



**KELSO TECHNOLOGIES INC.**

**THIRD QUARTER REPORT**

**For the Nine Months Ended**

**September 30, 2018**



**KELSO TECHNOLOGIES INC.**

**MANAGEMENT DISCUSSION & ANALYSIS**

**NINE MONTHS ENDED**

**September 30, 2018**

**(Expressed in US Dollars unless otherwise indicated)**

## **Kelso Technologies Inc.**

Management Discussion and Analysis  
Nine Months Ended September 30, 2018  
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### **MANAGEMENT DISCUSSION AND ANALYSIS**

#### **GENERAL**

The following management discussion and analysis (“MD&A”) of the operations and financial condition of **Kelso Technologies Inc.** (the “Company” or “Kelso”) provides an overview of significant developments that have affected the Company’s performance during the three and nine months ended September 30, 2018. It should be read in conjunction with the unaudited interim consolidated financial statements of the Company together with the related notes thereto for the nine months ended September 30, 2018.

The unaudited interim consolidated financial statements for the nine months ended September 30, 2018 referred to in this MD&A have been prepared in accordance with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”). The following MD&A and the Company’s unaudited interim consolidated financial statements were approved by the Audit Committee and the Board of Directors on November 8, 2018.

All amounts herein are expressed in United States dollars (the Company’s functional currency) unless otherwise indicated.

References to EBITDA in this MD&A refer to net earnings from continuing operations before interest, taxes and tax recoveries, amortization, deferred income tax recovery, unrealized foreign exchange losses, non-cash share-based expenses (Black-Scholes option pricing model) and write-off of intangible assets. EBITDA is not an earnings measure recognized by IFRS and does not have a standardized meaning prescribed by IFRS. Management believes that EBITDA is an alternative measure in evaluating the Company’s business performance. Readers are cautioned that EBITDA should not be construed as an alternative to net income as determined under IFRS; nor as an indicator of financial performance as determined by IFRS; nor a calculation of cash flow from operating activities as determined under IFRS; nor as a measure of liquidity and cash flow under IFRS. The Company’s method of calculating EBITDA may differ from methods used by other issuers and, accordingly, the Company’s EBITDA may not be comparable to similar measures used by any other issuer.

#### **LEGAL NOTICE REGARDING FORWARD-LOOKING STATEMENTS**

This MD&A contains “forward-looking statements” within the meaning of applicable securities laws that reflect the Company’s current expectations, forecasts and assumptions. Generally, forward looking statements can be identified by the use of forward-looking terminology such as “plans”, “expects” or “does not expect”, “is expected”, “budget”, “scheduled”, “estimates”, “forecasts”, “intends”, “anticipates” or “does not anticipate”, or “believes”, or variations of such words or phrases or state that certain actions, events or results “may”, “could”, “would”, “might” or “will be taken”, “occur” or “be achieved”.

Such forward looking statements involve a number of known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of the Company to be materially different from any future results expressed or implied by such forward looking statements

These include but are not limited to the economic condition of the railroad industry, which is affected by numerous factors beyond the Company’s control including slow sales cycles, creation and adoption of new technologies, the existence of present and possible government regulation and competition. Although Kelso believes its anticipated future results, performance or achievements expressed or implied by the forward-looking statements are based upon reasonable assumptions and expectations, they can give no assurance that such expectations will prove to be correct. The reader should not place undue reliance on forward-looking statements as such statements involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of Kelso to differ materially from anticipated future results, performance or achievement expressed or implied by such forward-looking statements. Such risks and uncertainties include, without limitation; the risk that the Company’s products may not work as well as expected; we may

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not be able to break in to new markets because such markets are served by strong and embedded competitors or because of long term supply contracts; we may not be able to grow and sustain anticipated revenue streams; we may have underestimated the cost of product development and the time it takes to bring products to market; we may not be able to finance our intended product development; that management may not be able to continue to initiate new product strategies to secure a more reliable growth of financial performance in the future; our products may not sell as well as expected, and competitors may offer better or cheaper alternatives to our products; our technologies may not be patentable, and if patents are granted, we may not protect our investment in intellectual property if our patents are challenged; our intended technologies may infringe on the intellectual property of other parties; we may not have any parties interested in licensing our technology as expected and certain other risks detailed from time-to-time in Kelso's public disclosure documents.

