at 5.0% per annum payable semi-annually on May 31<sup>st</sup> and November 30<sup>th</sup>, commencing November 30, 2016. At the holder's option, the Debentures may be converted into common shares of the Company at any time prior to the close of business on the earlier of the business day immediately preceding (i) the Maturity Date, (ii) if called for redemption, the date fixed for redemption by the Company, or (iii) if called for repurchase in the event of a change of control, the payment date, at a conversion price of \$5.50 per share (the "Conversion Price"), being a conversion rate of approximately 181.8182 common shares per \$1,000 principal amount of Debentures, subject to adjustment in certain circumstances. The Debentures are "in-the-money" based on the closing price of Kelt common shares on the TSX of \$6.28 as at June 30, 2017. To date, there have been no conversions the \$90.0 million principal amount is outstanding.

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

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

The Debentures trade on the TSX under the symbol "KEL.DB". As at June 30, 2017, the fair value of the Debentures was \$126.0 million based on the closing market price of \$140.00 per Debenture, being the price at which the Debentures last traded in the second quarter. The fair value was \$130.5 million at December 31, 2016.

## **SHARE INFORMATION**

The Company is authorized to issue an unlimited number of common shares and an unlimited number of preferred shares. As at June 30, 2017 there were 176.0 million common shares issued and outstanding (as of August 8, 2017 there are 176.0 million common shares outstanding). There are no preferred shares issued or outstanding.

The Company's common shares trade on the TSX under the symbol "KEL". During the first half of 2017, 125.3 million common shares traded on the TSX at a weighted average price of \$6.66 per common share, up from the volume weighted average trading price of \$4.93 per common share during the year ended December 31, 2016.

As at June 30, 2017, officers, directors, and employees have been granted options to purchase 8.3 million common shares of the Company at an average exercise price of \$6.62 per common share. In addition, there are 0.8 million

RSUs outstanding. Options and RSUs outstanding at June 30, 2017 represented 5.2% of total common shares issued and outstanding. Additional information regarding the Company's stock options and RSUs is included in note 11 of the interim financial statements.

## CONTRACTUAL OBLIGATIONS

As of June 30, 2017, the Company is committed to future payments under the following agreements:

<i>(CA\$ thousands)</i>	2017	2018	2019	2020	2021	Thereafter
Operating lease - office buildings	696	577	108	18	-	-
Operating lease - vehicles	178	287	174	24	-	-
Capital purchase commitments	11,500	-	-	-	-	-
Firm processing commitments	3,576	3,881	-	-	-	-
Firm transportation commitments <sup>(1)</sup>	7,956	8,062	5,599	2,731	2,056	8,885
<b>Total annual commitments</b>	<b>23,906</b>	<b>12,807</b>	<b>5,881</b>	<b>2,773</b>	<b>2,056</b>	<b>8,885</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, 2017 of CA\$/US\$1.2977.

During the second quarter of 2017, Kelt entered into an agreement to purchase gas compression facilities and equipment for \$12.5 million. A deposit of \$1.0 million was paid upon entering the agreement and subsequent to the reporting period, the balance of the purchase price of \$11.5 million was paid at closing on July 31, 2017 (see also, "Subsequent Events" and "Outlook and Guidance").

The Company has firm commitments for oil and gas transportation on major pipelines in Alberta and British Columbia. For periods subsequent to 2021, Kelt has an annual commitment of \$1.2 million for gas transportation until March 31, 2026 and an annual commitment of \$0.7 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 six months ended June 30, 2017, the Company incurred \$0.2 million (2016 – \$0.5 million) in legal fees and disbursements, of which \$0.1 million is payable at June 30, 2017 (\$0.1 million at December 31, 2016). The Company expects to continue using the services of this law firm from time to time.

## SUBSEQUENT EVENTS

On July 31, 2017, the Company completed the purchase of a major infrastructure package for \$12.5 million. After a new lease has been surveyed and built, this infrastructure package will be moved and installed on a new site at Inga, BC, in close proximity to the Company's existing facility located at 15-03-088-23W6. Refer to additional information under the heading of "Outlook and Guidance".

## OFF-BALANCE SHEET TRANSACTIONS

The Company did not engage in any off-balance sheet transactions during the periods ended June 30, 2017 and 2016.

## SUMMARY OF QUARTERLY RESULTS

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

<i>(CA\$ thousands, except as otherwise indicated)</i>	<b>Q2 2017</b>	Q1 2017	Q4 2016	Q3 2016
Revenue, before royalties and financial instruments	<b>60,072</b>	60,225	55,737	47,760
Adjusted funds from operations	<b>25,333</b>	26,823	23,100	17,658
Per share – basic (\$/common share)	<b>0.14</b>	0.15	0.13	0.10
Per share – diluted (\$/common share)	<b>0.14</b>	0.15	0.13	0.10
Profit (loss) and comprehensive income (loss)	<b>(4,869)</b>	(2,267)	11,856	(15,299)
Per share – basic (\$/common share)	<b>(0.03)</b>	(0.01)	0.07	(0.09)
Per share – diluted (\$/common share)	<b>(0.03)</b>	(0.01)	0.07	(0.09)
Total capital expenditures, net of dispositions	<b>31,630</b>	(35,364)	36,339	12,616
Total assets	<b>1,203,174</b>	1,193,644	1,255,958	1,232,147
Bank debt	<b>64,575</b>	39,258	111,693	122,024
Working capital deficiency	<b>16,043</b>	36,507	26,349	10,447
Convertible debentures	<b>72,685</b>	71,810	70,978	70,134
Shareholders' equity	<b>839,485</b>	842,351	843,301	823,887
Average daily production (BOE/d)	<b>20,684</b>	20,204	19,762	20,542
Average realized price, after financial instruments (\$/BOE)	<b>31.70</b>	33.13	30.53	25.47
Operating netback (\$/BOE)	<b>15.49</b>	16.63	15.08	11.73
Netback as a percentage of revenue	<b>49%</b>	50%	49%	46%

	Q2 2016	Q1 2016	Q4 2015	Q3 2015
Revenue, before royalties and financial instruments	40,718	40,398	42,797	45,015
Adjusted funds from operations	11,671	5,951	11,172	16,601
Per share – basic (\$/common share)	0.07	0.04	0.07	0.10
Per share – diluted (\$/common share)	0.07	0.04	0.07	0.10
Profit (loss) and comprehensive income (loss)	(20,413)	(25,918)	(92,987)	(21,557)
Per share – basic (\$/common share)	(0.12)	(0.15)	(0.55)	(0.13)
Per share – diluted (\$/common share) <sup>1</sup>	(0.12)	(0.15)	(0.55)	(0.13)
Total capital expenditures, net of dispositions	25,908	23,405	42,487	33,389
Total assets	1,260,245	1,268,268	1,279,475	1,363,348
Bank debt	126,993	214,360	177,570	147,801
Working capital deficiency	12,087	15,930	35,389	34,729
Convertible debentures	69,320	-	-	-
Shareholders' equity	835,241	822,229	846,754	937,658
Average daily production (BOE/d)	20,208	23,295	20,086	18,695
Average realized price, after financial instruments (\$/BOE)	22.13	19.06	22.01	25.71
Operating netback (\$/BOE)	8.72	4.76	8.05	11.52
Netback as a percentage of revenue	39%	25%	37%	45%

Since commencing active operations on February 26, 2013 with initial production of approximately 3,500 BOE per day, Kelt achieved corporate record average production of 23,295 BOE per day during the first quarter of 2016. Average production was lower in subsequent quarters of 2016 and in the first two quarters of 2017 due to normal declines in conjunction with much lower capital expenditures compared to 2015, as well as significant production downtime resulting from third-party pipeline restrictions, constrained pipeline capacity, and plant/facility outages.

