



**FIRST QUARTER REPORT
AS AT AND FOR THE THREE MONTHS ENDED
MARCH 31, 2014**

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FINANCIAL AND OPERATIONAL HIGHLIGHTS

(CA\$ thousands, except as otherwise indicated)

	Q1 2014	Q4 2013	Q1 2013
FINANCIAL			
Revenue, before royalties and financial instruments	47,793	18,543	3,865
Funds from operations ⁽¹⁾	26,084	9,396	2,179
Basic (\$/ common share) ⁽¹⁾	0.24	0.09	0.09
Diluted (\$/ common share) ⁽¹⁾	0.23	0.09	0.09
Profit (loss)	4,851	(1,838)	(140)
Basic (\$/ common share)	0.04	(0.02)	(0.01)
Diluted (\$/ common share)	0.04	(0.02)	(0.01)
Total capital expenditures, net of dispositions ⁽²⁾	40,933	231,329	40,210
Total assets	666,257	485,201	141,834
Bank debt	-	-	-
Working capital surplus (deficiency)	123,150	20,500	(24,471)
Shareholders' equity	539,410	392,872	98,138
Weighted average common shares outstanding (000's)			
Basic	110,991	99,244	25,359
Diluted	112,788	100,242	25,359
OPERATIONS			
Average daily production			
Oil (bbls/d)	2,428	809	158
NGLs (bbls/d)	654	487	82
Gas (mcf/d)	42,367	26,660	6,456
Combined (BOE/d) ⁽³⁾	10,143	5,739	1,316
Production per million common shares (BOE/d) ⁽¹⁾	91	58	52
Average realized prices, after financial instruments			
Oil (\$/bbl)	89.62	81.35	87.84
NGLs (\$/bbl)	69.36	57.00	70.96
Gas (\$/mcf)	6.00	3.97	3.60
Operating netbacks ⁽¹⁾ (\$/BOE)			
Oil and gas revenue	52.36	35.12	32.64
Realized loss on financial instruments	(1.37)	(0.38)	-
Average realized price, after financial instruments	50.99	34.74	32.64
Royalties	(6.52)	(4.71)	(4.36)
Production and transportation expense	(15.07)	(11.36)	(9.00)
Operating netback ⁽¹⁾	29.40	18.67	19.28
Undeveloped land			
Gross acres	346,120	299,142	134,238
Net acres	227,284	184,082	72,166

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

(2) Total capital expenditures incurred during the first quarter of 2013 include approximately \$22.9 million of expenditures incurred prior to completion of the Arrangement on February 26, 2013.

(3) Average daily production reported in the table above for the first quarter of 2013 is calculated over the 90 day period ended March 31, 2013. Production for the 33 day period following commencement of active operations on February 27, 2013, averaged 3,588 BOE per day.

MESSAGE TO SHAREHOLDERS

Kelt Exploration Ltd. (“Kelt” or the “Company”) is pleased to report its first quarter interim results to shareholders for the three months ended March 31, 2014.

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

Kelt achieved record production levels in the first quarter of 2014. Average production for the three months ended March 31, 2014 was 10,143 BOE per day, up 77% from average production of 5,739 BOE per day during the fourth quarter of 2013. Daily average production in the first quarter of 2014 was 183% higher than the average production of 3,588 BOE per day for the 33-day period ended March 31, 2013. On a production per share basis, the first quarter of 2014 was up 75% compared to the first quarter of 2013.

For the three months ended March 31, 2014, revenue was \$47.8 million, funds from operations was \$26.1 million (\$0.23 per share, diluted) and profit was \$4.9 million (\$0.04 per share, diluted). At March 31, 2014, Kelt did not have any outstanding bank debt on its \$100.0 million demand loan facility. The working capital surplus position, including cash and cash equivalents, at the end of the first quarter was \$123.2 million.

On March 25, 2014, the Company completed an equity financing issuing 9.8 million common shares at a price of \$11.60 per share and 2.6 million common shares on a “CDE flow-through” basis at a price of \$12.75 per share, resulting in aggregate gross proceeds of \$147.0 million. Certain insiders participated in the equity financing acquiring 1.1 million common shares for an aggregate subscription price of \$14.1 million. As at May 12, 2014, the Company has 122.5 million common shares issued and outstanding. Directors and officers of Kelt own (including shares that they exercise control or direction over) 24.4 million common shares or 19.9% of the total shares outstanding.

During the three months ended March 31, 2014, Kelt drilled seven gross (5.9 net) oil and gas wells, with a 100% success rate, and one service well. The Company drilled two gross (0.9 net) horizontal wells at Inga/Fireweed, British Columbia. These wells were targeting condensate-rich natural gas in the Triassic Doig formation. The Company drilled two gross (2.0 net) wells at Karr, Alberta targeting the Triassic Montney oil formation. In addition, Kelt drilled a 100% working interest water injection well at Karr, which will reduce production expenses by eliminating water trucking costs. At Pouce Coupe, Alberta, the Company drilled three gross (3.0 net) wells in the Triassic Montney formation. Two wells that were drilled in the natural gas leg have now been completed and the third well drilled in the oil leg is expected to be completed in the second quarter of 2014.

During the remainder of 2014 Kelt is well positioned financially and expects that it will have sufficient financial flexibility to carry out its operations during the year and to pursue new opportunities as they arise. Management is excited about the Company’s prospects and looks forward to updating shareholders with second quarter results in August 2014.

On behalf of the Board of Directors,

[signed]

David J. Wilson
President and Chief Executive Officer
May 12, 2014

MANAGEMENT'S DISCUSSION & ANALYSIS

INTRODUCTION

Kelt Exploration Ltd. ("Kelt" or the "Company") is an oil and gas company based in Calgary, Alberta, focused on the exploration, development and production of crude oil and natural gas resources, primarily in west central Alberta and northeastern British Columbia. The Company was incorporated under the *Business Corporations Act (Alberta)* on October 11, 2012 as 1705972 Alberta Ltd. and was inactive until February 26, 2013. On October 19, 2012, Articles of Amendment were filed to change the name of the Company to Kelt Exploration Ltd. Common shares of the Company are listed and posted for trading on the Toronto Stock Exchange ("TSX") under the symbol "KEL". The head office of Kelt is located at Suite 300, 311 – 6th Avenue S.W., Calgary, Alberta T2P 3H2.

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

This Management's Discussion and Analysis ("MD&A") is dated May 12, 2014 and should be read in conjunction with the Company's unaudited condensed interim financial statements and related notes as at and for the three months ended March 31, 2014 and its audited annual financial statements and MD&A as at and for the year ended December 31, 2013. The accompanying financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") as set out in the *CPA Canada Handbook – Accounting* ("CPA Handbook"). The CPA Handbook incorporates International Financial Reporting Standards ("IFRS") and publicly accountable enterprises, such as Kelt, are required to apply such standards. The Company's Board of Directors approved and authorized the condensed interim financial statements for issue on May 12, 2014.

The Company was incorporated as a wholly owned subsidiary of Celtic Exploration Ltd. ("Celtic"), for the purposes of participating in a Plan of Arrangement (the "Arrangement") between ExxonMobil Canada Ltd. ("ExxonMobil Canada"), ExxonMobil Celtic ULC (formerly 1690731 Alberta ULC) (the "Purchaser"), Celtic and Kelt. Pursuant to the Arrangement, the Purchaser purchased all of Celtic's outstanding common shares ("Celtic Shares"), including Celtic Shares issued upon conversion of Celtic's 5% convertible debentures, at a cash price of \$24.50 per Celtic Share. Additionally, Celtic shareholders received one-half (1/2) of a share of Kelt for each Celtic Share.

Pursuant to the Arrangement and a conveyance agreement (the "Conveyance Agreement") entered into by Celtic and Kelt upon closing of the Arrangement on February 26, 2013, Celtic transferred certain petroleum and natural gas assets (the "Celtic Assets") to Kelt in exchange for \$142.0 million of common share consideration (the "Common Control Transaction"). The Celtic Assets transferred pursuant to the Common Control Transaction included all of Celtic's rights, title, estate and interest in the petroleum, natural gas and related hydrocarbon rights and related personal property interests within, upon or under the lands and leases, including: a liquids-rich gas property in the Inga area of northeastern British Columbia; a gas property in the Grande Cache area of Alberta; and an oil prospect in the Karr area of west central Alberta.

Kelt commenced active operations on February 27, 2013 following completion of the Arrangement and the Common Control Transaction. Prior thereto, the Company did not have any assets, liabilities, or operations. As required under the applicable securities legislation, this MD&A includes the results of operations for the first quarter of 2014 compared to the same quarter of the previous year. However, given that the first quarter of 2013 only includes 33 days of active operations, this analysis will focus on comparing the results of operations for the quarter ended March 31, 2014 to the most recent quarter ended December 31, 2013.

ADVISORY REGARDING FORWARD-LOOKING STATEMENTS

This MD&A contains forward-looking statements and forward-looking information within the meaning of applicable securities laws. The use of any of the words "expect", "anticipate", "continue", "estimate", "objective", "ongoing", "may", "will", "project", "should", "believe", "plans", "intends" and similar expressions are intended to identify forward-looking information or statements. In particular, this MD&A contains forward-looking statements concerning the timing of future development capital expenditures and the extent of the size of Kelt's reserves. Statements relating to "reserves" or "resources" are deemed to be forward looking statements as they involve the implied assessment, based on current estimates and assumptions that the reserves and resources can be profitably produced in the

future.

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

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

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

NON-GAAP MEASURES

This document contains certain financial measures, as described below, which do not have standardized meanings prescribed by GAAP. As these measures are commonly used in the oil and gas industry, the Company believes that their inclusion is useful to investors. The reader is cautioned that these amounts may not be directly comparable to measures for other companies where similar terminology is used.

“Operating income” is calculated by deducting royalties, production expenses and transportation expenses from oil and gas revenue, after realized gains or losses on financial instruments. The Company refers to operating income expressed per unit of production as an “Operating netback”. “Funds from operations” is calculated by adding back settlement of decommissioning obligations and change in non-cash operating working capital to cash provided by operating activities. Funds from operations per common share is calculated on a consistent basis with profit (loss) per common share, using basic and diluted weighted average common shares as determined in accordance with GAAP. Funds from operations and operating income or netbacks are used by Kelt as key measures of performance and are not intended to represent operating profits nor should they be viewed as an alternative to cash provided by operating activities, profit or other measures of financial performance calculated in accordance with GAAP.

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

<i>(CA\$ thousands, except as otherwise indicated)</i>	Q1 2014	Q4 2013	Q1 2013
Oil and gas revenue	47,793	18,543	3,865
Realized loss on financial instruments	(1,249)	(201)	-
Royalties	(5,948)	(2,486)	(516)
Production expenses	(11,339)	(4,988)	(772)
Transportation expenses	(2,423)	(1,005)	(294)
Operating income	26,834	9,863	2,283
Production (mBOE)	913	528	118
Operating netback (\$/BOE)	29.40	18.67	19.28

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

<i>(CA\$ thousands, except as otherwise indicated)</i>	Q1 2014	Q4 2013	Q1 2013
Cash provided by operating activities	21,272	13,866	1,430
Settlement of decommissioning obligations	-	-	-
Change in non-cash working capital	4,812	(4,470)	749
Funds from operations	26,084	9,396	2,179

“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. Where amounts are expressed on a barrel of oil equivalent (“BOE”) basis, natural gas volumes have been converted to oil equivalence at six thousand cubic feet per barrel and sulphur volumes have been converted to oil equivalence at 0.6 long tons per barrel. The term BOE may be misleading, particularly if used in isolation. A BOE conversion ratio of six thousand cubic feet per barrel is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. References to oil in this discussion include crude oil and field condensate. References to natural gas liquids (“NGLs”) include, pentane, butane, propane, and ethane. References to gas in this discussion include natural gas and sulphur.

