kelt exploration

ANNUAL REPORT
AS AT AND FOR THE YEAR ENDED
DECEMBER 31, 2015

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FINANCIAL AND OPERATIONAL HIGHLIGHTS

(CA$ thousands, except as otherwise indicated)	Three months ended December 31			Year ended December 31		
	2015	2014	%	**2015**	2014	%
FINANCIAL						
Revenue, before royalties and financial instruments	**42,797**	54,396	-21%	**179,326**	214,691	-16%
Funds from operations(1)	**11,172**	29,668	-62%	**56,517**	115,737	-51%
Basic ($/ common share)(1)	**0.07**	0.23	-70%	**0.37**	0.95	-61%
Diluted ($/ common share)(1)	**0.07**	0.23	-70%	**0.36**	0.93	-61%
Profit (loss) and comprehensive income (loss)	**(94,109)**	1,256	-	**(140,175)**	10,628	-
Basic ($/ common share)	**(0.56)**	0.01	-	**(0.91)**	0.09	-
Diluted ($/ common share)	**(0.56)**	0.01	-	**(0.91)**	0.09	-
Total capital expenditures, net of dispositions	**42,487**	99,466	-57%	**496,408**	423,900	17%
Total assets	**1,279,475**	908,709	41%	**1,279,475**	908,709	41%
Bank debt, net of working capital	**212,095**	104,430	103%	**212,095**	104,430	103%
Shareholders' equity	**847,618**	619,639	37%	**847,618**	619,639	37%
Weighted average shares outstanding (000's)						
Basic	**168,610**	126,760	33%	**154,829**	121,779	27%
Diluted	**169,352**	128,512	32%	**155,936**	124,296	25%
OPERATIONS						
Average daily production						
Oil (bbls/d)	**5,185**	4,691	11%	**5,091**	3,413	49%
NGLs (bbls/d)	**1,864**	1,037	80%	**1,607**	924	74%
Gas (mcf/d)	**78,225**	58,984	33%	**71,272**	50,516	41%
Combined (BOE/d)	**20,086**	15,559	29%	**18,577**	12,756	46%
Production per million common shares (BOE/d)(1)	**119**	123	-3%	**120**	105	14%
Average realized prices, before financial instruments						
Oil ($/bbl)	**45.19**	68.16	-34%	**50.83**	85.91	-41%
NGLs ($/bbl)	**22.86**	44.98	-49%	**23.12**	59.47	-61%
Gas ($/mcf)	**2.40**	3.81	-37%	**2.74**	4.75	-42%
Operating netbacks(1) ($/BOE)						
Oil and gas revenue	**23.16**	38.00	-39%	**26.45**	46.11	-43%
Realized gain (loss) on financial instruments	**(1.15)**	1.96	-159%	**(0.12)**	(0.08)	50%
Average realized price, after financial instruments	**22.01**	39.96	-45%	**26.33**	46.03	-43%
Royalties	**(2.72)**	(4.55)	-40%	**(2.81)**	(6.11)	-54%
Production expense	**(9.21)**	(11.74)	-22%	**(11.34)**	(12.00)	-6%
Transportation expense	**(2.03)**	(2.12)	-4%	**(2.09)**	(2.30)	-9%
Operating netback(1)	**8.05**	21.55	-63%	**10.09**	25.62	-61%
Drilling activity						
Total wells	**8**	9	-11%	**19**	36	-47%
Working interest wells	**6.0**	5.4	11%	**15.5**	27.1	-43%
Success rate on working interest wells	**100%**	100%	0%	**100%**	100%	0%
Undeveloped land						
Gross acres	**649,297**	494,361	31%	**649,297**	494,361	31%
Net acres	**521,413**	318,743	64%	**521,413**	318,743	64%
Reserves – proved plus probable						
Oil (mbbls)	**33,367**	23,474	42%	**33,367**	23,474	42%
NGLs (mbbls)	**21,010**	10,800	95%	**21,010**	10,800	95%
Gas (mmcf)	**576,779**	389,014	48%	**576,779**	389,014	48%
Combined (mBOE)	**150,507**	99,110	52%	**150,507**	99,110	52%

(1) Refer to advisory regarding non-GAAP measures

MESSAGE TO SHAREHOLDERS

Kelt Exploration Ltd. ("Kelt" or the "Company") has reported its financial and operating results to shareholders for the fourth quarter and year ended December 31, 2015.

Kelt achieved record production levels in the fourth quarter of 2015. Average production for the three months ended December 31, 2015 was 20,086 BOE per day, up 29% from the average production of 15,559 BOE per day during the fourth quarter of 2014. Daily average production in the fourth quarter of 2015 was 7% higher than the average production of 18,695 BOE per day in the third quarter of 2015.

For the three months ended December 31, 2015, revenue was $42.8 million and funds from operations was $11.2 million ($0.07 per share, diluted). For the year ended December 31, 2015, revenue was $179.3 million and funds from operations was $56.5 million ($0.36 per share, diluted). At December 31, 2015, bank debt, net of working capital was $212.1 million.

Kelt drilled 19 gross (15.5 net) wells during 2015 with a success rate of 100%, resulting in 9 (8.1 net) oil wells, 9 (6.4 net) gas wells, and 1 (1.0 net) service well. Of the wells drilled during the year, 8 gross (6.0 net) wells were drilled during the fourth quarter.

Kelt incurred total capital expenditures during the year of $496.4 million, of which $313.5 was for the acquisition of Artek Exploration Ltd. ("Artek"). During the fourth quarter of 2015, the Company spent $30.3 million on drilling and completing wells of which a portion of the spending is expected to contribute to 2016 production additions as the wells are brought on-stream.

During 2015, Kelt continued with its focus on long-term value creation by accumulating significant land acreage on resource-style plays, with a primary focus on Triassic Montney oil and liquids-rich gas plays. At December 31, 2015, Kelt's net land holdings were 730,308 acres (of which 71% was undeveloped), an increase of 58% compared to 461,188 acres (of which 69% was undeveloped) as at December 31, 2014. In addition, Kelt invested significantly in facilities and infrastructure during 2015, with the objective of reducing future production and transportation expenses. The majority of savings is expected to be realized through connecting oil production to Company owned pipelines (eliminating the need to truck oil to market) and through waste water disposal at Company owned water injection wells (eliminating third-party charges for waste disposal).

Since Kelt began active operations at the end of February 2013, the Company has had exceptional drilling results in both Alberta and British Columbia, as it delineates its new prospects.

Top ten IP30 (gross sales, BOE/d) wells drilled by Kelt in Alberta are as follows:

(1) Karr 15-28-065-03W6 Upper Montney - 1,490 BOE/d (79% oil)
(2) Pouce Coupe 14-25-077-13W6 Lower Montney - 1,400 BOE/d (95% gas) *[a]*
(3) La Glace 13-33-074-08W6 Middle Montney - 1,090 BOE/d (88% oil)
(4) Pouce Coupe 16-17-077-12W6 Doig/Upper Montney - 1,071 BOE/d (90% gas) *[a]*
(5) Pouce Coupe 13-08-078-11W6 Lower-Middle Montney - 1,068 (83% oil)
(6) Pouce Coupe 02/08-18-078-11W6 Upper-Middle Montney - 1,034 BOE/d (73% oil)
(7) Karr 16-28-065-03W6 Upper Montney - 1,022 BOE/d (57% oil)
(8) Pouce Coupe 14-08-078-11W6 Lower-Middle Montney - 995 BOE/d (83% oil)
(9) Pouce Coupe 13-32-077-11W6 Doig/Upper Montney - 988 BOE/d (80% gas)
(10) Progress 15-13-078-09W6 Montney - 973 BOE/d (58% oil) *[b]*

Notes:

[a] The Pouce Coupe 14-25 and 16-17 wells were drilled with approximately two mile horizontal laterals and were put on production at restricted rates due to limited compression capacity.
[b] The Progress 15-13 well is a new Montney discovery well. The production rate is an IP23.
[c] Oil % includes crude oil and natural gas liquids.

At its Inga/Fireweed property in British Columbia, wells drilled prior to July 2014 (operated by Artek) were predominantly completed using propane fractures. Since then, the IP30 rates (gross sales, BOE/d) for the nine wells that have been drilled and completed using slick-water fractures are as follows:

(1) Inga 10-21-087-23W6 Doig - 2,043 BOE/d (27% gas)
(2) Inga 03-33-087-23W6 Doig - 1,326 BOE/d (23% gas)

(3) Inga 08-31-087-23W6 Upper Montney - 1,296 BOE/d (26% gas)
(4) Inga 02-28-087-23W6 Doig - 1,271 BOE/d (50% gas) *[d]*
(5) Fireweed c-026-A/094-A-13 Upper Montney - 1,188 BOE/d (35% gas)
(6) Inga 07-17-087-23W6 Middle Montney - 905 BOE/d (31% gas) *[e]*
(7) Fireweed c-085-I/094-A-12 Upper Montney - 844 BOE/d (31% gas)
(8) Fireweed a-058-I/094-A-12 Upper Montney - 686 BOE/d (32% gas) *[f]*
(9) Inga 13-15-088-23W6 Doig - 661 BOE/d (37% gas) *[g]*

Notes:
[d] Hybrid completion.
[e] The Inga 07-17 well is the first drilled into the Middle Montney. All other Montney wells were drilled in the Upper Montney.
[f] During the completion operation of the Fireweed a-058-I Upper Montney well, the Company experienced difficulty getting liner to bottom resulting in only stimulating two-thirds of the well.
[g] The Inga 13-15 Doig well was drilled to test the edge of the Inga Doig pool.

2016 Operating Catalysts:

At Pouce Coupe, Alberta, Kelt has been actively developing its high quality Montney oil reservoir targeting the lower lobe of the Middle Montney ("Sexsmith"). The Company has tested the upper lobe of the Middle Montney ("Montney H") and with success in its initial well located at 02/08-18-078-11W6 which had an IP30 rate of 1,034 BOE per day (73% oil), will continue to further develop this new part of the reservoir;

At Progress, Alberta, Kelt has accumulated approximately 40 gross sections (25 net sections) on a new prospective Montney play. The initial well (50% WI) has recently been put on production, however, is restricted due to capacity constraints. A follow-up well (50% WI) was drilled in January 2016, and is expected to be completed in the second quarter of 2016;

At Karr, Alberta, the Company continues to develop the Upper Montney, however, recently the Company has drilled wells in the Middle Montney and in the Dunvegan formations. Initial production results from these two wells are encouraging and Kelt will pursue further development after evaluating the production from these wells over the next 6 to 12 months;

At Inga, British Columbia, Kelt has actively developed the condensate-rich Doig gas reservoir. In early 2016, the Company has drilled what appears to be a new Doig anomaly on its lands and expects to complete this new prospect well in the second quarter of 2016;

At Inga/Fireweed, British Columbia, where the Company owns 162 contiguous net sections (approximately 103,000 acres) of Montney rights, Upper Montney drilling to date has been successful with high associated condensate rates on the eastern part of its land block, however, in 2016, Kelt expects to test the upper Montney on the western part of its land base; and

At Inga, Kelt has recently tested the Middle Montney formation by drilling a well located at 07-17-087-23W6. Similar to previous wells drilled in the Upper Montney in the area, this Middle Montney well flowed high volumes of field condensate with an IP30 rate (gross sales, BOE/d) of 905 BOE per day (69% condensate and liquids). Kelt is very excited about the possible scope of this new play and with further drilling success in the Middle Montney, the Company will have two Montney zones to pursue development and future growth on its large contiguous land block.

In light of the current energy business environment with much lower oil and gas prices year-to-date in 2016, compared to 2015, Kelt is optimistic that it can take advantage of the downturn by continuing with its strategy with emphasis on low-cost land accumulation in its core operating areas. Management looks forward to updating shareholders with 2016 first quarter results on or about May 11, 2016.

On behalf of the Board of Directors,

[signed]

David J. Wilson
President and Chief Executive Officer
March 7, 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 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. Kelt Exploration (LNG) Ltd. ("Kelt LNG") became a wholly-owned subsidiary of the Company on April 16, 2015. Kelt LNG's assets are located in the province of British Columbia. Common shares of the Company are listed and posted for trading on the Toronto Stock Exchange ("TSX") under the symbol "KEL". The head office of Kelt is located at Suite 300, 311 – 6th Avenue S.W., Calgary, Alberta T2P 3H2.

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

This Management's Discussion and Analysis ("MD&A") is dated March 7, 2016 and should be read in conjunction with the Company's audited consolidated annual financial statements and related notes 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 consolidated annual financial statements for issue on March 7, 2016.

ADVISORY REGARDING FORWARD-LOOKING STATEMENTS

This MD&A contains forward-looking statements and forward-looking information within the meaning of applicable securities laws. The use of any of the words "expect", "anticipate", "continue", "estimate", "objective", "ongoing", "may", "will", "project", "should", "believe", "plans", "intends" and similar expressions are intended to identify forward-looking information or statements. In particular, this MD&A contains forward-looking statements pertaining to the following: the anticipated continued reduction in production and transportation expenses resulting from operational initiatives and expenditures on infrastructure; the expectation that new firm service gas transportation contracts will alleviate production disruptions and discounted realized gas prices; the anticipated reduction in trucking costs at Karr upon completion of construction, by Pembina Pipeline Corp., of the Karr oil pipeline lateral which is expected to be in service by the second quarter of 2016; the expected outcome of the semi-annual review of the borrowing base available under Kelt's Credit Facility (defined herein); and the Company's expected future financial position and operating results, as well as the amount and timing of future development capital expenditures. Statements relating to "reserves" or "resources" are deemed to be forward looking statements, as they involve the implied assessment, based on certain estimates and assumptions, that the reserves described exist in the quantities predicted or estimated and that the reserves can be profitably produced in the future. Actual reserves may be greater than or less than the estimates provided herein.

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

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

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

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 December 31			Year ended December 31		
(CA$ thousands, except as otherwise indicated)	**2015**	2014	%	**2015**	2014	%
Cash provided by operating activities	**11,268**	28,300	-60%	**63,010**	112,391	-44%
Transaction costs	**-**	4	-100%	**2,409**	234	929%
Provision for potential credit losses	**548**	-	-	**611**	-	-
Settlement of decommissioning obligations	**151**	83	82%	**383**	229	67%
Change in non-cash working capital	**(795)**	1,281	-	**(9,896)**	2,883	-
Funds from operations	**11,172**	29,668	-62%	**56,517**	115,737	-51%

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

	Three months ended December 31			Year ended December 31		
(CA$ thousands, except as otherwise indicated)	**2015**	2014	%	**2015**	2014	%
Oil and gas sales	**42,797**	54,396	-21%	**179,326**	214,691	-16%
Realized gain (loss) on financial instruments(1)	**(2,129)**	2,808	-	**(833)**	(388)	115%
Royalties	**(5,022)**	(6,514)	-23%	**(19,033)**	(28,433)	-33%
Production expenses	**(17,012)**	(16,788)	1%	**(76,914)**	(55,901)	38%
Transportation expenses	**(3,756)**	(3,038)	24%	**(14,192)**	(10,719)	32%
Operating income	**14,878**	30,864	-52%	**68,354**	119,250	-43%
Production (mBOE)	**1,848**	1,431	29%	**6,780**	4,656	46%
Operating netback ($/BOE)	**8.05**	21.55	-63%	**10.09**	25.62	-61%

(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.

“Finding, development and acquisition” (“FD&A”) cost is the sum of capital expenditures incurred in the period and the change in future development capital (“FDC”) required to develop reserves. FD&A cost per BOE is determined by dividing current period net reserve additions into the corresponding period’s FD&A cost. Readers are cautioned that the aggregate of capital expenditures incurred in the year, comprised of exploration and development costs and acquisition costs, and the change in estimated FDC generally will not reflect total FD&A costs related to reserves additions in the year.

“Recycle ratio” is a measure for evaluating the effectiveness of a company’s re-investment program. The ratio measures the efficiency of capital investment by comparing the operating netback per BOE to FD&A cost per BOE.

“Net asset value per common share” is calculated by adding the present value of petroleum and natural gas reserves, undeveloped land value and proceeds from exercise of stock options, less the present value of decommissioning obligations and bank debt, net of working capital, and dividing by the diluted number of common shares outstanding. The calculation of proceeds from exercise of stock options and the diluted number of common shares outstanding only include stock options that are “in-the-money” based on the closing price of KEL common shares as at the calculation date.

The Company discloses certain key debt ratios in the *Capital Resources and Liquidity* section of the MD&A, including a “debt to funds from operations ratio”, an “asset coverage ratio” and a “debt to equity ratio”, all of which, are non-GAAP financial measures. Management believes that these ratios provide investors with additional information to understand the Company’s capital structure and liquidity risk. In particular, the Company uses the “debt to trailing funds from operations ratio” as a benchmark on which management monitors the Company’s capital structure and short-term financing requirements. The “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). “Net debt” is calculated by adding (subtracting) the working capital deficiency (surplus) to (from) bank debt. “Asset coverage” is calculated as total assets (as determined in accordance with GAAP), divided by net debt (as defined herein). “Debt to equity” is calculated as net debt (as defined herein), divided by total shareholders’ equity (as determined in accordance with GAAP).

OTHER MEASUREMENTS

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

NEW ACCOUNTING POLICIES

On April 16, 2015, Kelt completed the acquisition of Artek Exploration Ltd. (“Artek”) by way of a statutory plan of arrangement under the *Business Corporations Act* (Alberta) (hereinafter, the “Artek Acquisition”). Concurrently, a name change was effected to change the name of Artek to Kelt Exploration (LNG) Ltd. (“Kelt LNG”). Pursuant to the Artek Acquisition, Kelt LNG became a wholly-owned subsidiary of Kelt; prior thereto, Kelt did not have any subsidiaries. The annual consolidated financial statements as at and for the year ended December 31, 2015, include the consolidated accounts of Kelt and Kelt LNG. The Company has applied the principles of consolidation outlined in IFRS 10, whereby the financial statements of subsidiaries are prepared using uniform accounting policies and for the same reporting period as Kelt. Subsidiaries are consolidated from the date of acquisition of control and continue to be consolidated until the date there is a loss of control. All intercompany balances, transactions, revenue and expenses are eliminated on consolidation.

ACCOUNTING STANDARDS ISSUED BUT NOT YET EFFECTIVE

IFRS 15 *Revenue from Contracts with Customers* provides clarification for recognizing revenue from contracts with customers and establishes a single revenue recognition and measurement framework that applies to contracts with customers. The new standard is effective for annual periods beginning on or after January 1, 2018, with early adoption permitted. Management does not expect the adoption of IFRS 15 to have a material impact on the consolidated financial statements, however, the evaluation of all potential measurement and disclosure impacts is ongoing.

IFRS 9 *Financial Instruments*, is intended to replace IAS 39 *Financial Instruments: Recognition and Measurement* and uses a single approach to determine whether a financial asset is measured at amortized cost or fair value, replacing the multiple rules in IAS 39. For financial liabilities designated at fair value through profit or loss, a company can recognize the portion of the change in fair value related to the change in the company's own credit risk through other comprehensive income rather than profit or loss. The new standard also requires a single impairment method to be used, replacing the multiple impairment methods in IAS 39, and incorporates new hedge accounting requirements. The new standard is effective for annual periods beginning on or after January 1, 2018, with early adoption permitted. Based on the nature of the Company's existing financial assets and liabilities, management does not expect the adoption of IFRS 9 to have a material impact on the consolidated financial statements, however, the evaluation of all potential measurement and disclosure impacts is ongoing.

IFRS 16 *Leases,* is intended to replace IAS 17 and will bring fundamental changes for all companies, including Kelt, who lease assets. The new standard is effective for annual reporting periods beginning on or after January 1, 2019, with early application permitted. The most significant financial reporting impacts of the changes include: all leases will be on the balance sheet of lessees, except those that meet the limited exception criteria; non-GAAP measures such as "Funds from Operations" or other key metrics disclosed in this MD&A including "G&A per BOE" will be significantly impacted as rent expense is removed and replaced by the recording of depreciation and finance expenses; the amount of profit (loss) recognized in a period will likely change as the timing of expenses is accelerated when applying the new standard which uses a finance lease model compared to a straight line operating lease expense; and key ratios may be impacted with the introduction of lease assets and liabilities on the balance sheet and changes to the timing of expenses. Management is currently evaluating the potential impact of IFRS 16 on the consolidated financial statements as well as the potential broader impacts beyond financial statement presentation (ie: financial ratios or covenant calculations under credit agreements, the structure and/or basis for management compensation arrangements, earnings clauses included in business acquisitions, tax planning strategies, the design of new processes and internal controls, etc.).

SIGNIFICANT JUDGMENTS AND ESTIMATES

The significant accounting policies applied by the Company are disclosed in note 3 of the audited consolidated annual financial statements as at and for the year ended December 31, 2015. 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 consolidated financial statements as at and for the year ended December 31, 2015 are discussed below.

Depletion, depreciation and reserves

The Company calculates depletion based on total proved reserves as determined in accordance with the Canadian Oil and Gas Evaluation Handbook ("COGEH"). The process of determining reserves is complex. Significant judgments are based on available geological, geophysical, engineering, and economic data. These judgments are based on estimates and assumptions that may change substantially as additional data from ongoing development activities and production performance becomes available and as economic conditions impacting oil and gas prices and costs change. The reserve estimates are based on current production forecasts, prices and economic conditions. As circumstances change and additional data becomes available, reserve estimates also change. Estimates made are reviewed and revised, either upward or downward, as warranted by the new information. Revisions are often required due to changes in well performance, prices, economic conditions and governmental restrictions.

Although every reasonable effort is made to ensure that reserve estimates are accurate, reserve estimation can be impacted by subjective decisions, new geological or production information and a changing environment. In addition, revisions to reserve estimates can arise from changes in forecast oil and gas prices and reservoir performance. Such revisions can be either positive or negative.

Changes in reserve estimates impact the financial results of the Company as reserves and estimated future development costs are used to calculate depletion. Reserves are used in measuring the fair value less costs of disposal ("FVLCD") of property, plant and equipment ("PP&E") for impairment calculations and for determining the fair value of PP&E acquired in a business combination. Reserves also impact the Company's assessment of the commercial viability and technical feasibility of an exploration project and the decision to transfer exploration and evaluation ("E&E") assets to PP&E.

Exploration and evaluation assets

Judgment is required to determine the level at which E&E is assessed for impairment. For Kelt, the carrying value of E&E assets is assessed for overall impairment at the operating segment level and on a specific identification basis prior to transferring E&E assets to PP&E. The decision to transfer assets from E&E to PP&E requires judgment as it is based on estimated proved reserves, which are used, in part, to determine a project's technical feasibility and commercial viability. During the fourth quarter of 2015, the Company concluded that approximately $7.4 million of exploratory drilling costs were impaired. These costs were not transferred to PP&E as the Company was unable to economically establish proved reserves. Based on forecast commodity prices and the Company's current plans for future development, the Company does not expect to assign proved or probable reserves to these locations in the foreseeable future, therefore the costs were charged to E&E expense at December 31, 2015.

Determination of Cash Generating Units ("CGUs")

The determination of CGUs requires judgment in defining a group of assets that generate cash inflows that are largely independent of the cash inflows from other assets or groups of assets. CGUs are determined by similar geological structure, shared infrastructure, geographical proximity, commodity type, similar exposure to market risks and materiality. As at December 31, 2015, the Company has one CGU for its assets located in the province of British Columbia and four CGUs for its assets located in the province of Alberta. Refer to specific information regarding the Company's CGUs under the heading of *Depletion, Depreciation and Impairment* in the Results of Operations section of this MD&A.

Impairment of non-financial assets

Significant judgment is required to assess the Company's non-financial assets, namely E&E, PP&E and goodwill, for impairment. Management must first determine whether indicators of impairment exist that suggest the carrying value may not be recoverable through the asset's continued use or sale. As a result of the significant decrease in forecast oil and natural gas prices, an indication of potential impairment was identified for all CGUs, including allocated goodwill, and an impairment test was performed for PP&E and goodwill at December 31, 2015. The Company concluded there is no indication of impairment for its E&E assets at the operating segment level.

Significant judgment and estimates are required to calculate the recoverable amount of PP&E and goodwill in an impairment test. Management calculated the recoverable amount of each CGU based on its FVLCD, using an after-tax discounted cash flow analysis derived from proved plus probable reserves. Reserve estimates and expected future cash flows from production of reserves are subject to measurement uncertainty as discussed above and are subject to variability due to changes in forecasted commodity prices. In addition, the present value of forecast future cash flows is highly sensitive to the discount rate. Judgment is required to determine an appropriate discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Refer to details under the heading of *Depletion, Depreciation and Impairment* in the Results of Operations section of this MD&A for a discussion of the specific estimates and assumptions applied in the calculation of the recoverable amount.

Decommissioning obligations

The Company estimates the decommissioning obligations for oil and gas wells and their associated production facilities and infrastructure. In most instances, dismantling of assets and remediation occurs many years into the future. The value of the ultimate decommissioning obligation can fluctuate in response to many factors including changes to relevant legal requirements, the emergence of new restoration techniques, experience at other production sites, and changes to the risk-free discount rate. The expected timing and amount of expenditure can also change, for example, in response to changes in reserves or changes in laws and regulations or their interpretation. Judgments include the most appropriate discount rate to use, which management has determined to be a risk-free rate.

Kelt estimates abandonment and reclamation costs based on a combination of publically available industry benchmarks and internal site specific information. For producing wells and facilities, the expected timing of settlement is estimated based on the proved plus probable period to abandonment for each field, as per the independent reserve report. For non-producing wells, the expected timing of settlement is estimated to be half of the period applied to producing wells in that field, unless the timing to abandon and reclaim a specific well site or facility is known based on budgeted expenditures.

Business combinations

Business combinations are accounted for using the acquisition method of accounting. The determination of fair value often requires management to make assumptions and estimates about future events. The assumptions and estimates with respect to determining the fair value of exploration and evaluation assets and property, plant and equipment acquired generally require the most judgment and include estimates of reserves acquired, forecast benchmark commodity prices and discount rates. Assumptions are also required to determine the fair value of decommissioning obligations associated with the properties. Changes in any of these assumptions or estimates used in determining the fair value of acquired assets and liabilities could impact the amounts assigned to assets, liabilities and goodwill (or gain from a bargain purchase) in the acquisition equation. Future profit (loss) can be affected as a result of changes in future depletion and depreciation or impairment.

Deferred income taxes

The Company follows the liability method for calculating deferred income taxes. Tax interpretations, regulations and legislation in the jurisdictions in which the Company operates are subject to change. As such, deferred income taxes are subject to measurement uncertainty. The provision for deferred income taxes also includes the following significant judgments of management:

• Deferred income tax assets are assessed by management at the end of the reporting period to determine the likelihood that they will be realized from future taxable earnings. As at December 31, 2015, the Company has a consolidated deferred income tax liability of $47.2 million. The deferred tax liability reported in the Consolidated Statement of Financial Position is presented net of offsetting deferred income tax assets, most notably, a deferred income tax asset in the amount of $55.8 million related to non-capital losses which are estimated to be approximately $210.6 million at December 31, 2015. The Company's non-capital losses expire in years 2023 to 2035. Management believes that Kelt and Kelt LNG will have sufficient taxable income in the future in order to utilize the non-capital losses and has concluded that recognition of the associated deferred income tax assets is appropriate;

• Classification of intangible drilling and completion costs as Canadian exploration expenses ("CEE") or Canadian development expenses ("CDE") – CEE is deductible at a rate of 100% per year, whereas CDE may be deducted on a declining basis at 30% per year. Accordingly, the allocation of resource deductions will impact the period in which Kelt may become taxable in the future. In addition, the designation of certain expenditures as CEE and/or CDE impacts the Company's ability to satisfy its flow-through share obligations; and

• Recognition of unrecognized deferred income tax asset – per IAS 12, deferred income taxes are not initially recognized on transactions that are not business combinations. The Company did not initially recognize a deferred income tax asset of $14.4 million that arose on the spin-out certain assets from Celtic Exploration Ltd. ("Celtic") at Kelt's inception on February 26, 2013. The initially unrecognized deferred tax asset is now being amortized at a rate of 3.3% per quarter, which management believes is a reasonable estimate as it reflects the weighted average depletion rate of the properties at the time of the spin-out and is aligned with Kelt's corporate average depletion rate.

