THIRD QUARTER REPORT

AS AT AND FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2016

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FINANCIAL AND OPERATIONAL HIGHLIGHTS	Three months ended September 30			Nine months ended September 30		
(CA$ thousands, except as otherwise indicated)	**2016**	2015[2]	%	**2016**	2015[2]	%
FINANCIAL						
Revenue, before royalties and financial instruments	**47,760**	45,015	6	**128,876**	136,529	-6
Funds from operations[1]	**17,658**	16,601	6	**35,280**	45,282	-22
Basic ($/ common share)[1]	**0.10**	0.10	-	**0.20**	0.30	-33
Diluted ($/ common share)[1]	**0.10**	0.10	-	**0.20**	0.30	-33
Loss and comprehensive loss	**(15,299)**	(21,557)	-29	**(61,630)**	(48,052)	28
Basic ($/ common share)	**(0.09)**	(0.13)	-31	**(0.36)**	(0.32)	13
Diluted ($/ common share)	**(0.09)**	(0.13)	-31	**(0.36)**	(0.32)	13
Total capital expenditures, net of dispositions	**12,616**	33,389	-62	**61,929**	454,194	-86
Total assets	**1,232,147**	1,363,348	-10	**1,232,147**	1,363,348	-10
Bank debt, net of working capital[1]	**132,471**	182,530	-27	**132,471**	182,530	-27
Convertible debentures	**70,134**	-	-	**70,134**	-	-
Shareholders' equity	**823,887**	937,658	-12	**823,887**	937,658	-12
Weighted average shares outstanding (000s)						
Basic	**174,349**	167,935	4	**172,338**	150,185	15
Diluted	**174,671**	168,706	4	**172,585**	151,236	14
OPERATIONS						
Average daily production						
Oil (bbls/d)	**4,606**	4,803	-4	**5,179**	5,059	2
NGLs (bbls/d)	**2,960**	1,685	76	**2,778**	1,520	83
Gas (mcf/d)	**77,854**	73,243	6	**80,327**	68,929	17
Combined (BOE/d)	**20,542**	18,695	10	**21,345**	18,067	18
Production per million common shares (BOE/d)[1]	**118**	111	6	**124**	120	3
Average realized prices, before financial instruments						
Oil ($/bbl)	**52.47**	53.20	-1	**44.64**	52.77	-15
NGLs ($/bbl)	**17.96**	19.28	-7	**16.82**	23.22	-28
Gas ($/mcf)	**2.88**	2.75	5	**2.39**	2.87	-17
Operating netbacks[1] ($/BOE)						
Oil and gas revenue	**25.27**	26.17	-3	**22.04**	27.68	-20
Cash premiums on financial instruments	**0.13**	-	-	**0.04**	-	-
Realized gain (loss) on financial instruments	**0.07**	(0.46)	-115	**0.02**	0.26	-92
Average realized price, after financial instruments	**25.47**	25.71	-1	**22.10**	27.94	-21
Royalties	**(2.55)**	(2.40)	6	**(1.83)**	(2.84)	-36
Production expense	**(8.43)**	(10.45)	-19	**(9.23)**	(12.14)	-24
Transportation expense	**(2.76)**	(1.34)	106	**(2.78)**	(2.11)	32
Operating netback[1]	**11.73**	11.52	2	**8.26**	10.85	-24
Undeveloped land						
Gross acres	**717,641**	666,620	8	**717,641**	666,620	8
Net acres	**596,957**	537,318	11	**596,957**	537,318	11

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

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

MESSAGE TO SHAREHOLDERS

Kelt Exploration Ltd. ("Kelt" or the "Company") reports its financial and operating results to shareholders for the third quarter and nine months ended September 30, 2016.

Average production for the three months ended September 30, 2016 was 20,542 BOE per day, up 10% compared to average production of 18,695 BOE per day during the third quarter of 2015. Daily average production in the third quarter of 2016 was 2% higher than average production of 20,208 BOE per day in the second quarter of 2016. Production disruptions from plant, facility and third-party downtime resulted in shut-ins of approximately 1,400 BOE per day on average during the third quarter of 2016.

Kelt's realized average oil price was $52.47 per barrel, up 5% from $49.76 per barrel in the second quarter of 2016 and down 1% from $53.20 per barrel in the third quarter of 2015. The realized average NGLs price during the third quarter of 2016 was $17.96 per barrel, down 1% from $18.21 per barrel in the second quarter of 2016 and down 7% from $19.28 per barrel in the corresponding period of 2015. The realized average gas price was $2.88 per MCF, up 46% from $1.97 per MCF in the second quarter of 2016 and up 5% from the realized average gas price of $2.75 per MCF in the third quarter of the previous year.

For the three months ended September 30, 2016, revenue was $47.8 million and funds from operations was $17.7 million ($0.10 per share, diluted), compared to revenue of $45.0 million and funds from operations of $16.6 million ($0.10 per share, diluted) in the third quarter of 2015. At September 30, 2016, bank debt, net of working capital was $132.5 million, down 27% from $182.5 million at September 30, 2015. Production expenses of $8.43 per BOE continue to improve and were 19% lower compared to $10.45 per BOE in the third quarter of 2015.

Net capital expenditures incurred during the three months ended September 30, 2016 were $12.6 million after taking into account proceeds of $5.1 million from the disposition of certain non-producing lands located in Alberta. The Company continued its counter cyclical land capture and spent $4.0 million acquiring new undeveloped land parcels primarily at Crown sales during the quarter. As at September 30, 2016, Kelt's net working interest land holdings were 808,737 acres (1,263 sections) of which 596,957 acres (932 sections) are undeveloped.

Subsequent to the end of the third quarter, Kelt continued to improve its financial flexibility by completing a private placement of 1.0 million common shares on a "CDE flow-through" basis at a price of $7.10 per share, resulting in net proceeds of approximately $6.8 million. At September 30, 2016, Kelt had approximately $982.2 million of tax deductions available to shelter future taxable income.

Oil and gas prices continue to be volatile. Monthly average AECO gas prices during the first ten months of 2016 ranged from a low of $1.04/GJ in April to a high of $2.94/GJ in October. As for crude oil, monthly average WTI prices ranged from a low of US$30.62/bbl in February to a high of US$49.94/bbl in October. Kelt has prepared its 2017 budget based on management's forecasted commodity prices as follows:

- Average WTI oil price of US$52.00 per barrel;
- Average AECO gas price of $2.95 per GJ;
- Capital expenditures of $134.0 million;
- Forecasted average production in 2017 of 23,000 BOE per day;
- 2017 production mix is expected to be weighted 40% to oil & NGLs and 60% to gas;
- 2017 operating income is expected to be derived 69% from oil & NGLs and 31% from gas;
- Forecasted 2017 funds from operations of $124.0 million ($0.70 per share, diluted); and
- Estimated bank debt, net of working capital as at December 31, 2017 of $148.0 million (1.2x forecasted 2017 funds from operations).

In July 2016, the Government of Alberta released further details with respect to the Alberta Modernized Royalty Framework ("MRF"), providing companies the ability to apply for early adoption by drilling wells in 2016 and still qualifying for royalty treatment under MRF. Kelt has taken advantage of this early adoption on certain wells planned in its Montney oil prospects at Pouce Coupe and Karr.

Kelt has commenced development pad drilling on its Montney oil play at Pouce Coupe where the Company is currently drilling the third well on a four-well pad. Two of these wells are targeting the upper-middle Montney (D2) and the other two wells are targeting the lower-middle Montney (D1). These wells are expected to be completed with 46-stage fractures with approximately 50 tonnes of proppant per stage. During the last week of September, Kelt brought on production two wells in its Grande Prairie core area. At Pouce Coupe, the well located at 100/08-18-078-11W6/2 was completed in the lower-middle Montney (D1) and had an IP30 rate (gross sales) of 852 BOE per day of which oil and liquids was 38%. At Progress, the Company's second exploration well (50% working interest) into the prospect located at 100/14-14-078-09W6/0 was completed in the middle Montney and had an IP30 rate (gross sales) of 875 BOE per day of which 73% was oil and liquids. Kelt plans to follow-up with a third delineation test at Progress in the first quarter of 2017. Kelt expects to commence development pad drilling on its Montney oil play at Karr in late November upon ground freeze up. The Company currently plans to commence development pad drilling at La Glace in the second quarter of 2017.

At Inga/Fireweed in British Columbia, Kelt drilled its second middle Montney well during the third quarter and expects to commence completion operations in late November. The Company plans to drill two upper Montney wells located in the northeast and southeast parts of its land block in late 2016 and early 2017. After spring break-up in 2017, Kelt expects to commence full development in the upper Montney at Inga by switching to pad drilling which should result in significant savings in per well capital expenditures, as well as lower per unit operating expenses when the wells are brought on production.

In the current energy business environment, Kelt is optimistic that it can continue to take advantage of lower industry-wide spending levels with its strategy of low-cost land accumulation in its core operating areas and significantly lower drilling and completion costs as the Company transitions to full scale development.

Management looks forward to updating shareholders with 2016 annual results in early March 2017.

On behalf of the Board of Directors,

[signed]

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

MANAGEMENT'S DISCUSSION & ANALYSIS

INTRODUCTION

Kelt Exploration Ltd. ("Kelt" or the "Company") is an oil and gas company based in Calgary, Alberta, focused on the exploration, development and production of crude oil and natural gas resources, primarily in west central Alberta and northeastern British Columbia. The Company's common shares and 5% convertible debentures are listed on the Toronto Stock Exchange ("TSX") under the symbol "KEL" and "KEL.DB", respectively. The head office of Kelt is located at Suite 300, 311 - 6th Avenue S.W., Calgary, Alberta T2P 3H2.

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

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

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

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

ADVISORY REGARDING FORWARD-LOOKING STATEMENTS

This MD&A contains forward-looking statements and forward-looking information within the meaning of applicable securities laws. The use of any of the words "expect", "anticipate", "continue", "estimate", "objective", "ongoing", "may", "will", "project", "should", "believe", "plans", "intends" and similar expressions are intended to identify forward-looking information or statements. In particular, this MD&A contains forward-looking statements pertaining to the following: the anticipated decrease in financing fees under the Company's Credit Facility (defined herein) at the next applicable margin adjustment on or about November 29, 2016; the expectation that the Company will incur sufficient qualifying expenditures to fully satisfy its flow-through share commitments; the potential impact of the Modernized Royalty Framework ("MRF") on the Company's Alberta oil and gas assets; the Company's ability to continue accumulating land at a low-cost in its core operating areas; and the Company's expected future financial position and operating results, as well as the amount and timing of future development capital expenditures. Statements relating to "reserves" or "resources" are deemed to be forward looking statements, as they involve the implied assessment, based on certain estimates and assumptions, that the reserves described exist in the quantities predicted or estimated and that the reserves can be profitably produced in the future.

Although Kelt believes that the expectations and assumptions on which the forward-looking statements are based are reasonable, undue reliance should not be placed on the forward-looking statements because Kelt cannot give any assurance that they will prove to be correct. Since forward-looking statements address future events and conditions, by their very nature they involve inherent risks and uncertainties. Actual results could differ materially from those currently anticipated due to a number of factors and risks. These include, but are not limited to, the risks associated with the oil and gas industry in general (e.g., operational risks in development, exploration and production; delays or changes in plans with respect to exploration or development projects or capital expenditures; the uncertainty of

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

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

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

GROWTH STRATEGY

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

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

THIRD QUARTER FINANCIAL AND OPERATING HIGHLIGHTS

- Kelt reported average production of 20,542 BOE per day during the third quarter of 2016, up 10% from 18,695 BOE per day in the third quarter of 2015 and up 2% from 20,208 BOE per day in the second quarter of 2016. Production disruptions resulting from plant, facility and third party downtime reduced average daily production by approximately 1,400 BOE per day during the quarter ended September 30, 2016.
- The Company generated funds from operations of $17.7 million ($0.10 per common share, diluted) during the three months ended September 30, 2016, up 6% from $16.6 million ($0.10 per common share, diluted) in the same period of 2015. Compared to the second quarter ended June 30, 2016, funds from operations is up 51% from $11.7 million ($0.07 per common share, diluted), reflecting the significant improvement in natural gas prices and realized oil prices as well as lower production and transportation expenses during the third quarter of 2016.
- Corporate royalty rates averaged 10.1% of revenue during the third quarter of 2016 compared to 9.2% in the third quarter of 2015. Crown royalties on certain wells have transitioned to higher rates after utilizing the maximum benefits available under royalty incentive programs.
- Production expenses averaged $8.43 per BOE during the three months ended September 30, 2016, down 19% from $10.45 per BOE in the third quarter of 2015 reflecting the Company's ongoing operational initiatives to reduce costs.
- Kelt continues to incur below industry average general and administrative ("G&A") expenses, which averaged $0.92 per BOE in the third quarter of 2016 in comparison to $0.82 per BOE for the same quarter of 2015. G&A expense is reported net of standard overhead recoveries. Kelt does not capitalize any direct G&A expenses.
- The Company's capital expenditures, before dispositions, of $17.7 million for the quarter ended September 30, 2016 were in line with funds from operations for the period. Of this total, $4.0 million was spent on land, $7.5

million was spent on drilling and completions, and $6.2 million was spent on infrastructure and corporate assets.

- During the three month period ended September 30, 2016, Kelt received cash proceeds of $5.1 million on the disposition of certain non-producing assets and reported a gain of $2.7 million with respect to the disposition.
- As at September 30, 2016, the Company had drawn $122.0 million on its $185.0 million bank credit facility, down from $127.0 million drawn at June 30, 2016. Kelt is well positioned to execute on its capital expenditure program and has sufficient financial flexibility to take advantage of opportunities as they arise.

Refer to additional information under the heading of *"Subsequent events"*.