SIGNIFICANT JUDGMENTS AND ESTIMATES

The 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 1 of the December 31, 2013 annual financial statements. There have been no significant changes in the Company’s significant judgments and estimates applied during the interim period ended March 31, 2014 relative to the most recent annual financial statements as at and for the year ended December 31, 2013.

DISCLOSURE CONTROLS AND PROCEDURES

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

The CEO and the CFO have evaluated the effectiveness of Kelt’s disclosure controls and procedures as at December 31, 2013 and have concluded that such disclosure controls and procedures are effective. There were no material changes to the Company’s disclosure controls and procedures during the period from January 1, 2014 to March 31, 2014.

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.

The CEO and the CFO have evaluated the effectiveness of Kelt's internal controls over financial reporting as at December 31, 2013 and have concluded that such internal controls over financial reporting are effective. There were no material changes to the Company's internal controls over financial reporting during the interim period from January 1, 2014 to March 31, 2014.

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

GROWTH STRATEGY

The business plan of Kelt is to create sustainable and profitable growth as a participant in the oil and gas industry in Canada. Kelt seeks to identify and acquire strategic oil and gas properties where it believes further exploitation, development and exploration opportunities exist. In addition, Kelt has implemented a full cycle exploration program, resulting in exploration and development drilling based on opportunities generated internally.

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

RESULTS OF OPERATIONS

FINANCIAL AND OPERATING HIGHLIGHTS

- During the first quarter of 2014, production averaged 10,143 BOE per day, representing an increase of 77% from 5,739 BOE per day during the previous quarter ended December 31, 2013 and an increase of 671% from 1,316 BOE per day during the first quarter of 2013;
- The Company generated funds from operations in the amount of \$26.1 million (\$0.24 per common share, basic and \$0.23 per common share, diluted) during the three month period ended March 31, 2014. During the previous quarter ended December 31, 2013, funds from operations was \$9.4 million (\$0.09 per common share, basic and diluted). This equates to an absolute increase of 178% or a 156% increase in funds from operations per common share, diluted;
- During the first quarter of 2014, corporate royalty rates averaged 12.4% of revenue; production and transportation expense, combined, averaged \$15.07 per BOE; and G&A expense averaged \$0.97 per BOE;
- Drilled 8 (6.9 net working interest) wells during the first quarter of 2014 with a success rate of 100%;
- On February 10, 2014, Kelt completed the disposition of certain non-core and non-operated assets for proceeds of \$20.0 million, before closing adjustments; and
- On March 25, 2014, the Company completed a brokered and non-brokered private placement equity offering, issuing 9.775 million common shares (including 1.275 million common shares issued pursuant to the exercise, in full, of the over-allotment option) at a price of \$11.60 per common share resulting in gross proceeds of \$113.4 million. In addition, the Company issued 2.635 million common shares on a "flow-through" basis at a price of \$12.75 per flow-through share, providing additional gross proceeds of \$33.6 million. Approximately 42% or 1.105 million of the flow-through shares issued were purchased by directors, officers and employees of the Company. As at March 31, 2014, insiders own or control 24.4 million common shares, or 19.9% of the total shares outstanding.

REVENUE

<i>(CA\$ thousands, unless otherwise indicated)</i>	Q1 2014	Q4 2013	Q1 2013
Average daily production:			
Oil (bbls/d)	2,428	809	158
NGLs (bbls/d)	654	487	82
Gas (mcf/d)	42,367	26,660	6,454
Combined (BOE/d)	10,143	5,739	1,316
Average realized prices, before financial instruments:			
Oil (\$/bbl)	94.09	84.02	87.84
NGLs (\$/bbl)	73.98	57.00	70.96
Gas (\$/mcf)	6.00	3.97	3.60
Combined (\$/BOE)	52.36	35.12	32.64
Average realized prices, after financial instruments:			
Oil (\$/bbl)	89.62	81.35	87.84
NGLs (\$/bbl)	69.36	57.00	70.96
Gas (\$/mcf)	6.00	3.97	3.60
Combined (\$/BOE)	50.99	34.74	32.64
Revenue, before royalties and financial instruments:			
Oil	20,556	6,252	1,246
NGLs	4,354	2,554	525
Gas	22,883	9,737	2,094
Total revenue, before royalties and financial instruments	47,793	18,543	3,865

The Company commenced active operations on February 27, 2013 following the completion of the Arrangement and conveyance of the Celtic Assets from Celtic to Kelt on February 26, 2013. Production from the Celtic Assets averaged approximately 3,588 BOE per day during the 33 day period of active operations during the quarter ended March 31, 2013 (1,316 BOE per day over the 90 day quarter ended March 31, 2013).

During the first quarter of 2014, production averaged 10,143 BOE per day, an increase of 77% from 5,739 BOE per day during the fourth quarter of 2013. The increase in production quarter over quarter is primarily attributable to the following:

- On December 20, 2013, the Company completed a property acquisition in the Pouce Coupe/Spirit River area of west central Alberta. The acquired assets contributed to daily average production of approximately 4,470 BOE per day during the first quarter of 2014 relative to approximately 615 BOE per day during the fourth quarter of 2013. Approximately 210 BOE per day of the acquired non-core oil production was subsequently disposed on February 10, 2014, but was offset by approximately 250 BOE per day of oil and gas production from a minor property acquisition in the Spirit River area which was completed on March 7, 2014.
- The Company also has an active drilling program in its core areas at Inga, Grande Cache and Karr. The remaining increase in daily average production of approximately 550 BOE per day is a result of new production from wells drilled in these areas, partially offset by corporate declines.

During the three month period ended March 31, 2014, the Company earned revenue before royalties and financial instruments of \$47.8 million, an increase of 158% compared to the previous quarter ended December 31, 2013. The increase in revenue is a result of higher production volumes combined with strong commodity prices and appreciation of the US dollar. The Company realized a combined average sales price of \$52.36 per BOE (\$50.99 after financial instruments) during the first quarter of 2014. This represents an increase in average realized prices (after financial instruments) of 47% compared to the fourth quarter of 2013. The increase in the combined average realized sales price is also due to an increase in the proportion of total production being more heavily weighted to oil and NGLs during the first quarter of 2014.

BENCHMARK COMMODITY PRICES

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

	Q1 2014	Q4 2013	March 2013
WTI Cushing Oklahoma (US\$/bbl) ⁽¹⁾	98.68	97.46	93.24
Average FX rate (US\$/CA\$) ⁽¹⁾	0.9066	0.9528	0.9759
WTI Cushing Oklahoma (CA\$/bbl) ⁽²⁾	108.87	102.29	95.54
Edmonton Light Par 40 API (CA\$/bbl) ⁽¹⁾	100.18	86.26	89.53
As a % of CA\$ WTI	92%	84%	94%
Pentane (CA\$/bbl) ⁽¹⁾	112.92	98.77	105.76
As a % of CA\$ WTI	104%	97%	111%
Butane (CA\$/bbl) ⁽¹⁾	73.51	70.40	74.28
As a % of CA\$ WTI	68%	69%	78%
Propane (CA\$/bbl) ⁽¹⁾	80.58	57.65	32.28
As a % of CA\$ WTI	74%	56%	34%
NYMEX Henry Hub (US\$/mmbtu) ⁽³⁾	4.90	3.63	3.38
AECO 5A (CA\$/GJ) ⁽⁴⁾	5.42	3.35	3.29
AECO 7A (CA\$/GJ) ⁽⁵⁾	4.51	2.99	2.92

(1) Source: Sproule Associates Limited

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

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

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

(5) Source: Canadian Gas Price Reporter (NGX AB-NIT Month Ahead Index 7A)

OIL OPERATIONS

(\$/bbl)	Q1 2014	Q4 2013	Q1 2013
Oil revenue	94.09	84.02	87.84
Realized loss on financial instruments	(4.47)	(2.67)	-
Average realized price, after financial instruments	89.62	81.35	87.84
Royalties	(17.04)	(20.63)	(14.95)
Production and transportation expense	(19.17)	(12.87)	(9.00)
Operating netback	53.41	47.85	63.89

The Company realized an average oil price, before financial instruments, of \$94.09 per barrel and \$84.02 per barrel during each of the three month periods ended March 31, 2014 and December 31, 2013, respectively. Although the US\$ WTI benchmark oil price did not change significantly quarter over quarter, the appreciation of the US dollar had a positive impact on WTI prices denominated in Canadian dollars which contributed to the increase in the Company's realized prices. The average price realized by the Company for oil sales reflects a discount of 13.2% and 17.9% relative to the Canadian dollar equivalent WTI price in Q1 2014 and Q4 2013, respectively. The increase in the Company's average realized oil price also reflects a narrowing of the discount of the Edmonton Light Par crude oil price relative to WTI.

Oil royalties averaged 18.1% during the first quarter 2014 compared to 24.6% during the fourth quarter of 2013. The decrease in average oil royalties is primarily due to new oil production which qualifies for a minimum 5% royalty pursuant to various Alberta royalty incentive programs.

Production and transportation expenses, combined, averaged \$19.17 per barrel and \$12.87 per barrel during each of the three month periods ended March 31, 2014 and December 31, 2013, respectively. The increase in per unit

expenses during the first quarter of 2014 is primarily due to higher production and transportation expenses resulting from the initial integration of production from the Pouce Coupe/Spirit River properties, which were acquired on December 20, 2013.

NGL OPERATIONS

<i>(\$/bbl)</i>	Q1 2014	Q4 2013	Q1 2013
NGLs revenue	73.98	57.00	70.96
Realized loss on financial instruments	(4.62)	-	-
Average realized price, after financial instruments	69.36	57.00	70.96
Royalties	(12.12)	(9.14)	(12.73)
Production and transportation expense	(15.24)	(11.59)	(9.00)
Operating netback	42.00	36.27	49.23

The Company realized an average price of \$73.98 per barrel (before financial instruments) for NGL sales during the first quarter of 2014, an increase of 30% compared to \$57.00 per barrel (before financial instruments) during the previous quarter ended December 31, 2013. The average price realized by the Company for NGL sales reflects an average discount of 32.1% and 44.3% relative to the Canadian dollar equivalent WTI price in each corresponding period. The increase in the combined average realized price and decrease in the average discount to WTI is primarily due to strengthening pentane and propane prices, which represent more than 50% of the Company's total NGLs production.

NGL royalties averaged 16.4% during the first quarter 2014, consistent with the average NGLs royalty rate of 16.0% during the fourth quarter of 2013.

Production and transportation expenses, combined, averaged \$15.24 per barrel and \$11.59 per barrel during each of the three month periods ended March 31, 2014 and December 31, 2013, respectively. The increase in per unit expenses during the first quarter of 2014 is primarily due to higher production expenses resulting from the initial integration of production from the Pouce Coupe/Spirit River properties, which were acquired on December 20, 2013.

GAS OPERATIONS

<i>(CA\$/mcf)</i>	Q1 2014	Q4 2013	Q1 2013
Gas revenue	6.00	3.97	3.60
Royalties	(0.40)	(0.22)	(0.36)
Production and transportation expense	(2.27)	(1.84)	(1.50)
Operating netback	3.33	1.91	1.74
Barrel of oil equivalent netback (\$/BOE)	19.98	11.46	10.44

The Company realized an average price of \$6.00 per MCF during the first quarter of 2014, an increase of 51% compared to \$3.97 per MCF during the previous quarter ended December 31, 2013. The AECO 5A gas index price increased 62% to \$5.42 per GJ during the first quarter of 2014 compared to \$3.35 per GJ during the fourth quarter of 2013. Kelt receives a premium to the AECO gas index price due to the higher heat content of its gas sales.