Share based compensation

The Company uses the fair value method of accounting for its long-term incentive plans, which include an Incentive Stock Option Plan and a Restricted Share Unit Plan. Judgments include which valuation model is most appropriate for the grant of the award to estimate its fair value. Estimates and assumptions are then used in the valuation model to determine fair value.

For stock options, the Company uses the Black-Scholes option pricing model which requires that management make assumptions for the expected life of the option, the anticipated volatility of the share price over the life of the option, the risk-free interest rate for the life of the option, and the number of options that will ultimately vest. The assumptions used by the Company are discussed in note 11 of the consolidated financial statements.

The fair value of restricted share units is estimated based on the volume weighted average trading price (“VWAP”) on the TSX over three trading days immediately prior to the date of grant. Judgment is also required to estimate the number of restricted share units that will ultimately vest, in other words, the forfeiture rate. The assumptions used by the Company are discussed in note 11 of the consolidated financial statements.

Flow-through shares

There is no IFRS guidance that specifically addresses accounting for flow-through shares, therefore the Company is required to develop an accounting policy. Consistent with prior years, and as set-forth in note 3, the Company has applied the residual method. Under this method, judgement is required to determine of the fair value of ordinary shares. Typically, it is based on the share price at the time the parties agree to the transaction. In situations where flow-through shares are issued concurrent with an ordinary common share offering, the difference in subscription prices is used to value the premium. Otherwise, the Company uses the VWAP of KEL common shares for the five trading days immediately preceding the date of the binding agreement to value the ordinary common shares.

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

CHANGE IN CLASSIFICATION OF CERTAIN PRODUCTION AND TRANSPORTATION EXPENSES

In the fourth quarter of 2015, the Company reclassified certain charges that were previously presented as transportation expenses to production expenses. The charges were incurred pursuant to a pipeline transportation contract and a gas sales agreement that came into effect December 1, 2014, which secured firm commitments for transportation capacity and upstream services. In November 2015, these contracts were renewed and extended for an additional term from December 1, 2015 to October 31, 2017. Upon further review of the nature of the charges under the firm service contracts at the time of renewal, the Company concluded that the charges related to upstream services, primarily gas gathering and processing fees, are more appropriately presented as a production expense rather than transportation expense. The expenses being reclassified amount to approximately $1.8 million for the nine month period ended September 30, 2015. The presentation of production and transportation expenses reported for the previous year ended December 31, 2014 has not been revised as the impact was nominal. 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.

The CEO and the CFO have evaluated the effectiveness of Kelt's disclosure controls and procedures as at December 31, 2015 and have concluded that such disclosure controls and procedures are effective. The assessment was based on the framework in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

INTERNAL CONTROLS OVER FINANCIAL REPORTING

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

There were no material changes to the Company's internal controls over financial reporting during the interim period from October 1, 2015 to December 31, 2015. The CEO and the CFO have evaluated the effectiveness of Kelt's internal controls over financial reporting as at December 31, 2015 and have concluded that such internal controls over financial reporting are effective. The assessment was based on the framework in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

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

GROWTH STRATEGY

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

RESULTS OF OPERATIONS

FINANCIAL AND OPERATING HIGHLIGHTS

- Kelt achieved record production levels in 2015. Average production for 2015 was 18,577 BOE per day, up 46% from average production of 12,756 BOE per day in 2014. During the fourth quarter of 2015, corporate production averaged 20,086 BOE per day, up 29% from 15,559 BOE per day in the fourth quarter of 2014, and up 7% from 18,695 BOE in the third quarter of 2015. The Company showed significant year-over-year growth in fourth quarter production, despite having approximately 1,862 BOE per day of average production downtime during the three months ended December 31, 2015 as a result of third party pipeline restrictions (accounting for approximately 89% of total downtime) and facility related outages.
- The Company generated funds from operations in the amount of $11.2 million ($0.07 per common share, diluted) during the fourth quarter of 2015, down 62% from $29.7 million ($0.23 per common share, diluted) in the same quarter of 2014, reflecting significantly lower realized oil and gas prices. During the year ended December 31, 2015, the Company generated funds from operations of $56.5 million ($0.36 per common share, diluted) compared to $115.5 million ($0.93 per common share, diluted) during the previous year ended December 31, 2014.
- Corporate royalty rates averaged 11.7% of revenue during the fourth quarter of 2015, down from 12.0% in the fourth quarter of 2014. During 2015, royalties averaged 10.6% of revenue, down from 13.2% in the previous year.
- In the second half of 2015, the Company began to realize the benefit of its continued operational initiatives and previous expenditures on infrastructure, resulting in a significant reduction in production and transportation expenses. Production and transportation expenses, combined, averaged $11.24 per BOE during the quarter ended December 31, 2015, down 19% from $13.86 per BOE during the fourth quarter ended December 31, 2014. On an annual basis, the combined level of production and transportation expenses is down 6% to $13.43 per BOE on average for 2015 compared to $14.30 per BOE in 2014.
- Kelt continues to incur below industry average general and administrative (“G&A”) expenses, which on a per-unit basis, averaged $0.77 per BOE in 2015 ($0.78 per BOE in 2014), despite facing significant production downtime throughout 2015. G&A expense is reported net of standard overhead recoveries, however, Kelt does not capitalize any direct G&A expenses.
- The Company’s total capital expenditures amounted to $496.4 million in 2015, up 17% from $423.9 million in 2014. Of this total, $100.9 million was spent drilling and completing wells, $56.0 million was spent on infrastructure, $9.7 million was spent on land and seismic, and $329.8 million was spent on corporate and property acquisitions. Excluding acquisitions, the Company’s level of capital spending decreased by 34% to $166.6 million in 2015 compared to $251.2 million of capital expenditures in 2014.
- Kelt drilled 8 (6.0 net working interest) wells during the fourth quarter and 19 (15.5 net working interest) wells during the year ended December 31, 2015, with an overall success rate of 100%. The number of net wells drilled by the Company is down 43% compared to 36 (27.1 net working interest) wells drilled during the previous year ended December 31, 2014, although Kelt’s average working interest in wells drilled increased to 82% in 2015 compared to 75% in 2014.
- On April 16, 2015, Kelt completed 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 26.9 million Kelt common shares to the former shareholders of Artek. In addition, Kelt assumed Artek’s bank debt, net of working capital, of $95.5 million (net of $4.8 million of pre-existing intercompany amounts extinguished). The acquisition of Artek consolidates the majority of Kelt’s land acreage and ownership in key infrastructure in its Inga-Fireweed-Stoddart, British Columbia core area to 100% and is consistent with the Company’s strategy to operate and control all of its major core exploration and development prospects.
- During 2015, the Company raised aggregate gross proceeds of $123.4 million by issuing 14.1 million common shares (of which, 3.8 million common shares were issued on a “flow-through” basis) at an average issue price of $8.78 per common share. Certain officers, directors and employees of the Company purchased 2.1 million of the common shares issued pursuant to equity offerings during the year. As at December 31, 2015, insiders owned or controlled 29.6 million common shares, or 17.6% of the total shares outstanding.

- The Company reported significant growth in reserves as at December 31, 2015:
    - Proved developed producing reserves increased 26% to 33.8 million BOE;
    - Total proved reserves increased 37% to 83.8 million BOE; and
    - Total proved plus probable reserves increased 52% to 150.5 million BOE.
- Kelt reported proved plus probable ("2P") FD&A costs, including future development capital expenditures, of $14.78 per BOE for 2015, compared to $13.42 per BOE in 2014. The Company considers this to be a good result considering the significant amount of undeveloped land that was acquired on the Company's Montney plays, in addition to the large infrastructure build conducted in 2015.
- Reported net asset value at December 31, 2015 of $6.65 per common share, down 19% from $8.20 per common share at December 31, 2014.

REVENUE

	Three months ended December 31			Year ended December 31		
(CA$ thousands, except as otherwise indicated)	**2015**	2014	%	**2015**	2014	%
Average daily production:						
Oil (bbls/d)	**5,185**	4,691	11%	**5,091**	3,413	49%
NGLs (bbls/d)	**1,864**	1,037	80%	**1,607**	924	74%
Gas (mcf/d)	**78,225**	58,984	33%	**71,272**	50,516	41%
Combined (BOE/d)	**20,086**	15,559	29%	**18,577**	12,756	46%
Average realized prices, before financial instruments:						
Oil ($/bbl)	**45.19**	68.16	-34%	**50.83**	85.91	-41%
NGLs ($/bbl)	**22.86**	44.98	-49%	**23.12**	59.47	-61%
Gas ($/mcf)	**2.40**	3.81	-37%	**2.74**	4.75	-42%
Combined ($/BOE)	**23.16**	38.00	-39%	**26.45**	46.11	-43%
Average realized prices, after financial instruments:						
Oil ($/bbl)	**43.73**	74.11	-41%	**50.34**	85.53	-41%
NGLs ($/bbl)	**22.86**	47.48	-52%	**26.25**	59.73	-56%
Gas ($/mcf)	**2.20**	3.81	-42%	**2.67**	4.75	-44%
Combined ($/BOE)	**22.01**	39.96	-45%	**26.33**	46.03	-43%
Revenue, before royalties and financial instruments:						
Oil	**21,560**	29,414	-27%	**94,451**	107,020	-12%
NGLs	**3,920**	4,293	-9%	**13,558**	20,062	-32%
Gas	**17,317**	20,689	-16%	**71,317**	87,609	-19%
Total revenue, before royalties and financial instruments	**42,797**	54,396	-21%	**179,326**	214,691	-16%

Kelt achieved record production levels in 2015. Average production for 2015 was 18,577 BOE per day, up 46% from average production of 12,756 BOE per day in 2014. Production per million shares was 120 BOE per day, up 14% from 105 BOE per day in 2014. The increase in production in 2015 is due to the Company's active drilling program during the second half of 2014 and first quarter of 2015, over which period, Kelt drilled 24 net wells. Kelt's drilling program was complemented by strategic acquisitions, most notably, the acquisition of Artek on April 16, 2015, which more than doubled Kelt's production at its Inga-Fireweed-Stoddart core area in northeastern British Columbia ("BC"). Average production reported for the year ended December 31, 2015, only includes production from the Artek Acquisition subsequent to April 16, 2015. In addition, Kelt completed the acquisition of Capio Exploration Ltd. ("Capio") on July 2, 2014, adding oil and associated gas production at La Glace, Alberta. Average production reported for the year ended December 31, 2014, only included production from the Capio assets for the six month period following closing of the acquisition. Throughout 2015, a portion of the Company's production was constrained by third-party downtime and pipeline restrictions. Kelt voluntarily elected to shut-in production on certain days where pipeline capacity issues resulted in low and in some instances, negative natural gas prices. In order to strengthen the Company's access to alternative gas markets and to reduce the risk of future production downtime, Kelt entered into transportation agreements on the Alliance pipeline, with Chicago City Gate pricing effective December 1, 2015.

During the fourth quarter of 2015, corporate production averaged 20,086 BOE per day, up 7% from 18,695 BOE during the third quarter ended September 30, 2015 and up 29% from average production of 15,559 BOE per day in the fourth quarter of 2014. The Company showed significant year-over-year growth in fourth quarter production despite having approximately 1,862 BOE per day of average production downtime during the three months ended December 31, 2015 as a result of third party pipeline restrictions (accounting for approximately 89% of total downtime) and facility related outages.

The Company earned revenue before royalties and financial instruments of $42.8 million during the fourth quarter of 2015, down 21% from the fourth quarter of 2014, despite increasing production by 29% over the same period. As a result of the significant decline in industry-wide oil and gas prices, the Company's combined average sales price decreased to $23.16 per BOE ($22.01 after financial instruments) during the three month period ended December 31, 2015, down 39% from $38.00 per BOE ($39.96 after financial instruments) during the three month period ended December 31, 2014.

Revenue before royalties and financial instruments was $179.3 million for the year ended December 31, 2015; down 16% compared to $214.7 million earned during the previous year ended December 31, 2014. The decrease in the Company's combined average sales price to $26.45 per BOE ($26.33 after financial instruments) in 2015 from $46.11 per BOE ($46.03 after financial instruments) in 2014, more than offset the 46% increase in production volumes. During the year ended December 31, 2015, production was weighted 36% to oil and NGLs compared to 34% during the year ended December 31, 2014.

BENCHMARK COMMODITY PRICES

The following table summarizes average historical benchmark commodity prices for the periods indicated:

	Q4 2015	Q4 2014	% change	**YTD 2015**	YTD 2014	% change
WTI Cushing Oklahoma (US$/bbl)(1)	**42.18**	73.15	-42%	**48.80**	92.99	-48%
Average FX rate (CA$/US$)(1)	**1.3347**	1.1361	17%	**1.2764**	1.1045	16%
WTI Cushing Oklahoma (CA$/bbl)(2)	**56.22**	82.97	-32%	**62.12**	102.49	-39%
Canadian Light Sweet (CA$/bbl)(1)(3)	**52.55**	75.11	-30%	**57.45**	94.18	-39%
As a % of CA$ WTI	**93%**	91%	2%	**92%**	92%	-
Edmonton Pentane (CA$/bbl)(1)	**57.91**	80.11	-28%	**61.45**	102.33	-40%
As a % of CA$ WTI	**103%**	97%	6%	**99%**	100%	-1%
Edmonton Butane (CA$/bbl)(1)	**36.45**	62.67	-42%	**36.81**	68.02	-46%
As a % of CA$ WTI	**65%**	76%	-14%	**59%**	66%	-11%
Edmonton Propane (CA$/bbl)(1)	**9.89**	27.16	-64%	**6.17**	44.42	-86%
As a % of CA$ WTI	**18%**	33%	-45%	**10%**	43%	-77%
NYMEX Henry Hub (US$/mmbtu)(4)	**2.28**	3.94	-42%	**2.67**	4.37	-39%
AECO 5A (CA$/GJ)(5)	**2.34**	3.41	-31%	**2.55**	4.27	-40%
NGX Station #2 Day Ahead Index (CA$/GJ)(6)	**1.04**	2.95	-65%	**1.70**	3.90	-56%

(1) Source: Sproule Associates Limited

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

(3) The Edmonton Light Par price was discontinued as of May 1, 2014, and replaced by the Canadian Light Sweet crude blend which is traded daily on the Net Energy Index. Historical information is not available for the Canadian Light Sweet index for periods prior to May 1, 2014.

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

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

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

OIL OPERATIONS

(CA$/bbl)	Three months ended December 31 2015	2014	%	Year ended December 31 2015	2014	%
Oil revenue	**45.19**	68.16	-34%	**50.83**	85.91	-41%
Realized gain (loss) on financial instruments	**(1.46)**	5.95	-125%	**(0.49)**	(0.38)	29%
Average realized price, after financial instruments	**43.73**	74.11	-41%	**50.34**	85.53	-41%
Oil royalties	**(9.27)**	(11.77)	-21%	**(8.38)**	(15.67)	-47%
Revenue, after royalties and financial instruments	**34.46**	62.34	-45%	**41.96**	69.86	-40%

During the three month period ended December 31, 2015, the Company realized an average price for oil sales of $45.19 per barrel, down 34% from $68.16 per barrel realized in the same three month period of 2014. While the WTI index oil price fell by 42% over this period to US$42.18 per barrel in the fourth quarter of 2015, the US dollar appreciated by 17%, softening the impact of falling oil prices on the average oil price realized by the Company denominated in Canadian dollars. By comparison, the Canadian dollar equivalent WTI ("CA$WTI") index oil price decreased 32% from $82.97 per barrel during the fourth quarter of 2014 to $56.22 per barrel during the fourth quarter of 2015. Kelt's realized oil price reflects a 21.0% discount to CA$WTI compared to a discount of 18.5% in the comparative quarter of 2014.

Kelt realized an average price for oil sales of $50.83 per barrel during the year ended December 31, 2015, down 41% relative to Kelt's realized price for oil sales of $85.91 per barrel during the previous year ended December 31, 2014. The CA$WTI price fell by 39% over the corresponding period, averaging $62.12 per barrel in 2015. Canadian Light Sweet differentials were flat year over year, on average, at 92% of the CA$WTI index price. During the year ended December 31, 2015, 29% of Kelt's total oil volumes were derived from field condensate, up from 22% in 2014, as a result of the Artek Acquisition and corresponding increase in production from the Company's condensate rich Inga-Fireweed core area in northeastern BC. On average, Kelt's realized price for field condensate carried an additional 5% quality discount compared to Kelt's realized price for crude oil.

Kelt entered into a forward foreign exchange contract fixing the Canadian/US dollar exchange rate at $1.2580 on a notional US$3.0 million per month from March to December 2015. The exchange rate averaged $1.3347 during the three month period ended December 31, 2015, resulting in a realized loss of approximately $0.7 million or $1.46 per barrel of oil during the fourth quarter. The exchange rate averaged $1.2884 from March to December 2015, resulting in a realized loss of approximately $0.9 million over the term of the contract or $0.49 per barrel of oil for the year ended December 31, 2015.

Oil royalties averaged 20.5% of oil revenue during the three month period ended December 31, 2015, compared to 17.3% in the same quarter of 2014. The Company booked a one-time adjustment to oil royalties in the fourth quarter of 2015 which increased the rate for the quarter by 3.3% of oil revenue. Kelt's oil royalty rate decreased to 16.5% on average for the year ended December 31, 2015, compared to 18.2% on average in 2014, due to lower oil prices as well as new oil production which qualifies for various royalty incentives.

NGL OPERATIONS

(CA$/bbl)	Three months ended December 31 2015	2014	%	Year ended December 31 2015	2014	%
NGL revenue	**22.86**	44.98	-49%	**23.12**	59.47	-61%
Realized gain on financial instruments	**-**	2.50	-	**3.13**	0.26	1104%
Average realized price, after financial instruments	**22.86**	47.48	-52%	**26.25**	59.73	-56%
NGL royalties	**(1.02)**	(4.79)	-79%	**(1.85)**	(8.04)	-77%
Revenue, after royalties and financial instruments	**21.84**	42.69	-49%	**24.40**	51.69	-53%

During the quarter and year ended December 31, 2015, the Company realized an average price for NGL sales of $22.86 and $23.12 per barrel, respectively, a decrease of 49% and 61%, compared to the corresponding periods of the previous year. The decrease in the Company's average realized price reflects the sharp decline in market prices for all NGL products. Edmonton benchmark prices for pentane, butane and propane fell by 40%, 46% and 86%, respectively, during the year ended December 31, 2015 compared to average benchmark prices during the year ended December 31, 2014. Kelt's NGL sales volumes were weighted 33% pentane, 30% butane, 31% propane and 6% ethane, on average during 2015, in line with 2014 average NGL sales volumes.

The impact of the unprecedented decline in propane prices was partially mitigated by unwinding the Company's OPIS-Conway propane derivative contract for cash proceeds of US$1.5 million (CA$1.8 million) in January 2015, which added $3.13 per barrel to the Company's average realized NGLs price, after financial instruments.

NGL royalties averaged 4.5% and 8.0%, respectively, during the quarter and year ended December 31, 2015. During the corresponding periods of the previous year, NGL royalties averaged 10.6% and 13.5%. NGL royalties are reduced by gas cost allowance credits allocated to NGLs production, which do not fluctuate with NGL prices.

GAS OPERATIONS

	Three months ended December 31			Year ended December 31		
(CA$/MCF)	**2015**	2014	%	**2015**	2014	%
Gas revenue	**2.40**	3.81	-37%	**2.74**	4.75	-42%
Realized loss on financial instruments	**(0.20)**	-	-	**(0.07)**	-	-
Average realized price, after financial instruments	**2.20**	3.81	-42%	**2.67**	4.75	-44%
Gas royalties	**(0.06)**	(0.18)	-67%	**(0.09)**	(0.34)	-74%
Revenue, after royalties and financial instruments	**2.14**	3.63	-41%	**2.58**	4.41	-41%

The Company realized an average gas sales price of $2.40 per MCF and $2.74 per MCF during the quarter and year ended December 31, 2015, respectively, a decrease of 37% and 42% relative to the Company's realized gas sales price in the corresponding periods of the previous year. By comparison, the AECO 5A gas index price averaged $2.34 per GJ and $2.55 per GJ during the quarter and year ended December 31, 2015, respectively, a decrease of 31% and 40% compared to the average AECO 5A reference price in the corresponding periods of the previous year. Kelt generally receives a premium to the AECO gas index price due to the higher heat content of its gas production, however the Company's realized gas price was negatively impacted by third party pipeline capacity constraints in northeastern BC and west-central Alberta throughout 2015. A portion of Kelt's gas volumes were sold at discounted CREC and Station 2 pricing, most notably during October and November production months, which reduced Kelt's average realized price for gas sales in 2015. In order to strengthen the Company's access to alternative gas markets, Kelt entered into transportation agreements on the Alliance pipeline effective December 1, 2015, realizing Chicago City Gate pricing of US$1.94 per MMBTU on approximately 22,803 MMBTU per day of gas production in December.

Gas royalties averaged 2.5% and 3.3%, respectively, during the quarter and year ended December 31, 2015. During the corresponding periods of the previous year, gas royalties averaged 4.7% and 7.1%. Lower gas royalties reflect the significant decrease in gas prices as well as gas cost allowance credits which do not fluctuate with gas prices.

PRODUCTION EXPENSES

	Three months ended December 31			Year ended December 31		
(CA$ thousands, unless otherwise indicated)	**2015**	2014	%	**2015**	2014	%
Production expense(1)	**17,012**	16,788	1%	**76,914**	55,901	38%
$ per BOE	**9.21**	11.74	-22%	**11.34**	12.00	-6%

(1) The presentation of comparative information for the first nine months of 2015 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 incurred production expenses of $76.9 million during the year ended December 31, 2015, up 38% from $55.9 million during the previous year, in conjunction with 46% growth in daily average production in 2015. As a result of the Company's continued operational initiatives and previous expenditures to construct and acquire strategic infrastructure, Kelt achieved a 22% reduction in per unit production expenses in the fourth quarter of 2015. During the three month period ended December 31, 2015, production expense averaged $9.21 per BOE, compared to $11.74 per BOE during the three month period ended December 31, 2014. The Company has activated water injection facilities in its core operating areas, significantly reducing salt water disposal costs. After experiencing high initial integration costs associated with the Artek Acquisition on April 16, 2015, the Company began to realize the benefit of its efforts in the second half of 2015, which translated to a 6% reduction in per unit production expenses on an annual basis. Per unit production expenses averaged $11.34 per BOE for year ended December 31, 2015, compared to $12.00 per BOE during the previous year ended December 31, 2014.

TRANSPORTATION EXPENSES

	Three months ended December 31			Year ended December 31		
(CA$ thousands, unless otherwise indicated)	**2015**	2014	%	**2015**	2014	%
Transportation expense(1)	**3,756**	3,038	24%	**14,192**	10,719	32%
$ per BOE	**2.03**	2.12	-4%	**2.09**	2.30	-9%

(1) The presentation of comparative information for the first nine months of 2015 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 incurred total transportation expenses of $14.2 million during the year ended December 31, 2015, up 32% from $10.7 million during the previous year ended December 31, 2014. By comparison, Kelt's production grew by 46%, resulting in a 9% reduction in per unit transportation expenses, which averaged $2.09 per BOE in 2015. The decrease in per unit expenses is primarily attributed to the Company's infrastructure expenditures, which have reduced Kelt's reliance on trucking. Throughout 2014 and during the first half of 2015, Kelt incurred higher oil trucking costs due to long wait times. For the three month period ended December 31, 2015, transportation expenses averaged $2.03 per BOE, relatively in line with the fourth quarter of 2014, as lower oil trucking costs were partly offset by higher gas transportation expenses. The Company's firm commitments for gas transportation on the Alliance pipeline came into effect December 1, 2015 which is expected to result in higher transportation expenses on these volumes, however, Kelt receives Chicago City Gate pricing, providing a premium to the gas price previously realized at CREC and Station 2 pricing.

FINANCING EXPENSES

	Three months ended December 31			Year ended December 31		
(CA$ thousands, unless otherwise indicated)	**2015**	2014	%	**2015**	2014	%
Interest and fees on bank debt	**1,957**	426	359%	**6,584**	820	703%
Accretion of decommissioning obligations	**783**	469	67%	**2,816**	1,701	66%
Financing expense	**2,740**	895	206%	**9,400**	2,521	273%
Average bank debt outstanding	**163,295**	11,635	1303%	**151,781**	2,933	5075%
Average interest rate on indebtedness	**3.9%**	4.0%	-3%	**3.6%**	4.0%	-10%
Interest and fees on bank debt ($/BOE)	**1.06**	0.30	253%	**0.97**	0.18	439%

The Company has a $300.0 million revolving committed term credit facility (the "Credit Facility") with a syndicate of financial institutions. As at December 31, 2015, the authorized borrowing amount available under the Credit Facility was $275.0 million. Financing expenses increased in 2015 due to higher average debt levels, partly attributed to the assumption of corporate indebtedness on the acquisitions of Artek and Capio, compounded by rapidly falling commodity prices. During the quarter and year ended December 31, 2015, amounts drawn under the Credit Facility were primarily in the form of bankers' acceptances ("BAs"). Kelt's average interest rate increased to 3.9% during the fourth quarter of 2015, up from 3.5% on average for the first nine months 2015, as higher stamping fees on BAs more than offset the decrease in market interest rates. Under the Credit Facility, BA stamping fees fluctuate based on a pricing grid and range from 2.0% to 3.5%, depending upon the Company's debt to cash flow ratio of between less than one and one tenth times to greater than three times. Fees on bank debt include commitment fees and standby charges on the undrawn facility.

Accretion expense is a measure of the increase in the present value of the decommissioning obligation due to the passage of time. The increase in accretion expense is due to a significant increase in the carrying value of decommissioning obligations resulting from acquisitions and drilling activity.

GENERAL AND ADMINISTRATIVE ("G&A") EXPENSES

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

	Three months ended December 31			Year ended December 31		
(CA$ thousands, unless otherwise indicated)	**2015**	2014	%	**2015**	2014	%
Salaries and benefits	**1,342**	1,513	-11%	**5,502**	4,360	26%
Other G&A expenses	**1,299**	901	44%	**3,832**	3,052	26%
Gross G&A expenses	**2,641**	2,414	9%	**9,334**	7,412	26%
Overhead recoveries	**(1,130)**	(1,636)	-31%	**(4,134)**	(3,781)	9%
Total G&A expenses, net of recoveries	**1,511**	778	94%	**5,200**	3,631	43%
Net G&A ($ per BOE)	**0.82**	0.54	52%	**0.77**	0.78	-1%

In conjunction with the Company's significant growth in total assets and production during 2015, Kelt hired several new employees resulting in an increase in salaries, benefits and other overhead costs, including the cost of additional office space to accommodate new staff. In response to the current business environment of low commodity prices, Kelt reduced the amount of employee bonus accrued and expected to be paid for 2015 performance during the fourth quarter, resulting in a reduction of salaries and benefits reported for the three month period ended December 31, 2015.