Although the Company has attempted to identify important risk factors that could cause actual results to differ materially from those contained in forward-looking statements, there may be other factors that could cause results not to be as anticipated, estimated or intended. There can be no assurance that such statements will prove to be accurate as actual results and future events could differ materially from those anticipated in such statements.

Accordingly, readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date the statements were made. Readers are advised to consider such forward-looking statements in light of the risks set forth in the Risks and Uncertainties section of this MD&A (Page 18). The Company does not undertake to update any forward-looking statements that are incorporated by reference herein, except in accordance with applicable securities laws.

Additional information about the Company and its business activities is available on SEDAR at [www.sedar.com](http://www.sedar.com) or the Company's website at [www.kelsotech.com](http://www.kelsotech.com).

### **DATE OF REPORT**

November 8, 2018

### **SUMMARY OF THE YEAR-TO-DATE – NINE MONTHS ENDED SEPTEMBER 30, 2018**

- Reported net loss for the nine months ended September 30, 2018 was \$180,366 (\$0.00 per share) compared to reported net loss of \$2,803,514 (\$0.06 per share) for the nine months ended September 30, 2017.
- Revenues for the nine months ended September 30, 2018 were \$8,538,716 compared to \$4,150,321 for the nine months ended September 30, 2017.
- Gross profit for the nine months ended September 30, 2018 was \$3,471,679 (40.7% of revenues) compared to \$847,331 (20.4% of revenues) for the nine months ended September 30, 2017.
- EBITDA for the nine months ended September 30, 2018 was \$62,195 compared to EBITDA (Loss) for the nine months ended September 30, 2017 at \$(2,256,111).
- Operational expenses for the nine months ended September 30, 2018 remained consistent at \$3,655,067 compared to \$3,642,982 for the nine months ended September 30, 2017.
- Management compensation for the nine months ended September 30, 2018 remained consistent at \$404,843 compared to \$409,014 for the nine months ended September 30, 2017.
- Reported net loss of \$180,336 included items not involving cash for amortization of assets including our new production facility in Bonham, Texas in the amount of \$164,311, unrealized foreign exchange gain of \$14,485 and there was \$95,757 in share-based expense for employee incentive stock options (Black-Scholes).

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- The Company has recorded an income tax recovery for the nine months ended September 30, 2018 of \$3,052 compared to an income tax expense of \$17,856 for the nine months ended September 30, 2017.
- The Canadian dollar has been volatile against the US dollar during 2018 resulting in a provision for an unrealized foreign exchange gain for our Canadian assets in the amount of \$14,485 for the nine months ended September 30, 2018 compared to an unrealized exchange gain of \$117,987 for the nine months ended September 30, 2017.
- Cash on deposit at September 30, 2018 was \$421,500 compared to \$411,223 at December 31, 2017 with accounts receivable of \$1,754,749 at September 30, 2018 compared to \$653,445 at December 31, 2017.
- Working capital at September 30, 2018 was \$3,711,142 compared to working capital at December 31, 2017 of \$3,628,911.
- Company remains free of interest-bearing long-term debt commitments.
- Net assets were \$7,483,152 at September 30, 2018 compared to \$7,565,233 at December 31, 2017.

### **SUMMARY OF THE THIRD QUARTER - THREE MONTHS ENDED SEPTEMBER 30, 2018**

- Reported net income for the three months ended September 30, 2018 was \$261,717 (\$0.01 per share) compared to reported net loss of \$1,380,495 (\$0.03 per share) for the three months ended September 30, 2017.
- Revenues for the three months ended September 30, 2018 were \$3,491,602 compared to \$1,153,341 for the three months ended September 30, 2017.
- Gross profit was \$1,543,995 (44.2% of revenues) for the three months ended September 30, 2018 compared to a negative gross margin of \$178,414 (negative margin of 15.5% of revenues due to inventory write downs) for the three months ended September 30, 2017.
- EBITDA for the three months ended September 30, 2018 was \$383,563 compared to EBITDA (Loss) for the three months ended September 30, 2017 at \$(936,011).