Gas royalties averaged 6.7% during the first quarter 2014 compared to 5.5% during the fourth quarter of 2013. Higher gas prices and an increase in gas revenue resulted in a corresponding increase in gross gas royalties. Gas cost allowance credits do not fluctuate with gas prices, resulting in an increase in the Company's net gas royalties during the period.

Production and transportation expenses, combined, averaged \$2.27 per MCF and \$1.84 per MCF during each of the three month periods ended March 31, 2014 and December 31, 2013, respectively. The increase in per unit expenses during the first quarter of 2014 is primarily due to higher production expenses resulting from the initial integration of production from the Pouce Coupe/Spirit River properties, which were acquired on December 20, 2013.

FINANCING EXPENSES

<i>(CA\$ thousands, unless otherwise indicated)</i>	Q1 2014	Q4 2013	Q1 2013
Interest and fees on bank debt	51	31	7
Accretion of decommissioning obligations	379	96	21
Financing expense	430	127	28
Average bank debt outstanding	-	-	-
Interest and fees on bank debt, \$ per BOE	0.06	0.06	0.06

The Company has a revolving operating demand loan (the "Credit Facility") with a Canadian chartered bank (the "Lender"). During the fourth quarter of 2013, the Lender authorized an increase in the borrowing base from \$56.0 million to \$100.0 million, which came into effect upon closing of the Pouce Coupe/Spirit River acquisition on December 20, 2013. Interest is payable monthly for borrowings through direct advances. Interest rates fluctuate based on a pricing grid and range from bank prime plus 0.5% to bank prime plus 2.5%, depending upon Kelt's then current debt to cash flow ratio of between less than one times to greater than three times. Subsequent to the quarter, on May 6, 2014, the Company entered into an agreement with a syndicate of financial institutions to establish a new committed term credit facility, refer to additional information under the heading of *Subsequent Events*.

The Company did not draw any amounts on the Credit Facility during the current period ended March 31, 2014 or during the previous year ended December 31, 2013, and therefore did not incur any interest charges. Amounts reported as interest and fees on bank debt in the table above relate primarily to standby charges on the undrawn facility. Standby charges increased during the first quarter of 2014 as a result of an increase in the authorized borrowing amount.

Accretion expense is a measure of the increase in the present value of the decommissioning obligation due to the passage of time. The increase in accretion expense during the first quarter of 2014 is primarily due to a significant increase in the carrying value of the obligation resulting from the Pouce Coupe/Spirit River acquisition.

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>	Q1 2014	Q4 2013	Q1 2013
Salaries and benefits	792	408	98
Other G&A expenses	690	602	223
Gross G&A expenses	1,482	1,010	321
Recovery pursuant to the TSA	-	(1)	(87)
Overhead recoveries	(599)	(352)	(137)
Total G&A expenses, net of recoveries	883	657	97
Net G&A (\$ per BOE)	0.97	1.24	0.82

In conjunction with the Company's significant growth during the first quarter of 2014, the Company hired several new employees resulting in an increase in salaries, benefits and other overhead costs. The impact of the increase in gross G&A expenses is partially offset by higher overhead recoveries primarily due to higher capital spending (excluding acquisitions) on operated assets in the first quarter of 2014 compared to the fourth quarter of 2013.

On a per unit basis, net G&A expenses decreased by 22% during the first quarter of 2014 to \$0.97 per BOE from 1.24 per BOE during the fourth quarter of 2013. The decrease in per unit costs reflects the significant increase in production quarter over quarter.

SHARE BASED COMPENSATION

<i>(CA\$ thousands, unless otherwise indicated)</i>	Q1 2014	Q4 2013	Q1 2013
Stock options	906	824	150
Restricted share units	1,171	1,011	185
Total share based compensation expense	2,077	1,835	335
\$ per BOE	2.28	3.48	2.83

The increase in share based compensation expenses during the quarter ended March 31, 2014, compared to the previous quarter ended December 31, 2013, reflects the amortization of expense related to stock options and restricted share units granted to new head office and field employees hired in conjunction with the Pouce Coupe/Spirit River acquisition.

On a per unit basis, share based compensation expense decreased by 34% during the first quarter of 2014 to \$2.28 per BOE from \$3.48 per BOE during the fourth quarter of 2013. The decrease in per unit costs reflects the significant increase in production quarter over quarter.

DEPLETION AND DEPRECIATION

<i>(CA\$ thousands, unless otherwise indicated)</i>	Q1 2014	Q4 2013	Q1 2013
Depletion of development and production assets	14,218	8,216	2,220
Depreciation of corporate assets	59	55	4
Total depletion and depreciation	14,277	8,271	2,224
\$ per BOE	15.64	15.66	18.78

The Company calculates depletion of development and production assets based on production relative to total proved reserves, for each property. The increase in the absolute level of depletion expense quarter over quarter is due to an increase in the carrying value of assets subject to depletion, resulting from capital expenditures and acquisitions.

The decrease in per unit depletion and depreciation expense quarter over quarter represents the addition of proved reserves at lower than historic finding and development costs.

EXPLORATION AND EVALUATION

<i>(CA\$ thousands, unless otherwise indicated)</i>	Q1 2014	Q4 2013	Q1 2013
Expired mineral leases	85	-	21
\$ per BOE	0.09	-	0.18

OTHER INCOME AND EXPENSES

Interest income

The following table summarizes interest income earned on cash and cash equivalents:

<i>(CA\$ thousands, unless otherwise indicated)</i>	Q1 2014	Q4 2013	Q1 2013
Interest income	221	454	-
\$ per BOE	0.23	0.86	-

Transaction costs

During the first quarter of 2014, the Company incurred approximately \$0.03 million (\$0.03 per BOE) of transaction costs associated with acquisitions and dispositions (Q4 2013 – \$0.5 million; Q1 2013 – nil).

Premium on flow-through shares

On August 27, 2013, the Company issued 2.0 million flow-through shares at a price of \$9.80 per flow-through share. The implied premium on the flow-through shares was determined to be \$3.6 million or \$1.80 per flow-through share, in context of Kelt's concurrent private placement of common shares which was completed at a price of \$8.00 per ordinary common share. The deferred premium on flow-through shares is drawn down in proportion to the qualifying Canadian exploration expenditures incurred in the period, resulting in \$1.2 million being recognized as income during the quarter ended March 31, 2014. During the previous quarter ended December 31, 2013, the deferred premium was drawn down by \$2.4 million. As at March 31, 2014, the Company had incurred the full commitment of \$19.6 million of qualifying Canadian exploration expenditures and the deferred premium in respect of the August 27, 2013 flow-through share financing is fully drawn.

On March 25, 2014, the Company issued 2.635 million flow-through shares at a price of \$12.75 per flow-through share. The implied premium on the flow-through shares was determined to be \$3.0 million or \$1.15 per flow-through share, in context of Kelt's concurrent private placement of common shares which was completed at a price of \$11.60 per ordinary common share. As of March 31, 2014, the Company had not yet incurred any qualifying Canadian development expenditures. Accordingly, the premium in respect of the March 25, 2014 flow-through share offering was not drawn down during the quarter and is deferred as at March 31, 2014.

Loss on derivative financial instruments

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

<i>(CA\$ thousands)</i>	Q1 2014	Q4 2013	Q1 2013
Realized loss	(1,249)	(201)	-
Unrealized loss	(2,165)	(277)	-
Loss on derivative financial instruments	(3,414)	(478)	-
\$ per BOE	(3.74)	(0.91)	-

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

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

INCOME TAXES

During the first quarter of 2014, the Company recognized deferred income tax expense in the amount of \$3.4 million compared to a recovery of \$0.3 million in the same quarter of the previous year. This amount differs from the expected expense (recovery) of income taxes calculated based on the statutory tax rate due to non-deductible share based compensation expense, recognition of the unrecognized deferred income tax asset resulting from the Common Control Transaction, and the impact of flow-through shares. In addition, a deferred income tax recovery in the amount of \$1.5 million was charged directly to equity in respect of share issue costs incurred in the period. An analysis of the provision for deferred income taxes is included in note 12 of the interim financial statements.

During the current and prior three month periods ended March 31, 2014 and 2013, the Company was not required to pay current income taxes as it had sufficient income tax deductions available to shelter taxable income. Tax deductions available as of March 31, 2014 are estimated to be approximately \$461.4 million (COGPE 54%, CDE 13%, CEE 4%, UCC 21%, SIC 3%, NCL 5%).

PROFIT (LOSS) AND COMPREHENSIVE INCOME (LOSS)

<i>(CA\$ thousands, unless otherwise indicated)</i>	Q1 2014	Q4 2013	Q1 2013
Profit (loss) and comprehensive income (loss)	4,851	(1,838)	(140)
Weighted average common shares outstanding, basic (000's)	110,991	99,244	25,359
Weighted average common shares outstanding, diluted (000's)	112,788	100,242	25,359
\$ per common share, basic	0.04	(0.02)	(0.01)
\$ per common share, diluted	0.04	(0.02)	(0.01)
\$ per BOE	5.31	(3.48)	(1.18)

The Company generated a profit of \$4.9 million (\$0.04 per common share, basic and diluted) during the three months ended March 31, 2014. During the previous three month period ended December 31, 2013, the Company realized a loss of \$1.9 million (\$0.02 per common share, basic and diluted). The increase in profit quarter over quarter is primarily due to increased production combined with strong commodity prices. In addition, the integration of the Pouce Coupe/Spirit River properties, which were acquired December 20, 2013, contributed to a higher average operating netback as the assets are more oil weighted. Profit (loss) reported by the Company, as determined in accordance with GAAP, includes the provision for significant non-cash items such as depletion and depreciation and share based compensation expense.

FUNDS FROM OPERATIONS

<i>(CA\$ thousands, unless otherwise indicated)</i>	Q1 2014	Q4 2013	Q1 2013
Funds from operations ⁽¹⁾	26,084	9,396	2,179
Weighted average common shares outstanding, basic (000's)	110,991	99,244	25,359
Weighted average common shares outstanding, diluted (000's)	112,788	100,242	25,359
\$ per common share, basic ⁽²⁾	0.24	0.09	0.09
\$ per common share, diluted ⁽²⁾	0.23	0.09	0.09
\$ per BOE	28.57	17.80	18.40

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

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

The Company generated funds from operations in the amount of \$26.1 million (\$0.24 per common share, basic and \$0.23 per common share, diluted) during the three month period ended March 31, 2014. During the previous quarter ended December 31, 2013, funds from operations was \$9.4 million (\$0.09 per common share, basic and diluted). This equates to an absolute increase of 178% or a 156% increase in funds from operations per common share, diluted. The increase in funds from operations quarter over quarter is primarily due to increased production combined with strong commodity prices. In addition, the integration of the Pouce Coupe/Spirit River properties, which were acquired December 20, 2013, contributed to a higher average operating netback as the assets are more oil weighted.

INVESTMENT AND INVESTMENT EFFICIENCIES

CAPITAL EXPENDITURES

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

The Company's capital expenditures, including acquisitions and dispositions, are summarized in the following table:

	Q1 2014	% of total	Q4 2013	Q1 2013 ⁽¹⁾
Capital expenditures:				
Lease acquisition and retention	2,153	5%	1,068	6,200
Geological and geophysical	14	0%	-	911
Drilling and completion of wells	42,461	104%	29,650	27,702
Facilities, pipeline and well equipment	7,446	18%	5,795	5,006
Corporate assets	218	1%	123	91
	52,292	128%	36,636	39,910
Acquisitions	8,276	20%	194,693	300
Dispositions	(19,635)	-48%	-	-
Capital expenditures, net of dispositions	40,933	100%	231,329	40,210

(1) Of the \$40.2 million of total capital expenditures incurred during the first quarter of 2013, approximately \$22.9 million was incurred prior to completion of the Arrangement on February 26, 2013, as described under the heading of *Common Control Transaction* below.