The Company's G&A expenses are reported net of overhead recoveries. Kelt earned lower capital overhead recoveries during the three month period ended December 31, 2015 primarily due to significantly lower capital expenditures compared to the same period of 2014. Total overhead recoveries increased on a year-to-date basis in 2015 as the Company now operates a higher proportion of its assets compared to 2014. On a per unit basis, net G&A expense averaged $0.77 per BOE for the year ended December 31, 2015, reflecting the significant increase in production combined with management's continued efforts to maintain a low cost structure.

PROVISION FOR POTENTIAL CREDIT LOSSES

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. During the fourth quarter of 2015, the Company recognized a provision for potential credit losses of $0.5 million. The total provision for potential credit losses recognized through profit (loss) for the year ended December 31, 2015, was $0.6 million (2014 – nil).

SHARE BASED COMPENSATION ("SBC")

	Three months ended December 31			Year ended December 31		
(CA$ thousands, unless otherwise indicated)	**2015**	2014	%	**2015**	2014	%
Stock options	**1,142**	1,181	-3%	**4,472**	4,116	9%
Restricted share units ("RSUs")	**944**	1,345	-30%	**3,900**	4,917	-21%
Total SBC expense	**2,086**	2,526	-17%	**8,372**	9,033	-7%
$ per BOE	**1.13**	1.76	-36%	**1.23**	1.94	-37%

Total SBC expense decreased in each of the quarter and year ended December 31, 2015, 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 efforts to provide long term incentives to employees and grow production, while minimizing the dilutive impact to shareholders. As at December 31, 2015, stock options and RSUs outstanding represent 4.7% of total shares outstanding, down from 5.3% of total shares outstanding at December 31, 2014.

DEPLETION, DEPRECIATION AND IMPAIRMENT

	Three months ended December 31			Year ended December 31		
(CA$ thousands, unless otherwise indicated)	**2015**	2014	%	**2015**	2014	%
Depletion of D&P assets	**37,799**	26,148	45%	**140,518**	84,006	67%
Depreciation of corporate assets	**198**	152	30%	**618**	412	50%
Total depletion and depreciation	**37,997**	26,300	44%	**141,136**	84,418	67%
Impairment of PP&E	**64,068**	-	-	**64,068**	-	-
Total depletion, depreciation and impairment	**102,065**	26,300	288%	**205,204**	84,418	143%
Depletion and depreciation ($/BOE)	**20.56**	18.37	12%	**20.82**	18.13	15%
Impairment of PP&E ($/BOE)	**34.67**	-	-	**9.45**	-	-

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 is due to an increase in the carrying value of assets subject to depletion, resulting from capital expenditures and acquisitions. The increase in depletion and depreciation expenses per unit of production reflects the addition of proved reserves at higher than historical capital costs, primarily due to the development and acquisition of oil/liquids weighted assets that receive higher operating netbacks than gas weighted assets.

Due to the significant decline in forecast oil and natural gas prices as at December 31, 2015, there was an indication that the carrying value of the Company's PP&E may not be recoverable. Accordingly, the Company performed an impairment test by calculating the recoverable amount for all CGUs, including allocated goodwill. The Company's D&P assets are grouped into five CGUs, namely: i) the "BC CGU" which is comprised of Kelt LNG's condensate-rich Montney/Doig gas assets located in northeastern BC; ii) the "Greater Grande Prairie CGU" which holds the majority of the Company's Alberta oil and gas assets that are contiguously located in Kelt's core operating areas at Pouce Coupe, Progress, Spirit River and La Glace, in close proximity to the city of Grande Prairie; iii) the "Karr CGU", a light oil exploration and development prospect with associated gas production, located southeast of Grande Prairie in west central Alberta; iv) the "Grande Cache CGU", a steady, mature, low-decline dry gas property; and v) the "Leduc-Woodbend CGU", a minor, non-core oil property that was acquired pursuant to the Artek Acquisition on April 16, 2015. Based on the FVLCD calculation, the carrying value of each of the Company's Alberta CGUs was in excess of the recoverable amount as at December 31, 2015, resulting in an impairment of PP&E of $64.1 million and an impairment of goodwill of $18.2 million. The recoverable amount of the Company's BC CGU significantly exceeded its carrying value at December 31, 2015 and no impairment was recognized for Kelt LNG.

Of the total PP&E impairment loss, approximately $48.5 million is attributable to the Karr CGU. At the time when Kelt's original assets were spun-out from Celtic in February 2013, Kelt's interest in the Karr property was limited to a single producing well and a few sections of undeveloped land. Over the past three years, the Company has more than doubled its land position at Karr and the exploration and development of the property has been a key area of focus for the Company. As Kelt's Montney oil play at Karr is in the early stage of development, the program has been capital intensive, necessitating significant capital expenditures to construct and acquire access to key infrastructure and to delineate acreage. These capital expenditures were incurred over a period in which the industry in Alberta was very competitive (oil prices were in excess of $100 per barrel throughout most of 2013 and 2014), resulting in higher input costs as equipment and service providers were in high demand. At the same time, the reserves assigned by Sproule are relatively more conservative due to the early stage nature of the play. These factors, taken together along with the sudden drop in forecast oil and gas prices, resulted in the impairment of the Karr CGU as at December 31, 2015. The impairment loss recognized does not reflect asset quality, but rather, that in a severely depressed commodity price environment, Kelt's initial investment to develop the Karr area may not be fully recovered if conditions persist. Management continues to be optimistic about its prospects for the Montney oil play at Karr and intends to proceed with further exploration and development as commodity prices improve in the future.

The Company also wrote down its Grande Cache CGU by approximately $8.5 million at December 31, 2015. Compared to Sproule's prior forecast at December 31, 2014, forecast AECO-C gas prices fell by 32% for 2016 and by 17% on average, based on Sproule's revised forecast at December 31, 2015. Despite being a low-risk, low-cost, high quality gas property, the magnitude of the decrease in forecast gas prices had a pervasive impact on the recoverable amount calculated for the Grande Cache CGU.

The carrying value of the Leduc-Woodbend CGU at December 31, 2015, before impairment, approximated the fair value assigned to the property on the acquisition date pursuant to the purchase price allocation for the Artek Acquisition (net of depletion expense for the period). At the time of the Artek Acquisition, the forecast Canadian Light Sweet oil price was $75.76 per barrel for 2016 and $86.04 per barrel on average for the five year period from 2016 to 2020. During the interim period between the acquisition date and December 31, 2015, the forecast Canadian Light Sweet oil price fell by 27% to $55.20 for 2016 and the forecast five year average fell by 11%. Given that proved plus probable reserves of the Leduc-Woodbend CGU are weighted 90% to crude oil, the decrease in forecast oil prices resulted in an impairment loss of $7.1 million.

The carrying value of the Greater Grande Prairie CGU exceeded the recoverable amount at December 31, 2015, resulting in an impairment of $18.2 million in respect of the goodwill allocated to the CGU. Refer to detailed discussion under the heading of *Impairment of Goodwill.* Based on the analysis, the Company concluded the deficiency calculated is attributable to goodwill only and that the carrying value of PP&E in the Greater Grande Prairie CGU is not impaired at December 31, 2015.

Recoverable amounts for the Company's CGUs were estimated based on FVLCD methodology, calculated using the present value of the CGUs' expected future cash flows (after-tax). The cash flow information was derived from a report on the Company's oil and gas reserves (the "2015 Sproule Report") which was prepared by an independent qualified reserve evaluator, Sproule Associates Limited ("Sproule") as of December 31, 2015. The projected cash flows used in the FVLCD calculation reflect current market assessments of key assumptions, including long-term forecasts of commodity prices, inflation rates, and foreign exchange rates (Level 3 fair value inputs). Cash flow forecasts are also based on past experience, historical trends and Sproule's evaluation of the Company's reserves and resources to determine production profiles and volumes, operating costs, maintenance and future development capital expenditures. Future cash flow estimates are discounted using after-tax risk-adjusted discount rates. The after-tax discount rates applied in the impairment calculation as at December 31, 2015 ranged from 9% to 10%, depending on the risks specific to the assets in the CGU. Forecast future prices used in the impairment evaluation as at December 31, 2015, reflect the following benchmark prices, adjusted for basis differentials to determine local reference prices, transportation costs and tariffs, heat content and quality.

As at December 31, 2015	2016	2017	2018	2019	2020(1)
WTI Cushing Oklahoma (US$/bbl)	45.00	60.00	70.00	80.00	81.20
Canadian Light Sweet 40 API ($/bbl)	55.20	69.00	78.43	89.41	91.71
NYMEX Henry Hub (US$/mmbtu)	2.25	3.00	3.50	4.00	4.25
AECO-C Spot ($/mmbtu)	2.13	2.80	3.24	3.71	3.98
Exchange rate (CA$/US$)	1.3333	1.2500	1.2048	1.1765	1.1765

(1) Prices escalate at 1.5% thereafter

The recoverable amount is highly sensitive to the discount rate and forecast future commodity prices. Holding all other variables constant:

- if the discount rate applied to each CGU increased by 1%, the impairment of PP&E would increase by approximately $44.4 million;
- if the discount rate applied to each CGU decreased by 1%, the impairment of PP&E would decrease by approximately $15.1 million and goodwill of $18.2 million would not be impaired;
- if the forecast combined average realized price decreased by 5%, the impairment of PP&E would increase by approximately $74.1 million; and
- if the forecast combined average realized price increased by 5%, the impairment of PP&E would decrease by approximately $21.6 million and goodwill of $18.2 million would not be impaired as at December 31, 2015.

EXPLORATION AND EVALUATION ("E&E") EXPENSES

	Three months ended December 31			Year ended December 31		
(CA$ thousands, unless otherwise indicated)	**2015**	2014	%	**2015**	2014	%
Expired mineral leases	**434**	129	236%	**3,117**	377	727%
Impairment of E&E assets	**7,357**	-	-	**7,357**	-	-
Total E&E expenses	**7,791**	129	5940%	**10,474**	377	2678%
$ per BOE	**4.22**	0.09	4589%	**1.54**	0.08	1825%

The Company expensed $3.1 million of costs related to the expiry of non-core land holdings during the year ended December 31, 2015. Lease expiries increased compared to the previous year as the Company focused on the development of its core areas.

During the fourth quarter of 2015, the Company concluded that approximately $7.4 million of exploratory drilling costs were impaired. The capital expenditures were added to E&E assets in prior years, however proved reserves were not assigned and the Company was still evaluating the commercial viability of the projects. Although the wells are not "dry", additional capital would be required to equip and tie-in the wells in order to make production economic. Based on forecast commodity prices and the Company's prudent allocation of FDCs, Kelt does not expect to establish proved or probable reserves for these locations in the foreseeable future. As such, the exploratory drilling costs were charged to E&E expense.

IMPAIRMENT OF GOODWILL

As at December 31, 2015, the Company recognized an impairment of goodwill in the amount of $18.2 million. The impairment loss was recognized pursuant to a calculation of the recoverable amount of the Greater Grande Prairie CGU, which was determined to be less than the CGU's total carrying value including allocated goodwill as at December 31, 2015. The impairment calculation involves a number of significant assumptions (Level 3 fair value inputs), including an after-tax discount rate of 10%. Details of the foregoing are more particularly described under the heading of *Depletion, Depreciation and Impairment*.

The goodwill was initially recognized on the acquisition of Capio which closed on July 2, 2014. The Capio assets are located at Valhalla/La Glace, a light oil property adjacent to Kelt's core assets at Pouce Coupe/Spirit River in west central Alberta, thereby forming part of Kelt's Greater Grande Prairie CGU. The impairment of goodwill as at December 31, 2015 is attributed to the decrease in oil prices as the fair value of the net assets acquired was initially recognized on the acquisition date, at a time the WTI oil price was in excess of US$100 per barrel. In addition, the increase in Kelt's share price between the announcement and closing date of the acquisition contributed to $8.2 million of the total $18.2 million of goodwill recognized on the acquisition. The Company negotiated the number of common shares to be issued as partial consideration for the acquisition based on a total value of $58.0 million divided by the five day VWAP of Kelt common shares that traded on the TSX from June 9th to 13th, 2014, of $13.58 per common share, resulting in the issuance of 4,270,956 common shares. Under IFRS, the value of common share consideration must be recognized based on acquisition date fair value. Accordingly, the common share consideration was valued at $66.2 million based on the closing price of Kelt common shares on July 2, 2014 of $15.51 per common share.

The recoverable amount is highly sensitive to the discount rate and forecast future commodity price assumptions applied in the impairment calculation. Holding all other variables constant, if the discount rate applied decreased by 1%, or if the forecast combined average realized price increased by 5%, the recoverable amount of the Greater Grande Prairie CGU would have exceeded its carrying amount and the Company would not have recognized an impairment of goodwill as at December 31, 2015.

OTHER INCOME AND EXPENSES

Other income

During periods in which the Company has a cash surplus, cash on hand may be invested in short term guaranteed investment certificates or held on deposit in order to earn interest income. Kelt earned interest income of $0.9 million during the year ended December 31, 2014 (2015 – nil).

Transaction costs

The Company expensed $2.4 million of transaction costs during the year ended December 31, 2015. The transaction costs relate primarily to the acquisition of Artek (the “Acquiree”) which closed on April 16, 2015. Of the total $2.4 million expensed by Kelt (the “Acquirer”), approximately $2.0 million of expenses were physically incurred and paid by Artek prior to completion of the arrangement. In accordance with IFRS 3, transaction costs incurred by an Acquiree that are directly required as a result of the arrangement with the Acquirer, must be recognized as an expense by the Acquirer, regardless of which entity physically incurs the expenses. As such, transaction costs incurred and paid by Artek prior to April 16, 2015, including the fairness opinion, severance for key management under contract, and other legal, audit and advisory fees have been presented as an expense in Kelt’s consolidated financial statements as at and for the year ended December 31, 2015. During the previous year ended December 31, 2014, Kelt incurred $0.2 million of transaction costs pursuant to the acquisition of Capio.

Premium on flow-through shares

During the first quarter of 2015, the Company issued 3,881,400 flow-through shares at a price of $8.60 per flow-through share providing gross proceeds of $33.4 million. The implied premium on the flow-through shares was determined to be $2.9 million or $0.74 per flow-through share. As of December 31, 2015, the Company had incurred the full commitment of qualifying expenditures and renounced $33.4 million of Canadian development expenses to the subscribers of the flow-through shares. The deferred premium was drawn down in proportion to the qualifying expenditures incurred in each period resulting in $0.5 million and $2.4 million being recognized as income during the quarter and year ended December 31, 2015, respectively.

On December 18, 2014, the Company issued 182,000 flow-through shares at a price of $11.00 per flow-through share. The implied premium on the flow-through shares was determined to be $0.7 million or $3.80 per flow-through share. The Company incurred the full commitment of $2.0 million qualifying Canadian exploration expenses during the first quarter of 2015 and the premium of $0.7 million was recognized as income in the first quarter.

Gains and losses on derivative financial instruments

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

	Three months ended December 31			Year ended December 31		
(CA$ thousands, unless otherwise indicated)	**2015**	2014	%	**2015**	2014	%
Realized gain (loss)	**(2,155)**	2,808	-177%	**(886)**	(388)	128%
Unrealized gain (loss)	**1,460**	1,655	-12%	**(1,975)**	2,277	-187%
Gain (loss) on derivative financial instruments	**(695)**	4,463	-116%	**(2,861)**	1,889	-251%
$ per BOE	**(0.38)**	3.12	-112%	**(0.42)**	0.41	-202%

The Company entered into a risk management contract to fix the Canadian/US dollar exchange rate at $1.2580 on a notional US$3.0 million per month from March to December 2015. The exchange rate averaged $1.2884 over the term of the contract, resulting in a realized loss of approximately $0.9 million for the year ended December 31, 2015. In addition, the Company has an interest rate swap fixing the Canadian Dollar Offered Rate (“CDOR”) at 0.925% on a notional $100.0 million per month from July 2015 to June 2017. The CDOR rate averaged 0.819% during the second half of 2015, resulting in a nominal realized loss of $0.05 million. Kelt also contracted to fix the NYMEX-AECO basis differential at US$0.625/mmbtu on 30,000 mmbtu/d of natural gas from August to December of 2015. The NYMEX-AECO basis differential averaged US$0.338/mmbtu from August to December, resulting in a realized loss of $1.8 million.

Kelt realized a net loss of $0.9 million on its risk management contracts during the year ended December 31, 2015, the aggregate realized loss on the aforementioned contracts was partially offset by cash proceeds of US$1.5 million (CA$1.8 million) earned from unwinding a financial derivative contract in January 2015. The contract fixed the price of OPIS-Conway propane at US$40.95 per barrel on 250 barrels per day from March to December 2015.

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

INCOME TAXES

	Three months ended December 31			Year ended December 31		
(CA$ thousands, unless otherwise indicated)	**2015**	2014	%	**2015**	2014	%
Deferred income tax expense (recovery)	**(25,397)**	639	-	**(32,847)**	15,834	-
Profit (loss) before taxes	**(119,506)**	1,895	-	**(173,022)**	26,462	-
Effective tax rate	**21%**	34%	-38%	**19%**	60%	-68%

The Company recognized a deferred tax recovery of $25.4 million and $32.8 million, respectively, during the quarter and year ended December 31, 2015. A detailed analysis of the provision for deferred income taxes is included in note 12 of the consolidated annual financial statements. The analysis includes a reconciliation of the difference between the amount of deferred income tax expense (recovery) reported relative to expected expense (recovery) calculated based on the statutory tax rate. The consolidated combined federal and provincial statutory tax rate averaged 26.0% during the year ended December 31, 2015, up from 25.1% during the previous year ended December 31, 2014.

Effective July 1, 2015, the Alberta government increased the general corporate tax rate from 10% to 12%, resulting in an average tax rate of 11% for Alberta for the year ended December 31, 2015. The increase in Alberta's corporate tax rate resulted in an increase in Kelt's deferred tax liability and a reduction of the deferred tax recovery by approximately $3.0 million during the year ended December 31, 2015. The impact of the increase in the Alberta corporate tax rate is partially offset by a deferred tax recovery of $0.8 million representing the consolidated net tax benefit of the intercompany transfer of assets from Kelt to Kelt LNG, as Kelt's prior working interest in the BC assets is now subject to a lower tax rate in Kelt LNG.

Deferred income tax recoveries in the amounts of $1.3 million and $3.1 million were charged directly to equity in respect of share issue costs incurred in 2015 and 2014, respectively.

Kelt was not required to pay income taxes in the current or prior year as the Company had sufficient income tax deductions available to shelter taxable income. The Company's consolidated tax pools are estimated to be approximately $957.9 million as of December 31, 2015, up 60% from $599.8 million at December 31, 2014.

(CA$ thousands, unless otherwise indicated)	Rate	**2015**	2014	change
Canadian oil and gas property expenses (COGPE)	10%	**260,383**	250,377	4%
Canadian development expenses (CDE)	30%	**187,919**	106,719	76%
Canadian exploration expenses (CEE)	100%	**88,826**	45,043	97%
Undepreciated capital cost(1) (UCC)	25%	**193,420**	135,929	42%
Share and debt issue costs (SIC/DIC)	5 years	**16,677**	13,353	25%
Non-capital losses(2) (NCL)	100%	**210,628**	48,353	336%
Estimated tax deductions available, end of year		**957,853**	599,774	60%

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

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

PROFIT (LOSS) AND COMPREHENSIVE INCOME (LOSS)

	Three months ended December 31			Year ended December 31		
(CA$ thousands, unless otherwise indicated)	**2015**	2014	%	**2015**	2014	%
Profit (loss) and comprehensive income (loss)	**(94,109)**	1,256	-	**(140,175)**	10,628	-
Weighted avg. shares outstanding, basic (000's)	**168,610**	126,760	33%	**154,829**	121,779	27%
Weighted avg. shares outstanding, diluted (000's)	**168,610**	128,512	31%	**154,829**	124,296	25%
$ per common share, basic	**(0.56)**	0.01	-	**(0.91)**	0.09	-
$ per common share, diluted	**(0.56)**	0.01	-	**(0.91)**	0.09	-
$ per BOE	**(50.93)**	0.88	-	**(20.67)**	2.28	-

(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 both the quarter and year ended December 31, 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.

Kelt reported a loss of $94.1 million and $140.2 million for the fourth quarter and year ended December 31, 2015, respectively. By comparison, Kelt reported a profit of $1.3 million and $10.6 million in the corresponding periods of 2014. Kelt experienced significant growth over the past year, reporting an increase in total assets by 41% to $1.3 billion at December 31, 2015 compared to $908.7 million at December 31, 2014. Average daily production increased by 29% in the fourth quarter of 2015 compared to the same quarter of 2014 and by 46% year over year. In spite of achieving corporate record production levels, the Company's total revenue, net of royalties, decreased by 21% for the three month period and by 14% for the year ended December 31, 2015, compared to the same periods last year, due to the industry-wide decline in commodity prices. The Company's growth resulted in higher total expenses, although Kelt is starting to realize a reduction in most expenses of a recurring nature on a per unit basis. Non-cash depletion and depreciation expense of $141.1 million for the year ended December 31, 2015, was a significant driver of the loss reported by Kelt, as the expense increased by $56.7 million compared to the previous year ended December 31, 2014 due to higher assets and production. The significant decrease in forecast commodity prices also triggered an impairment of PP&E of $64.1 million and an impairment of goodwill of $18.2 million, compounding the loss reported for the fourth quarter and year ended December 31, 2015. The loss reported for the year ended December 31, 2015 is reduced by a bargain purchase gain of $16.8 million on the acquisition of Artek which closed on April 16, 2015.

FUNDS FROM OPERATIONS

	Three months ended December 31			Year ended December 31		
(CA$ thousands, unless otherwise indicated)	**2015**	2014	%	**2015**	2014	%
Funds from operations(1)	**11,172**	29,668	-62%	**56,517**	115,737	-51%
Weighted avg. shares outstanding, basic (000's)	**168,610**	126,760	33%	**154,829**	121,779	27%
Weighted avg. shares outstanding, diluted (000's)	**169,352**	128,512	32%	**155,936**	124,296	25%
$ per common share, basic(2)	**0.07**	0.23	-70%	**0.37**	0.95	-61%
$ per common share, diluted(2)	**0.07**	0.23	-70%	**0.36**	0.93	-61%
$ per BOE	**6.05**	20.73	-71%	**8.34**	24.86	-66%

(1) 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.

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

The Company generated funds from operations in the amount of $11.2 million ($0.07 per common share, diluted) during the fourth quarter of 2015, down from $29.7 million ($0.23 per common share, diluted) in the same quarter of 2014. During the year ended December 31, 2015, the Company generated $56.5 million ($0.36 per common share, diluted) of funds from operations, representing a decrease of 51% from $115.7 million ($0.93 per common share, diluted) in year ended December 31, 2014. The decrease in funds from operations reflects the impact of the significant decline in commodity prices in 2015. The impact of lower total revenue on operating cash flow was compounded by higher total expenses required to support the 46% increase in production volumes over the same period. Funds from operations for the fourth quarter of 2015 benefited from the Company's continued operational initiatives and previous expenditures on infrastructure, resulting in a significant reduction in per unit production and transportation expenses.

INVESTING ACTIVITIES

CAPITAL EXPENDITURES

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

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

	Three months ended December 31			Year ended December 31		
(CA$ thousands, unless otherwise indicated)	**2015**	2014	%	**2015**	2014	%
Capital expenditures:						
Lease acquisition and retention	**1,317**	2,990	-56%	**8,618**	15,086	-43%
Geological and geophysical	**16**	358	-96%	**1,093**	1,434	-24%
Drilling and completion of wells	**30,340**	61,514	-51%	**100,868**	188,615	-47%
Facilities, pipeline and well equipment	**9,557**	21,374	-55%	**55,216**	45,476	21%
Corporate assets	**247**	98	152%	**810**	636	27%
Capital expenditures, before A&D	**41,477**	86,334	-52%	**166,605**	251,247	-34%
Property acquisitions	**1,602**	13,132		**16,350**	24,714	
Property dispositions	**-**	-		**-**	(19,635)	
Corporate acquisition(1)	**(592)**	-		**313,453**	167,574	
Capital expenditures, net	**42,487**	99,466	-57%	**496,408**	423,900	17%

(1) The total cost of the Artek acquisition, as reported above, includes $217.9 million of common share consideration valued based on the negotiated price of $8.10 per common share of Kelt, and the $100.3 million working capital deficit assumed, net of $4.8 million of intercompany balances extinguished upon completion of the arrangement.

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% 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.

Key attributes of the assets acquired:

- Average production of Artek's Inga-Fireweed-Stoddart assets at the time of the acquisition was approximately 4,800 BOE/d (48% oil/ NGLs, and 52% gas) primarily from the Montney and Doig formations;
- Artek's petroleum and natural gas reserves were evaluated independently by Sproule effective December 31, 2014. Total proved reserves were 24.0 million BOE, with $184.0 million in associated future development capital and total proved plus probable reserves were 46.4 million BOE, with $291.0 million in associated future development capital; and
- The acquisition adds to Kelt's core land holdings in BC, adding 259,524 gross acres (405 sections) and 220,848 net acres (345 sections) of land, 202,967 net acres (317 net sections) were undeveloped.

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 are 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	(4,760)
Net consideration	**237,881**
Net working capital, including bank debt	(100,321)
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	**254,655**
Gain on acquisition(2)	**16,774**

(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) The Company reviewed the fair values of identifiable assets and liabilities acquired and the resultant gain on acquisition. Revisions to estimates over the measurement period resulted in a net decrease in gain on acquisition by $1.7 million, compared to the gain on acquisition initially estimated and previously reported in Kelt's consolidated interim financial statements as at June 30, 2015.

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.

The net working capital deficit includes $7.0 million of accounts receivable and accrued revenue, $0.4 million of deposits, $11.9 million of accounts payable and accrued liabilities 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.

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 $16.8 million.

The Statement of Profit (Loss) and Comprehensive Income (Loss) includes the results of operations for the period following closing of the Artek Acquisition on April 16, 2015. Specifically, Kelt's profit (loss) for year ended December 31, 2015 includes approximately $24.7 million of revenue and $7.8 million of operating income generated from the acquired interest in the properties subsequent to closing. If the acquisition had occurred on January 1, 2015, pro-forma revenue and operating income is estimated to be approximately $38.2 million and $9.3 million, respectively, for the year ended December 31, 2015. Operating income is defined as revenue, net of royalties, less production and transportation expenses. This pro-forma information is not necessarily indicative of the results of operations that would have resulted had the acquisition been effected on the dates indicated, or the results that may be obtained in the future.

Karr property acquisition

On April 1, 2015, Kelt completed a strategic property acquisition in its core area at Karr, whereby the Company acquired a 3.3% ownership interest in the Karr Gas Plant and approximately 110 BOE per day of production for cash consideration of $10.0 million, before closing adjustments. Securing ownership priority in this gas plant is instrumental in maintaining cash flow stability in the area. In addition, Pembina Pipeline Corp. is expected to have their Karr oil pipeline lateral constructed and in service in the second quarter of 2016 which will transport crude oil from the Karr area. The Company expects a reduction in trucking costs at Karr as a result.