### **CORPORATE OVERVIEW**

Kelso is an engineering development company that specializes in the development, production and distribution of proprietary service equipment used in transportation applications. Our reputation has been earned as a developer and reliable supplier of unique high-performance rail tank car equipment for the handling and containment of hazardous and non-hazardous commodities during transport. All Kelso products are developed with emphasis on economic and operational advantages to customers while mitigating the impact of human error and environmental release. The Company offers specialized rail tank car and truck tanker equipment, rail wheel cleaning systems, fuel loading systems, military applications, first responder emergency response kits and suspension systems for motor vehicles being used in rugged outback terrains.

Over the last eight years the Company has established itself as a leading North American producer of specialized rail tank car equipment. The Company's core rail tank car products include pressure relief, vacuum relief and bottom outlet valves as well as a proprietary one-bolt manway. These products provide some of the key elements of a rail tank car's structure to ensure the safe handling and containment of hazardous materials during transport. With a solid history of innovative technology solutions and a reputation anchored by the reliability of supply, the Company serves many of North America's largest railways with a wide range of custom engineering and production services.

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The Company's common shares are publicly traded on the Toronto Stock Exchange under the trading symbol KLS and the NYSE Markets Exchange under the trading symbol KIQ. The Company listed on the Toronto Stock Exchange on May 22, 2014 and on the NYSE Markets Exchange on October 14, 2014. The Company operates in combination with its wholly owned subsidiaries Kelso Technologies (USA) Inc, KIQ X Industries Inc., Kel-Flo Industries Inc.(formerly Kelso Innovative Solutions Inc.) and KIQ Industries Inc.

Over the past five years management has established multi-million dollar sales of its products to North American rail tank car manufacturers (OEM) and retrofit/repair businesses. Revenues over the last five audited year end periods were as follows: \$6,062,778 for the year ended December 31, 2017; \$8,077,143 for the year ended December 31, 2016; \$18,910,122 for the year ended December 31, 2015; \$23,816,809 for the year ended December 31, 2014; \$13,131,387 for the year ended December 31, 2013.

The Company's net earnings (loss) performance over the last five year end periods were as follows; a net loss of \$5,015,911 for the year ended December 31, 2017; a net loss of \$2,465,592 for the year ended December 31, 2016; net loss of \$2,510,826 for the year ended December 31, 2015; net income of \$4,025,781 for the year ended December 31, 2014; net income of \$2,456,636 for the year ended December 31, 2013.

Our primary revenue market (hazmat rail tank cars) has remained slow throughout 2017 and early 2018. Hazardous commodity businesses remained in cut back positions which led to historically low demand for Kelso's specialized equipment for rail tank cars.

In North America industry rail tank car analysts expect average new-build production rates to grow from approximately 12,000 in 2018 to 19,000 new rail tank cars annually for the next several years. Based on these new-build predictions and our historic retrofit/repair business Kelso expects to supply its specialized tank car equipment to over 8,000 tank cars in 2018 and over 10,000 tank cars in 2019. Depending on the makeup of customers' specifications and the status of our AAR approvals sales can range from \$1,400 to \$10,000 per tank car.

Long AAR approval processes continue to slow our ability to improve sales with additional rail tank car equipment. The Company continues to finish AAR approvals for our ceramic ball BOV, pressure car PRV and angle valve although the process could take two years to finish. Final approvals will depend on administration of our restrictive budgets and the challenges of strict AAR testing requirements that are time consuming, risky and contrary to short-term profit goals. Management believes its AAR approved rail tank car products still provide meaningful revenue opportunities that will contribute to the overall health of Kelso. However, due to the extreme cyclical nature of the rail tank car market and the economic fallout of the current downturn a more diverse strategic plan has been warranted.

Our roots and reputation in rail tank car technologies have established a solid foundation for corporate diversification strategies in new markets. New product development initiatives concentrate on a wider range of technology products that are designed to provide unique economic benefits and safe operational advantages to customers. New markets initiated in 2017 include technologies for truck tankers, fueling technologies for locomotives, military and heavy equipment, rail yard technologies, emergency response kits for first responders and rugged outback terrain suspension technologies for vehicles in commercial industry, homeland security and leisure applications.