PRODUCTION AND REVENUE

	Three months ended September 30			Nine months ended September 30		
(CA$ thousands, except as otherwise indicated)	**2016**	2015	%	**2016**	2015	%
Average daily production:						
Oil (bbls/d)	**4,606**	4,803	-4	**5,179**	5,059	2
NGLs (bbls/d)	**2,960**	1,685	76	**2,778**	1,520	83
Gas (mcf/d)	**77,854**	73,243	6	**80,327**	68,929	17
Combined (BOE/d)	**20,542**	18,695	10	**21,345**	18,067	18
Average realized prices, before financial instruments:						
Oil ($/bbl)	**52.47**	53.20	-1	**44.64**	52.77	-15
NGLs ($/bbl)	**17.96**	19.28	-7	**16.82**	23.22	-28
Gas ($/mcf)	**2.88**	2.75	5	**2.39**	2.87	-17
Combined ($/BOE)	**25.27**	26.17	-3	**22.04**	27.68	-20
Average realized prices, after financial instruments:						
Oil ($/bbl)	**53.07**	52.15	2	**44.82**	52.61	-15
NGLs ($/bbl)	**17.96**	19.28	-7	**16.82**	27.64	-39
Gas ($/mcf)	**2.90**	2.70	7	**2.40**	2.85	-16
Combined ($/BOE)	**25.47**	25.71	-1	**22.10**	27.94	-21
Revenue, before royalties and financial instruments:						
Oil	**22,232**	23,507	-5	**63,344**	72,891	-13
NGLs	**4,890**	2,988	64	**12,803**	9,638	33
Gas	**20,638**	18,520	11	**52,729**	54,000	-2
Total revenue, before royalties and financial instruments	**47,760**	45,015	6	**128,876**	136,529	-6

The Company reported average production of 20,542 BOE per day during the third quarter of 2016, up 10% from 18,695 BOE per day in the third quarter of 2015 and up 2% from 20,208 BOE per day during the second quarter of 2016. The increase in production reflects Kelt's successful drilling program, partly offset by corporate declines and production downtime. During the quarter ended September 30, 2016, third-party gas plant outages and intermittent pipeline and facility downtime impacted average production by approximately 1,400 BOE per day. The Company also faced approximately 1,700 BOE per day of average production downtime during the second quarter ended June 30, 2016, due to a planned turnaround of the Progress Gas Plant completed in June, along with the temporary shut-in of the West Stoddart Gas Plant as a result of forest fires in the vicinity of Fort St. John, BC, during April and May.

Notwithstanding these challenges, year-to-date average production of 21,345 BOE per day is up 18% from 18,067 BOE for the first nine months of 2015. The Artek Acquisition, which closed on April 16, 2015, added approximately 5,400 BOE per day of production at the time of the acquisition and contributed to the significant increase in NGLs volumes.

The Company earned revenue before royalties and financial instruments of $47.8 million and $128.9 million for the three month and nine month periods ended September 30, 2016, respectively. Despite the increase in corporate production volumes, significantly lower commodity prices resulted in a 6% decrease in revenues during the first nine months of 2016 compared to 2015.

Natural gas prices and realized oil prices strengthened during the third quarter ended September 30, 2016 and Kelt's combined average realized price was $25.27 ($25.47 after financial instruments) per BOE, up 15% from $22.14 ($22.13 after financial instruments) per BOE during the second quarter ended June 30, 2016.

OIL OPERATIONS

	Three months ended September 30			Nine months ended September 30		
(CA$ thousands, except as otherwise indicated)	**2016**	2015	%	**2016**	2015	%
Oil revenue	**22,232**	23,507	-5	**63,344**	72,891	-13
Oil royalties	**(4,072)**	(3,834)	6	**(9,390)**	(11,142)	-16
Oil revenue, after royalties	**18,160**	19,673	-8	**53,954**	61,749	-13
Average realized price, before financial instruments ($/bbl)	**52.47**	53.20	-1	**44.64**	52.77	-15
Cash premiums on financial instruments ($/bbl)	**0.60**	-	-	**0.18**	-	-
Realized gain (loss) on financial instruments ($/bbl)	**-**	(1.05)	-100	**-**	(0.16)	-100
Average realized price, after financial instruments ($/bbl)	**53.07**	52.15	2	**44.82**	52.61	-15
Benchmark oil prices:						
WTI Cushing Oklahoma (US$/bbl)[1]	**44.94**	46.43	-3	**41.33**	51.00	-19
WTI Cushing Oklahoma (CA$/bbl)[2]	**58.61**	60.71	-3	**54.40**	64.08	-15
Canadian Light Sweet ("CLS") ($/bbl)[1]	**54.19**	54.94	-1	**50.14**	59.03	-15
CLS % of CA$WTI	***92%***	*90%*	*3*	***92%***	*92%*	*0*
Average exchange rate (CA$/US$)[1]	**1.3041**	1.3085	0	**1.3205**	1.2581	5

(1) Source: Sproule Associates Limited.

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

Kelt realized an average price of $52.47 per barrel for oil sales during the third quarter ended September 30, 2016, representing significant improvement from the average price of $41.30 per barrel realized for the first half of 2016. Year-to-date, Kelt's average realized oil price of $44.64 per barrel is down 15% compared to the first nine months of 2015, in line with the decrease in benchmark oil prices over the same period.

The Company's realized oil price is discounted to benchmark oil prices as the base price paid by purchasers is adjusted for quality and is net of all applicable fees and deductions, including pipeline tariffs or location differentials. These tariffs and differentials vary depending on the delivery point, but do not fluctuate with oil prices.

The average discount of Kelt's realized oil price relative to the CLS reference price was $1.72 per barrel during the third quarter of 2016, compared to a discount of $5.25 per barrel in the second quarter of 2016 and $1.74 per barrel in the third quarter of 2015. The decrease in discount during the quarter ended September 30, 2016 reflects an improvement in contract pricing for the Company's oil production in Alberta and lower pipeline tariffs on BC oil production. As a result of capacity constraints on the BC Light pipeline, Kelt trucked a portion of its BC production volumes to terminals in Alberta with significantly lower pipeline tariffs.

For the three months ended September 30, 2016, oil royalties averaged 18.3% of oil revenue, up from 16.3% of oil revenue in the same quarter of 2015. The increase in Kelt's average oil royalty rate is primarily due to certain highly productive wells that have utilized the maximum credits available under royalty incentive programs. Oil royalties averaged 14.8% of oil revenue for the nine months ended September 30, 2016, down on average from 15.3% in the first nine months of 2015 as a result of lower oil prices in the first half of 2016.

NGL OPERATIONS

	Three months ended September 30			Nine months ended September 30		
(CA$ thousands, except as otherwise indicated)	**2016**	2015	%	**2016**	2015	%
NGLs revenue	**4,890**	2,988	64	**12,803**	9,638	33
NGLs royalties	**(158)**	(206)	-23	**(355)**	(908)	-61
NGLs revenue, after royalties	**4,732**	2,782	70	**12,448**	8,730	43
Average realized price, before financial instruments ($/bbl)	**17.96**	19.28	-7	**16.82**	23.22	-28
Realized gain (loss) on financial instruments ($/bbl)[(1)]	**-**	-	-	**-**	4.42	-100
Average realized price, after financial instruments ($/bbl)	**17.96**	19.28	-7	**16.82**	27.64	-39
Average realized price[(4)], percentage of CA$WTI	***31%***	*32%*		***31%***	*43%*	
Benchmark NGLs prices[(2)]:						
Edmonton Pentane (CA$/bbl)	**56.82**	59.58	-5	**52.66**	62.63	-16
Edmonton Butane (CA$/bbl)	**33.20**	30.60	8	**31.64**	36.92	-14
Edmonton Propane (CA$/bbl)	**12.22**	2.33	425	**9.77**	4.92	99
Edmonton Ethane (CA$/bbl)	**6.54**	8.08	-19	**5.18**	7.70	-33
Weighted average NGLs benchmark price ($/bbl)[(3)]	**28.07**	31.65	-11	**25.80**	34.94	-26

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

(2) Source: Sproule Associates Limited.

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

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

The Company's average realized price for NGL sales was $17.96 per barrel during the third quarter and $16.82 per barrel during the nine month period ended September 30, 2016. Kelt's realized price for NGL sales is reported net of deductions, primarily transportation and fractionation charges, which are generally a fixed dollar amount per unit under the NGLs purchase contracts, depending on the point of delivery. As these charges do not fluctuate with NGL prices, realized NGLs prices are more deeply discounted relative to WTI compared to 2015.

Kelt's NGL sales volumes were weighted 27% pentanes, 25% butane, 30% propane and 18% ethane during the nine months ended September 30, 2016. By comparison, NGL sales volumes were weighted 34% pentanes, 32% butane, 29% propane and 5% ethane during the same nine month period of 2015. The change in NGLs product mix is primarily attributable to a new marketing arrangement that came into effect in November 2015, resulting in higher total NGL recoveries on Company's production originating from the West Stoddart Gas Plant in northeastern BC. The arrangement results in a higher shrink of the Company's BC gas production, however, the price realized on additional NGL barrels extracted is at a premium to the Station 2 gas price.

NGL royalties averaged 2.8% during the nine months ended September 30, 2016, down from 9.4% during the same period of 2015. NGL royalties are reduced by various drilling incentive and cost allowance credits, which are allocated pro-rata to gas and NGLs and do not fluctuate with NGL prices.

GAS OPERATIONS

	Three months ended September 30			Nine months ended September 30		
(CA$ thousands, except as otherwise indicated)	**2016**	2015	%	**2016**	2015	%
Gas revenue	**20,638**	18,520	11	**52,729**	54,000	-2
Gas royalties	**(585)**	(100)	485	**(962)**	(1,960)	-51
Gas revenue, after royalties	**20,053**	18,420	9	**51,767**	52,040	-1
Average realized price, before financial instruments ($/MCF)	**2.88**	2.75	5	**2.39**	2.87	-17
Realized gain (loss) on financial instruments ($/MCF)	**0.02**	(0.05)	-140	**0.01**	(0.02)	-150
Average realized price, after financial instruments ($/MCF)	**2.90**	2.70	7	**2.40**	2.85	-16
Benchmark natural gas prices:						
NYMEX Henry Hub (US$/mmbtu)[(1)]	**2.78**	2.77	0	**2.26**	2.80	-19
AECO 5A (CA$/GJ)[(2)]	**2.20**	2.75	-20	**1.75**	2.62	-33
NGX Station #2 Day Ahead Index (CA$/GJ)[(3)]	**1.83**	1.71	7	**1.43**	1.91	-25
% of AECO 5A (CA$/GJ)	**83%**	62%	34	**82%**	73%	12
Platts Chicago City-Gate (US$/mmbtu)[(4)]	**2.78**	-	-	**2.30**	-	-
Platts Chicago City-Gate (CA$/mmbtu)[(4)]	**3.63**	-	-	**3.05**	-	-
% of AECO 5A (CA$/mmbtu)	**156%**	-	-	**165%**	-	-

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

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

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

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

The Company realized an average gas sales price of $2.88 per MCF during the quarter ended September 30, 2016, up 5% from $2.75 per MCF during the quarter ended September 30, 2015. By comparison, the AECO 5A gas index price fell by 20% over the same period, and averaged $2.20 per GJ during the third quarter of 2016. Kelt receives a premium to the AECO 5A gas index price due to the higher heat content of its gas production, and has marketing arrangements in place whereby the Company receives Chicago City-Gate pricing on a portion of its gas sales volumes.

Effective December 1, 2015, Kelt entered into gas sales agreements in BC and Alberta with 22,803 MMBTU per day of firm transportation on the Alliance pipeline, pursuant to which, Kelt receives Chicago City-Gate pricing (additional information is provided under the heading of *"Contractual Obligations"*). The Canadian dollar equivalent Chicago City-Gate price averaged $3.05 per MMBTU for the first nine months of 2016, representing a significant premium to AECO 5A and Station 2 prices. Approximately two-thirds of the Company's gas production from its Inga-Fireweed-Stoddart assets was sold under these contracts during the first nine months of 2016, resulting in stronger realized prices compared to previous periods in which the majority of Kelt's BC gas production was sold at Station 2 or CREC prices. The impact of the higher realized gas price on Kelt's funds from operations is partially offset by higher tolls on the Alliance pipeline, which are included in transportation expenses.

Gas royalties averaged 2.8% of gas revenue for the three months ended September 30, 2016 and averaged 1.8% year-to-date in 2016. The increase in gas royalties during the third quarter of 2016 reflects the increase in gas prices relative to the first half of 2016. By comparison, gas royalties averaged 0.5% and 3.6% of gas revenue during the three and nine month periods ended September 30, 2015, respectively. Crown royalties are calculated based on gas reference prices determined by the government and are reduced by royalty incentive credits, BC producer cost of service and Alberta gas cost allowance credits. These credits do not fluctuate with gas prices and impact the Company's reported average gas royalty rate each period.

PRODUCTION EXPENSES

	Three months ended September 30			Nine months ended September 30		
(CA$ thousands, unless otherwise indicated)	**2016**	2015[(1)]	%	**2016**	2015[(1)]	%
Production expense	**15,937**	17,980	-11	**53,973**	59,902	-10
$ per BOE	**8.43**	10.45	-19	**9.23**	12.14	-24

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

Kelt achieved a 19% reduction in per unit production expenses, which averaged $8.43 per BOE in the third quarter of 2016, compared to $10.45 per BOE for the third quarter of 2015. The decrease in total and per unit production expenses reflects Kelt's ongoing operational initiatives and previous expenditures to construct and acquire strategic infrastructure. In addition, with the Company's geographically concentrated asset base, Kelt is able to add new production at a lower incremental cost, reducing average production expense per BOE.