In the second half of 2014, global crude oil prices began a precipitous decline that subsequently resulted in massive cutbacks in capital spending on energy projects worldwide. After averaging US\$93.00 per barrel in 2014, WTI oil prices averaged US\$48.80 per barrel in 2015 and bottomed with a low average price of US\$33.45 per barrel during the first quarter of 2016. In November 2016, OPEC and certain non-OPEC countries agreed to cut oil production supplies, resulting in a recovery of oil prices. The impact is seen starting in the fourth quarter of 2016 and in the first quarter of 2017, the Company reported its highest average realized price and operating netback in the past eight consecutive quarters. Adjusted funds from operations of \$26.8 million (\$0.15 per common share, diluted) for the quarter ended March 31, 2017 was also at its highest level over this period. Results for the second quarter of 2017 were also strong, but fell short of the first quarter due lower oil prices and higher production and transportation expenses.

In addition to cash provided by operating activities, the Company's capital expenditures (net of proceeds from dispositions) were funded primarily through equity financings, supplemented by bank debt and the issuance of \$90 million principal amount of 5% convertible debentures on May 3, 2016.

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

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

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

#### Non-GAAP financial measures

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

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

<i>(CA\$ thousands, except as otherwise indicated)</i>	Three months ended June 30			Six months ended June 30		
	2017	2016	%	2017	2016	%
Cash provided by operating activities	28,480	7,776	266	54,370	7,649	611
Change in non-cash working capital	(3,313)	3,431	-197	(3,041)	9,509	-132
Funds from operations	25,167	11,207	125	51,329	17,158	199
Transaction costs	-	19	-100	-	19	-100
Provision for potential credit losses	-	228	-100	-	228	-100
Settlement of decommissioning obligations	166	217	-24	827	217	281
Adjusted funds from operations	25,333	11,671	117	52,156	17,622	196

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		
	2017	2016	%	2017	2016	%
Petroleum and natural gas revenue	60,072	40,718	48	120,297	81,116	48
Realized gain (loss) on financial instruments <sup>(1)</sup>	(396)	(21)	1786	(381)	(21)	1714
Royalties	(4,642)	(3,034)	53	(11,265)	(5,893)	91
Production expenses	(19,325)	(16,324)	18	(36,791)	(38,036)	-3
Transportation expenses	(6,529)	(5,316)	23	(12,438)	(11,055)	13
Operating income	29,180	16,023	82	59,422	26,111	128
Production (mBOE)	1,882	1,839	2	3,701	3,959	-6
Operating netback (\$/BOE)	15.49	8.72	78	16.06	6.59	144

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

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

#### *Other KPI*

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

## **OTHER MEASUREMENTS**

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

## **CHANGES IN ACCOUNTING POLICIES**

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

IFRS 9 uses a single approach to determine whether a financial asset is classified and measured at amortized cost or fair value, replacing the multiple rules in IAS 39. The approach in IFRS 9 is based on how an entity manages its financial instruments and the contractual cash flow characteristics of the financial assets. Most of the requirements in IAS 39 for classification and measurement of financial liabilities were carried forward in IFRS 9, and IFRS 9 has introduced a single expected credit loss impairment model, which is based on changes in credit quality since initial

recognition. The adoption of the expected credit loss impairment model did not have a significant impact on the Company, however there are additional required disclosures which have been included in note 13 to the interim financial statements as at June 30, 2017.

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

## **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, 2016 annual financial statements. There have been no significant changes in the Company's judgments and estimates applied during the interim period ended June 30, 2017 relative to those described in the most recent annual financial statements as at and for the year ended December 31, 2016.

## **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, 2017 to June 30, 2017 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.

## **CURRENT ECONOMIC ENVIRONMENT AND 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. In the current business environment, Kelt continues to focus on maintaining a strong balance sheet, giving the Company the ability to take advantage of opportunities as they arise. The Company's capital expenditure program is also flexible, with the ability to defer expenditures into the future if the current economic environment deteriorates. A comprehensive discussion of business risks, as well as economic and industry factors affecting the Company is included in Kelt's annual MD&A for the year ended December 31, 2016, dated March 7, 2017. Additional information is included in Kelt's Annual Information Form dated March 10, 2017 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.

### **OUTLOOK AND GUIDANCE**

There have been no material changes to the Company's previously disclosed financial and operating guidance for 2017, except for the increase in the capital expenditure budget discussed below. Initial production rates from recent drilling results in both BC and Alberta have exceeded the Company's estimates. As a result, despite the lower second quarter production, Kelt has not changed its full year guidance of average daily production of 23,500 BOE per day. The Company intends to review its production guidance again in September and will provide updated information at that time.

The Company's Board of Directors has agreed to increase the 2017 capital expenditure budget by a net \$10.0 million. Total exploration and development capital expenditures planned for 2017 are \$191.0 million (previously \$173.0 million) and proceeds from property dispositions are expected to be \$111.0 million (previously \$103.0 million), resulting in a net capital expenditure budget of \$80.0 million (previously \$70.0 million). The increase in the capital expenditure budget reflects an additional \$18.0 million for infrastructure expenditures and proceeds from minor property dispositions for \$8.0 million (\$3.3 million of which was already completed at June 30, 2017 and the balance is an estimate for further transactions in the second half of 2017).

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

Kelt has also commenced installation of blending facilities at its three main oil terminals located at Inga, La Glace and Progress, which are now pipeline connected to oil sales and water injection. These new facilities are expected to provide the Company with higher price realizations for its oil and butane sales in each of these areas and are anticipated to be completed prior to December 31, 2017.

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

The information set out herein is "financial outlook" within the meaning of applicable securities laws. The purpose of this financial outlook is to provide readers with disclosure regarding Kelt's reasonable expectations as to the anticipated results of its proposed business activities for 2017. Readers are cautioned that this financial outlook may not be appropriate for other purposes.



### **ADDITIONAL INFORMATION**

Additional information relating to Kelt, including the Company's Annual Information Form ("AIF") dated March 10, 2017 is filed on SEDAR and can be viewed on their website at [www.sedar.com](http://www.sedar.com). Copies of the AIF can also be obtained by contacting Sadiq H. Lalani, Vice President and Chief Financial Officer at Kelt Exploration Ltd., Suite 300, 311 Sixth Avenue SW, Calgary, Alberta, Canada, T2P 3H2. Further information relating to Kelt is also available on its website at [www.keltexploration.com](http://www.keltexploration.com).