### **DIVERSE REVENUE PLAN**

The key to future profitability will be the introduction and development of full AAR approved products and marketplaces. Throughout 2017 and 2018 Kelso has actively developed new product offerings. Kelso's new products initiatives do not require lengthy demanding regulatory approvals and the design and production process to sales and distribution is much quicker. Target markets include specialized truck tanker equipment, military products, fuel loading systems, rail wheel cleaning systems,

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emergency response kits for first responders and high performance suspension systems for motor vehicles being used in rugged sloped terrain applications in recreational and commercial operations. Most products are near completion and ready for market distribution commencing in 2018. The following chart shows anticipated new revenue streams.

### STRATEGIC PLAN

2017 New Revenue Markets	Regulatory Approval	2018 DIVERSIFICATION
<b>Rail Tank Cars</b>		<b>Rail Tank Cars</b>
Pressure Relief Valves	✓	Pressure Relief Valves
One-Bolt Manway	✓	One-Bolt Manway
Vacuum Relief Valve	Pending	Vacuum Relief Valve
Bottom Outlet Valve	Pending	Bottom Outlet Valve
Angle Valve	Pending	Angle Valve
Miscellaneous	✓	Miscellaneous
N/A	N/A	<b>Truck Tankers</b>
N/A	N/A	PRV/VRV Valve
		One-Bolt Manway
N/A	N/A	<b>Rail Operations Technology</b>
N/A	N/A	Rail Wheel Cleaner
Emergency Response Kit	N/A	Fuel Loading Systems
		Emergency Response Kit
N/A	N/A	<b>Truck Technologies</b>
N/A	N/A	ASCS Suspension Systems
		<b>Military Technologies</b>

### KEY PRODUCTS

Commercial revenue streams are generated from the following key products and services:

#### [Rail Tank Car External Constant Force Spring Pressure Relief Valves \(EPRV\) \(Patented\)](#)

Over the past decade Kelso has been involved in the development, regulatory approvals, marketing and manufacture of EPRV that are designed for railroad tank cars that carry hazardous and non-hazardous commodities. The Company currently offers 36 versions of the EPRV in its product line, including a number of high-performance EPRV products. As required all EPRV products have received AAR approval based on service trials and physical testing. The Company believes that its series of EPRV products are “best available technology” products; proprietary to Kelso; and have a number of significant competitive advantages that include:

- High “barrier to entry” for competitors due to our patent rights and the years of testing required by the AAR to gain regulatory approvals.
- The leader in bringing an external, low profile high flow valve to market which limits exposure to chemicals or other corrosive commodities transported in the tank car.
- Technological improvement over older valve systems as it eliminates the helical coil spring, the internal valve stems and spring guide tube.
- Multiple springs that prevent disruptions that occur when single spring designs become inoperable due to spring failure.
- Increased valve reliability due to little or no contact with HAZMAT.
- Uses flat gasket seal; more tolerant to contamination.
- Low profile provides for better roll over safety.
- External design allows complete inspection during loading.

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### **Rail Tank Car One-Bolt Manway (OBM) (Patented)**

The Company holds the patent rights for a unique OBM technology for use on rail tank cars and truck tank trailers. The Company believes that the OBM is an important technology change for the railroad industry where the return on investment and arguments for customers' adoption of the OBM are compelling. They include:

- One bolt-and-strap design eliminates eye-bolt problems and possible leaks due to crushed gaskets.
- Eliminates lid deformation and nozzle distortion due to the over-torque of eye-bolts.
- Eliminates relaxation of gaskets under eye-bolt location.
- Eliminates eye-bolt nuts loosening in transit due to vibration and improper cross-bolting technique – a violation subject to regulatory fines in excess of \$5,000 per tank car.
- Standard AAR-approved gasket retention method with currently used hard and soft gaskets.
- ACME Thread on T-Bolt virtually eliminates loosening due to vibration.
- Rigid collar at top of nozzle reduces risk of nozzle or lid distortion.
- Much faster opening and closing operation with one bolt management system which will take the current industry open/close standard cycle time of 25-35 minutes to 5 minutes with the OBM.
- Uniform load on the gasket prolongs service life as evidenced in field service trial.
- Reduces possible release of hazardous commodity in a roll-over accident by moving threaded closing mechanism below the plane of the lid.
- Ease of operation with lightweight hinged lid.
- No eye-bolts to kick at tank car inspection.