Pouce Coupe/Spirit River property acquisition

On December 20, 2013, the Company acquired certain crude oil and natural gas assets located at Pouce Coupe/Spirit River, for cash consideration of \$192.0 million, before closing adjustments. The acquisition included an established field office located in the city of Grande Prairie, Alberta which has now become Kelt's main field operating base for all of the Company's operated properties in the newly acquired Pouce Coupe/Spirit River area and in the Company's existing areas at Karr and Grande Cache. The Pouce Coupe/Spirit River assets included an extensive land position that is a complementary fit geographically to Kelt's existing core areas at Karr and Grande Cache and are located 20 and 40 miles north of Karr and Grande Cache respectively. The acquisition included 256,345 gross acres (400 gross sections) and 103,303 net acres (161 net sections) of land. The acquisition also included a major infrastructure component with interests in major oil and gas facilities including a 20.2% ownership interest in a 140 MMCF per day gas processing plant, varying ownership interests in gas compressors and oil batteries, as well as an extensive network of oil and gas gathering pipelines that will be accessible for transportation of oil and gas resulting from future drilling.

Fireweed property acquisition

On August 9, 2013, the Company acquired natural gas assets at Fireweed, adjacent to the Company's core producing area at Inga, in northeastern British Columbia, for cash consideration of \$15.5 million, before closing adjustments. Kelt acquired a 50% working interest in the Fireweed assets and its partner and the operator at Inga, also acquired a 50% working interest in the assets. The assets acquired include a compression and dehydration facility with approximately 16 MMCF per day of gross natural gas capacity and 25 kilometres of pipeline that adds to the Company's infrastructure in the area. The Fireweed assets are a complementary fit with a contiguous land position adjacent to Kelt's Inga exploration and development core area, including 11,227 net acres (15.8 net sections) of land (6,299 net acres with Doig mineral rights and 7,097 net acres with Montney mineral rights).

Common control transaction

Pursuant to the Arrangement and the Conveyance Agreement, Celtic transferred certain petroleum and natural gas assets to Kelt in exchange for \$142.0 million of common share consideration on February 26, 2013. Celtic incurred

approximately \$22.9 million of capital costs on behalf of Kelt prior to closing of the Arrangement, which were incremental to the value of common share consideration. Accordingly, the additional costs are included in the Company's total capital expenditures for the quarter ended March 31, 2013.

Non-core property disposition

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

CAPITAL RESOURCES AND LIQUIDITY

SOURCE OF FUNDS

During the three month period ended March 31, 2014, the Company generated \$21.3 million in cash provided by operating activities. In order to fund on-going operations and the Company's capital expenditure program, cash provided by operating activities is supplemented with access to a \$100.0 million Credit Facility, the issuance of common shares, and minor non-core asset dispositions.

The Company has a revolving operating demand loan (the "Credit Facility") with a Canadian chartered bank. As at March 31, 2014, the authorized borrowing amount under the Credit Facility is \$100.0 million. Repayments of principal are not required provided that the borrowings under the Credit Facility do not exceed the authorized borrowing amount and the Company is in compliance with all covenants, representations and warranties. The Company is not subject to any financial covenants under the Credit Facility and as at March 31, 2014, the Company is in compliance with all covenants. The Company did not draw any amounts on the Credit Facility during the period and as at March 31, 2014, the Credit Facility remains undrawn. Subsequent to the quarter, on May 6, 2014, the Company entered into an agreement with a syndicate of financial institutions to establish a new committed term credit facility, refer to additional information under the heading of *Subsequent Events*.

On March 25, 2014, Kelt completed brokered and non-brokered private placement equity offerings for aggregate gross proceeds of \$147.0 million. Pursuant to the brokered private placement, the Company issued 9.775 million common shares at a price of \$11.60 per common share (which includes the exercise, in full, of the over-allotment option to purchase 1.275 million common shares) and issued 1.53 million common shares on a "flow-through" basis at a price of \$12.75 per flow-through share. The Company issued an additional 1.105 million flow-through common shares at a price of \$12.75 per flow-through share to certain directors, officers and employees of the Company, pursuant to the non-brokered private placement. Kelt shall, pursuant to the provisions in the *Income Tax Act* (Canada), incur eligible Canadian development expenses, (the "Qualifying Expenditures") after March 25, 2014 and prior to December 31, 2014 in the aggregate amount of not less than the total amount of the gross proceeds raised from the issue of flow-through common shares of \$33.6 million. As of March 31, 2014, the Company had not yet incurred any Qualifying Expenditures related to the March 25, 2014 flow-through share offering. Kelt shall renounce the Qualifying Expenditures so incurred to the purchasers of the flow-through common shares in an amount equal to \$12.75 per flow-through common share on or prior to December 31, 2014. The common shares issued in connection with the March 25, 2014 private placements are subject to a statutory hold period of four months plus one day from the date of completion of the private placements, in accordance with applicable securities legislation.

On December 3, 2013, Kelt raised aggregate gross proceeds of \$101.06 million through a brokered and non-brokered subscription receipt equity financing. Pursuant to an agreement with a syndicate of underwriters, on a bought deal private placement basis, the Company issued 10.0 million subscription receipts of Kelt at a price of \$8.15 per subscription receipt, resulting in gross proceeds of \$81.5 million. Certain officers and directors of the Company purchased an additional 2.4 million subscriptions receipts at a price of \$8.15 per subscription receipt, on a non-brokered private placement basis, providing additional gross proceeds of \$19.56 million. The subscription receipts

were converted into common shares of the Company on December 20, 2013, at no additional cost, following successful completion of the Pouce Coupe/Spirit River acquisition. Concurrently, the aggregate gross proceeds of the subscription receipt financings were released by the escrow agent to the account of Kelt.

On August 27, 2013, the Company issued 11.5 million common shares at a price of \$8.00 per common share (which includes the exercise in full of the over-allotment option to purchase 1.5 million common shares) for gross proceeds of \$92.0 million. In addition, the Company issued 2.0 million flow-through shares in respect of Canadian exploration expenses at a price of \$9.80 per flow-through share, providing additional gross proceeds of \$19.6 million. The implied premium on the flow-through shares was determined to be \$3.6 million or \$1.80 per flow-through share. The Company incurred approximately \$13.2 million of qualifying expenditures from August 27, 2013 to December 31, 2013. During the first quarter of 2014, the Company incurred the remaining \$6.4 million of qualifying expenditures and as at March 31, 2014, the Company had fulfilled the full commitment. Qualifying expenditures in the amount of \$19.6 million were renounced to investors in February 2014, with an effective renunciation date of December 31, 2013.

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

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

Kelt expects to fund future capital expenditures through the use of a combination of cash provided by operating activities and bank debt, supplemented by new equity or debt offerings, as necessary. Refer to additional information under the heading of *Subsequent Events*.

WORKING CAPITAL

As at March 31, 2014, the Company has a working capital surplus of \$123.2 million and the Company's \$100.0 million Credit Facility is undrawn.

The Company's accounts receivable consists primarily of accrued revenue and joint venture receivables. The oil and gas industry has a pre-arranged monthly clearing day for payment of revenues from all buyers of oil and natural gas. This occurs on the 25th day following the month of sale. As a result, the Company's production revenues are collected in an orderly fashion. Kelt monitors its counterparty credit positions to mitigate any potential credit losses. To the extent that the Company has joint venture partners in its activities, it must collect the partners' share of capital expenditures and operating expenses on a monthly basis. Exceptions are in the event that the partners' share of a capital project is a significant amount. In this case, Kelt will collect such amounts from its partners in advance of expenditures taking place in accordance with standard industry operating procedures. At March 31, 2014, 98% of accounts receivable are current and all balances outstanding are expected to be fully collectable.

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

LIQUIDITY

Liquidity risk is the risk the Company will encounter difficulties in meeting its financial obligations. The Company's financial liabilities are comprised of accounts payable and bank debt (as at March 31, 2014, bank debt outstanding is nil). The Company manages liquidity risk through prudent use of bank debt and an actively managed production and capital expenditure budgeting process. In addition, risk management contracts such as derivative financial instruments may be used from time to time. Kelt targets a relatively low net debt to trailing funds from operations ratio. To manage this, the Board of Directors approves an annual capital expenditure budget, which is regularly monitored and updated as necessary in response to changing capital requirements. Kelt actively manages the pace of its capital spending program by monitoring forecasted production and commodity prices and resulting cash flows.

Should circumstances affect cash flow in a detrimental way, the Company is capable of reducing capital investment levels. In addition, the Company utilizes a control system with respect to authorizations for expenditures on both operated and non-operated projects to further manage capital expenditures.

The Company's \$100.0 million Credit Facility, which is undrawn at March 31, 2014, is structured as a revolving operating demand loan. Repayments of principal are not required provided that the borrowings under the Credit Facility do not exceed the authorized borrowing amount and the Company is in compliance with all covenants, representations and warranties. As at March 31, 2014, the Company is in compliance with all covenants. Subsequent to the quarter, on May 6, 2014, the Company entered into an agreement with a syndicate of financial institutions to establish a new committed term credit facility, refer to additional information under the heading of *Subsequent Events*.

SHARE INFORMATION

The Company is authorized to issue an unlimited number of common shares and an unlimited number of preferred shares. As at March 31, 2014 there were 122.4 million common shares issued and outstanding (as at May 12, 2014, there were 122.5 million common shares outstanding). There are no preferred shares issued or outstanding.

As at March 31, 2014, officers, directors, and employees have been granted options to purchase 3.4 million common shares of the Company at an average exercise price of \$8.27 per common share. In addition, there are 1.7 million restricted shares units outstanding. Additional information regarding the Company's stock options and restricted share units is included in note 11 to the interim financial statements.

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

FUTURE COMMITMENTS – DERIVATIVE FINANCIAL INSTRUMENTS

The Company may, from time to time, enter into fixed price contracts and derivative financial instruments with respect to oil and gas sales, currency exchange and interest rates in order to secure a certain amount of cash flow to protect a desired level of capital spending.

The following table summarizes the Company's risk management contracts outstanding as of March 31, 2014:

Commodity	Notional volume	Pricing point	Contract Price	Remaining term	Fair value
					Asset (Liability)
Crude oil	500 bbls/d	NYMEX – WTI	CA\$ 100.04/bbl	Apr 1 to Jun 30, 2014	(507)
Crude oil	500 bbls/d	NYMEX – WTI	CA\$ 100.00/bbl	Jul 1 to Dec 31, 2014	(639)
Crude oil	500 bbls/d	NYMEX – WTI	CA\$ 101.41/bbl	Apr 1 to Dec 31, 2014	(956)
Crude oil	500 bbls/d	NYMEX – WTI	CA\$ 103.10/bbl	Apr 1 to Dec 31, 2014	(725)
Propane	150 bbls/d	OPIS-Conway	US\$ 48.09/bbl	Apr 1 to Dec 31, 2014	130
Net derivative financial instrument liability					(2,697)

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

CONTRACTUAL OBLIGATIONS

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

<i>(CA\$ thousands)</i>	2014	2015	2016	2017	2018	Thereafter
Operating lease – office buildings	575	761	738	747	249	-
Operating lease – vehicles	133	168	105	25	-	-
Flow-through shares	33,596	-	-	-	-	-
Firm transportation commitments	2,138	2,840	1,120	13	-	-
Total annual commitments	36,442	3,769	1,963	785	249	-

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

The Company has a \$100.0 million revolving operating demand loan which is undrawn at March 31, 2014. Repayments of principal are not required provided that the borrowings under the Credit Facility do not exceed the authorized borrowing amount and the Company is in compliance with all covenants, representations and warranties. Subsequent to the quarter, on May 6, 2014, the Company entered into an agreement with a syndicate of financial institutions to establish a new committed term credit facility, refer to additional information under the heading of *Subsequent Events*.