Spirit River property acquisition

On February 9, 2015, Kelt acquired an additional 14.4% interest in the Spirit River Charlie Lake E&M Unit (along with some non-unit working interests in the Spirit River area) for cash consideration of $4.7 million, before closing adjustments. The acquisition increased the Company's existing working interest in the unit from 81.7% to 96.1%. On November 30, 2015, Kelt consolidated its interest to 100% by acquiring the remaining 3.9% unit interest for cash consideration of $1.3 million, before closing adjustments.

LAND HOLDINGS

As at December 31, 2015, the Company owned 521,413 net acres of undeveloped land. Based on an internal evaluation of the fair market value of the Company's land holdings at December 31, 2015, Kelt estimates the fair market value of its undeveloped land at $168.7 million. This implies an average fair value of $323 per acre.

Kelt continued to expand its prospect inventory in its core areas. In 2015, the Company expended approximately $6.9 million at Crown land sales acquiring 40,560 net acres (63.4 net sections) of petroleum and natural gas rights at an average bonus cost of $169 per acre, down 19% compared to an average bonus cost of $208 per acre during the year ended December 31, 2014.

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

The following table summarizes the Company's land holdings:

LAND HOLDINGS	**As at December 31, 2015**		As at December 31, 2014		Percentage Change	
(Acres)	**Gross**	**Net**	Gross	Net	Gross	Net
Developed	**389,916**	**208,895**	299,818	142,445	30%	47%
Undeveloped	**649,297**	**521,413**	494,361	318,743	31%	64%
Total	**1,039,213**	**730,308**	794,179	461,188	31%	58%
Average working interest		**70%**		58%		

DRILLING

During the year ended December 31, 2015, the Company drilled 19 (15.5 net) wells, with an overall success rate of 100% on net wells drilled. The Company's average working interest in wells drilled during 2015 was 82% (2014 – 75%). In 2015, Kelt's active horizontal drilling program resulted in an average measured depth of net wells drilled of 4,158 metres (2014 – 3,871 meters). The Company drilled a total of 66,938 net metres during the year ended December 31, 2015 (2014 – 104,955 net metres).

DRILLING ACTIVITY	**Three months ended December 31, 2015**		**Year ended December 31, 2015**	
	Gross	**Net**	**Gross**	**Net**
Oil	**4**	**4.0**	**9**	**8.1**
Gas	**4**	**2.0**	**9**	**6.4**
Service	**-**	**-**	**1**	**1.0**
Dry	**-**	**-**	**-**	**-**
Total wells	**8**	**6.0**	**19**	**15.5**
Success rate		**100%**		**100%**

The following table summarizes the Company's drilling activity during the previous year ended December 31, 2014:

DRILLING ACTIVITY	Three months ended December 31, 2014		Year ended December 31, 2014	
	Gross	Net	Gross	Net
Oil	5	3.1	20	16.2
Gas	4	2.3	15	9.9
Service	-	-	1	1.0
Dry	-	-	-	-
Total wells	9	5.4	36	27.1
Success rate		100%		100%

RESERVES

Kelt retained Sproule Associates Limited ("Sproule"), an independent qualified reserve evaluator to prepare a report on 100% of its oil and gas reserves (the "2015 Sproule Report"). The Company has a Reserves Committee which oversees the selection, qualifications and reporting procedures of the independent engineering consultants. Reserves as at December 31, 2015 were determined using the guidelines and definitions set out under National Instrument 51-101 ("NI 51-101").

At December 31, 2015, Kelt's proved plus probable reserves were 150.5 million BOE. The Company's net present value of proved plus probable reserves at December 31, 2015, discounted at 10% before tax, was $1.2 billion, relatively unchanged from $1.1 billion at December 31, 2014, despite significant reductions in commodity prices year-over-year. Sproule's forecasted commodity prices for 2016 used to determine the present value of the Company's reserves at December 31, 2015, were US$45.00 per barrel for WTI oil and CA$2.13 per GJ for AECO-C gas.

Proved developed producing reserves at December 31, 2015 were 33.8 million BOE, an increase of 26% from 26.8 million BOE at December 31, 2014. Total proved reserves at December 31, 2015 were 83.8 million BOE, up 37% from 61.1 million BOE at December 31, 2014. Proved plus probable reserves at December 31, 2015 were 150.5 million BOE, an increase of 52% from 99.1 million BOE at December 31, 2014.

At December 31, 2015, the weighting of proved plus probable reserves was 22% oil, 14% NGLs and 64% gas. At December 31, 2014, the weighting of proved plus probable reserves was 24% oil, 11% NGLs and 65% gas.

The following table outlines a summary of the Company's reserves at December 31, 2015:

SUMMARY OF RESERVE VOLUMES	Oil (mbbls)	NGLs (mbbls)	Gas (mmcf)	Combined (mBOE)	FDC Costs[1] ($ thousands)
Proved developed producing	7,299	4,105	134,591	33,836	100
Proved developed non-producing	580	302	7,621	2,152	2,100
Proved undeveloped	10,198	6,780	185,211	47,847	529,100
Total Proved	**18,077**	**11,187**	**327,423**	**83,835**	**531,200**
Probable additional	15,290	9,823	249,356	66,672	336,900
Total Proved plus Probable	**33,367**	**21,010**	**576,779**	**150,507**	**868,200**

(1) The sum of FDC costs by category does not add up to the 1P and 2P total due to minor rounding differences.

Future development capital ("FDC") expenditures of $531 million are included in the reserve evaluation for total proved reserves and are expected to be spent as follows: $40 million in 2016, $125 million in 2017, $106 million in 2018, $113 million in 2019, and $147 million thereafter. FDC expenditures of $868 million are included for proved plus probable reserves and are expected to be spent as follows: $63 million in 2016, $183 million in 2017, $169 million in 2018, $168 million in 2019 and $285 million thereafter.

The following table outlines FDC expenditures included in the December 31, 2015 reserve evaluation, for proved ("1P") and proved plus probable ("2P") reserves:

FDC EXPENDITURES	1P FDC ($ *thousands*)	1P Gross/ (Net) Wells	2P FDC ($ *thousands*)	2P Gross/ (Net) Wells
Alberta	231,800	41 / 36.3	359,700	62 / 55.1
British Columbia	299,400	43 / 41.7	508,500	76 / 73.4
Total FDC Expenditures	**531,200**	**84 / 78.0**	**868,200**	**138 / 128.5**

The following table reconciles the change in total proved reserves during the year:

RESERVES RECONCILIATION TOTAL PROVED	Oil (mbbls)	NGLs (mbbls)	Gas (mmcf)	Combined (mBOE)
Balance, December 31, 2014	14,939	6,309	239,105	61,099
Extensions	811	363	6,465	2,252
Infill drilling	449	318	5,313	1,652
Technical revisions	(331)	2,099	27,415	6,337
Economic factors	(431)	(201)	(7,364)	(1,859)
Acquisitions	4,498	2,885	82,343	21,107
Net additions	**4,996**	**5,464**	**114,172**	**29,489**
2015 Production(1)	(1,858)	(586)	(25,854)	(6,753)
Balance, December 31, 2015(1)	**18,077**	**11,187**	**327,423**	**83,835**

(1) Sulphur production of 27 MBOE and sulphur reserves of 365 MBOE have been excluded in the above table.

The following table reconciles the change in total proved plus probable reserves during the year:

RESERVES RECONCILIATION TOTAL PROVED PLUS PROBABLE	Oil (mbbls)	NGLs (mbbls)	Gas (mmcf)	Combined (mBOE)
Balance, December 31, 2014	23,474	10,800	389,014	99,110
Extensions	4,013	1,583	29,228	10,467
Infill drilling	323	273	4,690	1,378
Technical revisions	(533)	3,580	17,221	5,917
Economic factors	(454)	(282)	(8,453)	(2,145)
Acquisitions	8,402	5,642	170,933	42,533
Net additions	**11,751**	**10,796**	**213,619**	**58,150**
2015 Production(1)	(1,858)	(586)	(25,854)	(6,753)
Balance, December 31, 2015(2)	**33,367**	**21,010**	**576,779**	**150,507**

(1) Sulphur production of 27 MBOE and sulphur reserves of 365 MBOE have been excluded in the above table.

The WTI oil price during the years 2013 to 2015 averaged US$79.93 per barrel. After a precipitous decline since December 2014, Sproule is forecasting an average WTI oil price of US$45.00 per barrel in 2016. Natural gas prices during the 2013 to 2015 period at AECO-C averaged $3.27 per GJ. Sproule is forecasting an average AECO-C gas price of $2.13 per GJ in 2016.

In the 2015 Sproule Report, Sproule is forecasting WTI oil prices to average US$67.24 per barrel over the next five years from 2016 to 2020, 20% lower than the average price of US$83.81 per barrel used in the December 31, 2014 evaluation, over the same five year period. For natural gas, AECO-C natural gas prices are forecasted to average $3.17 per GJ over the 2016 to 2020 period, a decrease of 18% from the average price of $3.88 per GJ used in the December 31, 2014 evaluation, over the same five year period.

The following table outlines forecasted future prices that Sproule has used in their evaluation of the Company's reserves at December 31, 2015:

FUTURE COMMODITY PRICE FORECAST	WTI Cushing Oklahoma US$/bbl	Canadian Light Sweet CA$/bbl	NYMEX Henry Hub US$/mmbtu	AECO-C Spot CA$/GJ	USD/CAD Exchange US$/CA$
2016	45.00	55.20	2.25	2.13	0.75
2017	60.00	69.00	3.00	2.80	0.80
2018	70.00	78.43	3.50	3.24	0.83
2019	80.00	89.41	4.00	3.71	0.85
2020	81.20	91.71	4.25	3.98	0.85
Five year average	**67.24**	**76.75**	**3.40**	**3.17**	**0.82**

The Company's net present value of proved plus probable reserves, discounted at 10% before tax, was $1.2 billion as at December 31, 2015, up 11% from $1.1 billion as of December 31, 2014. The undiscounted future net cash flow, before tax, was $2.7 billion as of December 31, 2015, an increase of 17% from $2.3 billion as of December 31, 2014. The following table summarizes the net present value of the Company's reserves (before tax) as at December 31, 2015:

NET PRESENT VALUE (BEFORE TAX)

(CA$ millions)	Undiscounted	NPV 5% BT	NPV 8% BT	NPV 10% BT
Proved developed producing	526.9	432.3	388.5	363.6
Proved developed non-producing	33.2	27.0	24.1	22.5
Proved undeveloped	670.5	421.3	324.7	274.5
Total Proved	**1,230.6**	**880.6**	**737.3**	**660.6**
Probable additional	1,428.3	817.5	620.0	524.6
Total Proved plus Probable	**2,658.9**	**1,698.1**	**1,357.3**	**1,185.2**

The Company's net present value of proved plus probable reserves, discounted at 10% after tax, was $1.0 billion as of December 31, 2015, up 14% from $885.4 million as of December 31, 2014. The undiscounted future net cash flow, after tax, was $2.2 billion as of December 31, 2015, an increase of 19% from $1.8 billion as of December 31, 2014. The following table summarizes the net present value of the Company's reserves (after tax) as at December 31, 2015:

NET PRESENT VALUE (AFTER TAX)

(CA$ millions)	Undiscounted	NPV 5% AT	NPV 8% AT	NPV 10% AT
Proved developed producing	526.9	432.3	388.5	363.6
Proved developed non-producing	33.2	27.0	24.1	22.5
Proved undeveloped	589.7	373.9	289.3	245.2
Total Proved	**1,149.8**	**833.2**	**701.9**	**631.3**
Probable additional	1,054.6	599.1	452.6	382.0
Total Proved plus Probable	**2,204.4**	**1,432.3**	**1,154.5**	**1,013.3**

During 2015, the Company's capital expenditures, net of dispositions, resulted in proved plus probable reserve additions of 58.2 million BOE, resulting in 2P FD&A costs of $14.78 per BOE, including FDC costs. Proved reserve additions in 2015 were 29.5 million BOE, resulting in 1P FD&A costs of $21.87 per BOE, including FDC costs. The Company considers this to be a good result considering the significant amount of undeveloped land that was acquired on the Company's Montney plays, in addition to the large infrastructure build conducted in 2015.

The recycle ratio is a measure for evaluating the effectiveness of a company's re-investment program. The ratio measures the efficiency of capital investment. It accomplishes this by comparing the operating netback per BOE to the same period's reserve FD&A cost per BOE. Since inception, Kelt has successfully added high quality reserves at an all-in 2P FD&A cost of $13.83 per BOE. Since inception, corporate operating netbacks have averaged $16.47 per BOE, giving the Company an inception to date recycle ratio of 1.2 times. With the purchase and construction of facilities and infrastructure in 2015, along with land and asset acquisitions during the year, Kelt has positioned itself to achieve high efficiencies in production additions and finding and development costs over the upcoming years.

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

FINDING, DEVELOPMENT & ACQUISITION COSTS	Year ended December 31		Cumulative since
(CA$ thousands, except as otherwise noted)	**2015**	2014	Incorporation
Proved (1P) reserves:			
Capital expenditures	**496,408**	423,900	1,249,451
Value of assets conveyed from Celtic Exploration Ltd.	**-**	-	141,961
Change in FDC costs required to develop 1P reserves	**148,500**	163,200	531,300
Total capital costs	**644,908**	587,100	1,922,712
1P Reserve additions, net (mBOE)	**29,489**	30,495	96,689
FD&A cost, before FDC ($/BOE)	**16.83**	13.90	12.92
1P FD&A cost, including FDC ($/BOE)	**21.87**	19.25	19.89
Operating netback ($/BOE)(1)	**10.09**	25.62	16.47
1P Recycle ratio	**0.5 x**	1.3 x	0.8 x
Proved plus probable (2P) reserves:			
Capital expenditures	**496,408**	423,900	1,249,451
Value of assets conveyed from Celtic Exploration Ltd.	**-**	-	141,961
Change in FDC costs required to develop 2P reserves	**362,900**	174,000	868,200
Total capital costs	**859,308**	597,900	2,259,612
2P Reserve additions, net (mBOE)	**58,150**	44,568	163,361
FD&A cost, before FDC ($/BOE)	**8.54**	9.51	7.65
2P FD&A cost, including FDC ($/BOE)	**14.78**	13.42	13.83
Operating netback ($/BOE)(1)	**10.09**	25.62	16.47
2P Recycle ratio	**0.7 x**	1.9 x	1.2 x

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

Kelt's 2015 capital investment program resulted in net reserve additions that replaced 2015 production by a factor of 4.4 times on a proved basis (2014 – 6.5 times) and 8.6 times on a proved plus probable basis (2014 – 9.6 times).

The tables below summarize production replacement for 2015:

PRODUCTION REPLACEMENT **TOTAL PROVED RESERVES**	Oil (mbbls)	NGLs (mbbls)	Gas (mmcf)	Combined (mBOE)
Reserve additions, including revisions	4,996	5,464	114,172	29,489
2015 Production	1,858	586	25,854	6,753
Production replacement ratio – 1P	**2.7 x**	**9.3 x**	**4.4 x**	**4.4 x**

(1) Sulphur production of 27 MBOE has been excluded in the above table.

PRODUCTION REPLACEMENT **TOTAL PROVED PLUS PROBABLE RESERVES**	Oil (mbbls)	NGLs (mbbls)	Gas (mmcf)	Combined (mBOE)
Reserve additions, including revisions	11,751	10,796	213,619	58,150
2015 Production	1,858	586	25,854	6,753
Production replacement ratio – 2P	**6.3 x**	**18.4 x**	**8.3 x**	**8.6 x**

(1) Sulphur production of 27 MBOE has been excluded in the above table.

NET ASSET VALUE

The Company estimates its net asset value to be $1.1 billion or $6.65 per common share as at December 31, 2015. The components of Kelt's net asset value calculation are set-forth in the table below. The reader is cautioned that these amounts may not be directly comparable to other companies, as the term "net asset value" is a non-GAAP financial measure. The present value of petroleum and natural gas ("P&NG") reserves was determined by Sproule in their year-end evaluation reports, based on a discount rate of 10% before-tax. Undeveloped land at December 31, 2015 was internally valued at an average price of $323 per acre (2014 – $324 per acre). The Company's total decommissioning obligations, as determined in accordance with GAAP and as reported in the consolidated financial statements as of the calculation dates, were revalued using a discount rate of 10% to match the discount rate applied to value P&NG reserves. The present value of decommissioning obligations reported in the table below is the amount incremental to abandonment and reclamation costs assigned for existing locations by Sproule, which are already reflected in the present value of P&NG reserves.

NET ASSET VALUE *(CA$ thousands, except per share amounts)*	**December 31, 2015**	December 31, 2014
Present value of 2P P&NG reserves, discounted at 10% before tax	**1,185,240**	1,072,300
Undeveloped land	**168,674**	103,212
Present value of decommissioning obligations	**(11,702)**	(12,758)
Bank debt, net of working capital	**(212,095)**	(104,430)
Proceeds from exercise of stock options(1)	**-**	13,102
Net asset value	**1,130,117**	1,071,426
Fully diluted common shares outstanding (000's)(1)(2)	**169,872**	130,721
Net asset value ($ per common share)	**6.65**	8.20

(1) The calculation of proceeds from exercise of stock options and the fully diluted number of common shares outstanding only includes stock options that are "in-the-money" based on the closing price of KEL common shares of $4.24 and $7.00 as at December 31, 2015 and 2014, respectively. There were no "in-the-money" stock options at December 31, 2015.

(2) For purposes of the net asset value calculation, the Company does not apply the treasury stock-method prescribed by GAAP. Rather, the fully diluted number of common shares outstanding is determined by adding the total number of outstanding RSUs and "in-the-money" stock options (1) to the number of common shares outstanding at the calculation date.

CAPITAL RESOURCES AND LIQUIDITY

MARKET CAPITALIZATION

The Company's total capitalization was $1.1 billion as of December 31, 2015. The market value of common shares, based on the closing share price on the TSX, represented 64% of the total capitalization.

The following table summarizes the Company's capitalization:

CAPITALIZATION	**As at December 31, 2015**		As at December 31, 2014		
(CA$ thousands, except per share amounts)	**Amount**	**% of total**	Amount	% of total	change
Common shares outstanding (000's)	**168,668**		126,934		33%
Share price (last price traded at in the year)	**$4.24**		$7.00		-39%
Market capitalization	**715,152**	**64%**	888,538	78%	-20%
Bank debt, net of working capital	**212,095**	**19%**	104,430	9%	102%
Decommissioning obligations	**142,308**	**13%**	94,033	8%	51%
Deferred income tax liability	**47,189**	**4%**	49,882	5%	-5%
Total capitalization	**1,116,744**	**100%**	1,136,883	100%	-2%

As at December 31, 2015, the Company had $177.6 million of bank debt outstanding on its $300.0 million Credit Facility. Bank debt, net working capital was $212.1 million at December 31, 2015, representing 3.8 times 2015 funds from operations and 3.9 times forecasted 2016 funds from operations.

KEY DEBT RATIOS	**As at December 31, 2015**		As at December 31, 2014	
(CA$ thousands, except as otherwise indicated)	**Amount**	**Ratio**	Amount	Ratio
Debt to funds from operations ratio:				
Net debt(1)	**212,095**		104,430	
Funds from operations – Q4 trailing(2)	**44,688**		118,672	
Funds from operations – trailing(3)	**56,517**		115,737	
Funds from operations – forecast(4)(5)	**55,000**		88,000	
Debt to funds from operations – Q4 trailing		**4.7 x**		0.9 x
Debt to funds from operations – trailing		**3.8 x**		0.9 x
Debt to funds from operations – forecast		**3.9 x**		1.2 x
Asset coverage ratio:				
Total assets	**1,279,475**		908,709	
Net debt(1)	**212,095**		104,430	
Asset coverage		**6.0 x**		8.7 x
Debt to equity ratio:				
Net debt(1)	**212,095**		104,430	
Shareholders' equity	**847,618**		619,639	
Debt to equity		**0.3 x**		0.2 x

(1) "Net debt" is calculated by adding the working capital deficiency to bank debt.

(2) Q4 trailing funds from operations is calculated by multiplying funds from operations reported for the fourth quarters of 2015 and 2014, respectively, by a factor of 4.

(3) Trailing funds from operations is equal to actual funds from operations reported for the years ended December 31, 2015 and December 31, 2014.

(4) As of March 7, 2016, the date of this MD&A as at and for the period ended December 31, 2015, forecast funds from operations for 2016 is estimated to be $55.0 million. Refer to additional information under the heading of *Outlook and Guidance, as well as* advisories regarding forward looking statements.

(5) As of March 9, 2015, the date of the MD&A as at and for the year ended December 31, 2014, forecast funds from operations for 2015 was estimated to be $88.0 million.

SOURCE OF FUNDS

During the year ended December 31, 2015, the Company generated $63.0 million in cash provided by operating activities. The Company's 2015 capital expenditures were funded by cash provided by operating activities, equity financings, and bank debt.

The Company raised aggregate gross proceeds of $123.4 million by issuing 14.1 million common shares at an average price of $8.78 per common share during the year ended December 31, 2015. In addition, Kelt issued 26.9 million common shares to the shareholders of Artek as consideration for the acquisition. During the previous year ended December 31, 2014, the Company raised proceeds of $147.0 million through the issuance of 12.4 million common shares at an average price of $11.84 per common share and issued 4.3 million common shares pursuant to the acquisition of Capio. Details of the foregoing are set out in note 11 of the consolidated annual financial statements.

The Company has a $300.0 million revolving committed term Credit Facility with a syndicate of financial institutions, with an authorized borrowing amount available of $275.0 million, on which, Kelt had drawn $177.6 million at December 31, 2015. The Credit Facility is available for a revolving period of 364 days, maturing on April 30, 2016, and may be extended for an additional 364 days at the discretion of the lenders, with a term-out to April 29, 2017 if not renewed.

Kelt expects to fund future capital expenditures through the use of a combination of cash provided by operating activities and bank debt, supplemented by new equity or debt offerings, as necessary.

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 maintains sufficient unused bank credit lines to satisfy such working capital deficiencies. As at December 31, 2015, the Company's working capital deficit of $34.5 million combined with outstanding bank debt of $177.6 million, represented 77% of the authorized borrowing amount available under the Credit Facility of $275.0 million or 71% of the total Credit Facility commitment of $300.0 million.

The Company's accounts receivable consists primarily of accrued revenue and joint venture receivables. The oil and gas industry has a pre-arranged monthly clearing day for payment of revenues from all buyers of oil and natural gas. This occurs on the 25th day following the month of sale. As a result, the Company's production revenues are collected in an orderly fashion. Kelt monitors its counterparty credit positions to mitigate any potential credit losses. To the extent that the Company has joint venture partners in its activities, it must collect the partners' share of capital expenditures and operating expenses on a monthly basis. Exceptions are in the event that the partners' share of a capital project is a significant amount. In this case, Kelt will collect such amounts from its partners in advance of expenditures taking place in accordance with standard industry operating procedures. At December 31, 2015, approximately 85% of accounts receivable are current. The balance of accounts receivable outstanding for more than 90 days is approximately $1.6 million and relates primarily to receivables from 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 and expects the balances to be fully collectible, except for approximately $1.0 million of accounts receivable which are provided for in the allowance for doubtful accounts.

Accounts payable and accrued liabilities total $64.1 million as at December 31, 2015, of which approximately $13.2 million is payable and $50.9 million is accrued. Accrued liabilities include approximately $26.0 million of estimated capital expenditures related to the Company's capital program. Invoices are processed within the Company's normal payment period, which is typically 30 to 60 days.

LIQUIDITY

Liquidity risk is the risk the Company will encounter difficulties in meeting its financial obligations. The Company's financial liabilities are comprised of accounts payable, derivative financial instruments and bank debt. The Company manages liquidity risk through prudent use of bank debt and an actively managed production and capital expenditure budgeting process. In addition, risk management contracts such as derivative financial instruments may be used from time to time.

Kelt targets a 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. To manage this, the Board of Directors approves an annual capital expenditure budget, which is regularly monitored and updated as necessary in response to changing capital requirements. Kelt actively manages the pace of its capital spending program by monitoring forecasted production and commodity prices and resulting cash flows. Should circumstances affect cash flow in a detrimental way, the Company is capable of reducing capital investment levels. In addition, the Company utilizes a control system with respect to authorizations for expenditures on both operated and non-operated projects to further manage capital expenditures. As a result of the rapid decline in commodity prices during 2015, Kelt's net debt to trailing funds from operations ratio increased to 4.5 times as at December 31, 2015. In response, the Company has significantly reduced its capital expenditure budget for 2016 to $65.0 million, down 41% from its previous budget of $110.0 million (refer to *Outlook and Guidance* section, as well as advisories regarding forward looking statements).

As at December 31, 2015, the Company had drawn $177.6 million on its $300.0 million revolving committed term Credit Facility. The authorized borrowing amount was $275.0 million at December 31, 2015, with additional funds available up to the total Credit Facility commitment of $300.0 million subject to approval of the lending syndicate. The Credit Facility is available for a revolving period of 364 days, maturing on April 30, 2016, and may be extended for an additional 364 days at the discretion of the lenders, with a term-out to April 29, 2017 if not renewed. Repayments of principal are not required provided that the borrowings under the Credit Facility do not exceed the authorized borrowing amount and the Company is in compliance with all covenants, representations and warranties. The Company is not subject to any financial covenants under the Credit Facility as at December 31, 2015, Kelt is in compliance with all other covenants. The current business environment of low commodity prices has resulted in tighter credit markets. The Credit Facility is subject to semi-annual review by the lending syndicate and the authorized borrowing amount available is closely tied to the value of the Company's reserves. In the event that the lenders reduce the borrowing base below the amount drawn at the time of the redetermination, the Company would have 60 days to eliminate any borrowing base shortfall by repaying the amount drawn in excess of a re-determined borrowing base or by providing additional security or other consideration satisfactory to the lenders. Although management expects that the lenders will extend the Credit Facility at the end of the revolving period, there is no assurance that the financial institutions will choose to do so. Should the financial institutions not extend the loan, the Company would need to seek alternate sources of debt or equity financing.

SHARE INFORMATION

The Company is authorized to issue an unlimited number of common shares and an unlimited number of preferred shares. As at December 31, 2015 there were 168.7 million common shares issued and outstanding (as at March 7, 2016, there are 168.7 million common shares outstanding). There are no preferred shares issued or outstanding.

As at December 31, 2015, officers, directors, and employees have been granted options to purchase 6.7 million common shares of the Company at an average exercise price of $7.40 per common share. In addition, there are 1.2 million RSUs outstanding. Options and RSUs outstanding at December 31, 2015 represented 4.7% of total common shares issued and outstanding. Additional information regarding the Company's stock options and RSUs is included in note 11 of the consolidated annual financial statements.

The Company's common shares trade on the TSX under the symbol "KEL". During the period from January 1, 2015 to December 31, 2015, 218.3 million common shares traded on the TSX at a weighted average price of $6.65 per common share. The following table outlines Kelt's common share trading activity by quarter.