On behalf of the Board of Directors,

*[signed]*

David J. Wilson  
President and Chief Executive Officer  
August 8, 2017

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

<i>(CA\$ thousands)</i>	[Notes]	June 30, 2017	December 31, 2016
<b>ASSETS</b>			
<b>Current assets</b>			
Cash and cash equivalents		599	560
Accounts receivable and accrued revenue	[13]	28,177	30,406
Prepaid expenses and deposits		2,589	1,191
Derivative financial instruments	[13]	210	-
<b>Total current assets</b>		<b>31,575</b>	32,157
Assets held for sale	[5]	-	105,458
Exploration and evaluation assets	[6]	118,251	120,166
Property, plant and equipment	[7]	1,053,348	998,177
<b>Total assets</b>		<b>1,203,174</b>	1,255,958
<b>LIABILITIES</b>			
<b>Current liabilities</b>			
Accounts payable and accrued liabilities		46,151	55,659
Derivative financial instruments	[13]	388	599
Deferred premium on flow-through shares	[11]	-	798
Decommissioning obligations	[10]	1,079	1,450
<b>Total current liabilities</b>		<b>47,618</b>	58,506
Decommissioning obligations held for sale	[5]	-	2,532
Bank debt	[8]	64,575	111,693
Convertible debentures	[9]	72,685	70,978
Decommissioning obligations	[10]	138,400	126,597
Deferred income tax liability	[12]	40,411	42,351
<b>Total liabilities</b>		<b>363,689</b>	412,657
<b>SHAREHOLDERS' EQUITY</b>			
Shareholders' capital	[11]	1,058,528	1,055,959
Reserve from common control transaction		(57,668)	(57,668)
Equity component of convertible debentures	[9]	12,856	12,856
Contributed surplus		18,205	17,454
Retained earnings (deficit)		(192,436)	(185,300)
<b>Total shareholders' equity</b>		<b>839,485</b>	843,301
<b>Total liabilities and shareholders' equity</b>		<b>1,203,174</b>	1,255,958
<b>Commitments</b>	[15]		
<b>Subsequent events</b>	[18]		

*The accompanying notes form an integral part of these consolidated condensed 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	
		2017	2016	2017	2016
<b>Revenue</b>					
Petroleum and natural gas revenue		60,072	40,718	120,297	81,116
Royalties		(4,642)	(3,034)	(11,265)	(5,893)
		<b>55,430</b>	37,684	<b>109,032</b>	75,223
<b>Expenses</b>					
Production		19,325	16,324	36,791	38,036
Transportation		6,529	5,316	12,438	11,055
Financing	[14]	3,460	4,002	6,796	6,997
General and administrative		2,005	1,580	3,651	3,467
Provision for potential credit losses		-	228	-	228
Share based compensation	[11]	1,299	1,148	2,549	2,541
Exploration and evaluation	[6]	464	2,198	527	2,827
Depletion and depreciation	[7]	30,540	34,982	57,767	75,912
		<b>63,622</b>	65,778	<b>120,519</b>	141,063
<b>Loss before other items and taxes</b>					
		<b>(8,192)</b>	(28,094)	<b>(11,487)</b>	(65,840)
Gain (loss) on derivative financial instruments	[13]	(212)	106	50	215
Premium on flow-through shares	[11]	638	-	798	-
Gain on sale of assets	[5]	1,584	-	1,563	2,134
Transaction costs		-	(19)	-	(19)
		<b>(6,182)</b>	(28,007)	<b>(9,076)</b>	(63,510)
Deferred income tax recovery	[12]	(1,313)	(7,594)	(1,940)	(17,179)
<b>Loss and comprehensive loss</b>					
		<b>(4,869)</b>	(20,413)	<b>(7,136)</b>	(46,331)
<b>Loss per common share</b>					
Basic	[11]	<b>(0.03)</b>	(0.12)	<b>(0.04)</b>	(0.27)
Diluted	[11]	<b>(0.03)</b>	(0.12)	<b>(0.04)</b>	(0.27)

The accompanying notes form an integral part of these consolidated condensed 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, 2016		175,672	1,055,959	(57,668)	12,856	17,454	(185,300)	843,301
Loss and comprehensive loss		-	-	-	-	-	(7,136)	(7,136)
Exercise of stock options	[11]	154	1,024	-	-	(253)	-	771
Vesting of restricted share units	[11]	165	1,545	-	-	(1,545)	-	-
Share based compensation	[11]	-	-	-	-	2,549	-	2,549
<b>Balance at June 30, 2017</b>		<b>175,991</b>	<b>1,058,528</b>	<b>(57,668)</b>	<b>12,856</b>	<b>18,205</b>	<b>(192,436)</b>	<b>839,485</b>
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, net of costs:								
Private placements	[11]	4,700	22,090	-	-	-	-	22,090
Premium on flow-through shares	[11]	-	(2,585)	-	-	-	-	(2,585)
Share issue costs, net of tax	[11]	-	(83)	-	-	-	-	(83)
Issuance of convertible debentures	[9]	-	-	-	12,856	-	-	12,856
Vesting of restricted share units	[11]	782	5,479	-	-	(5,479)	-	-
Share based compensation	[11]	-	-	-	-	2,541	-	2,541
Balance at June 30, 2016		174,150	1,047,016	(57,668)	12,856	14,895	(181,858)	835,241

*The accompanying notes form an integral part of these consolidated condensed 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	
		2017	2016	2017	2016
<b>Operating activities</b>					
Loss and comprehensive loss		<b>(4,869)</b>	(20,413)	<b>(7,136)</b>	(46,331)
Items not affecting cash:					
Accretion of convertible debentures	[9,14]	<b>875</b>	487	<b>1,707</b>	487
Accretion of decommissioning obligations	[10,14]	<b>743</b>	744	<b>1,464</b>	1,503
Share based compensation		<b>1,299</b>	1,148	<b>2,549</b>	2,541
Exploration and evaluation		<b>464</b>	2,198	<b>527</b>	2,827
Depletion and depreciation		<b>30,540</b>	34,982	<b>57,767</b>	75,912
Unrealized gain on derivative financial instruments	[13]	<b>(184)</b>	(128)	<b>(421)</b>	(251)
Premium on flow-through shares		<b>(638)</b>	-	<b>(798)</b>	-
Gain on sale of assets		<b>(1,584)</b>	-	<b>(1,563)</b>	(2,134)
Deferred income tax recovery		<b>(1,313)</b>	(7,594)	<b>(1,940)</b>	(17,179)
Settlement of decommissioning obligations	[10]	<b>(166)</b>	(217)	<b>(827)</b>	(217)
Change in non-cash operating working capital	[16]	<b>3,313</b>	(3,431)	<b>3,041</b>	(9,509)
<b>Cash provided by operating activities</b>		<b>28,480</b>	7,776	<b>54,370</b>	7,649
<b>Financing activities</b>					
Increase (decrease) in bank debt		<b>25,317</b>	(87,367)	<b>(47,118)</b>	(50,577)
Issue of common shares, net of costs	[11]	-	21,976	-	21,976
Proceeds on exercise of stock options	[11]	<b>704</b>	-	<b>771</b>	-
Issue of convertible debentures, net of costs	[9]	-	86,444	-	86,444
<b>Cash provided by (used in) financing activities</b>		<b>26,021</b>	21,053	<b>(46,347)</b>	57,843
<b>Investing activities</b>					
Exploration and evaluation assets		<b>(9,258)</b>	(1,585)	<b>(26,247)</b>	(14,506)
Property, plant and equipment		<b>(25,713)</b>	(5,439)	<b>(76,336)</b>	(17,070)
Property acquisitions	[4]	-	(18,884)	-	(18,921)
Property dispositions	[5]	<b>3,341</b>	-	<b>106,317</b>	1,184
Change in non-cash investing working capital	[16]	<b>(22,576)</b>	(2,916)	<b>(11,718)</b>	(16,747)
<b>Cash used in investing activities</b>		<b>(54,206)</b>	(28,824)	<b>(7,984)</b>	(66,060)
<b>Net change in cash and cash equivalents</b>		<b>295</b>	5	<b>39</b>	(568)
<b>Cash and cash equivalents, beginning of period</b>		<b>304</b>	297	<b>560</b>	870
<b>Cash and cash equivalents, end of period</b>		<b>599</b>	302	<b>599</b>	302