### **OBM Adapter Plate**

Kelso has successfully developed and tested a fully functional loading arm adaptor that fits both the OBM and older hinged 6 and 8 eye-bolt manways currently in service on tank cars in North America. The adaptor attaches permanently to the existing loading arm apparatus and connects the loading arm to any existing manway in service today. The adaptors are a minimal expense when measured against the substantial capacity gains they will produce hence addressing the concerns of additional capital expenditures required to convert loading terminals that top-load HAZMAT.

### **Vacuum Relief Valve (VRV) (patented)**

The VRV is a patented low-pressure device specifically designed to protect rail tank cars from the effect of an excessive vacuum and prevents the implosion of the tank car. The development of our patent pending VRV has been driven by customers' demand for a better performing VRV due to high failure rates of current products in use in the market today.

Our new innovative VRV design features our patented constant force pressure springs and meets the new DOT-117 tank car specifications implemented on October 1, 2015. The Association of American Railroads (AAR) has approved Kelso's new vacuum relief valve (VRV) design for commercial service trials which are now complete. We await final AAR review and approval.

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### **Bottom Outlet Valve (BOV) (patented)**

Our patented bottom outlet valves are utilized on rail tank cars for the primary purpose of unloading the contents of the tank. The BOV must be a low-profile design as it is positioned at the lowest point of the tank so that a full discharge of the tank can be achieved. They are widely used in the transport of hazardous commodities such as crude oil, ethanol, chemicals, petrochemicals and minerals such as molten sulfur as well as many non-hazardous commodity applications.

The development of our patented BOV has been driven by customers' demand for a better performing BOV due to chronic performance problems with current products in use in the market today. Our new innovative BOV design prevents valve operating stem leaks and features the use of non-corrosive ceramic materials and a seal protecting wiper. Our BOV meets the new DOT-117 tank car specifications implemented on October 1, 2015 and the new M1002 Tank Car Standards requiring a removable handle. The Association of American Railroads (AAR) has approved Kelso's new bottom outlet valve (BOV) design for commercial field trial testing that will take up to two years to complete.

### **Emergency Response Kit (ERK) – First Responder Equipment**

Kelso ERK (ERK) is specialized equipment that is used by first responders to cap and contain chemical leaks in the field that originate in a HAZMAT rail tank car's valve assembly or its connections located on the top of the tank car. The ERK is specifically designed to be implemented quickly and safely to reduce potential dangers to human life and environmental harm to communities during emergency events involving hazardous materials.

The ERK was developed in partnership with hazardous materials specialists from a Class 1 Railroad company. It has numerous advantages for its users over current competitive designs:

- Compact – the Kelso ERK fits in one container which is a reduction from the three containers currently used. The ERK takes up less space on emergency response vehicles and allows handling by one person.
- Built with lightweight materials the ERK is half the weight of existing products providing easier deployment and operation of the ERK by emergency responders.
- No additional application tools are required which reduces kit weight and complexity of operation.
- Color-coded valve caps aid first responder in selecting proper valve cap under emergency conditions.
- Friction reduction system lowers torque needed to apply the valve cap. This reduces the number of tools needed to effectively apply the ERK reducing the potential effects of human error and potential injury to first responders.
- The ERK is designed for both pressure tank cars which include commodities such as chlorine, liquefied petroleum gas and anhydrous ammonia and non-pressurized tank cars.
- The Kelso ERK is the only emergency kit in the market that is designed to handle general service tank cars.

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### **Truck Tanker Equipment (patents pending)**

The Company has completed the design and engineering of two key pieces of truck tanker equipment for the containment and pressure management of hazardous and non-hazardous commodities that are transported via roads.

The specialized products include a pressure/vacuum relief valve (TPVR) and a one-bolt manway (TOBM). These new products are based on our patents that are utilized in rail tank car applications and meet DOT 407 49 CFR 178.345 regulations. Over the past several years our strategic development partners have been instrumental in finalizing all design aspects for roadway applications. The Company believes we have reached this key milestone of consensus of design with the trucking industry.

On July 10, 2017 the TPVR and TOBM were installed on a truck tanker for assessment testing by our industrial technology partner. This testing is not a required regulatory field trial as in rail regulations, but rather a customer review for suitability.