SHARE TRADING ACTIVITY (KEL)	Q1 2015	Q2 2015	Q3 2015	Q4 2015	YTD 2015
High ($)	**8.39**	**9.95**	**8.85**	**7.38**	**9.95**
Low ($)	**5.79**	**7.65**	**4.91**	**3.29**	**3.29**
Close ($)	**7.57**	**8.44**	**5.71**	**4.24**	**4.24**
Volume traded (thousands)	**57,663**	**41,511**	**48,683**	**70,456**	**218,314**
Value traded ($ thousands)	**418,446**	**365,799**	**316,207**	**350,779**	**1,451,231**
Weighted average trading price ($)	**7.26**	**8.81**	**6.50**	**4.98**	**6.65**

	Q1 2014	Q2 2014	Q3 2014	Q4 2014	YTD 2014
High ($)	13.08	15.60	15.61	12.17	15.61
Low ($)	9.38	12.49	11.84	6.64	6.64
Close ($)	12.85	15.23	12.00	7.00	7.00
Volume traded (thousands)	36,504	30,916	39,918	45,750	153,088
Value traded ($ thousands)	418,714	427,382	535,633	421,097	1,802,826
Weighted average trading price ($)	11.47	13.82	13.42	9.20	11.78

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.

At December 31, 2015, the following risk management contracts were 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%	January 1, 2016 to June 30, 2017	**(230)**
Derivative financial instrument liability					**(230)**

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.

COMMITMENTS AND CONTRACTUAL OBLIGATIONS

As of December 31, 2015, the Company is committed to future payments under the following agreements:

(CA$ thousands)	2016	2017	2018	2019	2020	Thereafter
Operating lease – office buildings	1,150	1,170	392	-	-	-
Operating lease – vehicles	242	175	76	4	-	-
Firm processing commitments	5,832	4,289	-	-	-	-
Firm transportation commitments	6,090	6,794	7,525	4,849	1,707	6,514
Firm transportation commitments – USD(1)	11,887	8,567	-	-	-	-
Total annual commitments	**25,201**	**20,995**	**7,993**	**4,853**	**1,707**	**6,514**

(1) Commitments under firm transportation contracts denominated in US dollars are translated to Canadian dollars at the spot rate on December 31, 2015 of $1.3840.

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 year ended December 31, 2015, the Company incurred $0.6 million (2014 – $0.4 million) in legal fees and disbursements, of which, less than $0.1 million is payable at December 31, 2015 ($0.1 million at December 31, 2014). The Company expects to continue using the services of this law firm from time to time.

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Company. The following table summarizes compensation paid or payable to officers and directors of the Company:

	Year ended December 31	
	2015	2014
Salaries, bonuses and other benefits	**958**	715
Share based compensation	**3,251**	4,096
Total compensation	**4,209**	4,811

During the year ended December 31, 2015, key management personnel were granted 87,684 RSUs and 750,000 stock options with an exercise price of $4.38 per share. During the previous year ended December 31, 2014, key management personnel were granted an aggregate of 970,000 stock options with an average exercise price of $9.34 per share.

OFF-BALANCE SHEET TRANSACTIONS

The Company did not engage in any off-balance sheet transactions during the periods ended December 31, 2015 and 2014.

SELECTED ANNUAL INFORMATION

The following table summarizes key annual financial and operating information over the most recently completed financial years.

(CA$ thousands, except as otherwise indicated)	**2015**	2014	2013
Revenue, before royalties and financial instruments	**179,326**	214,691	46,656
Funds from operations	**56,517**	115,503	23,656
Per share – basic ($/common share)	**0.37**	0.95	0.32
Per share – diluted ($/common share)	**0.36**	0.93	0.32
Profit (loss) and comprehensive income (loss)	**(140,175)**	10,628	(5,115)
Per share – basic ($/common share)	**(0.91)**	0.09	(0.07)
Per share – diluted ($/common share)	**(0.91)**	0.09	(0.07)
Total assets	**1,279,475**	908,709	485,201
Bank debt	**177,570**	46,929	-
Working capital deficiency (surplus)	**34,525**	57,501	(20,500)
Shareholders' equity	**847,618**	619,639	392,872
Average daily production (BOE/d)	**18,577**	12,756	3,961
Average realized price, after financial instruments ($/BOE)	**26.33**	46.03	32.03
Operating netback ($/BOE)	**10.09**	25.62	16.97
Netback as a percentage of revenue	**38%**	56%	53%

SUMMARY OF QUARTERLY RESULTS

(CA$ thousands, except as otherwise indicated)	**Q4 2015**	Q3 2015	Q2 2015	Q1 2015
Revenue, before royalties and financial instruments	**42,797**	45,015	52,131	39,383
Funds from operations	**11,172**	16,601	14,701	13,980
Per share – basic ($/common share)	**0.07**	0.10	0.10	0.11
Per share – diluted ($/common share)	**0.07**	0.10	0.09	0.11
Profit (loss) and comprehensive income (loss)	**(94,109)**	(22,135)	(7,407)	(16,524)
Per share – basic ($/common share)	**(0.56)**	(0.13)	(0.05)	(0.13)
Per share – diluted ($/common share)	**(0.56)**	(0.13)	(0.05)	(0.13)
Total assets	**1,279,475**	1,365,007	1,366,676	966,613
Bank debt	**177,570**	147,801	224,221	105,117
Working capital deficiency (surplus)	**34,525**	34,456	25,831	33,633
Shareholders' equity	**847,618**	939,644	872,647	635,708
Average daily production (BOE/d)	**20,086**	18,695	19,473	16,005
Average realized price, after financial instruments ($/BOE)	**22.01**	25.71	29.57	28.61
Operating netback ($/BOE)	**8.05**	11.52	10.23	10.78
Netback as a percentage of revenue	**37%**	45%	35%	38%

	Q4 2014	Q3 2014	Q2 2014	Q1 2014
Revenue, before royalties and financial instruments	54,396	61,136	51,366	47,793
Funds from operations	29,668	31,984	27,973	26,112
Per share – basic ($/common share)	0.23	0.25	0.23	0.24
Per share – diluted ($/common share)	0.23	0.25	0.22	0.23
Profit (loss) and comprehensive income (loss)	1,256	1,185	3,336	4,851
Per share – basic ($/common share)	0.01	0.01	0.03	0.04
Per share – diluted ($/common share)	0.01	0.01	0.03	0.04
Total assets	908,709	820,241	669,098	666,257
Bank debt	46,929	-	-	-
Working capital deficiency (surplus)	57,501	37,219	(116,488)	(123,150)
Shareholders' equity	619,639	614,384	544,735	539,410
Average daily production (BOE/d)	15,559	13,872	11,381	10,143
Average realized price, after financial instruments ($/BOE)	39.96	47.49	48.23	50.99
Operating netback ($/BOE)	21.55	25.81	27.63	29.40
Netback as a percentage of revenue	54%	54%	57%	58%

Since commencing active operations on February 27, 2013, the Company has significantly grown its asset and production base through a combination of a robust drilling program and accretive acquisitions. In addition to cash provided by operating activities, the Company's capital expenditures were funded primarily through equity financings, and 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. Refer to the *Results of Operations* section of this MD&A for further discussion.

BUSINESS RISKS

The business of exploring for, developing and producing oil and natural gas reserves is inherently risky. The following information is a summary only of certain risk factors relating to the Company and should be read in conjunction with the Company's Annual Information Form dated March 11, 2015 which can be found at www.sedar.com. In addition, the Company's Annual Information Form as at December 31, 2015, will be filed on or about March 11, 2016. The risks set out below are not an exhaustive list, nor should be taken as a complete summary or description of all the risks associated with the Company's business and the oil and natural gas business generally.

Weakness in the Oil and Gas Industry

Recent market events and conditions, including global excess oil and natural gas supply, recent actions taken by the Organization of the Petroleum Exporting Countries, slowing growth in China and other emerging economies, market volatility and disruptions in Asia, and sovereign debt levels in various countries, have caused significant decrease in the valuation of oil and gas companies and a decrease in confidence in the oil and gas industry. These difficulties have been exacerbated in Canada by the recent changes in government at a federal level and, in case of Alberta, the provincial level and the resultant uncertainty surrounding regulatory, tax and royalty changes that may be implemented by the new governments. In addition, the inability to get the necessary approvals to build pipelines and other facilities to provide better access to markets for the oil and gas industry in western Canada has led to additional uncertainty and reduced confidence in the oil and gas industry in western Canada. Lower commodity prices may also affect the volume and value of the Company's reserves especially as certain reserves become uneconomic. In addition, lower commodity prices have reduced, and are anticipated to continue to reduce the Company's cash flow which could result in a reduced capital expenditure budget. As a result, the Company may not be able to replace its production with additional reserves and both the Company's production and reserves could be reduced on a year over year basis. Any decrease in value of the Company's reserves may reduce the borrowing base under the Credit Facilities, which, depending on the level of the Company's indebtedness, could result in the Company having to repay a portion of its indebtedness. Given the current market conditions and the lack of confidence in the Canadian oil and gas industry, the Company may have difficulty raising additional funds in the future or if it is able to do it may be on unfavourable and highly dilutive terms.

Exploration, Development and Production Risks

Oil and natural gas operations involve many risks that even a combination of experience, knowledge and careful evaluation may not be able to overcome. There is no assurance that expenditures made on exploration by the Company will result in new discoveries of oil or natural gas in commercial quantities. It is difficult to project the costs of implementing an exploratory drilling program due to the inherent uncertainties of drilling in unknown formations, the costs associated with encountering various drilling conditions such as over pressured zones and tools lost in the hole, and changes in drilling plans and locations as a result of prior exploratory wells or additional seismic data and interpretations thereof. The long-term commercial success of the Company depends on its ability to find, acquire, develop and commercially produce oil and natural gas reserves. Without the continual addition of new reserves, the Company's existing reserves, and the production from them, will decline over time as the Company produces from such reserves. A future increase in the Company's reserves will depend on both the ability of the Company to explore and develop its existing properties and on its ability to select and acquire suitable producing properties or prospects. There is no assurance that the Company will be able continue to find satisfactory properties to acquire or participate in. Moreover, management of the Company may determine that current markets, terms of acquisition, participation or pricing conditions make potential acquisitions or participations uneconomic. There is also no assurance that the Company will discover or acquire further commercial quantities of oil and natural gas.

Future oil and gas exploration may involve unprofitable efforts, not only from dry wells but from wells that are productive but do not produce sufficient net revenues to return a profit after drilling, completing, operating and other costs. Completion of a well does not ensure a profit on the investment or recovery of drilling, completion and operating costs.

Drilling hazards or environmental damage could greatly increase the cost of operations and various field operating conditions may adversely affect the production from successful wells. These conditions include, but are not limited to, delays in obtaining governmental approvals or consents, shut-ins of connected wells resulting from extreme weather conditions, insufficient storage or transportation capacity or other geological and mechanical conditions.

While diligent well supervision and effective maintenance operations can contribute to maximizing production rates over time, it is not possible to eliminate production delays and declines from normal field operating conditions, which can negatively affect revenue and cash flow levels to varying degrees.

Oil and natural gas exploration, development and production operations are subject to all the risks and hazards typically associated with such operations, including, but not limited to, fire, explosion, blowouts, cratering and spills or other environmental hazards. These typical risks and hazards could result in substantial damage to oil and natural gas wells, production facilities, other property, the environment and personal injury.

Oil and natural gas production operations are also subject to all the risks typically associated with such operations, including encountering unexpected formations or pressures, premature decline of reservoirs and the invasion of water into producing formations. Losses resulting from the occurrence of any of these risks may have a material adverse effect on the Company's business, financial condition, results of operations and prospects.

As is standard industry practice, the Company is not fully insured against all risks, nor are all risks insurable. Although the Company maintains liability insurance in an amount that it considers consistent with industry practice, liabilities associated with certain risks could exceed policy limits or not be covered. In either event the Company could incur significant costs. See additional information under the heading of Insurance below.

Prices, Markets and Marketing of Crude Oil and Natural Gas

Oil and natural gas are commodities whose prices are determined based on world demand, supply and other factors, all of which are beyond the control of Kelt. World prices for oil and natural gas have decreased significantly since mid-2014 and have fluctuated in response to a variety of factors beyond the Corporation's control, including: (i) global energy supply, production and policies, including the ability of OPEC to set and maintain production levels in order to influence prices for oil; (ii) political conditions, including the risk of hostilities in the Middle East and global terrorism; (iii) global and domestic economic conditions, including currency fluctuations; (iv) the level of consumer demand, including demand for different qualities and types of crude oil and liquids; (v) the production and storage levels of North American natural gas and crude oil and the supply and price of imported oil and liquefied natural gas; (vi) weather conditions; (vii) the proximity of reserves and resources to, and capacity of, transportation facilities and the availability of refining and fractionation capacity; (viii) the ability, considering regulation and market demand, to export oil and liquefied natural gas and NGLs from North America; (ix) the effect of world-wide energy conservation and greenhouse gas reduction measures and the price and availability of alternative fuels; and (x) government regulations. Certain wells or other projects may become uneconomic as a result of a decline in world oil prices and natural gas prices, leading to a reduction in the future volume of Kelt's oil and gas production. Kelt might also elect not to produce from certain wells at lower prices. All these factors could result in a material decrease in Kelt's future net production revenue, causing a reduction in its oil and gas acquisition and development activities. In addition, bank borrowings available to Kelt will be in part determined by the borrowing base of Kelt. A sustained material decline in prices from historical average prices could reduce Kelt's future borrowing base, therefore reducing the bank credit available to Kelt, and could require that a portion of any existing bank debt of Kelt be repaid.

In addition to establishing markets for its oil and natural gas, Kelt must also successfully market its oil and natural gas to prospective buyers. The marketability and price of oil and natural gas which may be acquired or discovered by Kelt will be affected by numerous factors beyond its control. Kelt will be affected by the differential between the price paid by refiners for light quality oil and the grades of oil produced by Kelt. The ability of Kelt to market natural gas may depend upon its ability to acquire space on pipelines which deliver natural gas to commercial markets. Kelt will also likely be affected by deliverability uncertainties related to the proximity of its reserves to pipelines and processing facilities and related to operational problems with such pipelines and facilities and extensive government regulation relating to price, taxes, royalties, land tenure, allowable production, the export of oil and natural gas and the management of other aspects of the oil and natural gas business. Kelt has limited direct experience in the marketing of oil and natural gas.

Seasonality

The level of activity in the Canadian oil and gas industry is influenced by seasonal weather patterns. Wet weather and spring thaw may make the ground unstable. Consequently, municipalities and provincial transportation departments enforce road bans that restrict the movement of rigs and other heavy equipment, thereby reducing activity levels. Also, certain oil and gas producing areas are located in areas that are inaccessible other than during the winter months because the ground surrounding the sites in these areas consists of swampy terrain. There can be no assurance that these seasonal factors will not adversely affect the timing and scope of Kelt's exploration and development activities, which could in turn have a material adverse impact on Kelt's business, operations and prospects.

Possible Failure to Realize Anticipated Benefits of Acquisitions and Dispositions

As part of its ongoing strategy, the Company may complete acquisitions of assets or other entities in the future. Achieving the benefits of completed and future acquisitions depends in part on successfully consolidating functions and integrating operations, procedures and personnel in a timely and efficient manner, as well as the Company's ability to realize the anticipated growth opportunities and synergies from combining the acquired businesses and operations with those of the Company. The integration of acquired businesses and entities requires the dedication of substantial management effort, time and resources which may divert management's focus and resources from other strategic opportunities and from operational matters during this process. The integration process may result in the loss of key employees and the disruption of ongoing business, customer and employee relationships that may adversely affect the Company's ability to achieve the anticipated benefits of any acquisitions. In addition, noncore assets may be periodically disposed of so the Company can focus its efforts and resources more efficiently. Depending on the state of the market for such non-core assets, certain non-core assets of the Company, if disposed of, may realize less than their carrying value in the financial statements of the Company.

Royalty Regimes

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

Alberta Royalty Review

The Government of Alberta released its Royalty Review Advisory Panel Report on January 29, 2016 (the "Review"). The Review recommends new rules coming into effect in 2017, but also recommends grandfathering, under the current rules, all wells drilled before 2017 for a ten year period and recommends no change to the oil sands royalty structure. The Review recommended modernization of Alberta's conventional oil and gas royalty regime, but did not provide detail. The Government of Alberta has accepted the recommendations set out in the Review and is expected to adopt those recommendations in spring 2016. It is not anticipated that the new rules will materially impact the Corporation's financial condition; however, the specific manner in which the new rules will be applied has not yet been determined and may alter this view.

Capital Markets

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

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

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

Dilution

Kelt may make future acquisitions or enter into financings or other transactions involving the issuance of securities of Kelt which may be dilutive. Common shares, including rights, warrants, special warrants, subscription receipts and other securities to purchase, to convert into or to exchange into common shares, may be created, issued, sold and delivered on such terms and conditions and at such times as the Board of Directors may determine. In addition, the Company may issue additional common shares from time to time pursuant to the Company's Incentive Stock Option Plan and Restricted Share Unit Plan. The issuance of these common shares would result in dilution to holders of common shares.

Regulatory

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

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

Insurance

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

Litigation

In the normal course of the Company's operations, it may become involved in, named as a party to, or be the subject of, various legal proceedings, including regulatory proceedings, tax proceedings and legal actions, related to personal injuries, property damage, property tax, land rights, the environment and contract disputes. The outcome of outstanding, pending or future proceedings cannot be predicted with certainty and may be determined adversely to the Company and as a result, could have a material adverse effect on the Company's assets, liabilities, business, financial condition and results of operations.

Operational Dependence

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

In addition, due to the current low and volatile commodity prices, many companies, including companies that may operate some of the assets in which Kelt has an interest, may be in financial difficulty, which could impact their ability to fund and pursue capital expenditures, carry out their operations in a safe and effective manner and satisfy regulatory requirements with respect to abandonment and reclamation obligations. If companies that operate some of the assets in which Kelt has an interest fail to satisfy regulatory requirements with respect to abandonment and reclamation obligations, Kelt may be required to satisfy such obligations and to seek recourse from such companies. To the extent that any of such companies go bankrupt, become insolvent or make a proposal or institute any proceedings relating to bankruptcy or insolvency, it could result in such assets being shut-in, Kelt potentially becoming subject to additional liabilities relating to such assets and Kelt having difficulty collecting revenue due from such operators. Any of these factors could materially adversely affect Kelt's financial and operational results.

Competition

The oil and gas industry is highly competitive. Kelt actively competes for reserve acquisitions, exploration leases, licenses and concessions and skilled industry personnel with a substantial number of other oil and gas entities, many of which have significantly greater financial resources, staff and facilities than Kelt. Kelt's competitors include integrated oil and natural gas companies and numerous other independent oil and natural gas companies and individual producers and operators. Certain of Kelt's customers and potential customers may themselves explore for oil and natural gas and the results of such exploration efforts could affect Kelt's ability to sell or supply oil or gas to these customers in the future. Kelt's ability to successfully bid on and acquire additional property rights, to discover reserves to participate in drilling opportunities and to identify and enter into commercial arrangements with customers will be dependent upon developing and maintaining close working relationships with its future industry partners and joint operators and its ability to select and evaluate suitable properties and to consummate transactions in a highly competitive environment. Competitive factors in the distribution and marketing of oil and natural gas include price and methods and reliability of delivery and storage. Competition may also be presented by alternate fuel sources.

Environmental Risks

All phases of the oil and natural gas business present environmental risks and hazards and are subject to environmental regulation pursuant to a variety of international conventions and federal, provincial and municipal laws and regulations. Environmental legislation provides for, among other things, restrictions and prohibitions on spills, releases or emissions of various substances produced in association with oil and gas operations. The legislation also requires that wells and facility sites be operated, maintained, abandoned and reclaimed to the satisfaction of applicable regulatory authorities. Compliance with such legislation can require significant expenditures and a breach may result in the imposition of fines and penalties, some of which may be material.

Environmental legislation is evolving in a manner expected to result in stricter standards and enforcement, larger fines and liability and potentially increased capital expenditures and operating costs. The discharge of oil, natural gas or other pollutants into the air, soil or water may give rise to liabilities to foreign governments and third parties and may require Kelt to incur costs to remedy such discharge. Implementation of strategies with respect to climate change and reducing greenhouse gases could have material impact on the nature of oil and natural gas operations, including those of Kelt. No assurance can be given that the application of environmental laws to the business and operations of Kelt will not result in a curtailment of production or a material increase in the costs of production, development or exploration activities or otherwise adversely affect Kelt's financial condition, results of operations or prospects.

Global Financial Markets

Market events and conditions, including disruptions in the international credit markets and other financial systems, and the deterioration of global economic conditions caused significant volatility to commodity prices over the last few years. These conditions have resulted in a loss of confidence in the broader U.S. and global credit and financial markets and resulting in the collapse of, and government intervention in, major banks, financial institutions and insurers and creating a climate of greater volatility, less liquidity, widening of credit spreads, a lack of price transparency, increased credit losses and tighter credit conditions. Notwithstanding various actions by governments, concerns about the general condition of the capital markets, financial instruments, banks, investment banks, insurers and other financial institutions caused the broader credit markets to further deteriorate and stock markets to decline substantially. These factors have negatively impacted company valuations and may continue to impact the performance of the global economy going forward.

If the economic climate in the U.S. or the world generally deteriorates further, demand for petroleum products could diminish further and prices for oil and natural gas could decrease further, which could adversely impact Kelt's results of operations, liquidity and financial condition.

Geo-Political Risks

The marketability and price of oil and natural gas that may be acquired or discovered by Kelt is and will continue to be affected by political events throughout the world that cause disruptions in the supply of oil. Conflicts, or conversely peaceful developments, arising in the Middle East, and other areas of the world, have a significant impact on the price of oil and natural gas. Any particular event could result in a material decline in prices and therefore result in a reduction of Kelt's net production revenue.

In addition, Kelt's expected oil and natural gas properties, wells and facilities could be subject to a terrorist attack. As the oil and gas industry in Canada is a key supplier of energy to the United States, certain terrorist groups may target Canadian oil and gas properties, wells and facilities in an effort to choke the United States economy. If any of Kelt's properties, wells or facilities are the subject of terrorist attack it could have a material adverse effect on Kelt. Kelt does not have insurance to protect against the risk from terrorism.

BUSINESS OUTLOOK

ADVISORY REGARDING FORWARD-LOOKING STATEMENTS

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

CURRENT ECONOMIC ENVIRONMENT

The current economic environment continues to be challenging and uncertain. Increasing global crude oil supplies have surpassed global demand and as a result, crude oil prices have been negatively affected. North American winter demand for natural gas relating to heating has suffered this winter due to abnormally mild winter conditions caused by the weather pattern "El Nino" resulting in excess amounts of storage. In addition, natural gas infrastructure and capacity constraints continue to impact commodity prices being realized in domestic markets relative to world markets. In addition, uncertainties facing debt markets around the world could lead to tighter credit markets in the future.

The number of rigs drilling for crude oil in the U.S. declined to 536 in late December 2015, after peaking at about 1,600 in November 2014. With low current oil prices, Kelt believes that global oil supply will eventually be negatively affected as a result of significant reductions in capital investment. Kelt believes this could result in a recovery of crude oil prices in the second half of 2016.

The number of rigs drilling for natural gas in the U.S. declined to 162 in late December 2015, after peaking at about 1,600 in September 2008. Despite record high gas supply in the U.S. primarily due to higher productive shale wells, Kelt expects U.S. supply will be negatively affected as declines on new production sets in. In addition, with a declining crude oil rig count in the U.S., associated gas production will also be negatively affected. Kelt believes these factors bode well for natural gas prices in 2017, after the current surplus in storage balances out.

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

OUTLOOK AND GUIDANCE

The oil and gas industry in North America continues to operate in a challenging commodity price environment. Due to market instability and volatile commodity prices that have trended lower over the past twelve months, many oil and gas companies have reduced their capital spending plans. Ultimately, lower capital investment in oil and gas drilling can be expected to balance the supply and demand ratio. Kelt continues to remain optimistic about the long-term outlook for oil and gas commodity prices.

Kelt believes that the current business environment creates opportunities to add value at a reasonable cost. The cost to acquire land at Crown sales in the Company's core operating areas has dropped significantly and service related costs to drill and complete wells have also declined substantially. In order to capitalize on opportunities in the current energy business environment, Kelt expects to remain active at Crown land sales. The Company is opportunity driven and is confident that it can continue to build on its current inventory of development projects by adding new exploration prospects.

Kelt's capital expenditure budget for 2016 is $65.0 million, of which approximately $35.0 million is expected to be incurred in the first half of 2016. Planned capital expenditures during the second half of 2016 includes $15.0 million of discretionary capital mostly relating to the drill and complete of two wells, which the Company may elect to not incur if commodity prices during the second half appear to be lower than the Company's current forecast.

The table below outlines the Company's forecasted financial and operating guidance for 2016, as previously disclosed in the Company's press release dated February 10, 2016.

(CA$ millions, except as otherwise indicated)	**2016 Forecast**
Average Production	
Oil and NGLs (bbls/d)	**7,360**
Gas (mmcf/d)	**81,840**
Combined (BOE/d)	**21,000**
Production per million common shares (BOE/d)	**124**
Forecasted Average Commodity Prices	
WTI oil price (USD/bbl)	**39.00**
NYMEX natural gas price (USD/MMBTU)	**2.50**
AECO natural gas price ($/GJ)	**2.50**
Forecasted Average Exchange Rate (US$/CA$)	**0.730**
Capital Expenditures	
Drilling & completions	**37.0**
Facilities, pipeline & well equipment	**17.0**
Land and seismic	**11.0**
Total Capital Expenditures	**65.0**
Funds from operations	**55.0**
Per share, diluted	**0.32**
Bank debt, net of working capital, at year-end	**222.0**
Weighted average common shares outstanding (millions)	**169**
Common shares issued and outstanding (millions)	**169**

Forecast average production of 21,000 BOE per day in 2016 represents a 13% increase from average production of 18,577 BOE per day in 2015 and is estimated to be weighted 35% to oil and NGLs and 65% to gas. However, based on the Company's forecasted commodity prices for 2016, 81% of forecasted operating income in 2016 is expected to be generated from oil and NGLs versus 19% from gas.

During 2016, the Company is forecasting oil and gas prices to average WTI US$39.00 per barrel and AECO $2.50 per GJ, respectively. Sensitivities to changes in these prices are as follows: a change of 10% in the average WTI oil price forecast would affect funds from operations by $6.9 million or 13% and a change of 10% in the average AECO gas price forecast would affect funds from operations by $7.6 million or 14%. The Company reviews its commodity price forecasts periodically and retains the flexibility to adjust its capital expenditure plans accordingly.

Royalties are expected to average 9.4% of sales in 2016. On a combined basis production and transportation expense in 2016 is estimated to be $13.06 per BOE, G&A expense is estimated to be $0.89 per BOE and interest expense is forecasted at $1.07 per BOE.

After giving effect to the aforementioned production estimates, commodity price assumptions and estimated expenses: funds from operations for 2016 is forecasted to be approximately $55.0 million or $0.32 per common share, diluted. Kelt estimates that the Company's bank indebtedness, net of working capital, will be approximately $222.0 million as at December 31, 2016.

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

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

ADDITIONAL INFORMATION

Additional information relating to Kelt is filed on SEDAR and can be viewed on their website at www.sedar.com. In addition, the Company's Annual Information Form ("AIF") dated March 11, 2016, for the year ended December 31, 2015, will be filed on SEDAR on or about March 11, 2016. Copies of the AIF can also be obtained by contacting Sadiq H. Lalani, Vice President, Finance and Chief Financial Officer at Kelt Exploration Ltd., Suite 300, 311 Sixth Avenue SW, Calgary, Alberta, Canada, T2P 3H2. Further information relating to the Company is also available on its website at www.keltexploration.com.