On March 25, 2014, the Company issued 2.635 million flow-through shares at a price of \$12.75 per flow-through share. Kelt shall, pursuant to the provisions in the *Income Tax Act* (Canada), incur eligible Canadian development expenses, (the "Qualifying Expenditures") after March 25, 2014 and prior to December 31, 2014 in the aggregate amount of not less than the total amount of the gross proceeds raised from the issue of flow-through common shares of \$33.6 million. As of March 31, 2014, the Company has not yet incurred any Qualifying Expenditures related to the March 25, 2014 flow-through share offering. Kelt shall renounce the Qualifying Expenditures so incurred to the purchasers of the flow-through common shares in an amount equal to \$12.75 per flow-through common share on or prior to December 31, 2014.

RELATED PARTY TRANSACTIONS

A director of the Company is also a partner at a law firm which Kelt has engaged to provide legal services. During the first three months of 2014, the Company incurred \$0.2 million (2013 – \$0.1 million) in legal fees and disbursements, of which, \$0.2 million is payable at March 31, 2014. The Company expects to continue using the services of this law firm from time to time.

OFF-BALANCE SHEET TRANSACTIONS

The Company did not engage in any off-balance sheet transactions during the periods ended March 31, 2014 and 2013.

SUBSEQUENT EVENTS

On May 6, 2014, the Company entered into an agreement with a syndicate of financial institutions, led by National Bank of Canada, to establish a new committed term credit facility (the "New Facility") to replace the existing demand loan Credit Facility in place as at March 31, 2014. The lenders have approved a borrowing base of \$170.0 million, and a commitment amount of \$100.0 million. Kelt may, if necessary to meet the capital requirements of the Company, request to increase the commitment amount from \$100.0 million up to \$170.0 million prior to the next scheduled review, with any such increase request being subject to the approval of the lenders. The New Facility is available for a revolving period of 364 days, maturing on April 29, 2015, and may be extended for an additional 364 days at the discretion of the lenders, with a term-out to April 29, 2016 if not renewed. 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. Covenants include reporting requirements, permitted

indebtedness, permitted dispositions, permitted hedging, permitted encumbrances and other standard business operating covenants. There are no financial covenants under the New Facility. The authorized borrowing amount is subject to interim reviews by the financial institutions. 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 New 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.

SUMMARY OF QUARTERLY RESULTS

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

<i>(CA\$ thousands, except as otherwise indicated)</i>	Q1 2014	Q4 2013	Q3 2013	Q2 2013	Q1 2013
Revenue, before royalties and financial instruments	47,793	18,543	12,388	11,860	3,865
Funds from operations	26,084	9,396	5,473	6,608	2,179
Per share – basic (\$/common share)	0.24	0.09	0.06	0.08	0.09
Per share – diluted (\$/common share)	0.23	0.09	0.06	0.08	0.09
Profit (loss)	4,851	(1,838)	(2,400)	(737)	(140)
Per share – basic (\$/common share)	0.04	(0.02)	(0.03)	(0.01)	(0.01)
Per share – diluted (\$/common share)	0.04	(0.02)	(0.03)	(0.01)	(0.01)
Total assets	666,257	485,201	333,832	229,370	141,834
Bank debt	-	-	-	-	-
Working capital surplus (deficiency)	123,150	20,500	123,774	58,058	(24,471)
Average daily production (BOE/d)	10,143	5,739	4,636	4,097	1,316
Average realized price, after financial instruments (\$/BOE)	50.99	34.74	28.17	32.42	32.64
Operating netback (\$/BOE)	29.40	18.67	12.94	18.42	19.28
Netback as a percentage of revenue	58%	54%	46%	57%	59%

Since commencing active operations on February 27, 2013, the Company has significantly grown its asset and production base through a combination of robust drilling program and accretive acquisitions. In addition to cash provided by operating activities, the Company's capital expenditures were funded primarily through equity financings and the Company has not drawn on its \$100.0 million Credit Facility. Collectively, strong commodity prices combined with the maintenance of a low cost structure resulted in a significant improvement in funds from operations per common share and operating netbacks during the first quarter of 2014.

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

BUSINESS RISKS

The business of exploration, development, production and acquisition of oil and gas reserves involves a number of uncertainties. As a result, the Company is exposed to certain business risks inherent in the oil and gas industry which may impact the Company's operations or financial results. A discussion of the significant risk factors affecting the Company is included in Kelt's most recently filed Annual Information Form dated March 28, 2014, which can be found at 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.

CURRENT ECONOMIC ENVIRONMENT

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

In this environment, Kelt is focused on maintaining a strong balance sheet, giving the Company the ability to take advantage of opportunities as they arise. The Company's capital expenditure program is also flexible, with the ability to defer expenditures into the future if the current economic environment deteriorates.

2014 GUIDANCE

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

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

Kelt expects production in 2014 to average approximately 11,000 BOE per day. Production is expected to be weighted 24% oil, 6% NGLs, and 70% gas; however, operating income in 2014 is expected to be derived 47% from oil production, 10% from NGLs production, and 43% from gas production.

The Company's average commodity price assumptions for 2014 are US\$92.00 (previously US\$90.00) per barrel for WTI oil, US\$4.60 (previously US\$4.65) per MMBTU for NYMEX natural gas, \$4.55 (previously \$4.50) per GJ for AECO natural gas and a US/Canadian dollar exchange rate of US\$0.9174 (previously US\$0.9200). These prices compare to average calendar 2013 prices of US\$97.98 per barrel for WTI oil, US\$3.68 per MMBTU for NYMEX natural gas, \$2.97 per GJ for AECO natural gas and a US/Canadian dollar exchange rate of US\$0.971. Funds from

operations for 2014 is forecasted to be approximately \$103.0 million (previously \$102.0 million) or \$0.85 per common share, diluted.

Kelt estimates that the Company's bank indebtedness, net of working capital, will be approximately \$3.0 million (previously \$3.9 million) at December 31, 2014. On May 6, 2014, the Company established a new \$100.0 million committed term credit facility with a syndicate of financial institutions. Additional information is available under the heading of *Subsequent events*.

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

The information set out herein under the heading "2014 Guidance" is "financial outlook" within the meaning of applicable securities laws. The purpose of this financial outlook is to provide readers with disclosure regarding Kelt's reasonable expectations as to the anticipated results of its proposed business activities for 2014. Readers are cautioned that this financial outlook may not be appropriate for other purposes.

ADDITIONAL INFORMATION

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

On behalf of the Board of Directors,

[signed]

David J. Wilson
President and Chief Executive Officer
May 12, 2014

KELT EXPLORATION LTD.
STATEMENT OF FINANCIAL POSITION
[Unaudited]

<i>(CA\$ thousands)</i>	[Notes]	March 31, 2014	December 31, 2013
ASSETS			
Current assets			
Cash and cash equivalents		168,440	32,015
Accounts receivable and accrued revenue	[13]	24,721	13,082
Prepaid expenses and deposits		1,550	1,240
Derivative financial instruments	[13]	130	-
Assets held for sale	[6]	-	19,635
Total current assets		194,841	65,972
Deferred income tax asset	[12]	18	1,957
Exploration and evaluation assets	[7]	44,231	40,564
Property, plant and equipment	[8]	427,167	376,708
Total assets		666,257	485,201
LIABILITIES			
Current liabilities			
Accounts payable and accrued liabilities		65,522	43,447
Derivative financial instruments	[13]	2,827	532
Deferred premium on flow-through shares	[11]	3,030	1,181
Decommissioning obligations	[10]	312	312
Bank debt	[9]	-	-
Total current liabilities		71,691	45,472
Decommissioning obligations	[10]	55,156	46,857
Total liabilities		126,847	92,329
SHAREHOLDERS' EQUITY			
Shareholders' capital	[11]	589,356	449,876
Reserve from common control transaction	[4]	(57,668)	(57,668)
Contributed surplus		7,986	5,779
Retained earnings (deficit)		(264)	(5,115)
Total shareholders' equity		539,410	392,872
Total liabilities and shareholders' equity		666,257	485,201
Commitments	[15]		
Subsequent events	[18]		

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

On behalf of the Board of Directors:

[signed]

David J. Wilson, Director

[signed]

Neil G. Sinclair, Director

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

<i>(CA\$ thousands, except per share amounts)</i>		Three months ended March 31	
		[Notes]	2014
Revenue			
Oil and gas		47,793	3,865
Royalties		(5,948)	(516)
		41,845	3,349
Expenses			
Production		11,339	772
Transportation		2,423	294
Financing	[14]	430	28
General and administrative		883	97
Share based compensation	[11]	2,077	335
Depletion and depreciation		14,277	2,224
Exploration and evaluation	[7]	85	21
		31,514	3,771
Profit (loss) before other items and taxes		10,331	(422)
Interest income		212	-
Transaction costs	[5,6]	(28)	-
Premium on flow-through shares	[11]	1,181	-
Loss on derivative financial instruments	[13]	(3,414)	-
Profit (loss) before taxes		8,282	(422)
Deferred income tax expense (recovery)	[12]	3,431	(282)
Profit (loss) and comprehensive income (loss)		4,851	(140)
Profit (loss) per common share			
Basic	[11]	0.04	(0.01)
Diluted	[11]	0.04	(0.01)

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

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

<i>(CA\$ thousands)</i>	[Notes]	Shareholders' capital	Reserve	Contributed surplus	Retained earnings (deficit)	Total shareholders' equity
Balance at December 31, 2013		449,876	(57,668)	5,779	(5,115)	392,872
Profit (loss) and comprehensive income (loss)					4,851	4,851
Common shares issued:						
Private placements	[11]	146,986				146,986
Less: deferred premium on flow-through shares	[11]	(3,030)				(3,030)
Share issue costs, net of tax	[11]	(4,476)				(4,476)
Common shares to be issued	[11]			130		130
Share based compensation	[11]			2,077		2,077
Balance at March 31, 2014		589,356	(57,668)	7,986	(264)	539,410
<hr/>						
Balance at December 31, 2012		-	-	-	-	-
Profit (loss) and comprehensive income (loss)					(140)	(140)
Common shares issued, net of costs:						
Pursuant to the Arrangement	[4,11]	141,961	(57,668)			84,293
Private placements	[11]	13,920				13,920
Share issue costs, net of tax	[11]	(270)				(270)
Share based compensation	[11]			335		335
Balance at March 31, 2013		155,611	(57,668)	335	(140)	98,138

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

KELT EXPLORATION LTD.
STATEMENT OF CASH FLOWS
[Unaudited]

(CA\$ thousands)	[Notes]	Three months ended March 31	
		2014	2013
Operating activities			
Profit (loss)		4,851	(140)
Items not affecting cash:			
Accretion of decommissioning obligations	[10,14]	379	21
Share based compensation		2,077	335
Depletion and depreciation		14,277	2,224
Exploration and evaluation		85	21
Premium on flow-through shares		(1,181)	-
Unrealized loss on derivative financial instruments	[13]	2,165	-
Deferred income tax expense (recovery)		3,431	(282)
Change in non-cash operating working capital	[16]	(4,812)	(749)
Cash provided by operating activities		21,272	1,430
Financing activities			
Issue of common shares	[11]	146,986	13,920
Proceeds on exercise of stock options	[11]	130	-
Share issue costs		(5,968)	(270)
Cash provided by financing activities		141,148	13,560
Investing activities			
Pursuant to the Arrangement	[4]	-	(22,856)
Exploration and evaluation assets:			
Capital expenditures		(7,346)	(917)
Acquisitions	[5]	(3,773)	(300)
Property, plant and equipment:			
Capital expenditures		(44,946)	(16,137)
Acquisitions	[5]	(4,503)	-
Dispositions	[6]	19,635	-
Change in non-cash investing working capital	[16]	14,938	29,492
Cash used in investing activities		(25,995)	(10,718)
Net change in cash and cash equivalents		136,425	4,272
Cash and cash equivalents, beginning of period		32,015	-
Cash and cash equivalents, end of period		168,440	4,272

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

KELT EXPLORATION LTD.
NOTES TO THE CONDENSED INTERIM FINANCIAL STATEMENTS
AS AT AND FOR THE THREE MONTHS ENDED MARCH 31, 2014
[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") was incorporated under the *Business Corporations Act* (Alberta) on October 11, 2012 as 1705972 Alberta Ltd. and was inactive until February 26, 2013. On October 19, 2012, Articles of Amendment were filed to change the name of the Company to Kelt Exploration Ltd. The head office of Kelt is located at Suite 300, 311 – 6th Avenue S.W., Calgary, Alberta T2P 3H2.