### **Active Suspension Control System For Combined Road-No-Road Vehicles (Patents Pending)**

The Company has filed a United States provisional patent application and a corresponding Canadian patent application for an Active Suspension Control System and Method for No-Road Vehicles (ASCS). The ASCS patent application is owned by Kelso and covers numerous technologies. Kelso anticipates filing further patent applications relating to the ASCS technology as Kelso continues to develop and improve the ASCS technology.

Kelso seeks proprietary rights protection to allow for the development of our business of outfitting commercial industry and leisure-based motor vehicles with the ASCS system. This allows Kelso to market specialized, high-performance rugged sloped outback terrain vehicles for recreational and commercial operations in difficult road and no-road operations.

The innovations disclosed in the ASCS patent applications are believed to be unique and to represent a dramatic improvement over existing technologies presently used in commercial off-road vehicles. The converted vehicles feature a “spider” like independent suspension that keeps the vehicle stable and level through its proprietary gyroscopic technology. In road-mode it looks like a standard vehicle with very large wheels and when in no-road mode it can provide a 20 inch lift capability creating approximately 30 inch ground clearance. The technology allows the vehicle to stay level and stable in any operational environment.

Design dynamics include:

- The ASCS is a unique suspension methodology based on thirty years of research and experience.
- The ASCS is believed to represent a dramatic improvement over existing technologies presently used in commercial combined road-no-road vehicles.
- Vehicles featuring the ASCS are expected to provide distinct advantages to customers in terms of safety, effective performance and operational capabilities.
- The basic design premise of the ASCS is to manage the center-of-gravity of the vehicle with automated gyroscopic controlled air suspension.
- This ensures that the driver, passengers and payload remain in as stable and level a position as possible when driving in difficult rugged outback terrains including flooded areas.
- The ASCS technology package is well suited for use in desert, mountain, snow and low lying water regions around the world.

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Operational advantages include:

- Ideal for customers who need to traverse rough outback terrain in a wheeled vehicle for the purpose of reaching remote destinations with multiple passengers and maximum payload.
- Ideal for both industry and leisure markets.
- Eliminates need for expensive track-based vehicles.
- Ideal for outback operations around the world.
- Combined road-no-road capability eliminates additional transportation costs of equipment into service areas.
- Excels in all weather environments throughout the year.
- Cost effective operations.
- Lighter weight than competitive vehicles.
- Balanced distribution of weight reduces environmental impact.

The ASCS business operates under the Company's wholly owned subsidiary KIQ X Industries Inc that is incorporated under the laws of the Province of British, Columbia, Canada. Research and development, marketing and subcontracted production operations are located in Kelowna, British Columbia.

R&D is ongoing and when the Company can establish an economically viable commercial vehicle management believes that revenues could be possible from customers requiring heavy duty ASCS performance in agriculture, ranching, search & rescue, snow management, railroad, homeland security, police & border patrol, first responders, mining, forestry, and oil, gas and electric transmission applications.

### **Wheel Cleaning System (WCS) for Rail Cars (patents pending)**

The WCS is designed for rail wheel cleaning operations in railroad hump yards and industrial shipping facilities. Our WCS is a unique proprietary (patent pending) rail wheel cleaning system that has been designed in co-operation with Class I railroads. It addresses the problematic issue of railcar wheels "caking" with various commodities during operations. The industrial heavy-duty cleaning capabilities provided by the WCS for railcar operations can reliably maintain and improve the performance of rolling stock. Some of the more challenging commodities addressed by the WCS include crude oil/tar, salt water slurry, flour water slurry, Portland cement, lime powder slurry, sugar water slurry, potash and sulfur.

### **Fuel Loading Systems (Hydrau-Flo®) for Locomotives, Marine and Military Applications**

Hydrau-Flo® represents a unique opportunity for Kelso to participate in fueling technology markets with proven innovative products for our railroad customers. Company holds the non-exclusive distribution rights to a proven line of proprietary fueling technologies known as Hydrau-Flo®. The agreement covers the North American markets for a two year period with an option for one additional year. Kelso will concentrate on railroad, military and marine applications.