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

**KELT EXPLORATION LTD.  
NOTES TO THE CONSOLIDATED CONDENSED INTERIM FINANCIAL STATEMENTS  
AS AT AND FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2017  
[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 northwestern Alberta and northeastern British Columbia. The Company was incorporated under the *Business Corporations Act* (Alberta) on October 11, 2012 and was inactive until February 26, 2013. Kelt’s land holdings are located in two core areas, namely: (a) Grande Prairie, Alberta (including Pouce Coupe, Progress and La Glace), held directly by Kelt; and (b) Fort St. John, British Columbia (including Inga, Fireweed and Stoddart), held by the Company’s wholly-owned subsidiary, Kelt Exploration (LNG) Ltd. (“Kelt LNG”). The Company’s common shares and 5% convertible debentures are listed on the Toronto Stock Exchange (“TSX”) under the symbol “KEL” and “KEL.DB”, respectively.

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

**2. BASIS OF PRESENTATION**

The Company’s Board of Directors approved and authorized these consolidated condensed interim financial statements for issue on August 8, 2017.

**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, 2016.

**b) Basis of measurement**

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

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

**c) Significant judgments and estimates**

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

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are reviewed and for any future years affected. Significant judgments, estimates and assumptions made by management in these financial statements are outlined in note 2 of the December 31, 2016 consolidated annual financial statements. There have been no significant changes in the Company’s judgments and estimates applied during the interim period ended June 30, 2017 relative to those described in the most recent annual financial statements as at and for the year ended December 31, 2016.

### 3. SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies applied by the Company are described in note 3 of the December 31, 2016 consolidated annual financial statements. Except as outlined below, these condensed consolidated interim financial statements at June 30, 2017 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, 2016.

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

The IASB has issued accounting standards that are not yet effective, including: IFRS 15 *Revenue from Contracts with Customers* and IFRS 16 *Leases*. Details of the foregoing are outlined in note 3 of the December 31, 2016 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.

#### Changes in Accounting Policies

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

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

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

### 4. PROPERTY ACQUISITIONS

The following table summarizes the fair value of net assets acquired pursuant to property acquisitions during the year ended December 31, 2016. There were no property acquisitions completed during the six months ended June 30, 2017.

	June 30, 2017	December 31, 2016
Exploration and evaluation assets	-	252
Property, plant and equipment	-	18,538
Decommissioning obligations	-	(278)
<b>Fair value of net assets acquired</b>	-	18,512
<b>Cash consideration, after closing adjustments</b>	-	18,512

On April 28, 2016, the Company acquired oil and gas assets in its core area at Progress, Alberta, for cash consideration of \$18.0 million, before closing adjustments. The purchase price was adjusted for the results of operations between the effective date of January 1, 2016 and closing of the acquisition. The transaction was accounted for as a business combination whereby the net assets acquired and the liabilities assumed were recorded at fair value on the acquisition date, which was determined to be equal to the cash consideration paid of \$18.5 million after closing adjustments.

## 5. PROPERTY DISPOSITIONS

The table below summarizes the aggregate proceeds received and carrying values of the assets and associated decommissioning obligations disposed during the six months ended June 30, 2017, and prior year ended December 31, 2016, as well as the resulting net gain on sale in each period:

	June 30, 2017	December 31, 2016
Exploration and evaluation assets	4,565	2,575
Property, plant and equipment	102,986	6,257
Decommissioning obligations	(2,797)	(11,687)
<b>Carrying value of net assets (liabilities) disposed</b>	<b>104,754</b>	<b>(2,855)</b>
<b>Cash proceeds, after closing adjustments <sup>(1)</sup></b>	<b>106,317</b>	<b>5,891</b>
<b>Gain on sale of assets <sup>(1)</sup></b>	<b>1,563</b>	<b>8,746</b>

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

### *Karr Property Disposition*

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

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

Estimates as of: (CA\$ thousands)	June 30, 2017	December 31, 2016	Change in Estimates
Gross purchase price	100,000	100,000	-
Estimated closing adjustments <sup>(1)</sup>	3,092	2,926	166
<b>Fair value of consideration <sup>(1)</sup></b>	<b>103,092</b>	<b>102,926</b>	<b>166</b>
Exploration and evaluation assets	4,377	4,377	-
Property, plant and equipment, net <sup>(2)</sup>	101,264	101,081	183
Assets held for sale and disposed	105,641	105,458	183
Decommissioning obligations held for sale and disposed <sup>(3)</sup>	(2,532)	(2,532)	-
<b>Net assets held for sale and disposed</b>	<b>103,109</b>	<b>102,926</b>	<b>183</b>

(1) At the time of preparation of the interim financial statements, closing adjustments are estimated to be approximately \$3.1 million and include estimates for certain capital expenditures and operating income between the effective and closing date of the disposition. The total amount of adjustments will not be known until completion of the final statement of adjustments and as a result, the fair value of consideration may differ from this estimate.

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

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

### *Minor Property Disposition*

On June 20, 2017, Kelt completed a disposition of certain non-core assets located near Grande Cache, Alberta, for cash proceeds of \$3.2 million before closing adjustments. The assets and associated decommissioning obligations disposed had a net carrying value of approximately \$1.5 million resulting in a gain on sale of \$1.6 million (after estimated closing adjustments).