Kelt is an oil and gas company based in Calgary, Alberta, focused on the exploration, development and production of crude oil and natural gas resources, primarily in west central Alberta and northeastern British Columbia. The Company is a single reporting entity and does not have any subsidiaries. Common shares of the Company are listed and posted for trading on the Toronto Stock Exchange ("TSX") under the symbol "KEL".

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

2. BASIS OF PRESENTATION

These condensed interim financial statements were approved and authorized for issue by the Company's Board of Directors on May 12, 2014.

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 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 interim financial statements should be read in conjunction with the audited annual financial statements as at and for the year ended December 31, 2013.

b) Basis of measurement

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

These financial statements have been prepared on a historical cost basis, except for certain financial instruments which are recorded at fair value. The methods used to measure fair values are described in note 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 1 of the December 31, 2013 annual financial statements. There have been no significant changes in the Company's significant judgments and estimates applied during the interim period ended March 31, 2014 relative to the most recent annual financial statements as at and for the year ended December 31, 2013.

3. SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies applied by the Company are described in note 2 of the December 31, 2013 annual financial statements. Except as outlined below, these condensed interim financial statements have been prepared following the same accounting policies and methods of computation as the most recent annual financial statements as at and for the year ended December 31, 2013.

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

Effective January 1, 2014, the Company retrospectively adopted International Financial Reporting Interpretation Committee (“IFRIC”) 21 *Levies*. IFRIC 21 clarified that an entity recognizes a liability for a levy when the activity that triggers payment occurs. For a levy that is triggered upon reaching a minimum threshold, the interpretation clarified that no liability should be anticipated before the minimum threshold is reached. The adoption of this interpretation did not have an impact on the Company’s financial statements.

4. COMMON CONTROL TRANSACTION

The Company was incorporated as a wholly owned subsidiary of Celtic Exploration Ltd. (“Celtic”), for the purposes of participating in a Plan of Arrangement (the “Arrangement”) between ExxonMobil Canada Ltd. (“ExxonMobil Canada”), ExxonMobil Celtic ULC (formerly 1690731 Alberta ULC) (the “Purchaser”), Celtic and Kelt. Pursuant to the Arrangement, the Purchaser purchased all of Celtic’s outstanding common shares (“Celtic Shares”), including Celtic Shares issued upon conversion of Celtic’s 5% convertible debentures, at a cash price of \$24.50 per Celtic Share. Additionally, Celtic shareholders received one-half (1/2) of a share of Kelt for each Celtic Share.

Pursuant to the Arrangement and a conveyance agreement (the “Conveyance Agreement”) entered into by Celtic and Kelt upon closing of the Arrangement on February 26, 2013, Celtic transferred certain petroleum and natural gas assets (the “Celtic Assets”) to Kelt in exchange for \$142.0 million of common share consideration (the “Common Control Transaction”). The Celtic Assets transferred pursuant to the Common Control Transaction included all of Celtic’s rights, title, estate and interest in the petroleum, natural gas and related hydrocarbon rights and related personal property interests within, upon or under the lands and leases, including: a liquids-rich gas property in the Inga area of northeastern British Columbia; a gas property in the Grande Cache area of Alberta; and an oil prospect in the Karr area of west central Alberta.

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

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

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

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

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

Common shares	[note 11]	141,961
Carrying value of net assets transferred		(84,293)
Reserve from common control transaction		57,668

Under the terms of the Arrangement, the Company acquired tax pools in the amount of \$165.2 million relating to the Celtic Assets. The Company did not initially recognize a deferred income tax asset of \$14.4 million related to the excess of tax pools acquired relative to the carrying value of the net assets transferred because the Common Control Transaction is not a business combination and is therefore subject to the initial recognition exemption under IAS 12 *Income taxes*. Refer to note 12 for additional information.

5. PROPERTY ACQUISITIONS

There were no significant property acquisitions during the three month period ended March 31, 2014. During the first quarter of 2014, the Company completed a minor acquisition of petroleum and natural gas assets for cash consideration of \$7.5 million, before closing adjustments. The transaction has been accounted for as a business combination using the acquisition method whereby the net assets acquired and the liabilities assumed are recorded at fair value. The assets acquired are located at Spirit River, Alberta, and are a complementary fit with Kelt's existing core assets in the Grande Prairie area of west central Alberta.

The Company completed two significant property acquisitions during the previous year ended December 31, 2013. Additional information in respect of these significant acquisitions is outlined below.

Fireweed property acquisition

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

The transaction has been accounted for as a business combination using the acquisition method whereby the net assets acquired and the liabilities assumed are recorded at fair value.

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

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

The amounts reported above are estimates, which were made by management at the time of the preparation of the financial statements based on information then available.

Pouce Coupe/Spirit River property acquisition

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

effective date and closing of the transaction.

The transaction has been accounted for as a business combination using the acquisition method whereby the net assets acquired and the liabilities assumed are recorded at fair value.

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

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

(1) Includes \$20.6 million of property, plant and equipment classified as held for sale as at December 31, 2013, and disposed on February 10, 2014.

(2) Includes \$1.0 million of decommissioning obligations classified as held for sale as at December 31, 2013, and disposed on February 10, 2014.

The amounts reported above are estimates, which were made by management at the time of the preparation of the financial statements based on information then available.

6. DISPOSITION OF ASSETS HELD FOR SALE

On February 10, 2014, Kelt completed the disposition of certain non-core and non-operated assets located in northwestern Alberta (collectively referenced herein as the "Assets Held for Sale"). The Company received proceeds of \$20.0 million, before closing adjustments.

The Assets Held for Sale were acquired on December 20, 2013, as part of the greater Pouce Coupe/Spirit River property acquisition, as described in note 5. Management entered into negotiations to sell and received an initial offer to purchase the Assets Held for Sale, prior to closing of the acquisition. As of the acquisition date, it was considered highly probable that the disposition would be successfully completed. Accordingly, the acquired assets to be sold were classified as held for sale on the acquisition date and measured at their fair value less costs of disposal. The disposition had an effective date of January 1, 2014 and the fair value has been reduced by approximately \$0.4 million in respect of estimated closing adjustments between the effective date and closing of the transaction.

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

Property, plant and equipment	20,635
Decommissioning obligations	(1,000)
Net proceeds from disposition of Assets Held for Sale	19,635

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

The Statement of Profit and Comprehensive Income for the three month period ended March 31, 2014 includes approximately \$0.7 million of revenue and \$0.4 million of operating income in respect of the Assets Held for Sale for the 40 day period up to closing of the disposition on February 10, 2014. There were no future development costs assigned to these assets. The disposition did not result in a reduction of the authorized borrowing amount available under the Credit Facility (note 9).

7. EXPLORATION AND EVALUATION ASSETS

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

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

	March 31, 2014	December 31, 2013
Balance, beginning of period	40,564	-
Common control transaction [note 4]	-	12,785
Additions	7,346	46,717
Acquisitions [note 5]	3,773	11,355
Transfers to property, plant and equipment	(7,367)	(30,179)
Expired mineral leases	(85)	(114)
Balance, end of period	44,231	40,564

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

8. PROPERTY, PLANT AND EQUIPMENT

	March 31, 2014	December 31, 2013
Net carrying value		
Development and production assets	426,699	376,399
Corporate assets	468	309
Total net carrying value of property, plant and equipment	427,167	376,708

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

	D&P ⁽¹⁾ Assets	Corporate Assets	Total PP&E
Property, plant and equipment, at cost			
Balance at December 31, 2012	-	-	-
Common control transaction [note 4]	126,062	-	126,062
Additions	49,321	414	49,735
Acquisitions [note 5]	198,089	-	198,089
Decommissioning costs	38,833	-	38,833
Transfers from E&E	30,179	-	30,179
Assets held for sale [note 6]	(20,635)	-	(20,635)
Balance at December 31, 2013	421,849	414	422,263
Additions	44,728	218	44,946
Acquisitions [note 5]	4,503	-	4,503
Dispositions	-	(22)	(22)
Decommissioning costs	7,920	-	7,920
Transfers from E&E	7,367	-	7,367
Balance at March 31, 2014	486,367	610	486,977

Accumulated depletion and depreciation	D&P ⁽¹⁾ Assets	Corporate Assets	Total PP&E
Balance at December 31, 2012	-	-	-
Common control transaction [note 4]	22,218	-	22,218
Depletion and depreciation expense	23,232	105	23,337
Balance at December 31, 2013	45,450	105	45,555
Depletion and depreciation expense	14,218	59	14,277
Dispositions	-	(22)	(22)
Balance at March 31, 2014	59,668	142	59,810

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

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

Future capital costs required to develop proved reserves in the amount of \$225.0 million (2013 – \$219.6 million) are included in the depletion calculation for development and production assets.

9. BANK DEBT

The Company has a revolving operating demand loan (the "Credit Facility") with a Canadian chartered bank. As at March 31, 2014, the authorized borrowing amount under the Credit Facility is \$100.0 million. Repayments of principal are not required provided that the borrowings under the Credit Facility do not exceed the authorized borrowing amount and the Company is in compliance with all covenants, representations and warranties. Covenants include reporting requirements, permitted indebtedness, permitted asset dispositions, permitted risk management contracts and other standard business operating covenants; there are no financial covenants. As at March 31, 2014, the Company is in compliance with all covenants. Security is provided by a first fixed and floating charge debenture over all assets in the amount of \$500.0 million.

The Company did not draw any amounts on the Credit Facility during the current period ended March 31, 2014 or during the previous year ended December 31, 2013. As at March 31, 2014, the Credit Facility remains undrawn.

Subsequent to the quarter, on May 6, 2014, the Company entered into an agreement with a syndicate of financial institutions to establish a new committed term credit facility. Refer to note 18 *Subsequent Events*.