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Hydrau-Flo® products are a suite of mechanical and non-pressurized fuel filling valves that provide safe handling and overfill protection for heavy equipment applications such as locomotives. They offer a low cost solution that can improve fueling times up to 83% adding thousands of additional production hours to equipment fleets. They are designed to prevent overfilling, fuel spillage, waste, fuel theft and remove the risk of tank ruptures from pressure build up during and after filling. Hydrau-Flo® offers excellent wear resistance with proven increases in productivity. It improves the economics of ownership by effectively addressing the key issues of longevity, capacity and efficiency of operations.

### **PRODUCTION**

Kelso currently operates two facilities totaling 50,000 square feet in Bonham, Texas. The Company is fully qualified and certified to produce products for the railroad and other industries. It has been granted the required certifications including holding an AAR M1002 Class D Registration and AAR M1003 Quality Assurance System Certification for its production facilities from the Association of American Railroads.

ASCS subcontracted production operations are located in Kelowna, British Columbia, Canada. Kelso is currently assessing its business development plans for the ASCS program given current budget restraints.

### **PUBLIC INFORMATION POLICY**

The Company advises the public about its business progress by way of quarterly and consolidated annual financial statements as well as management discussions and analysis for those periods. The Company will issue press releases announcing material events that affect the business health of the Company in accordance with the policies and guidelines of the Toronto Stock Exchange and the NYSE Markets Exchange. The Company does not give investment advice to investors and does not respond to solicitations to discuss privileged information from the public in accordance with securities laws in Canada and the United States.

Further, Kelso does not provide forward looking revenue projections to the public. Kelso is a product development enterprise and management is unable to measure or determine the future financial impact related to new rail regulations, uncertain technology adoption strategies of customers and the deteriorating recessionary conditions surrounding the rail tank car industry. All of these factors are well beyond the control of Kelso.

### **RESULTS OF OPERATIONS**

The financial results for the three and nine months ended September 30, 2018 are indicative of an engineering organization that continues to develop into a viable industrial rail equipment supplier. The Company still relies on the sales of specialized rail tank car pressure relief valve equipment for the majority of its revenues.

Kelso has seen a consistent upside shift in rail tank car production, retrofit and repair activity throughout the first nine months of 2018. Since early 2017 management has implemented new business processes, changed our corporate culture and revamped how we approach our marketing and sales processes. The result is that sales growth and business momentum is building.

OEM and retrofit activity that was expected in 2015 before the collapse of oil prices is now occurring in 2018. Crude oil, ethanol and chemicals are the key commodities that are leading the way in the resurgence of tank car market activity. This stimulus has led rail tank car analysts to expect average new-build production rates to grow from approximately 12,000 to 19,000 new rail tank cars annually for the next several years. Based on these new-build predictions and our historic retrofit/repair business Kelso expects to supply its specialized tank car equipment to over 8,000 tank cars in 2018 and over 10,000 tank cars in 2019.

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Revenues, corresponding expenses, financial performance and capital management during nine months ended September 30, 2018 reflects Kelso's ability to manage recessionary times while still making progress in the execution of its product marketing and development plans. Financial results reflect the revenue and related operational costs of marketing, producing and distributing its PRV line and key investments in new product development associated with a more diverse product mix for future revenue growth.

Our strategic plan requires Kelso to make ongoing investments in our production capacity (including equipment, lease costs, training and qualifying human resources); railroad regulatory filings; liability insurance; marketing initiatives; independent lab testing and outsourced specialized industrial engineering services; new patent applications; regulatory disclosure processes in Canada and the United States; more efficient accounting systems and controls; pre-sales production planning and tooling for our growing portfolio of products. These costs are written off or capitalized in the period when they occur and reflect in the reported profitability of the Company in the period in which they were incurred.

### Year-to-date – Nine months ended September 30, 2018

For the nine months ended September 30, 2018, the Company reported a net loss of \$180,366 (\$0.00 per share) against revenues of \$8,538,716 compared to a net loss of \$2,803,514 (\$0.06 per share) against revenues of \$4,150,321 for the nine months ended September 30, 2017.