TRANSPORTATION EXPENSES

	Three months ended September 30			Nine months ended September 30		
(CA$ thousands, unless otherwise indicated)	**2016**	2015[(1)]	%	**2016**	2015[(1)]	%
Transportation expense	**5,211**	2,296	127	**16,266**	10,436	56
$ per BOE	**2.76**	1.34	106	**2.78**	2.11	32

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

The Company's per unit transportation expenses averaged $2.76 per BOE in the third quarter of 2016 and $2.78 per BOE year-to-date, up 32% from $2.11 per BOE on average for the first nine months of 2015. The increase in total transportation expenses reflects the increase in production volumes as well as higher gas transportation, partly offset by lower oil transportation expenses.

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

Oil transportation expenses averaged $2.19 per barrel for the nine month period ended September 30, 2016, down 34% from $3.33 per barrel during the corresponding period of 2015. The majority of Kelt's oil production is pipeline connected as a result of expenditures to construct and acquire strategic infrastructure in 2015. The Company was required to truck a portion of its BC oil production due to capacity constraints on the BC Light pipeline intermittently during the second and third quarters of 2016. However, the Company estimates that the impact of higher oil trucking expenses on operating netbacks in these circumstances has been relatively neutral as Kelt realized higher oil prices due to lower pipeline tariffs.

FINANCING EXPENSES

	Three months ended September 30			Nine months ended September 30		
(CA$ thousands, unless otherwise indicated)	**2016**	2015	%	**2016**	2015	%
Interest and fees on bank debt	**1,640**	1,776	-8	**5,932**	4,627	28
Interest on convertible debentures	**1,134**	-	-	**1,849**	-	-
Accretion of convertible debentures	**814**	-	-	**1,301**	-	-
Accretion of decommissioning obligations	**759**	784	-3	**2,262**	2,033	11
Financing expenses	**4,347**	2,560	70	**11,344**	6,660	70
Average bank debt outstanding	**130,223**	157,380	-17	**159,770**	147,901	8
Average interest rate on bank indebtedness	**4.4%**	3.7%	19	**4.3%**	3.5%	23
Interest expense per BOE [(1)]	**1.47**	1.03	43	**1.33**	0.94	41

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

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

On May 3, 2016, Kelt reduced borrowings under its revolving bank credit facility using the net proceeds of the offering of $90.0 million principal amount of convertible unsecured subordinated debentures (the "Debentures"). The Debentures mature on May 31, 2021 and bear interest at 5.0% per annum, payable semi-annually on May 31st and November 30th, commencing November 30, 2016. Financing expense for the quarter ended September 30, 2016 includes $1.1 million of accrued cash interest and $0.8 million of non-cash accretion expense. The carrying value allocated to the liability component of the Debentures is accreted to its principal amount of $90.0 million over the five year term to maturity, using the effective interest rate method.

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

The Company's debt to cash flow ratio has improved significantly as a result of the 51% increase in funds from operations during the third quarter of 2016 and decrease in net bank debt at September 30, 2016, compared to the second quarter ended June 30, 2016. As a result, Kelt expects to realize a 50 basis point decrease in the applicable margin (equivalent to a 17% decrease in stamping fees) at the next applicable margin adjustment under the Credit Facility, on or about November 29, 2016.

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

GENERAL AND ADMINISTRATIVE ("G&A") EXPENSES

	Three months ended September 30			Nine months ended September 30		
(CA$ thousands, unless otherwise indicated)	**2016**	2015	%	**2016**	2015	%
Salaries and benefits	**1,688**	1,534	10	**4,974**	4,160	20
Other G&A expenses	**877**	951	-8	**2,823**	2,596	9
Gross G&A expenses	**2,565**	2,485	3	**7,797**	6,756	15
Overhead recoveries	**(820)**	(1,075)	-24	**(2,585)**	(3,004)	-14
G&A expense, net of recoveries	**1,745**	1,410	24	**5,212**	3,752	39
Gross G&A ($ per BOE)	**1.36**	1.44	-6	**1.33**	1.37	-3
Net G&A ($ per BOE)	**0.92**	0.82	12	**0.89**	0.76	17

The Company incurred total G&A expenses, before recoveries, of $7.8 million during the first nine months of 2016, up 15% from the same period of 2015, in conjunction with the Company's significant growth. On a per unit basis, gross G&A expenses are relatively unchanged at $1.33 per BOE (before recoveries) due to management's continued efforts to maintain a low cost structure.

G&A expenses are reported net of overhead recoveries, however, Kelt does not capitalize any direct G&A expenses. On a per unit basis, net G&A expense was $0.92 per BOE for the quarter ended September 30, 2016, up 12% from the third quarter of 2015 as a result of lower capital overhead recoveries. Kelt earned lower capital overhead recoveries in the current year due to significantly lower capital expenditures resulting in an increase in net G&A expenses per BOE during the three and nine month periods ended September 30, 2016.

SHARE BASED COMPENSATION ("SBC")

	Three months ended September 30			Nine months ended September 30		
(CA$ thousands, unless otherwise indicated)	**2016**	2015	%	**2016**	2015	%
Stock options	**1,319**	995	33	**2,991**	3,330	-10
Restricted share units ("RSUs")	**482**	911	-47	**1,351**	2,956	-54
Total SBC expense	**1,801**	1,906	-6	**4,342**	6,286	-31
$ per BOE	**0.95**	1.11	-14	**0.74**	1.27	-42

Total SBC expense decreased in the three and nine month periods ended September 30, 2016, as the fair value of new stock options and RSUs granted is lower than previous periods. The significant decrease in SBC expense on a per unit basis reflects management's objective to provide long term incentives to employees and grow production, while minimizing the dilutive impact to shareholders. As at September 30, 2016, stock options and RSUs outstanding represent 5.2% of total common shares outstanding (4.7% of total shares outstanding at December 31, 2015).

EXPLORATION AND EVALUATION

	Three months ended September 30			Nine months ended September 30		
(CA$ thousands, unless otherwise indicated)	**2016**	2015	%	**2016**	2015	%
Expired mineral leases	**571**	1,259	-55	**3,398**	2,683	27
$ per BOE	**0.30**	0.73	-59	**0.58**	0.54	7

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

DEPLETION AND DEPRECIATION

	Three months ended September 30			Nine months ended September 30		
(CA$ thousands, unless otherwise indicated)	**2016**	2015	%	**2016**	2015	%
Depletion of development and production assets	**35,109**	37,140	-5	**110,625**	102,462	8
Depreciation of corporate assets	**208**	261	-20	**604**	677	-11
Total depletion and depreciation	**35,317**	37,401	-6	**111,229**	103,139	8
$ per BOE	**18.69**	21.75	-14	**19.02**	20.91	-9

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

GAIN ON SALE OF ASSETS

	Three months ended September 30			Nine months ended September 30		
(CA$ thousands, unless otherwise indicated)	**2016**	2015	%	**2016**	2015	%
Gain on sale of assets	**2,701**	-	-	**4,835**	190	2,445
$ per BOE	**1.43**	-	-	**0.83**	0.04	1,975

During the three month period ended September 30, 2016, Kelt received cash proceeds of $5.1 million on the disposition of certain non-producing assets. Year-to-date in 2016, proceeds from non-core property dispositions are $6.2 million and the Company has reported a gain on sale of $4.8 million.

On March 31, 2016, the Company disposed of certain non-core assets located at Boundary Lake in northwestern Alberta, for cash consideration of $1.2 million, after closing adjustments, and reported a gain of $2.1 million. The carrying amount of decommissioning obligations disposed was $2.4 million, which exceeded the $1.4 million combined carrying amount of the E&E and D&P assets. At the time of disposition, production from the assets was approximately 16 BOE per day.

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

DERIVATIVE FINANCIAL INSTRUMENTS

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

	Three months ended September 30			Nine months ended September 30		
(CA$ thousands, unless otherwise indicated)	**2016**	2015	%	**2016**	2015	%
Realized gain (loss)	**125**	(812)	-115	**89**	1,269	-93
Unrealized gain (loss)	**(241)**	(1,762)	-86	**10**	(3,435)	-100
Gain (loss) on derivative financial instruments	**(116)**	(2,574)	-95	**99**	(2,166)	-105
$ per BOE	**(0.06)**	(1.50)	-96	**0.02**	(0.44)	-105

Interest rate contracts

The Company has an interest rate swap fixing the CDOR rate at 0.925% on a notional $100.0 million per month from July 2015 to June 2017. The CDOR rate averaged 0.891% during the third quarter of 2016, resulting in a nominal realized loss in the period.

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

Contract Type	Notional Amount	Reference Price	Fixed Contract Price	Remaining Term	Fair value Asset (Liability)
Interest Rate Swap	$100,000,000	CDOR	0.925%	October 1, 2016 to June 30, 2017	**(46)**

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

Natural gas contracts

During the nine months ended September 30, 2016, the Company had a financial derivative contract to fix the basis differential between the Chicago Monthly Index and AECO 7A at US$0.96 per MMBTU on a notional of 10,000 MMBTU per day for the period from June to October 2016. The actual differential was US$1.0741 per MMBTU for the contract months July to September 2016, which resulted in a realized gain of approximately $0.1 million recognized in the third quarter of 2016. Kelt also had a financial derivative contract to fix the basis differential between the NYMEX Henry Hub and AECO 5A at $0.94 per MMBTU on a notional of 30,000 MMBTU for September 2016. The actual basis differential for September was US$0.9363, which resulted in a nominal realized loss recognized in the third quarter of 2016.

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

Remaining Term	Notional Volume	Reference Prices	Fixed Contract Price	Fair value Asset (Liability)
October 2016	10,000 MMBTU/d	Chicago Monthly Index AECO 7A	Chicago Monthly Index minus US$0.96 per MMBTU	**9**
October 2016	30,000 MMBTU/d	NYMEX Henry Hub Daily Index AECO 5A	NYMEX Henry Hub minus US$0.94 per MMBTU	**(189)**
April 2017 to October 2017	10,000 MMBTU/d	Southern California Border Avg. NYMEX Henry Hub	Southern California Border Avg. plus US$0.055 per MMBTU	**(57)**

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

- If the Chicago-AECO 7A basis differential increased (decreased) by $0.10/MMBTU, the fair market value of contract would increase (decrease) by approximately $0.04 million.
- If the NYMEX-AECO 5A basis differential increased (decreased) by $0.10/MMBTU, the fair market value of contract would increase (decrease) by approximately $0.1 million.
- If the Southern California Border Average-NYMEX basis differential increased (decreased) by $0.10/MMBTU, the fair market value of the contract would increase (decrease) by approximately $0.3 million.

Foreign exchange contracts

At September 30, 2016, the Company had a forward foreign exchange swaption contract whereby the counterparty has the right, if exercised on December 30, 2016, to enter a series of forward foreign exchange transactions fixing the exchange rate at CA$/US$1.33 from January to December 2017, on a notional amount of US$1.0 million per month. In consideration for the swaption, Kelt received a cash premium of $0.255 million at the time of entering into the contract. The fair value of the forward foreign exchange swaption as at September 30, 2016, resulted in a derivative financial instrument liability of $0.2 million.

PREMIUM ON FLOW-THROUGH SHARES

	Three months ended September 30		Nine months ended September 30	
(CA$ thousands)	**2016**	2015	**2016**	2015
Premium on flow-through shares	**846**	1,163	**846**	3,101

Management has employed a successful strategy of utilizing the Company's strong tax position, which includes approximately $1 billion of tax pools, to raise capital through equity private placements at a premium to market prices by issuing common shares on a "flow-through" basis. The premium received by the Company in excess of the fair value of its common shares at the time of the offering, is initially deferred and subsequently recognized in income as the premium is earned. During the quarter ended September 30, 2016, Kelt recognized a premium of $0.8 million based on qualifying capital expenditures incurred in the period.

On April 7, 2016, the Company completed private placements of 4.7 million flow-through common shares ("FTS") at a price of $4.70 per FTS, resulting in gross proceeds of $22.1 million (including $0.9 million of proceeds on the subscription of 0.2 million FTS by certain directors and officers of the Company). The implied premium was determined to be $2.6 million or $0.55 per FTS. Pursuant to the provisions of the *Income Tax Act* (Canada), the Company is obligated to incur eligible Canadian development expenses prior to December 31, 2016 in the aggregate amount of not less than the gross proceeds raised from the offering. The Company incurred approximately $7.2 million of qualifying expenditures during the three months ended September 30, 2016 and expects to fully satisfy the remaining commitment of $14.9 million with drilling and completion capital expenditures budgeted for the fourth quarter of 2016.

On August 23, 2016, the Company raised gross proceeds of $2.5 million by issuing 0.385 million FTS at a price of $6.50 per FTS, resulting in a premium of $0.6 million or $1.66 per FTS. The Company is obligated to incur eligible Canadian exploration expenses prior to December 31, 2017.

INCOME TAXES

Kelt was not required to pay income taxes in the current or prior periods as the Company had sufficient income tax deductions available to shelter taxable income. Tax deductions available as of September 30, 2016 are estimated to be approximately $982.2 million (COGPE 26%, CDE 17%, CEE 9%, UCC 18%, SIC 1%, NCL 29%).

	Three months ended September 30			Nine months ended September 30		
(CA$ thousands, unless otherwise indicated)	**2016**	2015	%	**2016**	2015	%
Deferred income tax recovery	**(3,254)**	(3,804)	-14	**(20,433)**	(7,450)	174
Loss before income taxes	**(18,553)**	(25,361)	-27	**(82,063)**	(55,502)	48
Effective tax rate	**18%**	15%	17	**25%**	13%	85

The consolidated combined federal and provincial statutory tax rate averaged 26.6% during the nine months ended September 30, 2016, up from 26.0% during the same period of 2015 due to the increase in Alberta's general corporate tax rate from 10% to 12% effective July 1, 2015. The impact of the increase in future tax rates resulted in a $4.5 million reduction in the deferred tax recovery that was recognized during the second quarter of 2015, partly contributing to the low effective tax recovery rate for the nine month period ended September 30, 2015. Qualifying expenditures incurred and expected to be renounced in respect of the Company's flow-through share commitments also reduce Kelt's effective tax recovery rate. Year-to-date in 2016, Kelt has incurred $7.2 million of qualifying expenditures, all of which were incurred during the three months ended September 30, 2016. A detailed analysis of the provision for deferred income taxes is included in note 14 of the consolidated interim financial statements, which includes a reconciliation of the difference between the deferred income tax recovery reported relative to expected recovery calculated based on the statutory tax rate.