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:

	March 31, 2014	December 31, 2013
Balance, beginning of period	48,169	-
Common control transaction [note 4]	-	9,089
Obligations incurred	714	1,698
Obligations acquired [note 5]	1,066	16,231
Disposition of obligations held for sale [note 6]	(1,000)	-
Changes in discount rate	6,140	21,491
Revisions to estimates	-	(587)
Accretion expense	379	247
Balance, end of period	55,468	48,169
Current portion of decommissioning obligations	(312)	(312)
Obligations associated with assets held for sale [note 6]	-	(1,000)
Long-term portion of decommissioning obligations	55,156	46,857

The key assumptions, on which the carrying amount of the decommissioning obligations is based, include a risk-free rate of 3.0% (2013 – 3.2%) and an inflation rate of 2.0% (2013 – 2.0%). As at March 31, 2014, the undiscounted amount of the estimated cash flows required to settle the obligation is \$78.0 million (2013 – \$74.0 million), which will be incurred over the next 50 years. Accretion of the decommissioning obligation due to the passage of time is presented within financing expenses in the Statement of Profit (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:

	Number of Shares (000's)	Amount (\$ thousands)
Balance at December 31, 2012	-	-
Issued pursuant to the Arrangement [note 4]	61,126	141,961
Issued for cash through private placement offerings	48,900	320,930
Deferred premium on flow-through shares	-	(3,600)
Share issue costs, net of deferred income taxes	-	(9,415)
Balance at December 31, 2013	110,026	449,876
Issued for cash through private placement offering	12,410	146,986
Deferred premium on flow-through shares	-	(3,030)
Share issue costs, net of deferred income taxes	-	(4,476)
Balance at March 31, 2014	122,436	589,356

There are no preferred shares issued or outstanding as of March 31, 2014 (2013 – nil).

i) Common share offerings

On March 25, 2014, Kelt completed brokered and non-brokered private placement equity offerings for aggregate gross proceeds of \$147.0 million. Pursuant to the brokered private placement, the Company issued 9.775 million common shares at a price of \$11.60 per common share (which includes the exercise, in full, of the over-allotment option to purchase 1.275 million common shares) and issued 1.53 million common shares on a “flow-through” basis at a price of \$12.75 per flow-through share. The Company issued an additional 1.105 million flow-through common shares at a price of \$12.75 per flow-through share to certain directors, officers and employees of the Company, pursuant to the non-brokered private placement. The implied premium on the flow-through shares was determined to be \$3.0 million or \$1.15 per flow-through share. Kelt shall, pursuant to the provisions in the *Income Tax Act* (Canada), incur eligible Canadian development expenses, (the “Qualifying Expenditures”) after March 25, 2014 and prior to December 31, 2014 in the aggregate amount of not less than the total amount of the gross proceeds raised from the issue of flow-through common shares of \$33.6 million. As of March 31, 2014, the Company had not yet incurred any Qualifying Expenditures related to the March 25, 2014 flow-through share offering. Kelt shall renounce the Qualifying Expenditures so incurred to the purchasers of the flow-through common shares in an amount equal to \$12.75 per flow-through common share on or prior to December 31, 2014. The common shares issued in connection with the March 25, 2014 private placements are subject to a statutory hold period of four months plus one day from the date of completion of the private placements, in accordance with applicable securities legislation.

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

On August 27, 2013, the Company issued 11.5 million common shares at a price of \$8.00 per common share (which includes the exercise in full of the over-allotment option to purchase 1.5 million common shares) for gross proceeds of \$92.0 million. In addition, the Company issued 2.0 million flow-through shares in respect of Canadian exploration expenses at a price of \$9.80 per flow-through share, providing additional gross proceeds of \$19.6 million. The implied premium on the flow-through shares was determined to be \$3.6 million or \$1.80 per flow-through share. The Company incurred approximately \$13.2 million of qualifying expenditures from August 27, 2013 to December 31, 2013. During the first quarter of 2014, the Company incurred the remaining \$6.4 million of qualifying expenditures and as at March 31, 2014, the Company had fulfilled the full commitment. Qualifying expenditures in the amount of \$19.6 million were renounced to investors in February 2014, with an effective renunciation date of December 31, 2013.

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

On February 26, 2013, the Arrangement described in note 4 was completed by way of a statutory plan of arrangement under Section 193 of the *Business Corporations Act* (Alberta). Pursuant to the Arrangement, the Purchaser acquired all of the issued and outstanding Celtic Shares, including Celtic Shares issued upon conversion of Celtic's 5% convertible debentures, for cash consideration of \$24.50 per Celtic Share. In addition to the cash consideration, each Celtic shareholder received one-half (1/2) of a share of Kelt for each Celtic Share, resulting in the issuance of 61,126,119 Kelt common shares for consideration of \$142.0 million. Concurrently with the closing of the Arrangement on February 26, 2013, Kelt also completed the private placement of 6.0 million common shares at a price of \$2.32 per share for aggregate gross proceeds of approximately \$13.92 million.

ii) Stock options

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

The following table summarizes the change in stock options outstanding:

	Number of Options (000's)	Average Exercise Price (\$/share)
Balance at December 31, 2012	-	-
Granted	2,421	6.84
Balance at December 31, 2013	2,421	6.84
Granted	938	11.95
Exercised ⁽¹⁾	-	-
Balance at March 31, 2014	3,359	8.27

(1) On March 31, 2014, the Company received cash proceeds of approximately \$0.13 million related to the exercise of 20,000 stock options with an exercise price of \$6.47 per share. The transaction was not settled until subsequent to the balance sheet date, and accordingly the options are still outstanding and the common shares were not issued as of March 31, 2014. As at March 31, 2014, the cash proceeds are recognized as "common shares to be issued" in contributed surplus and will be reclassified to shareholders' capital upon settlement.

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:

	Three months ended March 31	
	2014	2013
Risk free interest rate	1.3%	1.2%
Expected life (years)	3.6	3.7
Expected volatility ⁽¹⁾⁽²⁾	31.1%	54.4%
Expected dividend yield	0.0%	0.0%
Expected forfeiture rate	0.1%	0.0%
Fair value of options granted during the year (\$/share)	2.95	2.66

(1) The expected volatility for stock options granted during the three month period ended March 31, 2014 is based on the historical weekly volatility of the Company's common shares.

(2) The expected volatility for stock options granted during the previous three month period ended March 31, 2013 was estimated using a junior oil and gas company peer group average, given there was no stock price history for the Company prior to the listing of shares on March 1, 2013.

The following table summarizes information regarding stock options outstanding at March 31, 2014:

Range of exercise prices per common share	Number of options outstanding (000's)	Weighted average remaining term (years)	Weighted average exercise price for options outstanding (\$/share)	Number of options exercisable (000's)	Weighted average exercise price for options exercisable (\$/share)
\$5.00 to \$10.00	2,521	4.1	6.95	703	6.47
\$10.01 to \$15.00	833	5.0	12.26	-	-
Total	3,359	4.3	8.27	703	6.47

iii) Restricted share units

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

The following table summarizes the change in RSUs outstanding:

	Number of RSUs (000's)
Balance at December 31, 2012	-
Granted	1,623
Balance at December 31, 2013	1,623
Granted	97
Balance at March 31, 2014	1,720

Share based compensation expense

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

	Three months ended March 31	
	2014	2013
Stock options	906	150
Restricted share units	1,171	185
Total share based compensation expense	2,077	335

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:

	Three months ended March 31	
	2014	2013
Weighted average common shares outstanding, basic	110,991	25,359
Effect of stock options and RSUs	1,797	-
Weighted average common shares outstanding, diluted	112,788	25,359

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 quarter ended March 31, 2013, the Company excluded the effect of stock options and RSUs as they were anti-dilutive.

12. INCOME TAXES

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

	Three months ended March 31	
	2014	2013
Current income tax expense	-	-
Deferred income tax expense (recovery)	3,431	(282)
Total income tax expense (recovery)	3,431	(282)

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

	Three months ended March 31	
	2014	2013
Profit (loss) before income taxes	8,282	(422)
Canadian statutory tax rate	25.0%	25.0%
Expected income tax expense (recovery)	2,071	(106)
Increase (decrease) resulting from:		
Non-deductible expenses ⁽¹⁾	521	84
Recognition of unrecognized deferred income tax asset	(473)	(260)
Qualifying expenditures on flow-through shares [note 11]	1,607	-
Premium on flow-through shares	(295)	-
Deferred income tax expense (recovery)	3,431	(282)

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

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

Under the terms of the Arrangement and Common Control Transaction described in note 4, the Company acquired tax pools in the amount of \$165.2 million relating to the Celtic Assets. The Company did not initially recognize a deferred income tax asset of \$14.4 million related to the excess of tax pools acquired relative to the carrying value of the net assets transferred because the Common Control Transaction is not a business combination and is therefore subject to the initial recognition exemption under IAS 12 *Income taxes*. The unrecognized deferred income tax asset is being amortized based on the corporate weighted average depletion factor for the period.

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

Deferred income tax asset (liability)	Balance at December 31, 2013	Recognized in profit and CI ⁽¹⁾	Recognized directly in equity	Balance at March 31, 2014
Derivative financial instruments	133	541	-	674
PP&E and E&E	(6,780)	(5,779)	-	(12,559)
Decommissioning obligations	11,792	2,075	-	13,867
Share and debt issue costs	2,599	(230)	1,492	3,861
Reserve from common control transaction	(12,445)	473	-	(11,972)
Non-capital losses ⁽²⁾	6,658	(511)	-	6,147
	1,957	(3,431)	1,492	18

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

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

(2) The Company's non-capital losses expire in 20 years.

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

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

Fair value of financial assets and liabilities	March 31, 2014		December 31, 2013	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Financial assets				
Cash and cash equivalents	168,440	168,440	32,015	32,015
Accounts receivable and accrued revenue	24,721	24,721	13,082	13,082
Deposits	697	697	545	545
Derivative financial instruments	130	130	-	-
Financial liabilities				
Accounts payable and accrued liabilities	65,522	65,522	43,447	43,447
Derivative financial instruments	2,827	2,827	532	532
Bank debt	-	-	-	-

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

Offsetting of financial instruments

Financial assets and liabilities are only offset if the Company has the current legal right to offset and intends to settle on a net basis or settle the asset and liability simultaneously. Kelt offsets derivative contracts assets and liabilities when the counterparty, commodity, currency and timing of settlement are the same. As at March 31, 2014 and as at December 31, 2013, the Company did not have any offsetting derivative contract positions.

Fair value measurements

The Company classifies fair value measurements using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy has the following levels:

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

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

The table below summarizes fair value measurements for each hierarchy level as at March 31, 2014:

	Level 1	Level 2	Level 3
Financial assets			
Derivative financial instruments	-	130	-
Financial liabilities			
Derivative financial instruments	-	2,827	-

Risk Management Overview

The Company is exposed to financial risks arising from its financial assets and liabilities that include credit and liquidity risk in addition to the market risks associated with commodity prices, and interest and foreign exchange rates. Profit (loss), cash flows and the fair value of financial assets and liabilities may fluctuate due to movement in market prices or as a result of the Company's exposure to credit and liquidity risks. This note presents information about the Company's exposure to each of the above risks, the Company's objectives, policies and processes for measuring and managing risk, and the Company's management of capital. Further quantitative disclosures are included throughout these financial statements.

The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework. The Company's management has implemented and continues to maintain and monitor risk management procedures for the benefit of the organization. The Company's risk management policies are established to: i) identify and analyze the risks faced by the Company; ii) set appropriate risk limits and controls; and iii) monitor risks and consider the implications of market conditions in relation to the Company's activities.

Credit Risk

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

Accounts receivable & accrued revenue	March 31, 2014	December 31, 2013
Joint venture partners	6,063	5,771
Oil and gas marketers	15,428	4,384
GST input tax credits	2,935	1,981
Interest receivable	65	33
Risk management contracts	19	-
Other	211	913
Accounts receivable & accrued revenue	24,721	13,082

During the three month period ended March 31, 2014, sales to four external customers each individually represented more than 10% of total revenue. Sales to these customers account for approximately 54%, 17%, 14% and 13% of total revenue, respectively. During the previous three month period ended March 31, 2013, sales to one external customer accounted for 15% of total revenue.

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

The credit risk from joint venture receivables is mitigated by obtaining partner approval of significant capital expenditures prior to expenditure and in certain circumstances may require cash deposits in advance of incurring financial obligations on behalf of joint venture partners. However, the receivables are from participants in the oil and gas industry and collection of the outstanding balances is dependent on industry factors such as changes in commodity prices, escalating costs and the risk of unsuccessful drilling. In addition, further risk exists with joint venture partners from occasional contractual disputes that increase the potential for non-collection. The Company does have the ability to withhold production from joint venture partners in the event of non-payment or may be able to register security on the assets of joint venture partners.