On behalf of the Board of Directors,

[signed]

David J. Wilson
President and Chief Executive Officer
March 7, 2016

MANAGEMENT'S REPORT

The accompanying financial statements of Kelt Exploration Ltd. (the "Company") are the responsibility of management. The financial statements have been prepared by management in Canadian dollars in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") and include certain estimates that reflect management's best judgments. When alternative accounting methods exist, management has chosen those it deems most appropriate in the circumstances.

Management has the overall responsibility for internal controls and maintains a system of internal controls over financial reporting that provides reasonable assurance that the financial information is relevant, reliable and accurate and that the Company's assets are properly accounted for and adequately safeguarded.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal control. The Board exercises this responsibility with the assistance of the Audit Committee. This Committee, consisting of non-management directors, meets with management and independent auditors to ensure that each group is properly discharging its responsibilities and to discuss adequacy of internal controls, accounting policies and financial reporting matters. The Audit Committee has reviewed the financial statements and has reported thereon to the Board of Directors. The Board of Directors has approved the financial statements and authorized them for issuance to shareholders.

PricewaterhouseCoopers LLP, an independent firm of Chartered Professional Accountants, has been engaged, as approved by the shareholders of the Company, to provide an independent audit opinion on the Company's financial statements. Their report, contained herein, outlines the nature of their audit and expresses an unqualified opinion on the financial statements.

[signed]

David J. Wilson
President and Chief Executive Officer
March 7, 2016

[signed]

Sadiq H. Lalani
Vice President, Finance, and Chief Financial Officer
March 7, 2016

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of Kelt Exploration Ltd.

We have audited the accompanying financial statements of Kelt Exploration Ltd., which comprise the consolidated statements of financial position as at December 31, 2015 and December 31, 2014 and the consolidated statements of profit (loss) and comprehensive income (loss), changes in shareholders' equity and cash flows for the years then ended, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

Management's responsibility for the financial statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Kelt Exploration Ltd. as at December 31, 2015 and December 31, 2014 and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board.

PricewaterhouseCoopers LLP

Chartered Professional Accountants
Calgary, Alberta
March 7, 2016

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

"PwC" refers to PricewaterhouseCoopers LLP, an Ontario limited liability partnership.

KELT EXPLORATION LTD.
CONSOLIDATED STATEMENT OF FINANCIAL POSITION
AS AT DECEMBER 31, 2015 AND DECEMBER 31, 2014

(CA$ thousands)	[Notes]	**December 31, 2015**	December 31, 2014
ASSETS			
Current assets			
Cash and cash equivalents		**870**	1,049
Accounts receivable and accrued revenue	[13]	**27,266**	35,092
Prepaid expenses and deposits		**2,129**	2,839
Derivative financial instruments	[13]	**-**	1,745
Total current assets		**30,265**	40,725
Exploration and evaluation assets	[6]	**124,305**	79,294
Property, plant and equipment	[7]	**1,124,905**	770,484
Goodwill	[8]	**-**	18,206
Total assets		**1,279,475**	908,709
LIABILITIES			
Current liabilities			
Accounts payable and accrued liabilities		**64,067**	96,776
Derivative financial instruments	[13]	**230**	-
Deferred premium on flow-through shares	[11]	**-**	692
Decommissioning obligations	[10]	**493**	758
Total current liabilities		**64,790**	98,226
Bank debt	[9]	**177,570**	46,929
Decommissioning obligations	[10]	**142,308**	94,033
Deferred income tax liability	[12]	**47,189**	49,882
Total liabilities		**431,857**	289,070
SHAREHOLDERS' EQUITY			
Shareholders' capital	[11]	**1,022,115**	657,102
Reserve from common control transaction		**(57,668)**	(57,668)
Contributed surplus		**17,833**	14,692
Retained earnings (deficit)		**(134,662)**	5,513
Total shareholders' equity		**847,618**	619,639
Total liabilities and shareholders' equity		**1,279,475**	908,709

Acquisitions	[5]
Commitments	[15]

The accompanying notes form an integral part of these consolidated 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)
FOR THE YEARS ENDED DECEMBER 31, 2015 AND DECEMBER 31, 2014

		Year ended December 31	
(CA$ thousands, except per share amounts)	[Notes]	**2015**	2014
Revenue			
Oil and gas sales		**179,326**	214,691
Royalties		**(19,033)**	(28,433)
		160,293	186,258
Expenses			
Production	[17]	**76,914**	55,901
Transportation	[17]	**14,192**	10,719
Financing	[14]	**9,400**	2,521
General and administrative		**5,200**	3,631
Provision for potential credit losses	[13]	**611**	-
Share based compensation	[11]	**8,372**	9,033
Depletion, depreciation and impairment	[7]	**205,204**	84,418
Exploration and evaluation	[6]	**10,474**	377
Impairment of goodwill	[8]	**18,206**	-
		348,573	166,600
Profit (loss) before other items and taxes		**(188,280)**	19,658
Other income		**-**	938
Transaction costs	[5]	**(2,409)**	(234)
Premium on flow-through shares	[11]	**3,564**	4,211
Gain (loss) on derivative financial instruments	[13]	**(2,861)**	1,889
Gain on acquisition	[5]	**16,774**	-
Gain on sale of assets		**190**	-
Profit (loss) before taxes		**(173,022)**	26,462
Deferred income tax expense (recovery)	[12]	**(32,847)**	15,834
Profit (loss) and comprehensive income (loss)		**(140,175)**	10,628
Profit (loss) per common share			
Basic	[11]	**(0.91)**	0.09
Diluted	[11]	**(0.91)**	0.09

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

KELT EXPLORATION LTD.
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
AS AT AND FOR THE YEARS ENDED DECEMBER 31, 2015 AND DECEMBER 31, 2014

(CA$ thousands)	[Notes]	Shareholders' capital	Reserve	Contributed surplus	Retained earnings (deficit)	Total shareholders' equity
Balance at December 31, 2014		**657,102**	**(57,668)**	**14,692**	**5,513**	**619,639**
Loss and comprehensive loss					**(140,175)**	**(140,175)**
Common shares issued:						
Common share offerings	[11]	**123,429**				**123,429**
Less: deferred premium on flow-through shares	[11]	**(2,872)**				**(2,872)**
Pursuant to corporate acquisition	[5]	**242,641**				**242,641**
Share issue costs, net of tax	[11]	**(3,416)**				**(3,416)**
Vesting of restricted share units	[11]	**5,231**		**(5,231)**		**-**
Share based compensation	[11]			**8,372**		**8,372**
Balance at December 31, 2015		**1,022,115**	**(57,668)**	**17,833**	**(134,662)**	**847,618**
Balance at December 31, 2013		449,876	(57,668)	5,779	(5,115)	392,872
Profit and comprehensive income					10,628	10,628
Common shares issued:						
Common share offerings	[11]	148,988				148,988
Less: deferred premium on flow-through shares	[11]	(3,722)				(3,722)
Pursuant to corporate acquisition	[5]	66,243				66,243
Share issue costs, net of tax	[11]	(4,694)				(4,694)
Exercise of stock options	[11]	411		(120)		291
Share based compensation	[11]			9,033		9,033
Balance at December 31, 2014		657,102	(57,668)	14,692	5,513	619,639

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

KELT EXPLORATION LTD.
CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2015 AND DECEMBER 31, 2014

		Year ended December 31	
(CA$ thousands)	[Notes]	**2015**	2014
Operating activities			
Profit (loss) and comprehensive income (loss)		**(140,175)**	10,628
Items not affecting cash:			
Accretion of decommissioning obligations	[10,14]	**2,816**	1,701
Share based compensation		**8,372**	9,033
Depletion, depreciation and impairment		**205,204**	84,418
Exploration and evaluation		**10,474**	377
Impairment of goodwill		**18,206**	-
Premium on flow-through shares		**(3,564)**	(4,211)
Unrealized loss (gain) on derivative financial instruments	[13]	**1,975**	(2,277)
Gain on acquisition	[5]	**(16,774)**	-
Gain on sale of assets		**(190)**	-
Deferred income tax expense (recovery)		**(32,847)**	15,834
Settlement of decommissioning obligations	[10]	**(383)**	(229)
Change in non-cash operating working capital	[16]	**9,896**	(2,883)
Cash provided by operating activities		**63,010**	112,391
Financing activities			
Increase in bank debt	[9]	**130,641**	46,929
Issue of common shares	[11]	**123,429**	148,988
Proceeds on exercise of stock options	[11]	**-**	291
Share issue costs		**(4,674)**	(6,267)
Cash provided by financing activities		**249,396**	189,941
Investing activities			-
Exploration and evaluation assets		**(43,555)**	(101,524)
Property, plant and equipment		**(123,050)**	(149,723)
Property acquisitions	[5]	**(16,350)**	(24,714)
Property dispositions	[4]	**-**	19,635
Corporate acquisitions	[5]	**(95,839)**	(104,663)
Change in non-cash investing working capital	[16]	**(33,791)**	27,691
Cash used in investing activities		**(312,585)**	(333,298)
Net change in cash and cash equivalents		**(179)**	(30,966)
Cash and cash equivalents, beginning of year		**1,049**	32,015
Cash and cash equivalents, end of year		**870**	1,049

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

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

1. DESCRIPTION OF THE BUSINESS

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

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 transferred all of its British Columbia assets to Kelt LNG and at the same time, Kelt LNG transferred all of its Alberta assets to Kelt. Kelt LNG operates in British Columbia as a wholly-owned subsidiary of Kelt, headquartered in Calgary, Alberta.

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

a) Statement of compliance

These audited annual consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") as set out in the CPA Canada Handbook – Accounting ("CPA Handbook"). The CPA Handbook incorporates International Financial Reporting Standards ("IFRS") and publicly accountable enterprises, such as Kelt, are required to apply such standards.

These audited annual consolidated financial statements were approved and authorized for issue by the Company's Board of Directors on March 7, 2016.

b) Basis of measurement

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

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

c) Significant judgments and estimates

The timely preparation of the financial statements requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amount of assets, liabilities, income and expenses. Actual results may differ materially from these estimates. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are reviewed and for any future years affected. Significant judgments, estimates and assumptions made by management in these financial statements are discussed below.

Depletion, depreciation and reserves

The Company calculates depletion based on total proved reserves as determined in accordance with the Canadian Oil and Gas Evaluation Handbook ("COGEH"). The process of determining reserves is complex. Significant judgments are based on available geological, geophysical, engineering, and economic data. These judgments are based on estimates and assumptions that may change substantially as additional data from ongoing development activities and production performance becomes available and as economic conditions impacting oil and gas prices and costs change. The reserve estimates are based on current production forecasts, prices and economic conditions. As circumstances change and additional data becomes available, reserve estimates also change. Estimates made are reviewed and revised, either upward or downward, as warranted by the new information. Revisions are often required due to changes in well performance, prices, economic conditions and governmental restrictions.

Although every reasonable effort is made to ensure that reserve estimates are accurate, reserve estimation can be impacted by subjective decisions, new geological or production information and a changing environment. In addition, revisions to reserve estimates can arise from changes in forecast oil and gas prices and reservoir performance. Such revisions can be either positive or negative.

Changes in reserve estimates impact the financial results of the Company as reserves and estimated future development costs are used to calculate depletion. Reserves are used in measuring the fair value less costs of disposal ("FVLCD") of property, plant and equipment ("PP&E") for impairment calculations and for determining the fair value of PP&E acquired in a business combination. Reserves also impact the Company's assessment of the commercial viability and technical feasibility of an exploration project and the decision to transfer exploration and evaluation ("E&E") assets to PP&E.

Exploration and evaluation assets

Judgment is required to determine the level at which E&E is assessed for impairment. For Kelt, the carrying value of E&E assets is assessed for overall impairment at the operating segment level and on a specific identification basis prior to transferring E&E assets to PP&E. The decision to transfer assets from E&E to PP&E requires judgment as it is based on estimated proved reserves, which are used, in part, to determine a project's technical feasibility and commercial viability. During the fourth quarter of 2015, the Company concluded that approximately $7.4 million of exploratory drilling costs were impaired. These costs were not transferred to PP&E as the Company was unable to economically establish proved reserves. Based on forecast commodity prices and the Company's current plans for future development, the Company does not expect to assign proved or probable reserves to these locations in the foreseeable future, therefore the costs were charged to E&E expense at December 31, 2015.

Determination of Cash Generating Units ("CGUs")

The determination of CGUs requires judgment in defining a group of assets that generate cash inflows that are largely independent of the cash inflows from other assets or groups of assets. CGUs are determined by similar geological structure, shared infrastructure, geographical proximity, commodity type, similar exposure to market risks and materiality. As at December 31, 2015, the Company has one CGU for its assets located in the province of British Columbia and four CGUs for its assets located in the province of Alberta. Refer to specific information regarding the Company's CGUs in note 7 of the consolidated financial statements.

Impairment of non-financial assets

Significant judgment is required to assess the Company's non-financial assets, namely E&E, PP&E and goodwill, for impairment. Management must first determine whether indicators of impairment exist that suggest the carrying value may not be recoverable through the asset's continued use or sale. As a result of the significant decrease in forecast oil and natural gas prices, an indication of potential impairment was identified for all CGUs, including allocated goodwill, and an impairment test was performed for PP&E and goodwill at December 31, 2015. The Company concluded there is no indication of impairment for its E&E assets at the operating segment level.

Significant judgment and estimates are required to calculate the recoverable amount of PP&E and goodwill in an impairment test. Management calculated the recoverable amount of each CGU based on its FVLCD, using an after-tax discounted cash flow analysis derived from proved plus probable reserves. Reserve estimates and expected future cash flows from production of reserves are subject to measurement uncertainty as discussed above and are subject to variability due to changes in forecasted commodity prices. In addition, the present value of forecast future cash flows is highly sensitive to the discount rate. Judgment is required to determine an appropriate discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Refer to note 7 of the consolidated financial statements for a discussion of the specific estimates and assumptions applied in the calculation of the recoverable amount.

Decommissioning obligations

The Company estimates the decommissioning obligations for oil and gas wells and their associated production facilities and infrastructure. In most instances, dismantling of assets and remediation occurs many years into the future. The value of the ultimate decommissioning obligation can fluctuate in response to many factors including changes to relevant legal requirements, the emergence of new restoration techniques, experience at other production sites, and changes to the risk-free discount rate. The expected timing and amount of expenditure can also change, for example, in response to changes in reserves or changes in laws and regulations or their interpretation. Judgments include the most appropriate discount rate to use, which management has determined to be a risk-free rate.

Kelt estimates abandonment and reclamation costs based on a combination of publically available industry benchmarks and internal site specific information. For producing wells and facilities, the expected timing of settlement is estimated based on the proved plus probable period to abandonment for each field, as per the independent reserve report. For non-producing wells, the expected timing of settlement is estimated to be half of the period applied to producing wells in that field, unless the timing to abandon and reclaim a specific well site or facility is known based on budgeted expenditures.

Business combinations

Business combinations are accounted for using the acquisition method of accounting. The determination of fair value often requires management to make assumptions and estimates about future events. The assumptions and estimates with respect to determining the fair value of exploration and evaluation assets and property, plant and equipment acquired generally require the most judgment and include estimates of reserves acquired, forecast benchmark commodity prices and discount rates. Assumptions are also required to determine the fair value of decommissioning obligations associated with the properties. Changes in any of these assumptions or estimates used in determining the fair value of acquired assets and liabilities could impact the amounts assigned to assets, liabilities and goodwill (or gain from a bargain purchase) in the acquisition equation. Future profit (loss) can be affected as a result of changes in future depletion and depreciation or impairment.

Deferred income taxes

The Company follows the liability method for calculating deferred income taxes. Tax interpretations, regulations and legislation in the jurisdictions in which the Company operates are subject to change. As such, deferred income taxes are subject to measurement uncertainty. The provision for deferred income taxes also includes the following significant judgments of management:

• Deferred income tax assets are assessed by management at the end of the reporting period to determine the likelihood that they will be realized from future taxable earnings. As at December 31, 2015, the Company has a consolidated deferred income tax liability of $47.2 million. The deferred tax liability reported in the Consolidated Statement of Financial Position is presented net of offsetting deferred income tax assets, most notably, a deferred income tax asset in the amount of $55.8 million related to non-capital losses which are estimated to be approximately $210.6 million at December 31, 2015. The Company’s non-capital losses expire in years 2023 to 2035. Management believes that Kelt and Kelt LNG will have sufficient taxable income in the future in order to utilize the non-capital losses and has concluded that recognition of the associated deferred income tax assets is appropriate;

• Classification of intangible drilling and completion costs as Canadian exploration expenses (“CEE”) or Canadian development expenses (“CDE”) – CEE is deductible at a rate of 100% per year, whereas CDE may be deducted on a declining basis at 30% per year. Accordingly, the allocation of resource deductions will impact the period in which Kelt may become taxable in the future. In addition, the designation of certain expenditures as CEE and/or CDE impacts the Company’s ability to satisfy its flow-through share obligations; and

• Recognition of unrecognized deferred income tax asset – per IAS 12, deferred income taxes are not initially recognized on transactions that are not business combinations. The Company did not initially recognize a deferred income tax asset of $14.4 million that arose on the spin-out certain assets from Celtic Exploration Ltd. (“Celtic”) at

Kelt's inception on February 26, 2013. The initially unrecognized deferred tax asset is now being amortized at a rate of 3.3% per quarter, which management believes is a reasonable estimate as it reflects the weighted average depletion rate of the properties at the time of the spin-out and is aligned with Kelt's corporate average depletion rate.

Share based compensation

The Company uses the fair value method of accounting for its long-term incentive plans, which include an Incentive Stock Option Plan and a Restricted Share Unit Plan. Judgments include which valuation model is most appropriate for the grant of the award to estimate its fair value. Estimates and assumptions are then used in the valuation model to determine fair value.

For stock options, the Company uses the Black-Scholes option pricing model which requires that management make assumptions for the expected life of the option, the anticipated volatility of the share price over the life of the option, the risk-free interest rate for the life of the option, and the number of options that will ultimately vest. The assumptions used by the Company are discussed in note 11 of the consolidated financial statements.

The fair value of restricted share units is estimated based on the volume weighted average trading price ("VWAP") on the TSX over three trading days immediately prior to the date of grant. Judgment is also required to estimate the number of restricted share units that will ultimately vest, in other words, the rate of forfeiture. The assumptions used by the Company are discussed in note 11 of the consolidated financial statements.

Flow-through shares

There is no IFRS guidance that specifically addresses accounting for flow-through shares, therefore the Company is required to develop an accounting policy. Consistent with prior years, and as set-forth in note 3, the Company has applied the residual method. Under this method, judgement is required to determine of the fair value of ordinary shares. Typically, it is based on the share price at the time the parties agree to the transaction. In situations where flow-through shares are issued concurrent with an ordinary common share offering, the difference in subscription prices is used to value the premium. Otherwise, the Company uses the VWAP of KEL common shares for the five trading days immediately preceding the date of the binding agreement, to value the ordinary common shares.

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

3. SIGNIFICANT ACCOUNTING POLICIES

Joint Interests

A substantial portion of the Company's exploration, development and production activities is conducted jointly with others through unincorporated joint ventures. These financial statements reflect only the Company's proportionate interest of these jointly controlled assets and the proportionate share of the relevant revenue and related costs.

Foreign currency translation

The financial statements are presented in Canadian dollars, which is the Company's functional and presentation currency. Transactions in foreign currencies are initially recorded at the exchange rate in effect at the time of the transactions. Monetary assets and liabilities denominated in foreign currencies are translated to Canadian dollars using the closing exchange rate at the Statement of Financial Position date. The resulting exchange rate differences are included in the Statement of Profit and Comprehensive Income.

Business combinations

Business combinations are accounted for using the acquisition method. The identifiable net assets acquired are measured at their fair value at the date of acquisition. Any excess of the purchase price over the fair value of the net assets acquired is recognized as goodwill. Any deficiency of the purchase price below the fair value of the net assets acquired is recorded as a gain in the Statement of Profit and Comprehensive Income. Transaction costs associated with the acquisition are expensed when incurred.

Common control transactions

Business combinations involving entities under common control are outside the scope of IFRS 3 Business Combinations. IFRS provides no guidance on the accounting for these types of transactions and an entity is required to develop an accounting policy. The three most common methods utilized are the purchase method, the predecessor values since inception method, and the predecessor values from date of transaction method. A business combination involving entities under common control is a business combination in which all of the combining entities are ultimately controlled by the same party, both before and after the business combination, and control is not transitory. Management has determined the predecessor values from date of transaction method to be most appropriate. This method requires the financial statements to be prepared using the predecessor carrying values without any step up to fair value. The difference between any consideration and the aggregate carrying value of the assets and liabilities are recorded as a reserve from common control transaction in shareholders' equity. Transaction costs associated with a common control transaction are recognized as an expense in the period.

Principles of Consolidation

The consolidated financial statements include the accounts of Kelt and its subsidiaries. Subsidiaries are entities controlled by the Company. Control exists when the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. As at December 31, 2015, the Company has one wholly-owned subsidiary, Kelt LNG. The financial statements of subsidiaries are prepared for the same reporting period as Kelt, using uniform accounting policies. Subsidiaries are consolidated from the date of acquisition of control and continue to be consolidated until the date there is a loss of control. All intercompany balances, transactions, revenue and expenses are eliminated on consolidation

Assets held for sale

Non-current assets and disposal groups are classified as held for sale if their carrying amounts will be recovered through a sale transaction rather than through continuing use. This condition is regarded as met only when the sale is highly probable and the asset or disposal group is available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets. Management must be committed to the sale, which should be expected to qualify for recognition as a completed sale within one year from the date of classification as held for sale. Non-current assets and disposal groups classified as held for sale are measured at the lower of the carrying amount and fair value less costs of disposal, and depletion & depreciation ceases at the time this designation is made.

If a non-current asset or disposal group has been classified as held for sale, but subsequently ceases to meet the criteria to be classified as held for sale, the Company ceases to classify the asset or disposal group as held for sale. Non-current assets and disposal groups that cease to be classified as held for sale are measured at the lower of carrying amount before the asset or disposal group was classified as held for sale (adjusted for any depreciation, amortization or revaluation that would have been recognized had the asset or disposal group not been classified as held for sale) and its recoverable amount at the date of the subsequent decision not to sell. Any adjustment to the carrying amount is recognized in profit or loss in the period in which the asset ceases to be classified as held for sale.

Financial instruments

Financial assets and liabilities are recognized when the Company becomes a party to the contractual provisions of the instrument. Financial assets are derecognized when the rights to receive cash flows from the assets have expired or have been transferred and the Company has transferred substantially all risks and rewards of ownership.

Financial assets and liabilities are offset and the net amount is reported in the Statement of Financial Position when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis, or realize the asset and settle the liability simultaneously.

At initial recognition, the Company classifies its financial instruments in the following categories depending on the purpose for which the instruments were acquired:

i) Financial assets and liabilities at fair value through profit or loss

A financial asset or liability is classified in this category if acquired principally for the purpose of selling or repurchasing in the short-term. Derivatives are also included in this category unless they are designated as hedges.

Financial instruments in this category are recognized initially and subsequently at fair value. Transaction costs are expensed in the Statement of Profit and Comprehensive Income. Gains and losses arising from changes in fair value are presented in profit or loss in the period in which they arise.

Financial assets and liabilities at fair value through profit or loss are classified as current in the Statement of Financial Position, except for any portion expected to be realized or paid beyond twelve months of the Statement of Financial Position date.

ii) Available-for-sale investments

Available-for-sale investments are non-derivatives that are either designated in this category or not classified in any of the other categories. The Company does not currently hold any available-for-sale investments.

iii) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. The Company's loans and receivables are comprised of cash and cash equivalents, accounts receivable and deposits. They are included in current assets due to their short-term nature.

Loans and receivables are initially recognized at the amount expected to be received less any required discount to reduce the loans and receivables to fair value. Subsequently, loans and receivables are measured at amortized cost using the effective interest method less any provision for impairment.

iv) Financial liabilities at amortized cost

Financial liabilities at amortized cost include accounts payable and bank debt. Accounts payable are initially recognized at the amount required to be paid less any required discount to reduce the payables to fair value. Bank debt is recognized initially at fair value, net of any transaction costs incurred, and subsequently at amortized cost using the effective interest method. Financial liabilities are classified as current liabilities if payment is due within twelve months. Otherwise, they are presented as non-current liabilities.

v) Derivative financial instruments

The Company may use derivative financial instruments for risk management purposes. All derivatives have been classified at fair value through profit or loss. Financial instruments are included on the Statement of Financial Position within derivative financial instruments and are classified as current or non-current based on the contractual terms specific to the instrument. Gains and losses on re-measurement of derivatives are included in profit or loss in the period in which they arise.

Exploration and evaluation assets ("E&E") and Property, plant and equipment ("PP&E")

i) Recognition and measurement

Pre-license costs

Costs incurred prior to acquiring the legal rights to explore an area are charged directly to profit or loss as exploration expense in the period incurred. The Company did not incur pre-license costs in the current or prior period.

Exploration and evaluation assets

All costs directly associated with the exploration and evaluation of petroleum and natural gas reserves are initially capitalized. Exploration and evaluation costs include unproved property acquisition costs such as undeveloped land and mineral leases, geological and geophysical costs, and costs associated with exploratory drilling, sampling and appraisals.

The costs are accumulated by field or exploration area pending determination of technical feasibility and commercial viability. The technical feasibility and commercial viability is considered to be achieved when proved reserves are determined to exist. Prior to being transferred to PP&E, E&E costs are first tested for impairment. If proved/probable reserves have not been established through the completion of exploration and evaluation activities and there are no future plans for activity in that field, then the costs are determined to be impaired and the amounts are charged to the Statement of Profit and Comprehensive Income.

Such costs are not subject to depletion or depreciation until they are reclassified from E&E to PP&E.

Property, plant and equipment

Property, plant, and equipment primarily consists of petroleum and natural gas development and production assets, and is measured at cost less accumulated depletion and depreciation and accumulated impairment losses. These costs include property acquisitions, development drilling, completion, gathering and infrastructure, estimated decommissioning costs and transfers from E&E. In addition, borrowing costs incurred for the construction of qualifying assets are capitalized during the period of time that is required to complete and prepare the assets for their intended use.

ii) Subsequent costs

Costs incurred subsequent to the determination of technical feasibility and commercial viability and the costs of replacing components of equipment are recognized as property, plant and equipment only when they increase the future economic benefits embodied in the specific asset to which they relate. All other expenditures are expensed as incurred. Such capitalized amounts generally represent costs incurred in developing proved and/or probable reserves and bringing in or enhancing production from such reserves. The carrying amount of any replaced or sold component is derecognized.

The gain or loss from the divestitures of property, plant and equipment is recognized in the Statement of Profit and Comprehensive Income. In addition, risk-sharing agreements in which the Company cedes a portion of its working interest to a third-party are generally considered to be disposals of property, plant and equipment, potentially resulting in a gain or loss on disposition.

Exchanges of assets within property, plant and equipment are measured at fair value unless the exchange transaction lacks commercial substance or the fair value of neither the asset received nor the asset given up is reliably measurable. Unless the fair value of the asset received is more clearly evident, the cost of the acquired asset is measured at the fair value of the asset given up. Where fair value is not used, the cost of the acquired asset is measured at the carrying amount of the asset given up. The gain or loss on derecognition of the asset given up is recognized in profit or loss.