FUNDS FROM OPERATIONS

Three months ended September 30	**2016**		2015		% change	
(CA$ thousands, unless otherwise indicated)	**Amount**	**$/BOE**	Amount	$/BOE	Amount	$/BOE
Oil and gas revenue	**47,760**	**25.27**	45,015	26.17	6	-3
Cash premium on financial instruments	**255**	**0.13**	-	-	-	-
Realized gain (loss) on financial instruments[(1)]	**134**	**0.07**	(785)	(0.46)	-117	-115
Royalties	**(4,815)**	**(2.55)**	(4,140)	(2.40)	16	6
Production expense	**(15,937)**	**(8.43)**	(17,980)	(10.45)	-11	-19
Transportation expense	**(5,211)**	**(2.76)**	(2,296)	(1.34)	127	106
Operating income[(2)]	**22,186**	**11.73**	19,814	11.52	12	2
Financing expense[(3)]	**(2,774)**	**(1.47)**	(1,776)	(1.03)	56	43
G&A expense	**(1,745)**	**(0.92)**	(1,410)	(0.82)	24	12
Realized gain (loss) on financial instruments[(4)]	**(9)**	**-**	(27)	(0.02)	-67	-
Funds from operations[(5)]	**17,658**	**9.34**	16,601	9.65	6	-3
Basic ($ per common share)[(6)]	**0.10**		0.10		-	
Diluted ($ per common share)[(6)]	**0.10**		0.10		-	
Common shares outstanding (000s):						
Basic, weighted average	**174,349**		167,935		4	
Diluted, weighted average	**174,671**		168,706		4	

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

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

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

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

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

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

The Company generated funds from operations of $17.7 million ($0.10 per common share, diluted) during the third quarter of 2016, up 6% from $16.6 million ($0.10 per common share, diluted) in the same quarter of 2015. The increase in funds from operations is primarily attributed to the 10% increase in production volumes that was achieved along with significantly lower per unit production expenses, which decreased by 19% or $2.02 per BOE in the third quarter of 2016. Kelt incurred higher transportation expenses for its commitments on the Alliance pipeline, however stronger realized gas prices under these contracts contributed to a higher average operating netback. Funds from operations of $9.34 per BOE for the three months ended September 30, 2016 is down 3% compared to $9.65 per BOE in the same quarter of 2015, primarily due to higher financing expenses.

Funds from operations for the nine months ended September 30, 2016 was $35.3 million ($0.20 per common share, diluted), compared to $45.3 million ($0.30 per common share, diluted) for the first nine months of 2015. Oil and gas revenues declined to $128.9 million for the nine months ended September 30, 2016, resulting from a 20% decrease in average realized prices. Total royalties for the nine months end September 30, 2016, were 24% lower than the comparative period as a result of lower commodity prices in the first half of 2016. The impact of lower commodity prices was partly offset by a 16% reduction in combined per unit production and transportation expenses, driven by the decrease in production expenses of $2.91 in per BOE. Financing costs for the nine months ended September 30, 2016, were $3.1 million higher than the comparative period as a result of higher average debt levels related to the Artek Acquisition on April 16, 2015, compounded by the effect of lower commodity prices.

Nine months ended September 30	**2016**		2015		% change	
(CA$ thousands, unless otherwise indicated)	**Amount**	**$/BOE**	Amount	$/BOE	Amount	$/BOE
Oil and gas revenue	**128,876**	**22.04**	136,529	27.68	-6	-20
Cash premium on financial instruments	**255**	**0.04**	-	-	-	-
Realized gain (loss) on financial instruments[(1)]	**113**	**0.02**	1,296	0.26	-91	-92
Royalties	**(10,708)**	**(1.83)**	(14,011)	(2.84)	-24	-36
Production expense	**(53,973)**	**(9.23)**	(59,902)	(12.14)	-10	-24
Transportation expense	**(16,266)**	**(2.78)**	(10,436)	(2.11)	56	32
Operating income[(2)]	**48,297**	**8.26**	53,476	10.85	-10	-24
Financing expense[(3)]	**(7,781)**	**(1.33)**	(4,627)	(0.94)	68	41
G&A expense	**(5,212)**	**(0.89)**	(3,752)	(0.76)	39	17
Other income	**-**	**-**	212	0.04	-100	-
Realized gain (loss) on financial instruments[(4)]	**(24)**	**-**	(27)	(0.01)	-11	-
Funds from operations[(5)]	**35,280**	**6.04**	45,282	9.18	-22	-34
Basic ($ per common share)[(6)]	**0.20**		0.30		-33	
Diluted ($ per common share)[(6)]	**0.20**		0.30		-33	
Common shares outstanding (000s):						
Basic, weighted average	**172,338**		150,185		15	
Diluted, weighted average	**172,585**		151,236		14	

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

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

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

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

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

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

PROFIT (LOSS) AND COMPREHENSIVE INCOME (LOSS)

Kelt reported a loss of $15.3 million ($0.09 per common share, diluted) for the three months ended September 30, 2016. Compared to the third quarter of 2015, the loss reported decreased by 29% (31% per common share) primarily due to the increase in funds from operations, lower depletion expense and a gain of $2.7 million recognized on the disposition on non-producing assets.

For the nine month period ended September 30, 2016, the loss reported by Kelt is $61.6 million, up $13.5 million from a loss of $48.1 million in the corresponding nine month period of 2015 which included a gain on Artek Acquisition of $15.9 million. The impact of lower funds from operations and higher total depletion expenses on the loss reported for the first nine months of 2016 was partially mitigated by a $4.8 million gain on non-core property dispositions and deferred tax recoveries.

	Three months ended September 30			Nine months ended September 30		
(CA$ thousands, unless otherwise indicated)	**2016**	2015	%	**2016**	2015	%
Loss and comprehensive loss	**(15,299)**	(21,557)	-29%	**(61,630)**	(48,052)	28%
Weighted avg. shares outstanding, basic (000s)	**174,349**	167,935	4%	**172,338**	150,185	15%
Weighted avg. shares outstanding, diluted (000s)[(1)(2)]	**174,349**	167,935	4%	**172,338**	150,185	15%
$ per common share, basic	**(0.09)**	(0.13)	-31%	**(0.36)**	(0.32)	13%
$ per common share, diluted[(1)(2)]	**(0.09)**	(0.13)	-31%	**(0.36)**	(0.32)	13%
$ per BOE	**(8.10)**	(12.53)	-35%	**(10.54)**	(9.74)	8%

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

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

CAPITAL EXPENDITURES

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

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

	Three months ended September 30			Nine months ended September 30		
(CA$ thousands, unless otherwise indicated)	**2016**	2015	%	**2016**	2015	%
Capital expenditures:						
Lease acquisition and retention	**4,001**	1,203	233	**5,986**	7,301	-18
Geological and geophysical	**1**	5	-80	**161**	1,077	-85
Drilling and completion of wells	**7,541**	27,081	-72	**21,871**	70,528	-69
Facilities, pipeline and well equipment	**5,757**	5,260	9	**20,730**	45,659	-55
Corporate assets	**441**	33	1236	**569**	563	1
Capital expenditures, before A&D	**17,741**	33,582	-47	**49,317**	125,128	-61
Property acquisitions	**(60)**	(193)	-69	**18,861**	14,748	28
Property dispositions	**(5,065)**	-	-	**(6,249)**	-	-
Corporate acquisition	**-**	-	-	**-**	314,318	-100
Total capital expenditures, net of dispositions	**12,616**	33,389	-62	**61,929**	454,194	-86

The Company incurred capital expenditures, before A&D, of $17.7 million during the quarter ended September 30, 2016, down 47% from $33.6 million in the same quarter 2015. Kelt continues to be active at land sales and spent $4.0 million on lease acquisitions during the quarter ended September 30, 2016. The Company incurred $21.9 million of expenditures on drilling and completions during the first nine months of 2016, of which $7.5 million were incurred

during the third quarter of 2016. The 69% decrease in drilling and completion expenditures compared to the first nine months of 2015 is indicative of the current environment of significantly lower commodity prices and the Company's capital management policies. More than half of Kelt's 2016 drilling and completion budget has been allocated to the fourth quarter. Expenditures on infrastructure of $20.7 million for the nine months ended September 30, 2016 were primarily for wellsite equipment and infrastructure construction at Kelt's core areas in BC and west central Alberta. Facilities' spending during the first nine months of 2016 includes the scheduled turnaround of the non-operated Progress Gas Plant completed in June.

Property acquisitions

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

Acquisition of Artek Exploration Ltd.

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

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

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

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

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

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

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

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

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

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

CAPITAL RESOURCES AND LIQUIDITY

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

The capital intensive nature of Kelt's operations may create a working capital deficiency position during periods with high levels of capital investment. However, during such periods, the Company strives to maintain sufficient unused bank credit lines to satisfy such working capital deficiencies. As at September 30, 2016, the Company's working capital deficit, excluding current bank debt, of $10.4 million combined with outstanding bank debt of $122.0 million, represented 72% of the authorized borrowing amount available under the Credit Facility of $185.0 million.

The Board of Directors approves an annual capital expenditures budget which is regularly monitored and updated as necessary in response to changing capital requirements. Kelt actively manages the pace of its capital spending program by monitoring forecasted production and commodity prices and resulting cash flows. In response to the

current business environment of low commodity prices, the Company has moderated the pace of capital spending and short-term growth trajectory compared to historical levels. During the nine months ended September 30, 2016, the Company's net capital expenditures of $61.9 million were primarily funded by $22.8 million of cash provided by operating activities and $24.5 million of net proceeds from equity private placements. Borrowings under Kelt's revolving bank credit facility supplemented capital expenditures during the first quarter of 2016. Future capital expenditures are expected to be funded through a combination of cash flow from operations and bank debt, supplemented with new equity or debt offerings if required.

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

	September 30, 2016	December 31, 2015
Bank debt [(1)]	**122,024**	177,570
Working capital deficiency [(1)(2)]	**10,447**	35,389
Bank debt, net of working capital [(2)]	**132,471**	212,959
Trailing funds from operations [(3)(4)]	**70,632**	44,688
Net bank debt to trailing funds from operations ratio [(2)]	**1.9**	4.8

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

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

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

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

Kelt targets a net bank debt to trailing funds from operations ratio of less than 2.0 times, however, during periods of low commodity prices, the Company may exceed this target. Despite lower average commodity prices during the first nine months of 2016, Kelt reduced its net bank debt to trailing funds from operations ratio from 4.8 times at December 31, 2015 to 1.9 times as at September 30, 2016. The reduction in net bank debt was achieved through the completion of strategic financing transactions including the issuance of $90.0 million principal amount of convertible unsecured subordinated debentures with a maturity date of May 31, 2021. In addition, the Company closed private placements of 5.1 million common shares for net proceeds of $24.5 million and received $6.2 million of proceeds on the disposition of non-core assets during the nine months ended September 30, 2016. Kelt's management and employees continue to focus on cost saving initiatives, both corporately and at the field level.

The Company expects its net bank debt to trailing funds from operations ratio will decrease to 1.7 times at December 31, 2016 (based on annualized forecasted funds from operations of $20.7 million for the fourth quarter of 2016 and estimated net bank debt of $138.0 million at December 31, 2016). Refer to additional information under the heading of *"Outlook and Guidance"* and to advisories regarding forward-looking statements.

Credit Facility

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

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

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

Convertible debentures

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

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

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

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

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

Shareholder's capital

The Company is authorized to issue an unlimited number of common shares and an unlimited number of preferred shares. As at September 30, 2016 there were 174.6 million common shares issued and outstanding (as at November 9, 2016, there are 175.6 million common shares outstanding). There are no preferred shares issued or outstanding.

As at September 30, 2016, officers, directors, and employees have been granted options to purchase 8.4 million common shares of the Company at an average exercise price of $6.59 per common share. In addition, there are 0.8 million RSUs outstanding. Options and RSUs outstanding at September 30, 2016 represented 5.2% of total common shares issued and outstanding. Additional information regarding the Company's stock options and RSUs is included in note 13 of the consolidated interim financial statements.

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

CONTRACTUAL OBLIGATIONS

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

(CA$ thousands)	2016	2017	2018	2019	2020	Thereafter
Operating lease - office buildings	330	1,334	559	108	18	-
Operating lease - vehicles	64	228	146	45	-	-
Flow-through shares	14,859	2,500	-	-	-	-
Firm processing commitments	1,627	4,487	13	3	-	-
Firm transportation commitments[(1)]	4,821	18,078	8,973	6,642	3,647	17,794
Total annual commitments	**21,701**	**26,627**	**9,691**	**6,798**	**3,665**	**17,794**

(1) A portion of Kelt's commitments on the Alliance pipeline are denominated in US dollars. The volumes committed vary over the term of the contracts, which are effective until October 31, 2017, however, the maximum US denominated commitment in a given month does not exceed US$0.31 million. Amounts are translated to Canadian dollars at the spot rate on September 30, 2016 of CA$/US$1.3117.

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

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

RELATED PARTY TRANSACTIONS

A director of the Company is also a partner at a law firm which Kelt has engaged to provide legal services. During the nine months ended September 30, 2016, the Company incurred $0.6 million (2015 - $0.6 million) in legal fees and disbursements, of which, nil is payable at September 30, 2016 ($0.1 million at December 31, 2015). The Company expects to continue using the services of this law firm from time to time.