## 6. EXPLORATION AND EVALUATION ASSETS

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

The following table reconciles movements of exploration and evaluation assets:

	<b>June 30, 2017</b>	December 31, 2016
Balance, beginning of period	<b>120,166</b>	124,305
Additions	<b>26,247</b>	35,575
Property acquisitions [note 4]	-	252
Reclassification (to) from held for sale [note 5]	<b>4,377</b>	(4,377)
Property dispositions [note 5]	<b>(4,565)</b>	(2,575)
Transfers to property, plant and equipment	<b>(27,447)</b>	(28,754)
Expired mineral leases	<b>(527)</b>	(4,260)
Balance, end of period	<b>118,251</b>	120,166

The Company reviews its E&E assets for indicators of potential impairment each reporting period and prior to transferring E&E costs to PP&E. Except for costs associated with the expiry of mineral leases which are recognized as exploration and evaluation expense in the period incurred, the Company concluded that there are no indicators of potential impairment of its E&E assets at June 30, 2017.

## 7. PROPERTY, PLANT AND EQUIPMENT

Net carrying value	June 30, 2017	December 31, 2016
Development and production (“D&P”) assets	1,052,556	997,646
Corporate assets	792	531
<b>Total net carrying value of property, plant and equipment</b>	<b>1,053,348</b>	<b>998,177</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, 2015	1,458,222	1,838	1,460,060
Additions	49,436	636	50,072
Property acquisitions [note 4]	18,538	-	18,538
Reclassification (to) from held for sale [note 5]	(163,166)	-	(163,166)
Property dispositions [note 5]	(11,520)	-	(11,520)
Decommissioning costs	(2,848)	-	(2,848)
Transfers from E&E	28,754	-	28,754
<b>Balance at December 31, 2016</b>	<b>1,377,416</b>	<b>2,474</b>	<b>1,379,890</b>
Additions	75,604	732	76,336
Reclassification (to) from held for sale [note 5]	163,166	-	163,166
Property dispositions [note 5]	(172,822)	-	(172,822)
Decommissioning costs	11,060	-	11,060
Transfers from E&E	27,447	-	27,447
<b>Balance at June 30, 2017</b>	<b>1,481,871</b>	<b>3,206</b>	<b>1,485,077</b>

Accumulated depletion, depreciation and impairment	D&P Assets	Corporate Assets	Total PP&E
Balance at December 31, 2015	334,042	1,113	335,155
Depletion and depreciation expense	139,217	830	140,047
Impairments, net of impairment reversals	(26,141)	-	(26,141)
Reclassification (to) from held for sale [note 5]	(62,085)	-	(62,085)
Property dispositions [note 5]	(5,263)	-	(5,263)
<b>Balance at December 31, 2016</b>	<b>379,770</b>	<b>1,943</b>	<b>381,713</b>
Depletion and depreciation expense	57,296	471	57,767
Reclassification (to) from held for sale [note 5]	62,085	-	62,085
Property dispositions [note 5]	(69,836)	-	(69,836)
<b>Balance at June 30, 2017</b>	<b>429,315</b>	<b>2,414</b>	<b>431,729</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 \$541.0 million (December 31, 2016 – \$588.5 million) are included in the depletion calculation for development and production assets.

## 8. BANK DEBT

	June 30, 2017	December 31, 2016
Bank loan	5,200	82,100
Bankers' acceptances	60,000	30,000
Unamortized financing fees <sup>(1)</sup>	(625)	(407)
Bank debt	64,575	111,693

(1) Includes \$0.2 million of prepaid interest and stamping fees on bankers' acceptances as at June 30, 2017 (\$0.1 million as at December 31, 2016).

The Company has a revolving committed term credit facility (the "Credit Facility") with a syndicate of financial institutions. As at June 30, 2017, the authorized borrowing amount available under the Credit Facility was \$185.0 million (unchanged from December 31, 2016). The Credit Facility is available for a revolving period of 364 days, maturing on April 28, 2018, and may be extended annually at Kelt's option and subject to lender approval, with a term-out to April 28, 2019 if not renewed.

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

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

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

## 9. CONVERTIBLE DEBENTURES

	Number of convertible debentures	Liability component (\$ thousands)	Equity Component (\$ thousands)
Balance at December 31, 2015	-	-	-
Issuance of convertible debentures	90,000	71,665	18,335
Issue costs	-	(2,832)	(725)
Deferred income tax liability	-	-	(4,754)
Accretion of discount	-	2,145	-
<b>Balance at December 31, 2016</b>	<b>90,000</b>	<b>70,978</b>	<b>12,856</b>
Accretion of discount	-	1,707	-
<b>Balance at June 30, 2017</b>	<b>90,000</b>	<b>72,685</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 "in-the-money" based on the closing price of Kelt common shares on the TSX of \$6.28 as at June 30, 2017. To date, there have been no conversions the \$90.0 million principal amount is outstanding.

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

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

Accretion of the liability component and accrued interest payable on the Debentures are included in financing expenses in the Consolidated Statement of Profit (Loss) and Comprehensive Income (Loss) (note 14). At June 30, 2017, the fair value of the Debentures was \$126.0 million (note 13).

## 10. DECOMMISSIONING OBLIGATIONS

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

	June 30, 2017	December 31, 2016
Balance, beginning of period	128,047	142,801
Obligations incurred	2,216	1,233
Obligations acquired [note 4]	-	278
Reclassification (to) from held for sale [note 5]	2,532	(2,532)
Obligations disposed [note 5]	(2,797)	(11,687)
Obligations settled	(827)	(782)
Changes in discount rate	8,394	(8,502)
Revisions to estimates	450	4,421
Accretion expense	1,464	2,817
Balance, end of period	139,479	128,047
Decommissioning obligations – current	1,079	1,450
Decommissioning obligations – non-current	138,400	126,597

The underlying cost estimates are derived from a combination of published industry benchmarks as well as site specific information. As at June 30, 2017, the undiscounted amount of the estimated cash flows required to settle the obligation is \$144.7 million (December 31, 2016 – \$145.8 million), and is expected to be incurred over the next 50 years. Based on an inflation rate of 2.0%, the undiscounted amount of the estimated future cash flows required to settle the obligation is \$306.0 million at June 30, 2017 (December 31, 2016 – \$305.9 million). The inflated future cost estimates are discounted based on a risk-free rate to determine the carrying amounts presented in the table above. As at June 30, 2017, the carrying amount of the decommissioning obligations is based on a risk-free rate of 2.1% (December 31, 2016 – 2.3%).

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

## 11. SHARE CAPITAL

### Authorized

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

### Issued and outstanding

The following table summarizes the change in common shares issued and outstanding. There are no preferred shares issued or outstanding as of June 30, 2017 (December 31, 2016 – nil).