An asset within property, plant and equipment is derecognized upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying value of the asset) is included in profit or loss in the period in which the item is derecognized.

iii) Depletion and depreciation

Development and production costs are accumulated on a field or geotechnical area basis (“depletion units”). The net carrying value of each depletion unit is depleted using the unit of production method by reference to the ratio of production in the year to the related proved reserves, taking into account estimated future development costs necessary to bring those reserves into production. Future development costs are estimated taking into account the level of development required to produce the reserves. These estimates are reviewed by independent reserve engineers at least annually. Where significant components of development and production (“D&P”) assets have different useful lives, they are accounted for and depreciated as separate items of property, plant and equipment.

Impairment of assets

Non-financial assets

The Company reviews the carrying value of its non-financial assets, including PP&E and E&E, on a quarterly basis to determine whether there is any indication of impairment. Goodwill is evaluated when facts and circumstances indicate that it is impaired, or at least on an annual basis. If any such indication exists, then the asset’s recoverable amount is estimated. E&E assets are also assessed for impairment prior to being reclassified to PP&E.

For the purpose of impairment testing, assets are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or CGUs. The recoverable amount of an asset or a CGU is the greater of its value in use and its FVLCD. Goodwill is allocated to the CGU expected to benefit from the business combination. E&E assets are assessed for overall impairment at the operating segment level and individual E&E assets are assessed for impairment prior to transferring to PP&E.

FVLCD is defined as the amount obtainable from the sale of an asset or cash generating unit in an arm's length transaction between knowledgeable, willing parties, less the costs of disposal. The Company calculates FVLCD by reference to the after-tax future cash flows expected to be derived from production of proved plus probable reserves, less estimated selling costs. The estimated after-tax future cash flows are discounted to their present value using a discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Value in use is generally computed by reference to the present value of the future cash flows expected to be derived from production of proved reserves.

An impairment loss is recognized if the carrying amount of an asset or its CGU exceeds its estimated recoverable amount. Impairment losses are recognized in the Statement of Profit and Comprehensive Income. Impairment losses recognized in respect of CGUs are allocated to reduce the carrying amounts of the assets in the CGU on a pro rata basis.

Impairment losses recognized in prior years are assessed at each reporting date for any indication that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimate used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depletion and depreciation, if no impairment loss had been recognized.

Financial assets

A financial asset is assessed at each reporting date to determine whether there is any objective evidence that it is impaired. A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the fair value or estimated future cash flows of an asset.

An impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the original effective interest rate. Individually significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed collectively in groups that share similar credit risk characteristics.

All impairment losses are recognized in profit or loss. An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognized. For financial assets measured at amortized cost the reversal is recognized in profit or loss.

Goodwill

The Company records goodwill relating to a business combination when the consideration paid exceeds the fair value of the net identifiable assets and liabilities of the acquired business. Goodwill is reported at cost less any impairment and is not amortized. Goodwill is evaluated when facts and circumstances indicate that it is impaired, or at least on an annual basis. Goodwill impairments are not reversed.

Leases

Leases where the Company assumes substantially all the risks and rewards of ownership are classified as finance leases. Upon initial recognition, the leased asset is measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments. Subsequent to initial recognition, the asset is accounted for in accordance with the accounting policy applicable to that asset. Minimum lease payments made under finance leases are apportioned between the finance expenses and the reduction of the outstanding liability. The finance expenses are allocated to each year during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability. The Company does not currently have any finance leases.

All of the Company's leases are operating leases, which are not recognized on the Statement of Financial Position. Rather, payments in respect of operating leases are recognized in the Statement of Profit and Comprehensive Income on a straight-line basis over the term of the lease. In the event that lease inducements are received to enter into operating leases, such inducements are recognized as a deferred credit. The aggregate benefit of inducements is recognized as a reduction of the related rental expense on a straight-line basis, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed.

Provisions and Contingencies

Provisions are recognized when the Company has a present obligation as a result of a past event, if it is probable that an outflow of resources will be required and if a reliable estimate can be made of the amount of the obligation. Provisions are measured based on the best estimate of discounted future cash outflows.

Decommissioning obligations

The Company's activities give rise to dismantling, decommissioning and site disturbance remediation activities. An obligation is accrued for the estimated cost of site restoration and the corresponding amount is included in the cost of the assets to which the obligations relate. Decommissioning obligations are measured at the present value of management's best estimate of the expenditure required to settle the present obligation at the Statement of Financial Position date. Subsequent to the initial measurement, the obligation is adjusted at the end of each period to reflect the passage of time and changes in the estimated future cash flows underlying the obligation, changes to the expected timing of site restoration, as well as any changes in the risk-free discount rate. Increases in the provision due to the passage of time are recognized as a financing expense in the Statement of Profit and Comprehensive Income whereas increases/decreases due to changes in the estimated future cash flows are capitalized. Actual costs incurred upon settlement of the decommissioning obligations are charged against the provision to the extent the provision is established.

Contingencies

Contingent liabilities are possible obligations whose existence will only be confirmed by future events not wholly within the control of the Company. When a contingency is substantiated by confirming events, can be reliably measured and will likely result in an economic outflow, a liability is recognized in the financial statements as the best estimate required to settle the obligation. A contingent liability is disclosed where the existence of an obligation will only be confirmed by future events, or where the amount of a present obligation cannot be measured reliably or will likely not result in an economic outflow.

Contingent assets are only disclosed when the inflow of economic benefits is probable. When the economic benefit becomes virtually certain, the asset is no longer contingent and is recognized in the financial statements.

Income taxes

Total income tax expense is composed of both current and deferred income taxes.

Current tax is the expected tax payable on taxable income for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

The Company follows the liability method of accounting for income taxes. Under this method, deferred income tax is recognized in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred taxes are allocated between income and equity depending on the nature of the account balance or transaction that gives rise to the temporary difference.

Deferred tax liabilities are recognized for taxable temporary differences. Deferred tax assets are recognized for deductible temporary differences, unused tax losses and unused tax credits only if it is probable that sufficient future taxable income will be available to utilize those temporary differences and losses. Such deferred tax liabilities and assets are not recognized if the temporary difference arises from goodwill or from the initial recognition of an asset or liability in a transaction which is not a business combination and, at the time of the transaction, affects neither accounting profit nor taxable income. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. The effect of a change in income tax rates on deferred tax assets and liabilities is recognized in the Statement of Profit and Comprehensive Income in the period that the change occurs.

Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to income taxes levied by the same tax authority on the same taxable entity or on different tax entities but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously. Deferred tax assets and liabilities are recorded on a non-discounted basis.

Revenue recognition

Revenue from the sale of oil and natural gas is recorded when the significant risks and rewards of ownership of the product are transferred to the buyer which is usually when legal title passes to the external party and collectability is reasonably assured. This is generally at the time product enters the pipeline. Royalties, which are presented as a reduction in revenue in the Statement of Profit and Comprehensive Income, are recognized at the time of production. Net revenues earned from properties in which the Company shares a joint interest, are recognized proportionately based on the Company's working interest in those properties.

Royalty income is recognized as it accrues in accordance with the terms of the overriding royalty agreements.

Financing expense

Financing expenses include interest expense on borrowings and accretion of the discount on decommissioning obligations due to the passage of time.

Borrowing costs incurred for the construction of qualifying assets are capitalized during the period of time required to complete and prepare the assets for their intended use. All other borrowing costs are recognized in financing expense using the effective interest method.

Share based compensation

The Company has an Incentive Stock Option Plan and Restricted Share Unit Plan (collectively, the "Plans"). Pursuant to the Plans, stock options and restricted share units ("RSUs") may be granted to officers, directors, employees and certain consultants, which call for settlement through the issuance of new common shares of the Company.

The Company applies the fair value method of accounting for stock options, whereby each tranche in an award is valued separately on the grant date using the Black-Scholes option pricing model. The fair value of RSUs is calculated based on the volume weighted average trading price over three trading days immediately prior to the date of grant. The total fair value associated the stock options and RSUs is recognized over the service period using graded vesting, as share based compensation expense with a corresponding increase to contributed surplus. An estimated forfeiture rate is applied against the total fair value on the grant date and is adjusted to reflect the actual number of options that ultimately vest each period. The consideration received by the Company on the exercise of stock options is recorded as an increase in shareholders' capital, together with the corresponding amounts previously recognized in contributed surplus.

Flow-through shares

Canadian tax legislation permits entities meeting specified criteria to issue securities to investors whereby the deductions for tax purposes related to eligible expenditures may be claimed by the investors rather than by the entity (herein referred to as "flow-through shares"). The Company uses the residual method to account for flow-through shares. Under this method, the proceeds from the issuance are allocated between i) the proceeds of the offering of shares, and ii) the renunciation of tax deductions. At the time the flow-through shares are issued: i) shareholders' capital is credited based on the fair value of ordinary common shares, and ii) the tax deductions to be renounced are deferred and presented a liability in the Statement of Financial Position, at an amount equal to the residual difference between the fair value of the Company's ordinary common shares relative to the amount the investor pays for the flow-through shares. At the time the Company fulfills its obligation to pass on the tax deductions to investors, which is deemed to occur when the eligible expenditures are incurred, the liability (deferred premium) is drawn down in proportion to the eligible expenditures incurred in the period and the premium on flow-through shares is recognized as income in the Statement of Profit and Comprehensive Income. Concurrently, a deferred income tax liability is recognized for the taxable temporary difference that arises from the difference between the carrying amount of the eligible expenditures capitalized as an asset for accounting purposes and a tax base of nil, because the deduction has been renounced to investors.

Per share amounts

Basic profit (loss) per common share is calculated by dividing profit (loss) for the period attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the period. Common shares issued as part of the consideration transferred in a business combination or common control transaction are included in the weighted average number of common shares starting from the acquisition date.

Diluted profit (loss) per common share is calculated giving effect to the potential dilution that would occur if all outstanding "in-the-money" stock options were exercised or converted to common shares. The weighted average number of common shares outstanding during the period is adjusted by the incremental number of shares calculated in accordance with the treasury stock method. The treasury stock method assumes that the proceeds received from the exercise of all potentially dilutive instruments are used to repurchase common shares at the volume weighted average market price during the period.

Accounting standards issued but not yet effective

IFRS 15 *Revenue from Contracts with Customers* provides clarification for recognizing revenue from contracts with customers and establishes a single revenue recognition and measurement framework that applies to contracts with customers. The new standard is effective for annual periods beginning on or after January 1, 2018, with early adoption permitted. Management does not expect the adoption of IFRS 15 to have a material impact on the consolidated financial statements, however, the evaluation of all potential measurement and disclosure impacts is ongoing.

IFRS 9 *Financial Instruments*, is intended to replace IAS 39 *Financial Instruments: Recognition and Measurement* and uses a single approach to determine whether a financial asset is measured at amortized cost or fair value, replacing the multiple rules in IAS 39. For financial liabilities designated at fair value through profit or loss, a company can recognize the portion of the change in fair value related to the change in the company's own credit risk through other comprehensive income rather than profit or loss. The new standard also requires a single impairment method to be used, replacing the multiple impairment methods in IAS 39, and incorporates new hedge accounting requirements. The new standard is effective for annual periods beginning on or after January 1, 2018, with early adoption permitted. Based on the nature of the Company's existing financial assets and liabilities, management does not expect the adoption of IFRS 9 to have a material impact on the consolidated financial statements, however, the evaluation of all potential measurement and disclosure impacts is ongoing.

IFRS 16 *Leases,* is intended to replace IAS 17 and will bring fundamental changes for all companies, including Kelt, who lease assets. The new standard is effective for annual reporting periods beginning on or after January 1, 2019, with early application permitted. The most significant financial reporting impacts of the changes include: all leases will be on the balance sheet of lessees, except those that meet the limited exception criteria; the measurement and presentation of expenses will be significantly impacted as rent expense is removed and replaced by the recording of depreciation and financing expenses; the amount of profit (loss) recognized in a period will likely change as the timing of expenses is accelerated when applying the new standard which uses a finance lease model compared to a straight line operating lease expense; and key ratios may be impacted with the introduction of lease assets and liabilities on the balance sheet and changes to the timing of expenses. Management is currently evaluating the potential impact of IFRS 16 on the consolidated financial statements as well as the potential broader impacts beyond financial statement presentation (for example: financial ratios or covenant calculations under credit agreements, the structure and/or basis for management compensation arrangements, earnings clauses included in business acquisitions, tax planning strategies, the design of new processes and internal controls, etc.).

4. PROPERTY DISPOSITION

On February 10, 2014, Kelt completed the disposition of certain non-core and non-operated assets located in northwestern Alberta for cash proceeds of approximately $19.6 million, after closing adjustments. The disposition included property, plant and equipment of $20.6 million and associated decommissioning obligations of $1.0 million, which were classified as held for sale at December 31, 2013. No gain or loss was recognized on the disposition as the assets held for sale were measured at fair value.

5. ACQUISITIONS

a) Corporate Acquisitions

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 became a wholly-owned subsidiary of Kelt. The acquisition of Artek consolidated the majority of Kelt's land acreage in its Inga-Fireweed-Stoddart, British Columbia core area to 100% 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 British Columbia.

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 are recorded at the fair value on the acquisition date of April 16, 2015. The following tables 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	(4,760)
Net consideration	**237,881**
Bank debt, net of working capital	(100,321)
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(2)	**254,655**
Gain on acquisition(2)	**16,774**

(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) The Company reviewed the fair values of identifiable assets and liabilities acquired and the resultant gain on acquisition. Revisions to estimates over the measurement period resulted in a net decrease in gain on acquisition by $1.7 million, compared to the gain on acquisition initially estimated and previously reported in Kelt's consolidated interim financial statements as at June 30, 2015.

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.

The net working capital deficit includes $7.0 million of accounts receivable and accrued revenue, $0.4 million of deposits, $11.9 million of accounts payable and accrued liabilities 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.

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 $16.8 million.

Transaction costs of approximately $2.4 million were recognized as an expense in period. 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.

The Statement of Profit (Loss) and Comprehensive Income (Loss) includes the results of operations for the period following closing of the Artek Acquisition on April 16, 2015. Specifically, Kelt's profit (loss) for year ended December 31, 2015 includes approximately $24.7 million of revenue and $7.8 million of operating income generated from the acquired interest in the properties subsequent to closing. If the acquisition had occurred on January 1, 2015, pro-forma revenue and operating income is estimated to be approximately $38.2 million and $9.3 million, respectively, for the year ended December 31, 2015. Operating income is defined as revenue, net of royalties, less production and transportation expenses. This pro-forma information is not necessarily indicative of the results of operations that would have resulted had the acquisition been effected on the dates indicated, or the results that may be obtained in the future.

Acquisition of Capio Exploration Ltd.

On July 2, 2014, the Company closed the acquisition of Capio Exploration Ltd. ("Capio"), by acquiring all of the issued and outstanding common shares of Capio. Pursuant to the terms of the acquisition, which had an effective date of May 1, 2014, the consideration paid by Kelt, after closing adjustments, consisted of $72.1 million in cash and the issuance of 4,270,956 common shares of Kelt. In addition, Kelt assumed a working capital deficit of $37.4 million, including $32.5 million of bank indebtedness which was repaid at closing and Capio's demand loan credit facility was terminated. Immediately following closing of the acquisition, all of the property, assets and liabilities of Capio were assigned to Kelt and Capio was subsequently dissolved. The assets acquired, located at Valhalla/La Glace, are a complimentary fit with Kelt's existing core assets at Pouce Coupe/Spirit River in the Grande Prairie area of west central Alberta. The goodwill recognized on the acquisition of $18.2 million was attributed to the expected synergies and potential future cash flows to be derived from further exploration and development opportunities.

The table below summarizes the fair value of consideration and allocation of the purchase price:

Cash consideration, after closing adjustments	72,136
Issuance of common shares(1)	66,243
Total consideration	**138,379**
Bank debt, net of working capital	(37,439)
Exploration and evaluation assets	10,832
Property, plant and equipment	184,757
Goodwill	18,206
Decommissioning obligations	(399)
Deferred income tax liability	(37,578)
Fair value of net assets acquired	**138,379**

(1) The number of common shares issued pursuant to the acquisition was negotiated based on a total value of $58.0 million divided by the five day volume weighted average price of Kelt common shares that traded on the TSX from June 9th to 13th of $13.58 per common share. Under IFRS 3 *Business Combinations*, the value of common share consideration must be recognized based on acquisition date fair value. Accordingly, the value of common share consideration of $66.2 million reported above is based on the closing price of Kelt common shares on July 2, 2014 of $15.51 per common share.

b) Property acquisitions

During the years ended December 31, 2015 and 2014, the Company completed several minor strategic acquisitions of petroleum and natural gas assets in its core operating areas. The property acquisitions have been accounted for as business combinations using the acquisition method, whereby the net assets acquired and the liabilities assumed are recorded at fair value. The following table summarizes the aggregate cash consideration and fair value of net assets acquired pursuant to minor property acquisitions completed during the year ended December 31, 2015 and previous year ended December 31, 2014:

	December 31, 2015	December 31, 2014
Exploration and evaluation assets	**264**	8,368
Property, plant and equipment	**16,714**	23,489
Decommissioning obligations	**(628)**	(7,143)
Fair value of net assets acquired	**16,350**	24,714
Cash consideration, after closing adjustments	**16,350**	24,714

6. EXPLORATION AND EVALUATION ASSETS

The following table reconciles movements of exploration and evaluation assets:

	December 31, 2015	December 31, 2014
Balance, beginning of period	**79,294**	40,564
Additions	**43,555**	101,524
Property acquisitions [note 5]	**264**	8,368
Corporate acquisition [note 5]	**52,340**	10,832
Transfers to property, plant and equipment	**(40,674)**	(81,617)
Expired mineral leases	**(3,117)**	(377)
Impairments	**(7,357)**	-
Balance, end of period	**124,305**	79,294

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

During the fourth quarter of 2015, the Company concluded that approximately $7.4 million of exploratory drilling costs were impaired. These costs were not transferred to PP&E as proved reserves cannot be established based on forecast commodity prices and the Company's current intentions for the allocation of future development capital. Accordingly, the exploratory drilling costs were charged to exploration and evaluation expense, along with $3.1 million of costs associated with mineral leases that expired during the year ended December 31, 2015. The Company concluded that there are no indicators of potential impairment of its E&E assets at the operating segment level.

7. PROPERTY, PLANT AND EQUIPMENT

Net carrying value	**December 31, 2015**	December 31, 2014
Development and production ("D&P") assets	**1,124,180**	769,951
Corporate assets	**725**	533
Total net carrying value of property, plant and equipment	**1,124,905**	770,484

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

Property, plant and equipment, at cost	D&P Assets	Corporate Assets	Total PP&E
Balance at December 31, 2013	421,849	414	422,263
Additions	149,087	636	149,723
Property acquisitions [note 5]	23,489	-	23,489
Corporate acquisition [note 5]	184,757	-	184,757
Dispositions	-	(22)	(22)
Decommissioning costs	38,608	-	38,608
Transfers from E&E	81,617	-	81,617
Balance at December 31, 2014	**899,407**	**1,028**	**900,435**
Additions	**122,240**	**810**	**123,050**
Property acquisitions [note 5]	**16,714**	**-**	**16,714**
Corporate acquisition [note 5]	**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**

Accumulated depletion, depreciation and impairment	D&P Assets	Corporate Assets	Total PP&E
Balance at December 31, 2013	45,450	105	45,555
Depletion and depreciation expense	84,006	412	84,418
Dispositions	-	(22)	(22)
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**

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 $531.2 million (December 31, 2014 – $382.8 million) are included in the depletion calculation for development and production assets.

As a result of the significant decrease in forecast oil and natural gas prices, an indication of potential impairment was identified for all CGUs. Recoverable amounts for the Company's CGUs were estimated based on FVLCD methodology, calculated using the present value of the CGUs' expected future cash flows (after-tax). The cash flow information was derived from a report on the Company's oil and gas reserves (the "2015 Sproule Report") which was prepared by an independent qualified reserve evaluator, Sproule Associates Limited ("Sproule") as of December 31, 2015. The projected cash flows used in the FVLCD calculation reflect current market assessments of key assumptions, including long-term forecasts of commodity prices, inflation rates, and foreign exchange rates (Level 3 fair value inputs). Cash flow forecasts are also based on past experience, historical trends and Sproule's evaluation of the Company's reserves and resources to determine production profiles and volumes, operating costs, maintenance and future development capital expenditures. Future cash flow estimates are discounted using after-tax risk-adjusted discount rates. The after-tax discount rates applied in the impairment calculation as at December 31, 2015 ranged from 9% to 10%, depending on the risks specific to the assets in the CGU. Based on the FVLCD calculation, the carrying value of each of the Company's Alberta CGUs was in excess of the recoverable amount, resulting in an impairment of PP&E of $64.1 million and an impairment of goodwill of $18.2 million. The recoverable amount of the Company's BC CGU significantly exceeded its carrying value and was not impaired at December 31, 2015.

Of the total PP&E impairment loss, approximately $48.5 million is attributable to the Karr CGU, a light oil prospect with associated gas production. As Kelt's Montney oil play at Karr is in the early stage of development, the Company has devoted significant capital expenditures to construct and acquire access to key infrastructure and to delineate acreage. At the same time, the reserves assigned by Sproule are relatively more conservative due to the early stage nature of the play. These factors, taken together along with the sudden drop in forecast oil and gas prices, resulted in the impairment of the Karr CGU as at December 31, 2015. The impairment loss recognized for the Karr CGU does not reflect asset quality, but rather, that in a severely depressed commodity price environment, Kelt's initial investment to develop the Karr area may not be fully recovered if conditions persist.

The Company's Grande Cache CGU, which is comprised of mature, low-decline dry gas assets, was impaired by approximately $8.5 million at December 31, 2015. Compared to Sproule's prior forecast at December 31, 2014, forecast AECO-C gas prices fell by 32% for 2016 and by 17% on average based on Sproule's revised forecast at December 31, 2015. Despite being a low-cost, high quality gas property, the magnitude of the decrease in forecast gas prices had a pervasive impact on the recoverable amount calculated for the Grande Cache CGU.

The Leduc-Woodbend CGU, which is comprised of a minor, non-core oil property that was acquired pursuant to the Artek Acquisition on April 16, 2015, was impaired by $7.1 million. The carrying value of the Leduc-Woodbend CGU at December 31, 2015, before impairment, approximated the fair value assigned to the property on the acquisition date pursuant to the purchase price allocation for the Artek Acquisition (net of depletion expense for the period). At the time of the Artek Acquisition, the forecast Canadian Light Sweet oil price was $75.76 per barrel for 2016 and $86.04 per barrel on average for the five year period from 2016 to 2020. During the interim period between the acquisition date and December 31, 2015, the forecast Canadian Light Sweet oil price fell by 27% to $55.20 for 2016 and the forecast five year average fell by 11% resulting on an impairment of the oil property.

The carrying value of the Greater Grande Prairie CGU exceeded the recoverable amount, resulting in an impairment of $18.2 million in respect of the goodwill allocated to the CGU (refer to note 8 for additional information). Based on the analysis, the Company concluded the deficiency calculated is attributable to goodwill only and that the carrying value of PP&E in the Greater Grande Prairie CGU is not impaired at December 31, 2015.

The recoverable amount is highly sensitive to the discount rate and forecast future commodity prices. Holding all other variables constant:

- if the discount rate applied to each CGU increased by 1%, the impairment of PP&E would increase by approximately $44.4 million;
- if the discount rate applied to each CGU decreased by 1%, the impairment of PP&E would decrease by approximately $15.1 million and goodwill of $18.2 million would not be impaired;
- if the forecast combined average realized price decreased by 5%, the impairment of PP&E would increase by approximately $74.1 million; and
- if the forecast combined average realized price increased by 5%, the impairment of PP&E would decrease by approximately $21.6 million and goodwill of $18.2 million would not be impaired as at December 31, 2015.

Forecast future prices used in the impairment evaluations as at December 31, 2015, and at December 31, 2014, reflect the benchmark prices set-forth in the tables below, adjusted for basis differentials to determine local reference prices, transportation costs and tariffs, heat content and quality.

As at December 31, 2015	2016	2017	2018	2019	2020(1)
WTI Cushing Oklahoma (US$/bbl)	45.00	60.00	70.00	80.00	81.20
Canadian Light Sweet 40 API ($/bbl)	55.20	69.00	78.43	89.41	91.71
NYMEX Henry Hub (US$/mmbtu)	2.25	3.00	3.50	4.00	4.25
AECO-C Spot ($/mmbtu)	2.13	2.80	3.24	3.71	3.98
Exchange rate (CA$/US$)	1.3333	1.2500	1.2048	1.1765	1.1765

(1) Prices escalate at 1.5% thereafter

As at December 31, 2014	2015	2016	2017	2018	2019(1)
WTI Cushing Oklahoma (US$/bbl)	65.00	80.00	90.00	91.35	92.72
Canadian Light Sweet 40 API ($/bbl)	70.35	87.36	98.28	99.75	101.25
NYMEX Henry Hub (US$/mmbtu)	3.25	3.75	4.00	4.50	5.00
AECO-C Spot ($/mmbtu)	3.32	3.71	3.90	4.47	5.05
Exchange rate (CA$/US$)	1.1765	1.1494	1.1494	1.1494	1.1494

(1) Prices escalate at 1.5% thereafter

During the previous year ended December 31, 2014, indicators of potential impairment were identified and recoverable amounts for each CGU were estimated based on FVLCD, calculated using the present value of the CGUs' expected future cash flows (after-tax). The after-tax discount rate applied in the impairment calculation at December 31, 2014 was 10% for all CGUs. Based on the analysis performed at December 31, 2014, the recoverable amount of each CGU exceeded its' carrying value, and accordingly, no impairment losses were recorded.

8. GOODWILL

	December 31, 2015	December 31, 2014
Balance, beginning of period	**18,206**	-
Acquisition of Capio Exploration Ltd. [note 5]	**-**	18,206
Impairment of goodwill	**(18,206)**	-
Balance, end of period	**-**	18,206

The carrying value of goodwill is attributable to the acquisition of Capio which closed on July 2, 2014. The Capio assets are located at Valhalla/La Glace, a light-oil property adjacent to Kelt's core producing assets at Pouce Coupe/Spirit River in the Grande Prairie area of west central Alberta. As more particularly described in note 7, the Company completed an impairment test as at December 31, 2015 and concluded that the goodwill allocated Greater Grande Prairie CGU of $18.2 million was impaired based on an after-tax discount rate of 10%. The impairment of goodwill as at December 31, 2015 is attributed to the decrease in oil prices as the fair value of the net assets acquired was initially recognized at a time the WTI oil price was in excess of US$100 per barrel. In addition, the increase in Kelt's share price between the announcement and closing date of the acquisition contributed to $8.2 million of the total $18.2 million of goodwill recognized on the acquisition.

The recoverable amount is highly sensitive to the discount rate and forecast future commodity price assumptions applied in the impairment calculation. Holding all other variables constant, if the discount rate applied decreased by 1%, or if the forecast combined average realized price increased by 5%, the recoverable amount of the Greater Grande Prairie CGU would have exceeded its carrying amount at December 31, 2015, and the full balance of $18.2 million would not be impaired.