OFF-BALANCE SHEET TRANSACTIONS

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

SUBSEQUENT EVENTS

Non-core asset disposition

On October 7, 2016, Kelt completed the disposition of certain non-core assets located at Stoddart, BC, for proceeds of one dollar, before closing adjustments. The assets and associated decommissioning obligations disposed were classified as held for sale as at September 30, 2016. The table summarizes the preliminary accounting for the disposition, which was effective July 1, 2016 and closed subsequent to the third quarter on October 7, 2016.

Purchase price, after closing adjustments [(1)]	38
Estimated costs of disposal [(1)]	(373)
Net proceeds (costs) of disposal [(1)]	**(335)**
Exploration and evaluation assets	(48)
Property, plant and equipment, net	(4,892)
Decommissioning obligations	9,173
Net carrying value of (assets) liabilities disposed	**4,233**
Gain on sale of assets [(1)]	**3,898**

(1) The proceeds and costs of disposal were estimated at the time of preparation of the September 30, 2016 interim financial statements. Adjustments to the purchase price between the July 1, 2016 effective date and October 7, 2016 closing date were estimated based on an interim statement of adjustments. The gain on sale ultimately recognized by the Company upon finalizing the accounting for the property disposition may differ from these estimates.

As a result of the property disposition, Kelt discharged liabilities for future abandonment and site restoration of approximately $9.2 million ($9.6 million undiscounted). The petroleum and natural gas assets disposed were previously acquired by Kelt through larger strategic acquisitions, and were tertiary to the core assets and infrastructure being targeted in those acquisitions. At the time of the disposition, production from the assets was approximately 11 BOE per day as the majority of wells were inactive and did not have reserves assigned.

Private placement of flow-through shares

On November 2, 2016, the Company closed a private placement of 1.0 million common shares for gross proceeds of $7.1 million. The common shares were issued on a “flow-through” basis in respect of Canadian development expenses at a price of $7.10 per share, resulting in a premium of $0.9 million or $0.88 per share. After estimated expenses related to the private placement, net proceeds to Kelt were approximately $6.8 million.

SUMMARY OF QUARTERLY RESULTS

(CA$ thousands, except as otherwise indicated)	**Q3 2016**	Q2 2016	Q1 2016	Q4 2015
Revenue, before royalties and financial instruments	**47,760**	40,718	40,398	42,797
Funds from operations	**17,658**	11,671	5,951	11,172
Per share - basic ($/common share)	**0.10**	0.07	0.04	0.07
Per share - diluted ($/common share)	**0.10**	0.07	0.04	0.07
Profit (loss) and comprehensive income (loss)	**(15,299)**	(20,413)	(25,918)	(92,123)[(1)]
Per share - basic ($/common share)	**(0.09)**	(0.12)	(0.15)	(0.55)[(1)]
Per share - diluted ($/common share)	**(0.09)**	(0.12)	(0.15)	(0.55)[(1)]
Total assets	**1,232,147**	1,260,245	1,268,268	1,279,475
Bank debt	**122,024**	126,993	214,360	177,570
Working capital deficiency [(2)]	**10,447**	12,087	15,930	35,389[(1)]
Shareholders' equity	**823,887**	835,241	822,229	846,754[(1)]
Average daily production (BOE/d)	**20,542**	20,208	23,295	20,086
Average realized price, after financial instruments ($/BOE)	**25.47**	22.13	19.06	22.01
Operating netback ($/BOE)	**11.73**	8.72	4.76	8.05
Netback as a percentage of revenue	**46%**	39%	25%	37%

	Q3 2015	Q2 2015	Q1 2015	Q4 2014
Revenue, before royalties and financial instruments	45,015	52,131	39,383	54,396
Funds from operations	16,601	14,701	13,980	29,668
Per share - basic ($/common share)	0.10	0.10	0.11	0.23
Per share - diluted ($/common share)	0.10	0.09	0.11	0.23
Profit (loss) and comprehensive income (loss)	(21,557)[(1)]	(9,971)[(1)]	(16,524)	1,256
Per share - basic ($/common share)	(0.13)[(1)]	(0.06)[1)]	(0.13)	0.01
Per share - diluted ($/common share)	(0.13)[(1)]	(0.06)[(1)]	(0.13)	0.01
Total assets	1,363,348[(1)]	1,365,445[(1)]	966,613	908,709
Bank debt	147,801	224,221	105,117	46,929
Working capital deficiency	34,729[(1)]	27,031[(1)]	33,633	57,501
Shareholders' equity	937,658[(1)]	870,083[(1)]	635,708	619,639
Average daily production (BOE/d)	18,695	19,473	16,005	15,559
Average realized price, after financial instruments ($/BOE)	25.71	29.57	28.61	39.96
Operating netback ($/BOE)	11.52	10.23	10.78	21.55
Netback as a percentage of revenue	45%	35%	38%	54%

(1) Certain comparative information has been revised, refer to information under the heading of "*Capital Expenditures*".
(2) The working capital deficiency excludes the current portion of bank debt.

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

NON-GAAP MEASURES

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

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

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

	Three months ended September 30			Nine months ended September 30		
(CA$ thousands, except as otherwise indicated)	**2016**	2015	%	**2016**	2015	%
Cash provided by operating activities	**15,152**	14,446	5	**22,801**	51,742	-56
Transaction costs	**-**	13	-100	**19**	2,409	-99
Provision for potential credit losses	**-**	-	-	**228**	-	-
Settlement of decommissioning obligations	**245**	69	255	**462**	232	99
Change in non-cash working capital	**2,261**	2,073	9	**11,770**	(9,101)	-229
Funds from operations	**17,658**	16,601	6	**35,280**	45,282	-22

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

	Three months ended September 30			Nine months ended September 30		
(CA$ thousands, except as otherwise indicated)	**2016**	2015	%	**2016**	2015	%
Oil and gas revenue	**47,760**	45,015	6	**128,876**	136,529	-6
Cash premiums on financial instruments	**255**	-	-	**255**	-	-
Realized gain (loss) on financial instruments[(1)]	**134**	(785)	-117	**113**	1,296	-91
Royalties	**(4,815)**	(4,140)	16	**(10,708)**	(14,011)	-24
Production expenses	**(15,937)**	(17,980)	-11	**(53,973)**	(59,902)	-10
Transportation expenses	**(5,211)**	(2,296)	127	**(16,266)**	(10,436)	56
Operating income	**22,186**	19,814	12	**48,297**	53,476	-10
Production (mBOE)	**1,890**	1,720	10	**5,849**	4,932	19
Operating netback ($/BOE)	**11.73**	11.52	2	**8.26**	10.85	-24

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

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

Throughout this MD&A, the term "net bank debt" is used synonymously with, and is equal to, "bank debt, net of working capital". "Net bank debt" is calculated by adding the working capital deficiency to bank debt. The working capital deficiency is equal to total current assets net of total current liabilities, excluding the current portion of bank debt. The Company uses a "net bank debt to trailing funds from operations ratio" as a benchmark on which management monitors the Company's capital structure and short-term financing requirements. Management believes that this ratio, which is a non-GAAP financial measure, provides investors with information to understand the

Company's liquidity risk. The "net bank debt to trailing funds from operations ratio" is also indicative of the "debt to cash flow" calculation used to determine the applicable margin for a quarter under the Company's Credit Facility agreement (though the calculation may not always be a precise match, it is representative).

OTHER MEASUREMENTS

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

SIGNIFICANT JUDGMENTS AND ESTIMATES

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

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

Acquisition of Artek Exploration Ltd.

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

Convertible debentures

On May 3, 2016, the Company issued $90.0 million principal amount of convertible debentures that bear interest at a fixed rate of 5% per annum (refer to additional information regarding the Debentures under the heading of *"Capital Resources and Liquidity"*). Calculation of the fair value of the liability component of the Debentures requires significant judgement with respect to the determination of a market interest rate for similar debt instruments without a conversion option. A change in the market rate of interest would impact the fair value allocated to the liability and equity components on initial recognition, deferred income taxes, and subsequent finance expense related to the accretion of the liability component recorded in profit or loss. The Company's calculation of the fair value of the liability component assumes a market interest rate of 10.5%. If the estimated market interest rate increased (decreased) by 0.5% the fair value of the liability component would decrease (increase) by approximately $1.5 million and the fair value of the equity component, net of deferred taxes, would increase (decrease) by approximately $1.1 million.

CHANGE IN CLASSIFICATION OF CERTAIN PRODUCTION AND TRANSPORTATION EXPENSES

During the previous year ended December 31, 2015, the Company reclassified certain charges that were previously presented as transportation expenses to production expenses. The Company concluded that a portion of the charges being incurred pursuant to a firm transportation contract and gas sales agreement related to upstream services,

primarily gas gathering and processing fees, which are more appropriately presented as a production expense rather than transportation expense. The adjustment, which was recognized in the Company's financial statements during the fourth quarter of 2015, resulted in a total reclassification of production and transportation expenses previously reported by $1.8 million for the nine month period ended September 30, 2015. The reclassification has a net nil impact on cash flow provided by operating activities and profit (loss) and comprehensive income (loss) reported for the periods.

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

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

DISCLOSURE CONTROLS AND PROCEDURES

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

INTERNAL CONTROLS OVER FINANCIAL REPORTING

The CEO and the CFO have designed, or caused to be designed under their supervision, internal controls over financial reporting as defined in National Instrument 52-109 of the Canadian Securities Administrators, in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS.

There were no changes to the Company's internal controls over financial reporting during the interim period from July 1, 2016 to September 30, 2016 that have materially affected, or are reasonably likely to materially affect the Company's internal controls over financial reporting.

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

BUSINESS RISKS

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

BUSINESS OUTLOOK

ADVISORY REGARDING FORWARD-LOOKING STATEMENTS

Certain information with respect to Kelt contained herein, including management's assessment of future plans and operations, contains forward-looking statements. These forward-looking statements are based on assumptions and are subject to numerous risks and uncertainties, certain of which are beyond Kelt's control, including the impact of general economic conditions, industry conditions, volatility of commodity prices, currency exchange rate fluctuations, imprecision of reserve estimates, environmental risks, competition from other explorers, stock market volatility and ability to access sufficient capital. As a result, Kelt's actual results, performance or achievement could differ materially from those expressed in, or implied by, these forward-looking statements and, accordingly, no assurance can be given that any events anticipated by the forward-looking statements will transpire or occur. In addition, the reader is cautioned that historical results are not necessarily indicative of future performance.

RECENT DEVELOPMENTS

Alberta Modernized Royalty Framework

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

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

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

CURRENT ECONOMIC ENVIRONMENT

The current economic environment in the energy industry continues to be volatile. Global crude oil supplies and high inventory levels in excess of global demand have persisted affecting crude oil prices negatively. Last year's record mild winter conditions resulted in lower North American demand for natural gas related to heating, however, a hotter than normal summer in 2016 has resulted in much of the excess amounts of natural gas in storage to dissipate. In addition, natural gas infrastructure and capacity constraints continue to impact commodity prices being realized in domestic markets relative to world markets. In the current business environment, Kelt continues to focus on maintaining a strong balance sheet, giving the Company the ability to take advantage of opportunities as they arise. The Company's capital expenditure program is also flexible, with the ability to defer expenditures into the future if the current economic environment deteriorates.

OUTLOOK AND GUIDANCE

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

Kelt believes that the current business environment creates opportunities to add value at a reasonable cost. The cost to acquire land at Crown sales in the Company's core operating areas has dropped significantly and service related costs to drill and complete wells have also declined substantially. In order to capitalize on opportunities in the current energy business environment, Kelt expects to remain active at Crown land sales and has transitioned to development pad drilling in order to take advantage of lower oilfield related service costs.

The Company's Board of Directors, have increased Kelt's 2016 capital expenditures budget to $97.0 million, up 11% from its previous budget of $87.0 million. The Board has also approved an initial capital expenditure budget of $134.0 million for 2017. Kelt expects to drill 17 gross (16.5 net) wells in 2017, however the Company expects to complete 26 gross (24.3 net) wells in 2017, as there is estimated to be 9 gross (7.8 net) drilled but un-completed ("DUC") wells from 2016.

The table below outlines the Company's forecasted financial and operating guidance for 2017, compared to updated guidance for 2016:

(CA$ millions, except as otherwise indicated)	**2017 Budget**	2016 Forecast	Change
Average Production			
Oil (bbls/d)	**6,550**	5,130	28%
NGLs (bbls/d)	**2,800**	2,700	4%
Gas (mmcf/d)	**81,900**	79,020	4%
Combined (BOE/d)	**23,000**	21,000	10%
Production per million common shares (BOE/d)	**131**	121	8%
Forecasted Average Commodity Prices			
WTI oil price (US$/bbl)	**52.00**	43.25	20%
Canadian Light Sweet ($/bbl)	**65.24**	52.92	23%
NYMEX natural gas price (US$/MMBTU)	**3.05**	2.45	24%
AECO natural gas price ($/GJ)	**2.95**	2.04	45%
Average Exchange Rate (US$/CA$)	**0.749**	0.755	-1%
Capital Expenditures			
Drilling & completions	**100.0**	46.5	115%
Facilities, pipeline & well equipment	**26.0**	28.8	-10%
Land, seismic & property acquisitions (net of dispositions)	**8.0**	21.7	-63%
Total Capital Expenditures	**134.0**	97.0	38%
Funds from operations	**124.0**	56.0	121%
Per common share, diluted	**0.70**	0.32	119%
Bank debt, net of working capital, at year-end (1)	**148.0**	138.0	7%
Net bank debt to trailing annual funds from operations ratio	**1.2 x**	2.5 x	
Weighted average common shares outstanding (millions)	**173.1**	175.7	0%
Common shares issued and outstanding (millions)	**175.7**	175.7	1%

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

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

Forecast average production of 23,000 BOE per day in 2017 represents a 10% increase from forecast average production of 21,000 BOE per day in 2016 and is estimated to be weighted 40% to oil and NGLs and 60% to gas. However, based on the Company's forecasted commodity prices for 2017, 69% of forecasted operating income in 2017 is expected to be generated from oil and NGLs versus 31% from gas.