	Number of Shares (000s)	Amount (\$ thousands)
Balance at December 31, 2015	168,668	1,022,115
Issued for cash through common share offerings	6,085	31,690
Deferred premium on flow-through shares	-	(4,103)
Issued for cash on exercise of stock options	67	293
Transfer from contributed surplus on exercise of stock options	-	91
Released upon vesting of restricted share units	852	6,153
Share issue costs, net of deferred taxes	-	(280)
<b>Balance at December 31, 2016</b>	<b>175,672</b>	<b>1,055,959</b>
Issued for cash on exercise of stock options	154	771
Transfer from contributed surplus on exercise of stock options	-	253
Released upon vesting of restricted share units	165	1,545
<b>Balance at June 30, 2017</b>	<b>175,991</b>	<b>1,058,528</b>

### Private placements of flow-through common shares

The table below summarizes flow-through common shares (“FTS”) issued pursuant to private placements during the year ended December 31, 2016, and the cumulative amount of qualifying expenditures incurred over the expenditure periods. As of June 30, 2017, the Company has incurred the required amounts of eligible expenditures and fully satisfied all FTS obligations.

<i>(CA\$ thousands, except as otherwise indicated)</i>					Eligible Expenditures (1)			Expenditure Period End / Effective date of Renunciation
Closing Dates	# of FTS	Price per FTS	Gross Proceeds	Deferred Premium	Type	As at June 30, 2017		
						Incurred	Remaining	
April 7, 2016	4.7 million	\$4.70	22,090	2,585	CDE	22,090 <sup>(2)</sup>	-	December 31, 2016 December 31, 2016
August 23, 2016	0.385 million	\$6.50	2,500	638	CEE	2,500 <sup>(3)</sup>	-	December 31, 2017 December 31, 2016
November 2, 2016	1.0 million	\$7.10	7,100	880	CDE	7,100 <sup>(4)</sup>	-	March 31, 2017 March 31, 2017

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

(2) The full commitment of \$22.1 million of qualifying expenditures were incurred as of December 31, 2016.

(3) The full commitment of \$2.5 million of qualifying expenditures were incurred as of June 30, 2017.

(4) Of the total commitment of \$7.1 million, Kelt incurred \$5.8 million during the fourth quarter of 2016 and \$1.3 million during the first quarter of 2017.

## Stock options

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

The following table summarizes the change in stock options outstanding:

	Number of Options (000s)	Average Exercise Price (\$/share)
Balance at December 31, 2015	6,690	7.40
Granted	2,533	4.71
Exercised <sup>(1)</sup>	(67)	4.38
Forfeited	(780)	7.85
Balance at December 31, 2016	<b>8,376</b>	<b>6.57</b>
Granted	<b>181</b>	<b>7.23</b>
Exercised <sup>(1)</sup>	<b>(154)</b>	<b>4.98</b>
Forfeited	<b>(93)</b>	<b>6.08</b>
<b>Balance at June 30, 2017</b>	<b>8,310</b>	<b>6.62</b>

(1) The weighted average share price on the date stock options were exercised during the period ended June 30, 2017 was \$6.82 per common share (\$5.25 per common share on average during the year ended December 31, 2016).

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	
	2017	2016
Risk free interest rate	<b>0.8%</b>	0.6%
Expected life (years)	<b>3.0</b>	3.6
Expected volatility <sup>(1)</sup>	<b>55.5%</b>	51.8%
Expected dividend yield	<b>0.0%</b>	0.0%
Expected forfeiture rate	<b>4.3%</b>	2.0%
Fair value of options granted during the year (\$/share)	<b>2.68</b>	1.71

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

The following table summarizes information regarding stock options outstanding at June 30, 2017:

Range of exercise prices per common share	Number of options outstanding (000s)	Weighted average remaining term (years)	Weighted average exercise price for options outstanding (\$/share)	Number of options exercisable (000s)	Weighted average exercise price for options exercisable (\$/share)
\$0.00 to \$5.00	3,569	3.7	4.52	1,082	4.51
\$5.01 to \$10.00	3,700	1.8	6.97	2,857	7.00
\$10.01 to \$15.00	981	1.8	12.39	973	12.38
\$15.01 to \$20.00	60	2.0	15.40	60	15.40
<b>Total</b>	<b>8,310</b>	<b>2.6</b>	<b>6.62</b>	<b>4,972</b>	<b>7.61</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, 2015	1,204
Granted	439
Released upon vesting	(852)
Forfeited	(71)
Balance at December 31, 2016	<b>720</b>
Granted	<b>233</b>
Released upon vesting	<b>(165)</b>
Forfeited	<b>(19)</b>
<b>Balance at June 30, 2017</b>	<b>769</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	
	2017	2016	2017	2016
Stock options	<b>860</b>	807	<b>1,756</b>	1,672
Restricted share units	<b>439</b>	341	<b>793</b>	869
Total share based compensation expense	<b>1,299</b>	1,148	<b>2,549</b>	2,541

## Per share amounts

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

<i>(Thousands of common shares)</i>	Three months ended June 30		Six months ended June 30	
	2017	2016	2017	2016
Weighted average common shares outstanding, basic	<b>175,894</b>	173,818	<b>175,805</b>	171,321
Effect of stock options and RSUs	<b>1,422</b>	154	<b>1,288</b>	123
Effect of convertible debentures	-	-	-	-
Weighted average common shares outstanding, diluted	<b>177,316</b>	173,972	<b>177,093</b>	171,444

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 three and six month periods ended June 30, 2017 and 2016, the Company excluded the effect of stock options and RSUs as they were anti-dilutive. The common shares potentially issuable on conversion of the Debentures are also excluded as they are anti-dilutive to the loss reported per share, for all periods outstanding.



## 12. INCOME TAXES

Kelt was not required to pay income taxes in the current or prior year as the Company had sufficient income tax deductions available to shelter taxable income. Tax deductions available as of June 30, 2017 are estimated to be approximately \$916.6 million (December 31, 2016 – \$975.4 million).

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

	Three months ended June 30		Six months ended June 30	
	2017	2016	2017	2016
Loss before income taxes	<b>(6,182)</b>	(28,007)	<b>(9,076)</b>	(63,510)
Canadian statutory tax rate	<b>26.4%</b>	26.6%	<b>26.3%</b>	26.6%
Expected income tax recovery	<b>(1,632)</b>	(7,450)	<b>(2,390)</b>	(16,894)
Increase (decrease) resulting from:				
Non-deductible expenses <sup>(1)</sup>	<b>352</b>	317	<b>691</b>	695
Recognition of unrecognized deferred tax asset	<b>(514)</b>	(514)	<b>(1,028)</b>	(1,028)
Qualifying expenditures on flow-through shares	<b>649</b>	-	<b>998</b>	-
Premium on flow-through shares	<b>(172)</b>	-	<b>(215)</b>	-
True-up of tax pools	<b>4</b>	53	<b>4</b>	48
Deferred income tax recovery	<b>(1,313)</b>	(7,594)	<b>(1,940)</b>	(17,179)

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

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

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

	Balance at December 31, 2016	Recognized in profit and CI <sup>(1)</sup>	Recognized in balance sheet	Balance at June 30, 2017
Deferred income tax asset (liability)				
Derivative financial instruments	162	(114)	-	<b>48</b>
PP&E and E&E	(144,335)	(4,349)	-	<b>(148,684)</b>
Decommissioning obligations	34,144	3,040	-	<b>37,184</b>
Convertible debentures	(4,368)	366	-	<b>(4,002)</b>
Share and debt issue costs	2,847	(779)	-	<b>2,068</b>
Reserve from common control transaction	(7,113)	1,028	-	<b>(6,085)</b>
Non-capital losses <sup>(2)</sup>	76,312	2,748	-	<b>79,060</b>
	<b>(42,351)</b>	<b>1,940</b>	<b>-</b>	<b>(40,411)</b>

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

(2) The Company's non-capital losses expire in years 2023 to 2036.