9. BANK DEBT

The Company has a $300.0 million revolving committed term credit facility (the "Credit Facility") with a syndicate of financial institutions. The Credit Facility is available for a revolving period of 364 days, maturing on April 30, 2016, and may be extended for an additional 364 days at the discretion of the lenders, with a term-out to April 29, 2017 if not renewed. As at December 31, 2015, the authorized borrowing amount was $275.0 million, with additional funds available up to the total Credit Facility commitment of $300.0 million subject to approval of the lending syndicate. The Credit Facility is subject to semi-annual borrowing base reviews, occurring approximately in April/May and October/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. Covenants include reporting requirements, permitted indebtedness, permitted dispositions, permitted hedging, permitted encumbrances and other standard business operating covenants, to which Kelt is in full compliance at December 31, 2015. There are no financial covenants under the Credit Facility. 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.

	December 31, 2015	December 31, 2014
Bank loan	**5,800**	47,200
Bankers' acceptances	**172,800**	-
Unamortized financing fees(1)	**(1,030)**	(271)
Bank debt	**177,570**	46,929

(1) Includes $0.6 million of prepaid interest and stamping fees on bankers' acceptances as at December 31, 2015 (2014 – nil),

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

10. DECOMMISSIONING OBLIGATIONS

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

	December 31, 2015	December 31, 2014
Balance, beginning of period	**94,791**	48,169
Obligations incurred	**1,807**	3,259
Obligations acquired [note 5]	**12,594**	7,542
Obligations disposed [note 4]	**(190)**	(1,000)
Obligations settled	**(383)**	(229)
Changes in discount rate(1)	**33,664**	35,095
Revisions to estimates	**(2,298)**	254
Accretion expense	**2,816**	1,701
Balance, end of period	**142,801**	94,791
Current portion of decommissioning obligations	**(493)**	(758)
Long-term portion of decommissioning obligations	**142,308**	94,033

(1) Decommissioning obligations acquired as part of a business combination are initially measured at fair value using a credit-adjusted risk-free rate to discount estimated future cash outflows. The revaluation of obligations acquired using the risk-free rate at the end of the period results in an increase in the present value of the obligation reported in the Statement of Financial Position.

The key assumptions on which the carrying amount of the decommissioning obligations is based, include a risk-free rate of 2.2% (December 31, 2014 – 2.3%) and an inflation rate of 2.0% (December 31, 2014 – 2.0%). The underlying cost estimates are derived from a combination of published industry benchmarks as well as site specific information. As at December 31, 2015, the undiscounted amount of the estimated cash flows required to settle the obligation is $150.6 million (December 31, 2014 – $105.9 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 14).

11. SHARE CAPITAL

Authorized

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

Issued and outstanding

The following table summarizes the change in common shares issued and outstanding:

	Number of Shares (000's)	Amount ($ thousands)
Balance at December 31, 2013	110,026	449,876
Issued for cash through common share offering	12,592	148,988
Deferred premium on flow-through shares	-	(3,722)
Issued pursuant to corporate acquisition [note 5]	4,271	66,243
Issued for cash on exercise of stock options	45	291
Transfer from contributed surplus on exercise of stock options	-	120
Share issue costs, net of deferred income taxes ($1,573)	-	(4,694)
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 corporate 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**

There are no preferred shares issued or outstanding as of December 31, 2015 (2014 – nil).

Common share offerings

On July 7, 2015, the Company completed a bought deal public offering and a non-brokered private placement for aggregate gross proceeds of $90.0 million. The bought deal public offering was led by a syndicate of underwriters by way of a short-form prospectus, pursuant to which the Company issued 9.775 million common shares of Kelt (which includes the exercise in full of the over-allotment option to purchase 1.275 million common shares) at a price of $8.85 per common share. Kelt issued 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.

On April 16, 2015, the Company issued 26.9 million common shares to the shareholders of Artek as consideration for the acquisition (note 5). The number of common shares issued pursuant to the acquisition was determined using a share exchange ratio of 0.34, which 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. Under IFRS 3 *Business Combinations*, the value of common share consideration must be recognized based on acquisition date fair value. Accordingly, the value of common share consideration of $242.6 million reported above is based on the closing price of Kelt common shares on April 16, 2015 of $9.02 per common share.

During the first quarter of 2015, the Company completed non-brokered private placements of 3.881 million flow-through shares at a price of $8.60 per flow-through share, resulting in gross proceeds of $33.4 million. The implied premium on the flow-through shares was determined to be $2.9 million or $0.74 per flow-through share, assuming a market price of $7.86 per ordinary common share. Certain directors and officers of the Company subscribed to purchase 1.714 million flow-through shares for gross proceeds of $14.9 million, representing approximately 44% of the aggregate issue. Pursuant to the provisions of the *Income Tax Act* (Canada), the Company committed to incur eligible Canadian development expenses after the respective closing dates and prior to December 31, 2015 in the aggregate amount of not less than the total gross proceeds raised from the offering. As of December 31, 2015, the Company had incurred the full commitment of $33.4 million. Kelt renounced the qualifying expenditures to the subscribers of the flow-through shares in an amount equal to $8.60 per flow-through share, of which, approximately $3.0 million was renounced with an effective date of May 31, 2015, and $30.4 million was renounced with an effective date of December 31, 2015.

On December 18, 2014, the Company completed a non-brokered private placement of 0.182 million flow-through shares at a price of $11.00 per flow-through share, providing gross proceeds of $2.0 million. The implied premium on the flow-through shares was determined to be $0.7 million or $3.80 per flow-through share, assuming a market price of $7.20 per ordinary common share. Pursuant to the provisions in the *Income Tax Act* (Canada), the Company committed to incur Canadian exploration expenses after December 18, 2014 and prior to December 31, 2015 in the aggregate amount of not less than $2.0 million. Kelt incurred the full commitment of qualifying expenditures during the first quarter of 2015, however, the qualifying expenditures were renounced to the subscriber of the flow-through shares with an effective renunciation date of December 31, 2014.

On July 2, 2014, the Company issued 4.3 million common shares to the shareholders of Capio as partial consideration for the acquisition (note 5). The number of common shares issued pursuant to the acquisition was negotiated based on a total value of $58.0 million divided by the five day volume weighted average price of Kelt common shares that traded on the Toronto Stock Exchange from June 9th to 13th of $13.58 per common share. Under IFRS 3 *Business Combinations*, the value of common share consideration must be recognized based on acquisition date fair value. Accordingly, the value of common share consideration of $66.2 million reported above is based on the closing price of Kelt common shares on July 2, 2014 of $15.51 per common share.

On March 25, 2014, Kelt completed brokered and non-brokered private placement equity offerings for aggregate gross proceeds of $147.0 million. Pursuant to the brokered private placement, the Company issued 9.775 million common shares at a price of $11.60 per common share and issued 1.53 million common shares on a “flow-through” basis at a price of $12.75 per flow-through share. The Company issued an additional 1.105 million flow-through shares at a price of $12.75 per flow-through share to certain directors, officers and employees of the Company, pursuant to the non-brokered private placement. The implied premium on the flow-through shares was determined to be $3.0 million or $1.15 per flow-through share. Pursuant to the provisions in the *Income Tax Act* (Canada), Kelt committed to incur eligible Canadian development expenses after March 25, 2014 and prior to December 31, 2014 in the aggregate amount of not less than the total amount of the gross proceeds raised from the issue of flow-through shares of $33.6 million. As of December 31, 2014, the Company had incurred the full commitment. Kelt renounced the qualifying expenditures to the subscribers of the flow-through shares in an amount equal to $12.75 per flow-through share with an effective renunciation date of December 31, 2014.

Stock options

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

The following table summarizes the change in stock options outstanding:

	Number of Options (000's)	Average Exercise Price ($/share)
Balance at December 31, 2013	2,421	6.84
Granted	2,624	9.79
Exercised(1)	(45)	6.47
Forfeited	(73)	8.91
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**

(1) The weighted average share price on the date of exercise for stock options exercised in 2014 was $10.15 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:

	Year ended December 31	
	2015	2014
Risk free interest rate	**0.7%**	1.2%
Expected life (years)	**3.5**	3.5
Expected volatility(1)	**44.5%**	37.3%
Expected dividend yield	**-**	-
Expected forfeiture rate	**1.4%**	0.6%
Fair value of options granted during the year ($/share)	**1.56**	2.72

(1) The Company estimates the expected volatility over the life of the option 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 December 31, 2015:

Range of exercise prices per common share	Number of options outstanding (000's)	Weighted average remaining term (years)	Weighted average exercise price for options outstanding ($/share)	Number of options exercisable (000's)	Weighted average exercise price for options exercisable ($/share)
$0.00 to $5.00	1,610	4.9	4.38	-	-
$5.00 to $10.00	3,869	3.0	7.04	1,975	6.91
$10.01 to $15.00	1,151	3.3	12.42	384	12.42
$15.01 to $20.00	60	3.5	15.40	20	15.40
Total	**6,690**	**3.5**	**7.40**	**2,379**	**7.87**

Restricted share units

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

The following table summarizes the change in RSUs outstanding:

	Number of RSUs (000's)
Balance at December 31, 2013	1,623
Granted	208
Forfeited	(69)
Balance at December 31, 2014	**1,762**
Granted	**247**
Released upon vesting	**(778)**
Forfeited	**(27)**
Balance at December 31, 2015	**1,204**

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:

	Year ended December 31	
	2015	2014
Stock options	**4,472**	4,116
Restricted share units	**3,900**	4,917
Total share based compensation expense	**8,372**	9,033

Per share amounts

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

	Year ended December 31	
(000's of common shares)	**2015**	2014
Weighted average common shares outstanding, basic	**154,829**	121,779
Effect of stock options and RSUs	**1,107**	2,517
Weighted average common shares outstanding, diluted	**155,936**	124,296

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 both the quarter and year ended December 31, 2015, the Company excluded the effect of stock options and RSUs as they were anti-dilutive.

12. INCOME TAXES

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

	Year ended December 31	
	2015	2014
Current income tax expense	**-**	-
Deferred income tax expense	**(32,847)**	15,834
Total income tax expense	**(32,847)**	15,834

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 December 31, 2015 are estimated to be approximately $958.0 million (2014 – $599.8 million).

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

	Year ended December 31	
	2015	2014
Profit (loss) before income taxes	**(173,022)**	26,462
Canadian statutory tax rate	**26.0%**	25.1%
Expected income tax expense (recovery)	**(44,986)**	6,640
Increase (decrease) resulting from:		
Non-deductible expenses(1)	**2,810**	2,272
Recognition of unrecognized deferred tax asset	**(1,979)**	(2,061)
Qualifying expenditures on flow-through shares	**9,553**	10,044
Premium on flow-through shares	**(927)**	(1,057)
Change in tax rates(2)	**2,247**	(4)
True-up of tax pools	**63**	-
Impairment of goodwill	**4,734**	-
Gain on acquisition	**(4,362)**	-
Deferred income tax expense (recovery)	**(32,847)**	15,834

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

(2) Includes a deferred tax recovery of approximately $0.8 million representing the consolidated net tax benefit of intercompany transactions between Kelt and Kelt LNG.

The Canadian statutory tax rate per the rate reconciliation above 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%, resulting in an average tax rate of 11% for Alberta for the year ended December 31, 2015. The increase in Alberta's corporate tax rate resulted in an increase in Kelt's deferred tax liability and a reduction of the deferred tax recovery by approximately $3.0 million during the year ended December 31, 2015.

During the year ended December 31, 2015, the Company renounced tax pools in the amount of $35.4 million related to qualifying expenditures incurred pursuant to flow-through share offerings. The Company renounced $40.0 million of tax pools to the subscribers of flow-through shares during the previous year ended December 31, 2014.

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, 2014	Recognized in profit and CI(1)	Recognized in balance sheet	**Balance at December 31, 2015**
Derivative financial instruments	(438)	500	-	**62**
PP&E and E&E	(78,194)	(855)	(57,367)	**(136,416)**
Decommissioning obligations	23,786	11,183	3,046	**38,015**
Share and debt issue costs	3,283	(1,280)	2,361	**4,364**
Reserve from common control transaction	(10,430)	1,262	-	**(9,168)**
Non-capital losses(2) and other(3)	12,111	22,037	21,806	**55,954**
	(49,882)	32,847	(30,154)	**(47,189)**

Deferred income tax asset (liability)	Balance at December 31, 2013	Recognized in profit and CI(1)	Recognized in balance sheet	Balance at December 31, 2014
Derivative financial instruments	133	(571)	-	(438)
PP&E and E&E	(6,780)	(31,134)	(40,280)	(78,194)
Decommissioning obligations	11,792	11,894	100	23,786
Share and debt issue costs	2,599	(889)	1,573	3,283
Reserve from common control transaction	(12,445)	2,015	-	(10,430)
Non-capital losses(2)	6,658	2,851	2,602	12,111
	1,957	(15,834)	(36,005)	(49,882)

(1) Comprehensive income has been abbreviated as "CI".
(2) The Company's non-capital losses expire in years 2023 to 2035.
(3) Includes a deferred tax asset of $0.1 million related to a portion of the provision for potential credit losses as at December 31, 2015 (2014 – nil).

The amount and timing of reversals of temporary differences will be dependent upon a number of factors, including the nature and timing of future capital expenditures and the Company's future operating results. In the next twelve months, the Company expects approximately $1.9 million of deferred income tax assets to be recovered related to temporary differences in respect of share and debt issue costs, provisions for potential credit losses and the derivative financial instrument liability. The Company does not expect any other deferred income tax assets or liabilities to reverse within the next twelve months.

13. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Financial instruments of the Company include cash and cash equivalents, accounts receivable and accrued revenue, deposits, accounts payable and accrued liabilities, derivative financial instruments and bank debt. The fair value of the Company's financial assets and liabilities approximate their carrying value due to the short-term maturity of those instruments. In addition, the fair value of bank debt approximates its carrying value given it bears a floating rate of interest. The methodology used to determine the fair value for the Company's derivative financial instruments is described further in this note.

Offsetting of financial instruments

Financial assets and liabilities are only offset if the Company has the current legal right to offset and intends to settle on a net basis or settle the asset and liability simultaneously. Kelt offsets derivative contracts assets and liabilities when the counterparty, commodity, currency and timing of settlement are the same. As at December 31, 2015, there are no offsetting derivative financial contracts.

Fair value measurements

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

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

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

The table below summarizes fair value measurements for each hierarchy level as at December 31 2015:

	Level 1	Level 2	Level 3
Financial assets and liabilities			
Derivative financial instrument liability	-	230	-

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

	Level 1	Level 2	Level 3
Financial assets and liabilities			
Derivative financial instrument asset	-	1,745	-

Risk Management Overview

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

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

Credit Risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations. As at December 31, 2015, the carrying amount of cash and cash equivalents, 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 year ended December 31, 2015, sales to five oil and gas marketers each individually represented more than 10% of total revenue. Sales to these customers account for approximately 23%, 17%, 15%, 13%, and 11% of total revenue, respectively. During the previous year ended December 31, 2014, sales to three oil and gas marketers accounted for approximately 53%, 16% and 15% of total revenue, respectively.

The composition of the Company's accounts receivable is set out in the following table:

Accounts receivable and accrued revenue	**December 31, 2015**	December 31, 2014
Joint venture partners	**5,154**	11,972
Oil and gas marketers	**16,085**	15,488
GST input tax credits	**4,773**	5,461
Risk management contracts	**-**	1,681
Other	**1,254**	490
Accounts receivable and accrued revenue	**27,266**	35,092

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

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

The Company has International Swaps and Derivatives Association ("ISDA") agreements with certain financial institutions that are part of Kelt's Credit Facility syndicate, to address counterparty credit risk associated with derivative financial instruments. These agreements and confirmations provide some credit protection in that they generally allow parties to aggregate amounts owing to each other under all outstanding transactions and settle with a single net amount in the case of a credit event.

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

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 December 31, 2015	**23,071**	**1,836**	**783**	**1,576**	**27,266**
Balance at December 31, 2014	31,071	2,499	208	1,314	35,092

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 December 31, 2015 and expects the accounts to be collectible, except for approximately $1.0 million of accounts receivable which are provided for in the allowance for doubtful accounts. A continuity of the change in allowance for doubtful accounts and the provision for potential credit losses is set-forth in the table below:

	December 31, 2015	December 31, 2014
Allowance for doubtful accounts, beginning of period	**-**	-
Provisions recognized in balance sheet(1)	**391**	-
Provisions for potential credit losses through profit (loss)	**611**	-
Allowance for doubtful accounts, end of period	**1,002**	-

(1) Provision applied to opening balance of accounts receivable acquired pursuant to the Artek Acquisition (note 5).

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 and bank debt. The Company manages liquidity risk through prudent use of bank debt and an actively managed production and capital expenditure budgeting process. In addition, risk management contracts such as derivative financial instruments may be used from time to time. As discussed further under the *Capital Management* section to follow, Kelt targets a relatively low debt to trailing funds from operations ratio. To manage this, the Board of Directors approves an annual capital expenditure budget, which is regularly monitored and updated as necessary in response to changing capital requirements. The Company utilizes a control system with respect to authorizations for expenditures on both operated and non-operated projects to further manage capital expenditures.

The capital intensive nature of Kelt's operations may create a working capital deficiency position during periods with high levels of capital investment. However, during such periods, the Company maintains sufficient unused bank credit lines to satisfy such working capital deficiencies. As at December 31, 2015, the Company's working capital deficit of $34.5 million combined with outstanding bank debt of $177.6 million, represented 77% of the authorized borrowing amount available under the Credit Facility of $275.0 million, or 71% of the total Credit Facility commitment of $300.0 million. The availability of additional funds up to the total Credit Facility commitment of $300.0 million is subject to approval of the lending syndicate. The Credit Facility is available for a revolving period of 364 days, maturing on April 30, 2016, and may be extended for an additional 364 days at the discretion of the lenders, with a term-out to April 29, 2017 if not renewed.

Due to the current business environment of low commodity prices, many oil and gas companies, including Kelt, are facing a number of uncertainties. The authorized borrowing amount available under the Credit Facility, which is subject to semi-annual review by the lending syndicate, is closely tied to the value of the Company's reserves. In the event that the lenders reduce the borrowing base below the amount drawn at the time of the redetermination, the Company would have 60 days to eliminate any borrowing base shortfall by repaying the amount drawn in excess of a re-determined borrowing base or by providing additional security or other consideration satisfactory to the lenders. Although management expects that the lenders will extend the Credit Facility in at the end of the revolving period, there is no assurance that the financial institutions will choose to do so. Should the financial institutions not extend the loan, the Company would need to seek alternate sources of debt or equity financing.

The table below outlines a contractual maturity analysis for Kelt's financial liabilities as at December 31, 2015:

	Within 1 Year	1 to 5 Years	More than 5 Years	Total
Accounts payable and accrued liabilities	64,067	-	-	64,067
Derivative financial instrument liability	230	-	-	230
Bank debt and estimated interest[(1)]	6,965	180,871	-	187,836
Total	**71,262**	**180,871**	**-**	**252,133**

(1) Estimated interest for future periods related to the Credit Facility was calculated using the weighted average interest rate of 3.9% for the fourth quarter ended December 31, 2015, applied to the principal balance outstanding as at that date. Principal repayment of the Company's revolving Credit Facility is assumed on April 29, 2017.

Market Risks

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

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

Commodity price risk

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

The Company's current risk management policies permit management to enter into commodity agreements, provided that: i) the contracts are not entered into for speculative purposes; ii) that the notional quantity hedged, at the time of entering into the contract, does not exceed 65% of average daily production; and iii) that the term does not exceed 36 months. The Company did not have any commodity price risk management contracts outstanding as of December 31, 2015.

Interest rate risk

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. The Company is exposed to interest rate risk to the extent that changes in market interest rates will impact the Company's Credit Facility which is subject to a floating interest rate. An increase (decrease) of 1% in market interest rates would have decreased (increased) shareholders' equity and profit by $1.5 million for the year ended December 31, 2015, based on the Company's average debt balance outstanding of $151.8 million during the year.

The following table summarizes the Company's interest rate risk management contracts outstanding as of December 31, 2015:

Contract Type	Notional Amount	Reference Price	Fixed Contract Price	Remaining Term	Fair value Asset (Liability)
Interest Rate Swap	$100,000,000	CDOR	0.925%	January 1, 2016 to June 30, 2017	**(230)**

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 rate risk

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

As outlined in note 15, the Company has commitments for firm gas transportation service under contracts denominated in U.S. dollars. As at December 31, 2015, Kelt's total commitment over the term of the USD contracts is CA$20.5 million, translated at the spot rate on December 31, 2015 of $1.3840.

In order to mitigate a portion of the risk relating to revenue that is subject to fluctuations in the exchange rate, the Company may enter into commodity swap transactions whereby commodity prices denominated in U.S. dollars are converted to Canadian dollars. There are no such contracts in place as at December 31, 2015.

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

	Year ended December 31	
	2015	2014
Realized loss	**(886)**	(388)
Unrealized gain (loss)	**(1,975)**	2,277
Gain (loss) on derivative financial instruments	**(2,861)**	1,889

Capital Management

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

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

	December 31, 2015	December 31, 2014
Bank debt	**177,570**	46,929
Working capital deficiency	**34,525**	57,501
Net debt	**212,095**	104,430
Trailing funds from operations(1)(2)	**44,688**	118,656
Debt to trailing funds from operations ratio	**4.7**	0.9

(1) 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.

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

Kelt targets a debt to trailing funds from operations ratio of less than 2.0 times. As a result of severely depressed commodity prices during the first year of 2015, Kelt's trailing debt to funds from operations ratio as at December 31, 2015 was 4.7 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.

Kelt is subject to certain non-financial covenants under the Credit Facility agreement. As at December 31, 2015, the Company is in compliance with all covenants. The Company is not subject to any other externally imposed capital requirements.

14. FINANCING EXPENSES

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

	Year ended December 31	
	2015	2014
Interest and fees on bank debt	**6,584**	820
Accretion of decommissioning obligations [note 10]	**2,816**	1,701
Financing expense	**9,400**	2,521

15. COMMITMENTS

As of December 31, 2015, the Company is committed to future payments under the following agreements:

(CA$ thousands)	2016	2017	2018	2019	2020	Thereafter
Operating lease – office buildings	1,150	1,170	392	-	-	-
Operating lease – vehicles	242	175	76	4	-	-
Firm processing commitments	5,832	4,289	-	-	-	-
Firm transportation commitments	6,090	6,794	7,525	4,849	1,707	6,514
Firm transportation commitments – USD(1)	11,887	8,567	-	-	-	-
Total annual commitments	**25,201**	**20,995**	**7,993**	**4,853**	**1,707**	**6,514**

(1) Commitments under firm transportation contracts denominated in US dollars are translated to Canadian dollars at the spot rate on December 31, 2015 of $1.3840.

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

16. SUPPLEMENTAL CASH FLOW INFORMATION

	Year ended December 31	
Changes in non-cash working capital	**2015**	2014
Accounts receivable and accrued revenue	**21,413**	(16,675)
Prepaid expenses and deposits	**1,131**	(1,557)
Accounts payable and accrued liabilities	**(46,439)**	43,040
Change in non-cash working capital	**(23,895)**	24,808
Relating to:		
Operating activities	**9,896**	(2,883)
Investing activities	**(33,791)**	27,691
Change in non-cash working capital	**(23,895)**	24,808

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

	Year ended December 31	
Cash outlays in respect of interest and taxes	**2015**	2014
Interest and standby fees on bank debt	**6,921**	359
Taxes	**-**	-

17. CHANGE IN CLASSIFICATION OF CERTAIN PRODUCTION AND TRANSPORTATION EXPENSES

In the fourth quarter of 2015, the Company reclassified certain charges that were previously presented as transportation expenses to production expenses. The charges were incurred pursuant to a pipeline transportation contract and a gas sales agreement that came into effect December 1, 2014, which secured firm commitments for transportation capacity and upstream services. In November 2015, these contracts were renewed and extended for an additional term from December 1, 2015 to October 31, 2017. Upon further review of the nature of the charges under the firm service contracts at the time of renewal, the Company concluded that the charges related to upstream services, primarily gas gathering and processing fees, are more appropriately presented as a production expense rather than transportation expense. The expenses being reclassified amount to approximately $1.8 million for the nine month period ended September 30, 2015. The presentation of production and transportation expenses reported for the previous year ended December 31, 2014 has not been revised as the impact was nominal. 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.

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

18. 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 year ended December 31, 2015, the Company incurred $0.6 million (2014 – $0.4 million) in legal fees and disbursements, of which, less than $0.1 million is payable at December 31, 2015 ($0.1 million at December 31, 2014). The Company expects to continue using the services of this law firm from time to time.

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Company. The following table summarizes compensation paid or payable to officers and directors of the Company:

	Year ended December 31	
	2015	2014
Salaries, bonuses and other benefits	**958**	715
Share based compensation	**3,251**	4,096
Total compensation	**4,209**	4,811

During the year ended December 31, 2015, key management personnel were granted 87,684 RSUs and 750,000 stock options with an average exercise price of $4.38 per share. During the previous year ended December 31, 2014, key management personnel were granted an aggregate of 970,000 stock options with an average exercise price of $9.34 per share.

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ABBREVIATIONS

bbls	barrels
mbbls	thousand barrels
bbls/d	barrels per day
BOE	barrels of oil equivalent
mBOE	thousand barrels of oil equivalent
BOE/d	barrels of oil equivalent per day
mcf	thousand cubic feet
mmcf	million cubic feet
bcf	billion cubic feet
mmcf/d	million cubic feet per day
mmbtu	million British Thermal Units
GJ	gigajoules
LT	long tonnes
AECO-C	Alberta Energy Company "C" Meter Station of the Nova Pipeline System
WTI	West Texas Intermediate
NYMEX	New York Mercantile Exchange
CREC	Alliance Pipeline Canadian receipt location
Station 2	Spectra Energy receipt location
NGX	Natural Gas Exchange Inc. (Canada)
API	American Petroleum Institute
MD&A	Management's Discussion and Analysis
Q1	First quarter ended March 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
FD&A	Finding, development and acquisition costs
CGU	Cash generating unit
FVLCD	Fair value less costs of disposal

CONVERSION OF UNITS

Imperial = Metric

1 acre = 0.4 hectares

2.5 acres = 1 hectare

1 bbl = 0.159 cubic metres

6.29 bbls = 1 cubic metre

1 foot = 0.3048 metres

3.281 feet = 1 metre

1 mcf = 28.2 cubic metres

0.035 mcf = 1 cubic metre

1 mile = 1.61 kilometres

0.62 miles = 1 kilometre

1 mmbtu = 1.054 GJ

0.949 mmbtu = 1 GJ

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

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

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, Finance & Chief Financial Officer

Douglas J. Errico
Vice President, Land

Alan G. Franks
Vice President, Production

Douglas O. MacArthur
Vice President, Operations

Patrick Miles
Vice President, Exploration

HEAD OFFICE

Suite 300, East Tower, 311 Sixth Avenue S.W.
Calgary, Alberta T2P 3H2

Phone: 403.294.0154
Fax: 403.291.0155
www.keltexploration.com

REGISTRAR AND TRANSFER AGENT

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

LEGAL COUNSEL

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

BANKERS

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

AUDITORS

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

EVALUATION ENGINEERS

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

STOCK EXCHANGE LISTING

Toronto Stock Exchange
Common Shares “KEL”

SUITE 300, EAST TOWER
311 SIXTH AVENUE SOUTH WEST
CALGARY, ALBERTA T2P 3H2