After giving effect to the aforementioned production estimates, commodity price assumptions and estimated expenses: funds from operations for 2017 is forecasted to be approximately $124.0 million or $0.70 per common share, diluted. Kelt estimates that the Company's bank debt, net of working capital, will be approximately $148.0 million as at December 31, 2017. Royalties are expected to average 10.8% of oil and gas sales in 2017. During 2017, combined production and transportation expense is estimated to be $11.67 per BOE ($9.00 per BOE and $2.67 per BOE respectively), G&A expense is estimated to be $0.91 per BOE and interest expense is forecasted at $1.18 per BOE.

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

The information set out herein is "financial outlook" within the meaning of applicable securities laws. The purpose of this financial outlook is to provide readers with disclosure regarding Kelt's reasonable expectations as to the anticipated results of its proposed business activities for the balance of 2016 and 2017. Readers are cautioned that this financial outlook may not be appropriate for other purposes.

ADDITIONAL INFORMATION

Additional information relating to Kelt, including the Company's Annual Information Form ("AIF") dated March 11, 2016 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 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
November 9, 2016

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

(CA$ thousands)	[Notes]	**September 30, 2016**	December 31, 2015
			Revised [note 5]
ASSETS			
Current assets			
Cash and cash equivalents		**347**	870
Accounts receivable and accrued revenue	[15]	**23,762**	27,266
Prepaid expenses and deposits		**1,647**	2,129
Derivative financial instruments	[15]	**9**	-
Total current assets		**25,765**	30,265
Assets held for sale	[4]	**4,940**	-
Deferred income tax asset	[14]	**5,759**	-
Exploration and evaluation assets	[8]	**125,802**	124,305
Property, plant and equipment	[9]	**1,069,881**	1,124,905
Total assets		**1,232,147**	1,279,475
LIABILITIES			
Current liabilities			
Accounts payable and accrued liabilities		**32,129**	64,931
Derivative financial instruments	[15]	**484**	230
Deferred premium on flow-through shares	[13]	**2,377**	-
Decommissioning obligations	[12]	**1,222**	493
Bank debt	[10]	**10,000**	-
Total current liabilities		**46,212**	65,654
Decommissioning obligations held for sale	[4]	**9,173**	-
Bank debt	[10]	**112,024**	177,570
Convertible debentures	[11]	**70,134**	-
Decommissioning obligations	[12]	**133,482**	142,308
Deferred income tax liability	[14]	**37,235**	47,189
Total liabilities		**408,260**	432,721
SHAREHOLDERS' EQUITY			
Shareholders' capital	[13]	**1,049,344**	1,022,115
Reserve from common control transaction		**(57,668)**	(57,668)
Equity component of convertible debentures	[11]	**12,856**	-
Contributed surplus		**16,511**	17,833
Retained earnings (deficit)		**(197,156)**	(135,526)
Total shareholders' equity		**823,887**	846,754
Total liabilities and shareholders' equity		**1,232,147**	1,279,475

Commitments	[17]
Subsequent Events	[21]

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

On behalf of the Board of Directors:

[signed]
David J. Wilson, Director

[signed]
Neil G. Sinclair, Director

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

		Three months ended September 30		Nine months ended September 30	
(CA$ thousands, except per share amounts)	[Notes]	**2016**	2015	**2016**	2015
			Revised [note 5]		Revised [note 5]
Revenue					
Oil and gas sales		**47,760**	45,015	**128,876**	136,529
Royalties		**(4,815)**	(4,140)	**(10,708)**	(14,011)
		42,945	40,875	**118,168**	122,518
Expenses					
Production	[19]	**15,937**	17,980	**53,973**	59,902
Transportation	[19]	**5,211**	2,296	**16,266**	10,436
Financing	[16]	**4,347**	2,560	**11,344**	6,660
General and administrative		**1,745**	1,410	**5,212**	3,752
Provision for potential credit losses	[15]	**-**	-	**228**	-
Share based compensation	[13]	**1,801**	1,906	**4,342**	6,286
Exploration and evaluation	[8]	**571**	1,259	**3,398**	2,683
Depletion and depreciation	[9]	**35,317**	37,401	**111,229**	103,139
		64,929	64,812	**205,992**	192,858
Loss before other items and taxes		**(21,984)**	(23,937)	**(87,824)**	(70,340)
Other income		**-**	-	**-**	212
Transaction costs	[5,6]	**-**	(13)	**(19)**	(2,409)
Premium on flow-through shares	[13]	**846**	1,163	**846**	3,101
Gain (loss) on derivative financial instruments	[15]	**(116)**	(2,574)	**99**	(2,166)
Gain on acquisition	[5]	**-**	-	**-**	15,910
Gain on sale of assets	[7]	**2,701**	-	**4,835**	190
Loss before taxes		**(18,553)**	(25,361)	**(82,063)**	(55,502)
Deferred income tax recovery	[14]	**(3,254)**	(3,804)	**(20,433)**	(7,450)
Loss and comprehensive loss		**(15,299)**	(21,557)	**(61,630)**	(48,052)
Loss per common share					
Basic	[13]	**(0.09)**	(0.13)	**(0.36)**	(0.32)
Diluted	[13]	**(0.09)**	(0.13)	**(0.36)**	(0.32)

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

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

(CA$ thousands)	[Notes]	Shareholders' capital: Number of Shares (000s)	Shareholders' capital: Amount ($ thousands)	Reserve	Convertible debentures – equity portion	Contributed surplus	Retained earnings (deficit)	Total shareholders' equity
Balance at December 31, 2015		168,668	1,022,115	(57,668)	-	17,833	(135,526)	846,754
Loss and comprehensive loss			-	-	-	-	(61,630)	(61,630)
Common shares issued:								
Private placements	[13]	5,085	24,590	-	-	-	-	24,590
Deferred premium on flow-through shares	[13]	-	(3,223)	-	-	-	-	(3,223)
Share issue costs, net of tax	[13]	-	(91)	-	-	-	-	(91)
Issuance of convertible debentures	[11]	-	-	-	12,856	-	-	12,856
Exercise of stock options	[13]	66	379	-	-	(90)	-	289
Vesting of restricted share units	[13]	790	5,574	-	-	(5,574)	-	-
Share based compensation	[13]	-	-	-	-	4,342	-	4,342
Balance at September 30, 2016		**174,609**	**1,049,344**	**(57,668)**	**12,856**	**16,511**	**(197,156)**	**823,887**
Balance at December 31, 2014		126,934	657,102	(57,668)	-	14,692	5,513	619,639
Loss and comprehensive loss			-	-	-	-	(48,052)	(48,052)
Common shares issued:								
Common share offerings	[13]	14,057	123,429	-	-	-	-	123,429
Deferred premium on flow-through shares	[13]	-	(2,872)	-	-	-	-	(2,872)
Pursuant to corporate acquisition	[5]	26,900	242,641	-	-	-	-	242,641
Share issue costs, net of tax	[13]	-	(3,413)	-	-	-	-	(3,413)
Vesting of restricted share units	[13]	708	4,581	-	-	(4,581)	-	-
Share based compensation	[13]	-	-	-	-	6,286	-	6,286
Balance at September 30, 2015		168,599	1,021,468	(57,668)	-	16,397	(42,539)	937,658

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

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

		Three months ended September 30		Nine months ended September 30	
(CA$ thousands)	[Notes]	**2016**	2015	**2016**	2015
Operating activities					
Loss and comprehensive loss		**(15,299)**	(21,557)	**(61,630)**	(48,052)
Items not affecting cash:					
Accretion of convertible debentures	[11,16]	**814**	-	**1,301**	-
Accretion of decommissioning obligations	[12,16]	**759**	784	**2,262**	2,033
Share based compensation		**1,801**	1,906	**4,342**	6,286
Exploration and evaluation		**571**	1,259	**3,398**	2,683
Depletion and depreciation		**35,317**	37,401	**111,229**	103,139
Premium on flow-through shares		**(846)**	(1,163)	**(846)**	(3,101)
Unrealized (gain) loss on derivative financial instruments	[15]	**241**	1,762	**(10)**	3,435
Gain on acquisition		**-**	-	**-**	(15,910)
Gain on sale of assets		**(2,701)**	-	**(4,835)**	(190)
Deferred income tax recovery		**(3,254)**	(3,804)	**(20,433)**	(7,450)
Cash premiums on derivatives		**255**	-	**255**	-
Settlement of decommissioning obligations		**(245)**	(69)	**(462)**	(232)
Change in non-cash operating working capital	[18]	**(2,261)**	(2,073)	**(11,770)**	9,101
Cash provided by operating activities		**15,152**	14,446	**22,801**	51,742
Financing activities					
Increase (decrease) in bank debt		**(4,969)**	(76,420)	**(55,546)**	100,872
Issue of common shares, net of costs	[13]	**2,489**	86,191	**24,465**	118,766
Proceeds on exercise of stock options	[13]	**289**	-	**289**	-
Issue of convertible debentures, net of costs	[11]	**(1)**	-	**86,443**	-
Cash (used in) provided by financing activities		**(2,192)**	9,771	**55,651**	219,638
Investing activities					
Exploration and evaluation assets		**(7,254)**	(7,121)	**(21,760)**	(23,660)
Property, plant and equipment		**(10,487)**	(26,461)	**(27,557)**	(101,468)
Property acquisitions	[6]	**60**	193	**(18,861)**	(14,748)
Property dispositions	[7]	**5,065**	-	**6,249**	-
Corporate acquisition	[5]	**-**	-	**-**	(95,839)
Change in non-cash investing working capital	[18]	**(299)**	8,414	**(17,046)**	(36,147)
Cash used in investing activities		**(12,915)**	(24,975)	**(78,975)**	(271,862)
Net change in cash and cash equivalents		**45**	(758)	**(523)**	(482)
Cash and cash equivalents, beginning of period		**302**	1,325	**870**	1,049
Cash and cash equivalents, end of period		**347**	567	**347**	567

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

1. DESCRIPTION OF THE BUSINESS

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

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

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

2. BASIS OF PRESENTATION

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

a) Statement of compliance

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

b) Basis of measurement

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

These financial statements have been prepared on a historical cost basis, except for certain financial instruments which are recorded at fair value. The methods used to measure fair values are described in note 15 of these financial statements.

c) Significant judgments and estimates

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

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

Acquisition of Artek Exploration Ltd.

In March of 2016, the British Columbia Ministry of Energy and Mining ("BC Ministry") completed a petroleum and natural gas by-products royalty audit which resulted in Kelt recording a revision to previously reported amounts for the Artek Acquisition. Refer to note 5 for additional information regarding the revision recognized during the first quarter ended March 31, 2016.

Convertible debentures

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

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

3. SIGNIFICANT ACCOUNTING POLICIES

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

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

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

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

4. ASSETS HELD FOR SALE

Subsequent to the end of the reporting period, on October 7, 2016, Kelt completed a disposition of certain non-core assets located at Stoddart in northeastern BC for proceeds of one dollar, before closing adjustments. The carrying amount of the assets and liabilities disposed was classified as held for sale as at September 30, 2016.

	September 30, 2016	December 31, 2015
Exploration and evaluation assets	**48**	-
Property, plant and equipment	**4,892**	-
Assets held for sale	**4,940**	-
Decommissioning obligations held for sale[(1)]	**(9,173)**	-
Net assets held for sale	**(4,233)**	-

(1) The carrying amount of the decommissioning obligations held for sale was estimated based on a risk-free rate of 1.66% and an inflation rate of 1.5%. The estimated undiscounted cash flows required to settle the obligation are approximately $9.6 million.

5. CORPORATE ACQUISITION

Acquisition of Artek Exploration Ltd.

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

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

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

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

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

(3) The net working capital deficit includes $7.0 million of accounts receivable and accrued revenue, $0.4 million of deposits, $12.8 million of accounts payable and accrued liabilities (includes $0.9 million of additional royalties payable resulting from the BC Royalty Audit) and $13.7 million of bank

overdraft. Pursuant to the change in control provisions in Artek's credit agreement, Artek's demand loan credit facility, on which $82.1 million was outstanding as of the closing date, was repaid and terminated by Kelt at closing using borrowings available under Kelt's Credit Facility.

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

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

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

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

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

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

6. PROPERTY ACQUISITIONS

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

	September 30, 2016	December 31, 2015
Exploration and evaluation assets	**252**	264
Property, plant and equipment	**18,887**	16,714
Decommissioning obligations	**(278)**	(628)
Fair value of net assets acquired [(1)]	**18,861**	16,350
Cash consideration, after closing adjustments [(1)]	**18,861**	16,350

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

On April 28, 2016, the Company closed the acquisition of oil and gas assets in its core area at Progress, Alberta, for cash consideration of $18.9 million, after estimated closing adjustments. The purchase price was adjusted for the results of operations between the effective date of January 1, 2016 and closing of the acquisition. The transaction has been accounted for as a business combination using the acquisition method whereby the net assets acquired and the liabilities assumed are recorded at fair value.

7. PROPERTY DISPOSITIONS

During the nine month period ended September 30, 2016, Kelt completed dispositions of certain non-core assets located in Alberta for cash proceeds of $6.2 million, resulting in a gain of $4.8 million. The carrying values of assets and associated decommissioning obligations disposed are summarized below.