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.

### 13. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

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

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

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

#### Commodity price risk management contracts

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

As at June 30, 2017, the following commodity price risk management contracts are outstanding:

Contract Type	Notional Volume	Reference Prices	Fixed Contract Price	Remaining Term	Fair value Asset (Liability)
Financial Swap Natural Gas	10,000 MMBtu/d	SoCAL Border Avg. NYMEX Henry Hub	SoCAL Border Avg. plus US\$0.055 per MMBtu	July to October 2017	(198) <sup>(1)</sup>
Financial Swap Propane	500 bbls/d	OPIS-Conway propane WTI Cushing Oklahoma	50% of US\$WTI	July to December 2017	(190) <sup>(2)</sup>

(1) The fair value is sensitive to changes in natural gas reference prices. If the Southern California Border Average ("SoCAL Border Avg.") - NYMEX basis differential increased (decreased) by \$0.10/MMBtu, the fair market value of the contract would decrease (increase) by approximately \$0.2 million.

(2) The fair value is sensitive to changes in propane reference prices. If the OPIS-Conway propane price increased (decreased) by 5% relative to the fixed contract price, the fair market value of the contract would decrease (increase) by approximately \$0.1 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. Based on average bank debt outstanding of \$47.7 million during the first six months of 2017, an increase (decrease) in the market rate of interest by 25 basis points would have increased (decreased) interest expense by \$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. In addition, the Company has a natural gas marketing arrangement effective November 1, 2016 through October 31, 2017, whereby Kelt receives revenue on the firm contract volume of 4,739 MMBtu per day in U.S. dollars. The Company also has commitments for firm gas transportation service under contracts denominated in U.S. dollars as outlined in note 15. Exposure to foreign exchange rates is mitigating by entering U.S. dollar denominated commodity price or foreign exchange derivative financial instruments.

As at June 30, 2017, the following foreign exchange (“FX”) risk management contract was outstanding:

Contract Type	Notional Amount per month	Fixed Contract Price	Remaining Term	Fair value Asset (Liability)
FX swap <sup>(1)</sup>	US\$1,000,000	CA\$/US\$ 1.3300	July to December 2017	<b>210</b> <sup>(2)</sup>

(1) The FX swap outstanding at June 30, 2017 resulted from an FX swaption contract which was exercised by the counterparty on December 30, 2016. Kelt received a cash premium of \$0.255 million at the time of entering into the contract on July 11, 2016.

(2) The fair value of the contract is sensitive to changes in the exchange rate. If the CA\$/US\$ exchange rate increased (decreased) by \$0.05, the fair market value of the contract would decrease (increase) by approximately \$0.3 million.

Subsequent to the end of the reporting period, on July 26, 2017, the FX swap contract was unwound for the remaining five month period from August to December 2017. Kelt received cash proceeds of \$0.4 million and has no further obligations under the contract.

### Gains and losses on risk management contracts

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

	Three months ended June 30		Six months ended June 30	
	2017	2016	2017	2016
Realized gain (loss)	<b>(396)</b>	(22)	<b>(371)</b>	(36)
Unrealized gain (loss)	<b>184</b>	128	<b>421</b>	251
Gain (loss) on derivative financial instruments	<b>(212)</b>	106	<b>50</b>	215

### Fair value measurements

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

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

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

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

The fair value of financial assets and liabilities, excluding working capital, is attributable to the following fair value hierarchy levels at June 30, 2017:

	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	210	-	-	-	210	-
<b>Financial liabilities</b>						
Derivative financial instruments	388	-	-	-	388	-
Convertible debentures <sup>(2)</sup>	72,685	-	-	126,000	-	-

(1) Financial assets and liabilities are only offset if the Company has the current legal right to offset and intends to settle on a net basis or settle the asset and liability simultaneously. Kelt offsets derivative contracts assets and liabilities when the counterparty, commodity, currency and timing of settlement are the same. As at June 30, 2017, there are no offsetting derivative financial contracts.

(2) The fair value of the convertible debentures is based on the closing market price of \$140.00 per Debenture as at June 30, 2017, being the date the debentures last traded on the TSX, and represents the market value of the entire instrument.

### Credit Risk

As at June 30, 2017, the carrying amount of cash and cash equivalents, accounts receivable and accrued revenue, deposits, and derivative financial instrument assets represent the Company's maximum credit exposure. Cash and cash equivalents are held on deposit with a Canadian chartered bank. The Company's credit risk exposure arises primarily from receivables from oil and gas marketers and joint venture partners.

The Company applies the simplified approach to providing for expected credit losses prescribed by IFRS 9, which permits the use of the lifetime expected loss provision for all trade receivables. The Company uses a combination of historical and forward looking information to determine the appropriate loss allowance provision.

During the six months ended June 30, 2017, sales to three oil and gas marketers each individually represented more than 10% of total revenue. Sales to these marketers account for approximately 38%, 21%, and 15%, of total revenue, respectively. During the comparative period ended June 30, 2016, sales to four oil and gas marketers accounted for approximately 39%, 18%, 15%, and 10% of total revenue, respectively. Kelt has secured parental guarantees (with terms ranging from two to five years) or letters of credit covering approximately 80% of its monthly credit exposure from oil and gas marketers, calculated based on average sales by purchaser for the second quarter of 2017.

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, 2017</b>	<b>26,522</b>	<b>276</b>	<b>385</b>	<b>994</b>	<b>28,177</b>
Balance at December 31, 2016	28,657	539	253	957	30,406

The balance of accounts receivable outstanding for more than 90 days relates primarily to receivables from the Company's joint venture partners. Due to the current business environment and low commodity prices, many oil and gas companies, including some of Kelt's partners, continue to face significant financial challenges. Management has reviewed past due accounts receivable balances as at June 30, 2017 and expects the accounts to be collectible, except for approximately \$0.8 million of accounts receivable which are provided for in the allowance for doubtful accounts (December 31, 2016 – \$0.8 million).

## Liquidity Risk

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

The capital intensive nature of Kelt's operations may create a working capital deficiency position during periods with high levels of capital investment. However, during such periods, the Company maintains sufficient unused bank credit lines to satisfy such working capital deficiencies. As at June 30, 2017, the Company's working capital deficit of \$16.0 million combined with outstanding bank debt of \$64.6 million, represented 44% of the authorized borrowing amount available under the Credit Facility of \$185.0 million (down from 75% at December 31, 2016). As discussed in Note 8, the Credit Facility is available for a revolving period of 364 days, maturing on April 28, 2018, and may be extended annually at Kelt's option and subject to lender approval, with a term-out to April 28, 2019 if not renewed. The next semi-annual borrowing base review is scheduled to occur during November 2017. In an event that the lenders reduce the borrowing base below the amount drawn at the time of the redetermination, the Company would have 60 days to eliminate any borrowing base shortfall by repaying the amount drawn in excess of a re-determined borrowing base or by providing additional security or other consideration satisfactory to the lenders.