The balance of "other receivables" outstanding as of March 31, 2014 and December 31, 2013, include accrued receivables related to closing adjustments on property acquisitions. It is customary in the industry for such adjustments to be settled within one year of completion of an acquisition.

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

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

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

Accounts receivable & accrued revenue	Current	30-60 days	60-90 days	Over 90 days	Total
Balance at March 31, 2014	24,327	-	61	333	24,721
Balance at December 31, 2013	11,799	194	834	255	13,082

Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they are due. The Company's financial liabilities include accounts payable and bank debt (as at March 31, 2014, bank debt outstanding is nil). Kelt's approach to managing liquidity is to ensure, as far as possible, that it will have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking harm to the Company's reputation.

As at March 31, 2014, the Company has a working capital surplus of \$123.2 million. However, the capital intensive nature of Kelt's activities may create a working capital deficiency position during periods with high levels of capital investment. The Company manages liquidity risk through prudent use of bank debt and an actively managed production and capital expenditure budgeting process. In addition, risk management contracts such as derivative financial instruments may be used from time to time. As discussed further under the Capital Management section to follow, Kelt targets a relatively low net debt to trailing funds from operations ratio. To manage this, the Board of

Directors approves an annual capital expenditure budget, which is regularly monitored and updated as necessary in response to changing capital requirements. The Company utilizes a control system with respect to authorizations for expenditures on both operated and non-operated projects to further manage capital expenditures.

As discussed in note 9, Kelt has a \$100.0 million Credit Facility. Repayments of principal are not required provided that the borrowings under the Credit Facility do not exceed the authorized borrowing amount and the Company is in compliance with all covenants, representations and warranties. The Company is not subject to any financial covenants under the Credit Facility. As at March 31, 2014, the Credit Facility is undrawn and the Company is in compliance with all covenants. On May 6, 2014, the Company entered into an agreement with a syndicate of financial institutions to establish a new committed term credit facility. Refer to note 18 *Subsequent Events*.

During the quarter ended March 31, 2014, the Company raised gross proceeds \$147.0 million through equity financings. The equity financings and undrawn Credit Facility provide Kelt with significant financial flexibility to execute its 2014 and 2015 capital expenditure programs.

Market Risks

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

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

Commodity price risk

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

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

The following table summarizes the Company's financial derivative risk management contracts outstanding as of March 31, 2014:

Commodity	Notional volume	Pricing point	Contract Price	Remaining term	Fair value Asset (Liability)
Crude oil	500 bbls/d	NYMEX – WTI	CA\$ 100.04/bbl	Apr 1 to Jun 30, 2014	(507)
Crude oil	500 bbls/d	NYMEX – WTI	CA\$ 100.00/bbl	Jul 1 to Dec 31, 2014	(639)
Crude oil	500 bbls/d	NYMEX – WTI	CA\$ 101.41/bbl	Apr 1 to Dec 31, 2014	(956)
Crude oil	500 bbls/d	NYMEX – WTI	CA\$ 103.10/bbl	Apr 1 to Dec 31, 2014	(725)
Propane	150 bbls/d	OPIS-Conway	US\$ 48.09/bbl	Apr 1 to Dec 31, 2014	130
Net derivative financial instrument liability					(2,697)

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

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

	Three months ended March 31	
	2014	2013
Realized loss	(1,249)	-
Unrealized loss	(2,165)	-
Loss on derivative financial instruments	(3,414)	-

Interest rate risk

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. The Company is exposed to interest rate risk to the extent that changes in market interest rates will impact the Company's Credit Facility which is subject to a floating interest rate.

As at March 31, 2014, the Credit Facility is undrawn therefore the Company's exposure to interest rate risk is limited. The Company did not have any interest rate risk management contracts in place during the current year.

Foreign exchange rate risk

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

The Company did not have any foreign exchange rate contracts in place during the interim periods ended March 31, 2014 and 2013.

In order to mitigate a portion of the risk relating to revenue that is subject to fluctuations in the exchange rate, the Company may enter into commodity swap transactions whereby commodity prices denominated in U.S. dollars are converted to Canadian dollars. Refer to the *Commodity price risk* section above for details of contracts in place as of March 31, 2014.

Capital Management

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

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

	March 31, 2014	December 31, 2013
Accounts receivable & accrued revenue		
Bank debt	-	-
Working capital deficiency (surplus) ⁽¹⁾	(128,877)	(22,213)
Net debt (surplus)	(128,877)	(22,213)
Trailing funds from operations ⁽²⁾⁽³⁾	104,336	37,584
Net debt to trailing funds from operations ratio	N/A ⁽⁴⁾	N/A ⁽⁴⁾

(1) For the purposes of the net debt to trailing funds from operations ratio, working capital excludes bank debt, derivative financial instruments assets and liabilities, and the deferred premium on flow-through shares.

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

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

(4) The Company had a net surplus as at March 31, 2014 and December 31, 2013, therefore the net debt to trailing funds from operations ratio is not applicable.

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

As described in note 9, Kelt is subject to certain non-financial covenants under the Credit Facility agreement. As at March 31, 2014, 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 March 31	
	2014	2013
Interest and fees on bank debt	51	7
Accretion of decommissioning obligations [note 10]	379	21
Financing expense	430	28

During each of the three month periods ended March 31, 2014 and 2013, the Company did not draw on the Credit Facility and therefore did not incur any interest charges. Amounts reported as interest and fees on bank debt in the table above primarily relate to standby charges on the undrawn Credit Facility.

15. COMMITMENTS

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

(CA\$ thousands)	2014	2015	2016	2017	2018	Thereafter
Operating lease – office buildings	575	761	738	747	249	-
Operating lease – vehicles	133	168	105	25	-	-
Flow-through shares	33,596	-	-	-	-	-
Firm transportation commitments	2,138	2,840	1,120	13	-	-
Total annual commitments	36,442	3,769	1,963	785	249	-

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

The Company has a \$100.0 million revolving operating demand loan which is undrawn at March 31, 2014. Repayments of principal are not required provided that the borrowings under the Credit Facility do not exceed the authorized borrowing amount and the Company is in compliance with all covenants, representations and warranties. Subsequent to the quarter, on May 6, 2014, the Company entered into an agreement with a syndicate of financial institutions to establish a new committed term credit facility. Refer to note 18 *Subsequent Events*.

On March 25, 2014, the Company issued 2.635 million flow-through shares at a price of \$12.75 per flow-through share. Kelt shall, pursuant to the provisions in the *Income Tax Act* (Canada), incur eligible Canadian development expenses, (the "Qualifying Expenditures") after March 25, 2014 and prior to December 31, 2014 in the aggregate amount of not less than the total amount of the gross proceeds raised from the issue of flow-through common shares of \$33.6 million. As of March 31, 2014, the Company had not yet incurred any Qualifying Expenditures related to the March 25, 2014 flow-through share offering. Kelt shall renounce the Qualifying Expenditures so incurred to the purchasers of the flow-through common shares in an amount equal to \$12.75 per flow-through common share on or prior to December 31, 2014.

16. SUPPLEMENTAL CASH FLOW INFORMATION

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

	Three months ended March 31	
	2014	2013
Accounts receivable and accrued revenue	(11,639)	(4,486)
Prepaid expenses and deposits	(310)	(202)
Accounts payable and accrued liabilities	22,075	33,431
Change in non-cash working capital	10,126	28,743
Relating to:		
Operating activities	(4,812)	(749)
Investing activities	14,938	29,492
Change in non-cash working capital	10,126	28,743

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

	Three months ended March 31	
	2014	2013
Interest and fees on bank debt	46	-
Taxes	-	-

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 first three months of 2014, the Company incurred \$0.2 million (2013 – \$0.1 million) in legal fees and disbursements, of which, \$0.2 million is payable at March 31, 2014. The Company expects to continue using the services of this law firm from time to time.

18. SUBSEQUENT EVENTS

On May 6, 2014, the Company entered into an agreement with a syndicate of financial institutions, led by National Bank of Canada, to establish a new committed term credit facility (the "New Facility") to replace the existing demand loan Credit Facility in place as at March 31, 2014. The lenders have approved a borrowing base of \$170.0 million, and a commitment amount of \$100.0 million. Kelt may, if necessary to meet the capital requirements of the Company, request to increase the commitment amount from \$100.0 million up to \$170.0 million prior to the next scheduled review, with any such increase request being subject to the approval of the lenders. The New Facility is available for a revolving period of 364 days, maturing on April 29, 2015, and may be extended for an additional 364 days at the discretion of the lenders, with a term-out to April 29, 2016 if not renewed. 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. Covenants include reporting requirements, permitted indebtedness, permitted dispositions, permitted hedging, permitted encumbrances and other standard business operating covenants. There are no financial covenants under the New Facility. The authorized borrowing amount is subject to interim reviews by the financial institutions. 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 New 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.

ABBREVIATIONS

bbls	barrels
mmbbls	thousand barrels
bbls/d	barrels per day
BOE	barrels of oil equivalent
mBOE	thousand barrels of oil equivalent
BOE/d	barrels of oil equivalent per day
mcf	thousand cubic feet
mmcf	million cubic feet
bcf	billion cubic feet
mmcf/d	million cubic feet per day
mmbtu	million British Thermal Units
GJ	gigajoules
LT	long tonnes
AECO-C	Alberta Energy Company "C" Meter Station of the Nova Pipeline System
WTI	West Texas Intermediate
NYMEX	New York Mercantile Exchange
API	American Petroleum Institute
CICA	Canadian Institute of Chartered Accountants
MD&A	Management's Discussion and Analysis
Q1	First quarter ended March 31 st
Q2	Second quarter ended June 30 th
Q3	Third quarter ended September 30 th
Q4	Fourth quarter ended December 31 st
CEE	Canadian exploration expenses
CDE	Canadian development expenses
COGPE	Canadian oil and gas property expenses
UCC	Undepreciated capital cost
NCL	Non-capital losses
SIC	Share issue costs

CONVERSION OF UNITS

Imperial = Metric
1 acre = 0.4 hectares
2.5 acres = 1 hectare
1 bbl = 0.159 cubic metres
6.29 bbls = 1 cubic metre
1 foot = 0.3048 metres
3.281 feet = 1 metre
1 mcf = 28.2 cubic metres
0.035 mcf = 1 cubic metre
1 mile = 1.61 kilometres
0.62 miles = 1 kilometre
1 mmbtu = 1.054 GJ
0.949 mmbtu = 1 GJ
Natural gas is equated to oil on the basis of 6 mcf = 1 BOE
Sulphur is equated to gas on the basis of 1LT = 10 mcf (1 BOE = 0.6 LT)

CORPORATE INFORMATION

BOARD OF DIRECTORS

Robert J. Dales^{2, 3, 4, 6}
President, Valhalla Ventures Inc.

William C. Guinan^{1, 5, 6}
Partner, Borden Ladner Gervais LLP

Eldon A. McIntyre^{2, 3, 4, 6}
President, Jarrod Oils Ltd.

Neil G. Sinclair^{2, 3, 4, 5}
President, Sinson Investments Ltd.

David J. Wilson⁵
President & Chief Executive Officer,
Kelt Exploration Ltd.

1 chairman of the board

2 member of the audit committee

3 member of the reserves committee

4 member of the compensation committee

5 member of the health, safety and environment committee

6 member of the nominating committee

OFFICERS

David J. Wilson
President & Chief Executive Officer

Sadiq H. Lalani
Vice President, Finance & Chief Financial Officer

Douglas J. Errico
Vice President, Land

Alan G. Franks
Vice President, Production

Douglas O. MacArthur
Vice President, Operations

Patrick Miles
Vice President, Exploration

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AUDITORS

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Toronto Stock Exchange
Common Shares "KEL"



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