	September 30, 2016	December 31, 2015
Exploration and evaluation assets	**(2,513)**	-
Property, plant and equipment	**(1,367)**	-
Decommissioning obligations	**2,466**	190
Carrying value of net (assets) liabilities disposed	**(1,414)**	190
Cash proceeds, after closing adjustments	**6,249**	-
Gain on sale of assets	**4,835**	190

8. EXPLORATION AND EVALUATION ASSETS

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

The following table reconciles movements of exploration and evaluation assets:

	September 30, 2016	December 31, 2015
Balance, beginning of year	**124,305**	79,294
Additions	**21,760**	43,555
Corporate acquisition [note 5]	**-**	264
Property acquisitions [note 6]	**252**	52,340
Property dispositions [note 7]	**(2,513)**	-
Transfers to property, plant and equipment	**(14,556)**	(40,674)
Expired mineral leases	**(3,398)**	(3,117)
Impairments	**-**	(7,357)
Reclassification – Assets held for sale [note 4]	**(48)**	-
Balance, end of period	**125,802**	124,305

The Company reviewed its E&E assets for indicators of potential impairment as at September 30, 2016. Except for $3.4 million of costs associated with the expiry of mineral leases which have been recognized as an expense during the nine months ended September 30, 2016, the Company concluded that there are no indicators of potential impairment of its E&E assets at September 30, 2016.

9. PROPERTY, PLANT AND EQUIPMENT

Net carrying value	**September 30, 2016**	December 31, 2015
Development and production ("D&P") assets	**1,069,191**	1,124,180
Corporate assets	**690**	725
Total net carrying value of property, plant and equipment	**1,069,881**	1,124,905

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

Property, plant and equipment, at cost	D&P Assets	Corporate Assets	Total PP&E
Balance at December 31, 2014	899,407	1,028	900,435
Additions	122,240	810	123,050
Corporate acquisition [note 5]	16,714	-	16,714
Property acquisitions [note 6]	346,014	-	346,014
Decommissioning costs	33,173	-	33,173
Transfers from E&E	40,674	-	40,674
Balance at December 31, 2015	**1,458,222**	**1,838**	**1,460,060**
Additions	**26,988**	**569**	**27,557**
Property acquisitions [note 6]	**18,887**	**-**	**18,887**
Property dispositions [note 7]	**(4,748)**	**-**	**(4,748)**
Decommissioning costs	**1,464**	**-**	**1,464**
Transfers from E&E	**14,556**	**-**	**14,556**
Reclassification – Assets held for sale [note 4]	**(6,773)**	**-**	**(6,773)**
Balance at September 30, 2016	**1,508,596**	**2,407**	**1,511,003**

Accumulated depletion, depreciation and impairment	D&P Assets	Corporate Assets	Total PP&E
Balance at December 31, 2014	129,456	495	129,951
Depletion and depreciation expense	140,518	618	141,136
Impairments	64,068	-	64,068
Balance at December 31, 2015	**334,042**	**1,113**	**335,155**
Depletion and depreciation expense	**110,625**	**604**	**111,229**
Property dispositions [note 7]	**(3,381)**	**-**	**(3,381)**
Reclassification – Assets held for sale [note 4]	**(1,881)**	**-**	**(1,881)**
Balance at September 30, 2016	**439,405**	**1,717**	**441,122**

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

10. BANK DEBT

	September 30, 2016	December 31, 2015
Bank loan	**2,400**	5,800
Bankers' acceptances	**120,400**	172,800
Unamortized financing fees [(1)]	**(776)**	(1,030)
Bank debt	**122,024**	177,570
Bank debt – current	**10,000**	-
Bank debt – non-current	**112,024**	177,570

(1) Includes $0.3 million of prepaid interest and stamping fees on bankers' acceptances as at September 30, 2016 ($0.6 million as at December 31, 2015).

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

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

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

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

11. CONVERTIBLE DEBENTURES	Number of convertible debentures	Liability component ($ thousands)	Equity Component ($ thousands)
Balance at December 31, 2015	-	-	-
Issuance of convertible debentures	90,000	71,665	18,335
Issue costs	-	(2,832)	(724)
Deferred income tax liability	-	-	(4,754)
Accretion of discount	-	1,301	-
Balance at September 30, 2016	**90,000**	**70,134**	**12,856**

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

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

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

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

Accretion of the liability component and accrued interest payable on the Debentures are included in financing expenses in the Consolidated Statement of Profit (Loss) and Comprehensive Income (Loss) (note 16). At September 30, 2016, the fair value of the Debentures was $118.1 million (note 15).

12. DECOMMISSIONING OBLIGATIONS

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

	September 30, 2016	December 31, 2015
Balance, beginning of year	**142,801**	94,791
Obligations incurred	**551**	1,807
Obligations acquired [note 5,6]	**278**	12,594
Obligations disposed [note 7]	**(2,466)**	(190)
Obligations settled	**(462)**	(383)
Changes in discount rate	**25,446**	33,664
Revisions to estimates	**(24,533)**	(2,298)
Accretion expense	**2,262**	2,816
Reclassification – Decommissioning obligations held for sale [note 4]	**(9,173)**	-
Balance, end of period	**134,704**	142,801
Decommissioning obligations – current	**1,222**	493
Decommissioning obligations – non-current	**133,482**	142,308

The key assumptions on which the carrying amount of the decommissioning obligations is based, include a risk-free rate of 1.66% (December 31, 2015 - 2.2%) and an inflation rate of 1.5% (December 31, 2015 - 2.0%).

Revaluation of decommissioning obligations at the end of the period using a risk-free rate of 1.66% resulted in an increase in the present value of the obligation reported in the Statement of Financial Position of $25.4 million, including a $1.6 million change in estimate related to obligations acquired at Progress, Alberta (note 6) during the period, which are initially measured at fair value using a credit adjusted risk-free rate. Revaluation of decommissioning obligations at the end of the period using an inflation rate of 1.5% resulted in a decrease in the present value of the obligation reported in the Statement of Financial Position of $24.5 million.

The underlying cost estimates are derived from a combination of published industry benchmarks as well as site specific information. As at September 30, 2016, the undiscounted amount of the estimated cash flows required to settle the obligation is $141.3 million (December 31, 2015 - $150.6 million), and is expected to be incurred over the next 50 years.

Accretion of the decommissioning obligation due to the passage of time is presented within financing expenses in the Consolidated Statement of Profit (Loss) and Comprehensive Income (Loss) (note 16).

13. SHARE CAPITAL

Authorized

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

Issued and outstanding

The following table summarizes the change in common shares issued and outstanding. There are no preferred shares issued or outstanding as of September 30, 2016 (December 31, 2015 - nil).

	Number of Shares (000s)	Amount ($ thousands)
Balance at December 31, 2014	126,934	657,102
Issued for cash through common share offerings	14,056	123,429
Deferred premium on flow-through shares	-	(2,872)
Issued pursuant to Artek Acquisition [note 5]	26,900	242,641
Released upon vesting of restricted share units	778	5,231
Share issue costs, net of deferred income taxes ($1,258)	-	(3,416)
Balance at December 31, 2015	**168,668**	**1,022,115**
Issued for cash through common share offerings	**5,085**	**24,590**
Deferred premium on flow-through shares	**-**	**(3,223)**
Issued for cash on exercise of stock options	**66**	**289**
Transfer from contributed surplus on exercise of stock options	**-**	**90**
Released upon vesting of restricted share units	**790**	**5,574**
Share issue costs, net of deferred taxes ($34)	**-**	**(91)**
Balance at September 30, 2016	**174,609**	**1,049,344**

Common share offerings

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

Private placements of flow-through common shares

The table below summarizes flow-through common shares ("FTS") issued pursuant to private placements for the period from January 1, 2015 to September 30, 2016, the amount of qualifying expenditures incurred and the Company's outstanding commitments to incur eligible expenditures as at the end of the current reporting period.

(CA$ thousands, except as otherwise indicated)					Eligible Expenditures (1)			Expenditure Period End / Effective date of Renunciation
Closing Dates	# of FTS	Price per FTS	Gross Proceeds	Deferred Premium	Type	As at September 30, 2016		
						Incurred	Remaining	
First quarter of 2015	3.881 million	$8.60	33,380	2,872	CDE	33,380	-	December 31, 2015 December 31, 2015
April 7, 2016	**4.7 million**	**$4.70**	**22,090**	**2,585**	**CDE**	**7,231**	**14,859**	**December 31, 2016** **December 31, 2016**
August 23, 2016	**0.385 million**	**$6.50**	**2,500**	**638**	**CEE**	**-**	**2,500**	**December 31, 2017** **December 31, 2016**

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

Stock options

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

The following table summarizes the change in stock options outstanding:

	Number of Options (000s)	Average Exercise Price ($/share)
Balance at December 31, 2014	4,927	8.38
Granted	1,845	4.85
Forfeited	(82)	9.32
Balance at December 31, 2015	**6,690**	**7.40**
Granted	**2,383**	**4.61**
Exercised [(1)]	**(66)**	**4.38**
Forfeited	**(650)**	**7.89**
Balance at September 30, 2016	**8,357**	**6.59**

(1) The weighted average share price on the date of exercise for stock options exercised in 2016 was $5.33 per common share.

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

	Nine months ended September 30	
	2016	2015
Risk free interest rate	**0.6%**	0.6%
Expected life (years)	**3.5**	3.0
Expected volatility [(1)]	**52.3%**	40.2%
Expected dividend yield	**0.0%**	0.0%
Expected forfeiture rate	**2.3%**	2.9%
Fair value of options granted during the year ($/share)	**1.72**	2.24

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

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

Range of exercise prices per common share	Number of options outstanding (000s)	Weighted average remaining term (years)	Weighted average exercise price for options outstanding ($/share)	Number of options exercisable (000s)	Weighted average exercise price for options exercisable ($/share)
$0.00 to $5.00	3,759	4.5	4.50	54	4.57
$5.01 to $10.00	3,517	2.3	6.98	2,474	6.85
$10.01 to $15.00	1,021	2.5	12.40	687	12.38
$15.01 to $20.00	60	2.7	15.40	40	15.40
Total	**8,357**	**3.3**	**6.59**	**3,255**	**8.08**

Restricted share units

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

The following table summarizes the change in RSUs outstanding:

	Number of RSUs (000s)
Balance at December 31, 2014	1,762
Granted	247
Released upon vesting	(778)
Forfeited	(27)
Balance at December 31, 2015	**1,204**
Granted	**402**
Released upon vesting	**(790)**
Forfeited	**(55)**
Balance at September 30, 2016	**761**

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 September 30		Nine months ended September 30	
	2016	2015	**2016**	2015
Stock options	**1,319**	995	**2,991**	3,330
Restricted share units	**482**	911	**1,351**	2,956
Total share based compensation expense	**1,801**	1,906	**4,342**	6,286

Per share amounts

The table below summarizes the weighted average number of common shares outstanding. The Company uses the treasury stock method to determine the dilutive effect of stock options and RSUs. Under this method, only "in-the-money" dilutive instruments impact the calculation of diluted profit per common share. Accordingly, in computing the diluted loss per common share for the each of the three and nine month periods ended September 30, 2016 and 2015, respectively, the Company excluded the effect of stock options and RSUs as they were anti-dilutive. The common shares potentially issuable on conversion of the Debentures are also excluded as they were determined to be anti-dilutive.

	Three months ended September 30		Nine months ended September 30	
(000s of common shares)	**2016**	2015	**2016**	2015
Weighted avg. common shares outstanding, basic	**174,349**	167,935	**172,338**	150,185
Effect of stock options and RSUs	**322**	771	**247**	1,051
Effect of convertible debentures	**-**	-	**-**	-
Weighted avg. common shares outstanding, diluted	**174,671**	168,706	**172,585**	151,236

14. INCOME TAXES

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

	Three months ended September 30		Nine months ended September 30	
	2016	2015	**2016**	2015
Loss before income taxes	**(18,553)**	(25,361)	**(82,063)**	(55,502)
Canadian statutory tax rate [(1)]	**26.6%**	26.0%	**26.6%**	26.0%
Expected income tax recovery	**(4,935)**	(6,594)	**(21,829)**	(14,431)
Increase (decrease) resulting from:				
Non-deductible expenses [(2)]	**489**	501	**1,184**	2,265
Recognition of unrecognized deferred tax asset	**(513)**	(494)	**(1,541)**	(1,484)
Qualifying expenditures on flow-through shares	**1,921**	3,651	**1,921**	8,101
Premium on flow-through shares	**(228)**	(302)	**(228)**	(806)
Change in tax rates	**60**	(259)	**40**	4,438
True-up of tax pools	**(48)**	(307)	**20**	(1,397)
Gain on acquisition	**-**	-	**-**	(4,136)
Deferred income tax recovery	**(3,254)**	(3,804)	**(20,433)**	(7,450)

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

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

Kelt was not required to pay income taxes in the current or prior periods as the Company had sufficient income tax deductions available to shelter taxable income. Tax deductions available as of September 30, 2016 are estimated to be approximately $982.2 million (December 31, 2015 - $958.0 million).

	September 30, 2016	December 31, 2015
Deferred income tax asset	**5,759**	-
Deferred income tax liability	**(37,235)**	(47,189)
Net deferred income tax asset (liability)	**(31,476)**	(47,189)

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

Deferred income tax asset (liability)	Balance at December 31, 2015	Recognized in profit and CI[(1)]	Recognized in balance sheet	**Balance at September 30, 2016**
Derivative financial instruments	62	66	-	**128**
PP&E and E&E	(136,416)	2,768	-	**(133,648)**
Decommissioning obligations	38,015	(2,103)	-	**35,912**
Convertible debentures	-	207	(4,754)	**(4,547)**
Share and bank debt issue costs	4,364	(1,202)	34	**3,196**
Reserve from common control transaction	(9,168)	1,542	-	**(7,626)**
Non-capital losses[(2)]	55,954	19,155	-	**75,109**
	(47,189)	20,433	(4,720)	**(31,476)**

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

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

The amount and timing of reversals of temporary differences will be dependent upon a number of factors, including the nature and timing of future capital expenditures and the Company's future operating results.

15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

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

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

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

Commodity price risk management contracts

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

At September 30, 2016, the Company had financial derivative contracts to fix the basis differential between certain natural gas reference prices.