The table below outlines a contractual maturity analysis for Kelt's financial liabilities as at June 30, 2017:

	Within 1 Year	1 to 5 Years	More than 5 Years	Total
Accounts payable and accrued liabilities	46,151	-	-	46,151
Derivative financial instrument liability	388	-	-	388
Bank debt and estimated interest <sup>(1)</sup>	2,196	66,386	-	68,582
Convertible debentures <sup>(2)</sup>	4,500	103,500	-	108,000
<b>Total</b>	<b>53,235</b>	<b>169,886</b>	<b>-</b>	<b>223,121</b>

(1) Estimated interest for future periods related to the Credit Facility was calculated using the weighted average interest rate of 3.4% for the quarter ended June 30, 2017, applied to the principal balance outstanding as at that date. For purposes of this analysis, principal repayment of the Company's revolving Credit Facility is assumed to occur on April 28, 2019.

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

## Capital Management

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

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

	June 30, 2017	December 31, 2016
Bank debt	64,575	111,693
Working capital deficiency	16,043	26,349
Bank debt, net of working capital <sup>(1)</sup>	80,618	138,042
Trailing annualized adjusted funds from operations <sup>(2)(3)</sup>	101,332	92,400
Net bank debt to trailing adjusted funds from operations ratio <sup>(1)</sup>	0.8	1.5

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

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

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

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

The Company has reduced its net bank debt to trailing adjusted funds from operations ratio to 0.8 times as at June 30, 2017 from 1.5 times at December 31, 2016. The Karr Property Disposition was completed on January 18, 2017 for cash proceeds of \$103.1 million (note 5). The proceeds were used initially to reduce bank indebtedness under the Credit Facility, and a portion subsequently used, along with \$54.4 million of cash provided by operating activities, to fund exploration and development capital expenditures during the six month period ended June 30, 2017.

As more particularly described in note 8, Kelt is subject to certain non-financial covenants under the Credit Facility agreement. As at June 30, 2017, the Company is in compliance with all covenants. The Company is not subject to any other externally imposed capital requirements.

#### 14. FINANCING EXPENSES

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

	Three months ended June 30		Six months ended June 30	
	2017	2016	2017	2016
Interest and fees on bank debt [note 8]	720	2,056	1,393	4,292
Interest on convertible debentures [note 9]	1,122	715	2,232	715
Accretion of convertible debentures [note 9]	875	487	1,707	487
Accretion of decommissioning obligations [note 10]	743	744	1,464	1,503
<b>Financing expense</b>	<b>3,460</b>	<b>4,002</b>	<b>6,796</b>	<b>6,997</b>

#### 15. COMMITMENTS

As of June 30, 2017, the Company is committed to future payments under the following agreements:

(CA\$ thousands)	2017	2018	2019	2020	2021	Thereafter
Operating lease - office buildings	696	577	108	18	-	-
Operating lease - vehicles	178	287	174	24	-	-
Capital purchase commitments	11,500	-	-	-	-	-
Firm processing commitments	3,576	3,881	-	-	-	-
Firm transportation commitments <sup>(1)</sup>	7,956	8,062	5,599	2,731	2,056	8,885
<b>Total annual commitments</b>	<b>23,906</b>	<b>12,807</b>	<b>5,881</b>	<b>2,773</b>	<b>2,056</b>	<b>8,885</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, 2017 of CA\$/US\$1.2977.

During the second quarter of 2017, Kelt entered into an agreement to purchase gas compression facilities and equipment for \$12.5 million. A deposit of \$1.0 million was paid upon entering the agreement and subsequent to the reporting period, the balance of the purchase price of \$11.5 million was paid at closing on July 31, 2017 (note 18).

The Company has firm commitments for oil and gas transportation on major pipelines in Alberta and British Columbia. For periods subsequent to 2021, Kelt has an annual commitment of \$1.2 million for gas transportation until March 31, 2026 and an annual commitment of \$0.7 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.

## 16. SUPPLEMENTAL CASH FLOW INFORMATION

	Three months ended June 30		Six months ended June 30	
	2017	2016	2017	2016
<b>Changes in non-cash working capital</b>				
Accounts receivable and accrued revenue	2,921	(1,132)	2,229	2,553
Prepaid expenses and deposits	(1,210)	404	(1,398)	573
Accounts payable and accrued liabilities	(20,974)	(5,619)	(9,508)	(29,382)
Change in non-cash working capital	(19,263)	(6,347)	(8,677)	(26,256)
Relating to:				
Operating activities	3,313	(3,431)	3,041	(9,509)
Investing activities	(22,576)	(2,916)	(11,718)	(16,747)
Change in non-cash working capital	(19,263)	(6,347)	(8,677)	(26,256)

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	
	2017	2016	2017	2016
<b>Cash outlays in respect of interest and taxes</b>				
Interest and standby fees on bank debt	748	1,833	1,391	4,518
Interest on convertible debentures <sup>(1)</sup>	2,244	-	2,244	-
Taxes <sup>(2)</sup>	-	-	-	-

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

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

## 17. 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 six months ended June 30, 2017, the Company incurred \$0.2 million (2016 – \$0.5 million) in legal fees and disbursements, of which \$0.1 million is payable at June 30, 2017 (\$0.1 million at December 31, 2016). The Company expects to continue using the services of this law firm from time to time.

## 18. SUBSEQUENT EVENTS

On July 31, 2017, the Company completed the purchase of a major infrastructure package for \$12.5 million. After a new lease has been surveyed and built, this infrastructure package will be moved from its existing location in northeastern British Columbia and installed on a new site in the Company's core area at Inga, British Columbia.

## ABBREVIATIONS

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

## CONVERSION OF UNITS

Imperial = Metric
1 acre = 0.4 hectares
2.5 acres = 1 hectare
1 bbl = 0.159 cubic metres
6.29 bbls = 1 cubic metre
1 foot = 0.3048 metres
3.281 feet = 1 metre
1 mcf = 28.2 cubic metres
0.035 mcf = 1 cubic metre
1 mile = 1.61 kilometres
0.62 miles = 1 kilometre
1 MMBtu = 1.054 GJ
0.949 MMBtu = 1 GJ
Natural gas is equated to oil on the basis of 6 mcf = 1 BOE
Sulphur is equated to gas on the basis of 1LT = 10 mcf (1 BOE = 0.6 LT)
IP24 = initial production from a well for the first 576 hours (24 days) based on operating/producing hours
IP30 = initial production from a well for the first 720 hours (30 days) based on operating/producing hours



## **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 W.G. Miles**  
Vice President, Exploration

### **HEAD OFFICE**

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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.  
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### **STOCK EXCHANGE LISTING**

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



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