Remaining Term	Notional Volume	Reference Prices	Fixed Contract Price	Fair value Asset (Liability)
October 2016	10,000 mmbtu/d	Chicago Monthly Index AECO 7A	Chicago Monthly Index minus US$0.96 per MMBTU	**9**
October 2016	30,000 mmbtu/d	NYMEX Henry Hub Daily Index AECO 5A	NYMEX Henry Hub minus US$0.94 per MMBTU	**(189)**
April 2017 to October 2017	10,000 mmbtu/d	Southern California Border Avg. NYMEX Henry Hub	Southern California Border Avg. plus US$0.055 per MMBTU	**(57)**

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

- If the Chicago-AECO 7A basis differential increased (decreased) by $0.10/MMBTU, the fair market value of the contract would increase (decrease) by approximately $0.04 million.
- If the NYMEX-AECO 5A basis differential increased (decreased) by $0.10/MMBTU, the fair market value of the contract would increase (decrease) by approximately $0.1 million.
- If the Southern California Border Average-NYMEX basis differential increased (decrease) by $0.10/MMBTU, the fair market value of the contract would increase (decrease) by approximately $0.3 million.

Interest rate risk management contracts

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

Contract Type	Notional Amount	Reference Price	Fixed Contract Price	Remaining Term	Fair value Asset (Liability)
Interest Rate Swap	$100,000,000	CDOR	0.925%	October 1, 2016 to June 30, 2017	**(46)**

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

Foreign exchange risk management contracts

Kelt is exposed to fluctuations of the Canadian to U.S. dollar exchange rate given realized pricing is directly influenced by U.S. dollar denominated benchmark pricing. The Company also has commitments for firm gas transportation service under contracts denominated in U.S. dollars as outlined in note 17. Exposure to foreign exchange rates is mitigating by entering U.S. dollar denominated commodity price or foreign exchange derivative financial instruments.

At September 30, 2016, the Company had a forward foreign exchange swaption contract whereby the counterparty has the right, if exercised on December 30, 2016, to enter a series of forward foreign exchange transactions fixing the exchange rate at CA$/US$1.33 from January to December 2017, on a notional amount of US$1.0 million per month. In consideration for the swaption, Kelt received a cash premium of $0.255 million at the time of entering into the contract. The fair value of the forward foreign exchange swaption as at September 30, 2016, resulted in a derivative financial instrument of $0.2 million.

Gains and loss on risk management contracts

	Three months ended September 30		Nine months ended September 30	
	2016	2015	**2016**	2015
Realized gain (loss)	**125**	(812)	**89**	1,269
Unrealized gain (loss)	**(241)**	(1,762)	**10**	(3,435)
Gain (loss) on derivative financial instruments	**(116)**	(2,574)	**99**	(2,166)

Fair value measurements

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

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

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

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

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

	Carrying Value ("CV")			Fair Value		
	Gross	Netting[(1)]	Net CV	Level 1	Level 2	Level 3
Financial assets						
Derivative financial instruments	9	-	9	-	9	-
Financial liabilities						
Derivative financial instruments	484	-	484	-	484	-
Convertible debentures[(2)]	70,134	-	70,134	118,125	-	-

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

(2) The fair value of the convertible debentures is based on the closing market price on the TSX of 131.25 per debenture as at September 30, 2016, and represents the market value of the entire instrument.

Credit Risk

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

During the quarter ended September 30, 2016, sales to four oil and gas marketers each individually represented more than 10% of total revenue. Sales to these marketers account for approximately 38%, 21%, 12%, and 10% of total revenue, respectively. During the previous year ended December 31, 2015, sales to five oil and gas marketers accounted for approximately 23%, 17%, 15%, 13% and 11% of total revenue, respectively. Kelt has secured parental guarantees (with terms ranging from two to five years) or letters of credit covering approximately 90% its monthly credit exposure from oil and gas marketers, calculated based on average sales by purchaser for the third quarter of 2016.

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

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

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

Accounts receivable and accrued revenue	Current	30-60 days	60-90 days	Over 90 days	Total
Balance at September 30, 2016	**21,354**	**312**	**280**	**1,816**	**23,762**
Balance at December 31, 2015	23,071	1,836	783	1,576	27,266

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

collectible, except for approximately $1.2 million of accounts receivable which are provided for in the allowance for doubtful accounts.

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

Liquidity Risk

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

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

	Within 1 Year	1 to 5 Years	More than 5 Years	Total
Accounts payable and accrued liabilities	32,129	-	-	32,129
Derivative financial instrument liability	484	-	-	484
Bank debt and estimated interest[(1)]	15,181	114,833	-	130,014
Convertible debentures[(2)]	4,845	108,000		112,845
Total	**52,639**	**222,833**	**-**	**275,472**

(1) Estimated interest for future periods related to the Credit Facility was calculated using the weighted average interest rate of 4.4% for the third quarter ended September 30, 2016, applied to the principal balance outstanding as at that date. Principal repayment of $10.0 million to the Term Lender under Credit Facility is assumed on April 28, 2017, with the remaining repayment assumed to occur on April 27, 2018.

(2) The contractual maturity analysis includes semi-annual cash interest payments at the fixed coupon rate of 5.0%, assuming that the $90.0 million principal amount of the Debentures is outstanding for the full term to maturity on May 31, 2021, provided that: the equity conversion option is not first exercised by the holder; and that the Company does not elect to settle its financial obligation by issuing common shares instead of cash at redemption or maturity. Refer to additional information regarding the Debentures in note 11.

As at September 30, 2016, the Company's working capital deficit of $10.4 million (excluding current bank debt) combined with outstanding bank debt of $122.0 million, represented 72% of the authorized borrowing amount available under the Credit Facility of $185.0 million. The Company is obligated to repay $10.0 million to the Term Lender under the Credit Facility on April 28, 2017. The remaining $112.0 million drawn on the Credit Facility is available for a revolving period of 364 days, maturing on April 29, 2017, and may be extended for an additional 364 days at the discretion of the lenders, with a term-out to April 27, 2018 if not renewed. The next semi-annual borrowing base review is scheduled to occur during November 2016. In an event that the lenders reduce the borrowing base below the amount drawn at the time of the redetermination, the Company would have 60 days to eliminate any borrowing base shortfall by repaying the amount drawn in excess of a re-determined borrowing base or by providing additional security or other consideration satisfactory to the lenders.

Capital Management

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

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

	September 30, 2016	December 31, 2015
Bank debt [(1)]	**122,024**	177,570
Working capital deficiency [(1)(2)]	**10,447**	35,389
Bank debt, net of working capital [(2)]	**132,471**	212,959
Trailing funds from operations [(3)(4)]	**70,632**	44,688
Net bank debt to trailing funds from operations ratio [(2)]	**1.9**	4.8

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

(2) Comparative information for the year ended December 31, 2015 has been revised. Details regarding the revision are set-forth in note 5 of these interim financial statements. Kelt previously reported a debt to trailing funds from operation ratio of 4.7 times as at December 31, 2015.

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

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

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

The Company has reduced its net bank debt to trailing funds from operations ratio to 1.9 times as at September 30, 2016 from 4.8 times at December 31, 2015. On May 3, 2016, the Company significantly reduced the amount drawn under its revolving bank credit facility using net proceeds of the offering of $90.0 million principal amount of convertible debentures that mature on May 31, 2021. In addition, the Company closed private placements of 5.1 million common shares for net proceeds of $24.5 million and received $6.2 million of proceeds on the disposition of non-core assets during the nine months ended September 30, 2016.

As more particularly described in note 10, Kelt is subject to certain non-financial covenants under the Credit Facility agreement. As at September 30, 2016, the Company is in compliance with all covenants. The Company is not subject to any other externally imposed capital requirements.

16. FINANCING EXPENSES

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

	Three months ended September 30		Nine months ended September 30	
	2016	2015	**2016**	2015
Interest and fees on bank debt	**1,640**	1,776	**5,932**	4,627
Interest on convertible debentures [note 11]	**1,134**	-	**1,849**	-
Accretion of convertible debentures [note 11]	**814**	-	**1,301**	-
Accretion of decommissioning obligations [note 12]	**759**	784	**2,262**	2,033
Financing expense	**4,347**	2,560	**11,344**	6,660

17. COMMITMENTS

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

(CA$ thousands)	2016	2017	2018	2019	2020	Thereafter
Operating lease - office buildings	330	1,334	559	108	18	-
Operating lease - vehicles	64	228	146	45	-	-
Flow-through shares [note 13]	14,859	2,500	-	-	-	-
Firm processing commitments	1,627	4,487	13	3	-	-
Firm transportation commitments[(1)]	4,821	18,078	8,973	6,642	3,647	17,794
Total annual commitments	**21,701**	**26,627**	**9,691**	**6,798**	**3,665**	**17,794**

(1) A portion of Kelt's commitments on the Alliance pipeline are denominated in US dollars. The volumes committed vary over the term of the contracts, which are effective until October 31, 2017, however, the maximum US denominated commitment in a given month does not exceed US$0.31 million. Amounts are translated to Canadian dollars at the spot rate on September 30, 2016 of CA$/US$1.3117

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

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

18. SUPPLEMENTAL CASH FLOW INFORMATION

	Three months ended September 30		Nine months ended September 30	
	2016	2015	**2016**	2015
Accounts receivable and accrued revenue	**951**	652	**3,504**	21,717
Prepaid expenses and deposits	**(91)**	(148)	**482**	805
Accounts payable and accrued liabilities	**(3,420)**	5,837	**(32,802)**	(49,568)
Change in non-cash working capital	**(2,560)**	6,341	**(28,816)**	(27,046)
Relating to:				
Operating activities	**(2,261)**	(2,073)	**(11,770)**	9,101
Investing activities	**(299)**	8,414	**(17,046)**	(36,147)
Change in non-cash working capital	**(2,560)**	6,341	**(28,816)**	(27,046)

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

	Three months ended September 30		Nine months ended September 30	
	2016	2015	**2016**	2015
Interest and standby fees on bank debt	**1,446**	1,333	**5,964**	4,766
Taxes	**-**	-	**-**	-

19. CHANGE IN CLASSIFICATION OF CERTAIN PRODUCTION AND TRANSPORTATION EXPENSES

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

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

20. RELATED PARTY TRANSACTIONS

A director of the Company is also a partner at a law firm which Kelt has engaged to provide legal services. During the nine months ended September 30, 2016, the Company incurred $0.6 million (2015 - $0.6 million) in legal fees and disbursements, of which, nil is payable at September 30, 2016 ($0.1 million at December 31, 2015). The Company expects to continue using the services of this law firm from time to time.

21. SUBSEQUENT EVENTS

Non-core asset disposition

On October 7, 2016, Kelt completed the disposition of certain non-core assets located at Stoddart, BC, for proceeds of one dollar, before closing adjustments. The assets and associated decommissioning obligations disposed were classified as held for sale as at September 30, 2016 (note 4). The table summarizes the preliminary accounting for the disposition, which was effective July 1, 2016 and closed subsequent to the third quarter on October 7, 2016.

Purchase price, after closing adjustments [(1)]	38
Estimated costs of disposal [(1)]	(373)
Net proceeds (costs) of disposal [(1)]	**(335)**
Exploration and evaluation assets	(48)
Property, plant and equipment, net	(4,892)
Decommissioning obligations	9,173
Net carrying value of (assets) liabilities disposed	**4,233**
Gain on sale of assets [(1)]	**3,898**

(1) The proceeds and costs of disposal were estimated at the time of preparation of these interim financial statements. Adjustments to the purchase price between the July 1, 2016 effective date and October 7, 2016 closing date were estimated based on an interim statement of adjustments. The gain on sale ultimately recognized by the Company upon finalizing the accounting for the property disposition may differ from these estimates.

Private placement of flow-through shares

On November 2, 2016, the Company closed a private placement of 1.0 million common shares for gross proceeds of $7.1 million. The common shares were issued on a "flow-through" basis in respect of Canadian development expenses at a price of $7.10 per share, resulting in a premium of $0.9 million or $0.88 per share. After estimated expenses related to the private placement, net proceeds to Kelt were approximately $6.8 million.

ABBREVIATIONS

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

CONVERSION OF UNITS

Imperial = Metric

1 acre = 0.4 hectares

2.5 acres = 1 hectare

1 bbl = 0.159 cubic metres

6.29 bbls = 1 cubic metre

1 foot = 0.3048 metres

3.281 feet = 1 metre

1 mcf = 28.2 cubic metres

0.035 mcf = 1 cubic metre

1 mile = 1.61 kilometres

0.62 miles = 1 kilometre

1 mmbtu = 1.054 GJ

0.949 mmbtu = 1 GJ

Natural gas is equated to oil on the basis of 6 mcf = 1 BOE

Sulphur is equated to gas on the basis of 1LT = 10 mcf (1 BOE = 0.6 LT)

CORPORATE INFORMATION

BOARD OF DIRECTORS

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

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

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

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

David J. Wilson [5]
President & Chief Executive Officer,
Kelt Exploration Ltd.

1 chairman of the board

2 member of the audit committee

3 member of the reserves committee

4 member of the compensation committee

5 member of the health, safety and environment committee

6 member of the nominating committee

OFFICERS

David J. Wilson
President & Chief Executive Officer

Sadiq H. Lalani
Vice President & Chief Financial Officer

Douglas J. Errico
Vice President, Land

Alan G. Franks
Vice President, Production

Bruce D. Gigg
Vice President, Engineering

Ashley D. Hohm
Vice President, Finance

Douglas O. MacArthur
Vice President, Operations

Patrick Miles
Vice President, Exploration

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AUDITORS

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Calgary, Alberta T2P 5L3

EVALUATION ENGINEERS

Sproule Associates Limited
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STOCK EXCHANGE LISTING

Toronto Stock Exchange
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Convertible Debentures “KEL.DB”

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