Gross profit returns grew to 3,471,679 (40.7% of revenues) for the nine months ended September 30, 2018 compared to \$847,331 (20.4% of revenues) for the nine months ended September 30, 2017. In 2017 we began re-branding our organization by implementing new business processes, new personnel, changing our corporate culture and revamping our approach to customer service, marketing and sales processes. The results have been encouraging with growth in sales and improved financial performance and business momentum seems to be building for future periods.

Total operational expenses remained steady at \$3,655,067 during the nine months ended September 30, 2018 compared to \$3,642,982 for the nine months ended September 30, 2017.

EBITDA for the nine months ended September 30, 2018 and 2017 has been calculated as follows:

	Nine months ended Sept 30, 2018	Nine months ended Sept 30, 2017
Net income (loss)	\$ (180,336)	\$ (2,803,514)
Share-based expense	\$ 95,757	\$ Nil
Unrealized foreign exchange loss (gain)	\$ (14,485)	\$ (117,987)
Amortization	\$ 164,311	\$ 203,765
Income tax expense (recovery)	\$ (3,052)	\$ 17,856
Write down of inventory	\$ -	\$ 443,769
EBITDA (loss)	\$ 62,195	\$ (2,256,111)

Factors in the reported income for the nine months ended September 30, 2018 include expenses related to ongoing marketing initiatives in the amount of \$208,024 (2017 - \$439,111) and related travel costs of \$127,574 (2017 - \$340,115). These expenses are related to ongoing marketing programs for existing and new products. Our new customer service and marketing initiatives and sales processes implemented in 2017 have proven to be more effective and economic compared to past periods and reflect in improved sales volume and gross margin returns.

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A key component of our future business growth is the research, design, testing and qualification of new products. During the nine months ended September 30, 2018 our industrial product design and development costs were \$1,225,822 (2017 - \$645,251). This includes expenses related to design and continuing testing of our key products and new equipment initiatives all of which may form a significant opportunity for Kelso to grow its future revenues from new markets and the rail tank car market when demand improves.

Management continues to adjust operations and product development methods to become more efficient. This is reflected in our investments in human resources, marketing, sales and production operations for the nine months ended September 30, 2018. The Company recorded office and administrative costs of \$1,229,306 (2017 - \$1,335,374), management compensation was \$404,843 (2017 - \$409,014). There were no accruals for management performance bonuses as none were due at September 30, 2018. Consulting fees were \$158,863 (2017 - \$188,903) while investor relations remained unchanged at \$63,000 (2017 - \$63,000).

Accounting, audit and legal fees are cost components of our corporate development strategies and the administration functions of a publicly listed industrial company. Costs for these professional services were down significantly to \$133,484 for the nine months ended September 30, 2018 (2017 - \$333,299) due to the reorganization of our complement of personnel in 2017. The Company accrues its audit costs on a quarterly basis. These fees have increased due in large part to tax restructuring. Legal costs are related to public company administration including reorganization costs, the preparation and filing of press releases, documentation and reviewing possible acquisition targets and new business arrangements regulatory documentation including Annual Information Form (AIF) and Securities Exchange Commission documentation (20-F).

The Company's functional currency is US dollars but Kelso also holds various assets in Canadian dollars. The Canadian dollar has remained volatile in value against the US dollar therefore we have recorded an unrealized foreign exchange gain of \$14,485 for the nine months ended September 30, 2018

Although Kelso has seen a consistent upside shift in rail tank car production, retrofit and repair activity throughout the first nine months of 2018 management cautions that the economics and overall infrastructure of the railroad industry including the effects of new regulations and recessionary affects of low commodity prices still pose many challenges to our future business success. Further slow business activity stemming from economic and regulatory uncertainty could have a material effect on our current and future business abilities including financial condition and results of operations (see Risks and Uncertainties on Page 18).

### **Third Quarter – Three months ended September 30, 2018**

Net income for the three months ended September 30, 2018 was \$261,717 (\$0.01 per share) compared to reported net loss of \$1,380,495 (\$0.03 per share) for the three months ended September 30, 2017.

Revenues for the three months ended September 30, 2018 grew over 300% to \$3,491,602 compared to \$1,153,341 for the three months ended September 30, 2017. The Company's resurgence has been due to a consistent upside shift in rail tank car production, retrofit and repair activity throughout 2018.

Gross profit was \$1,543,995 (44.2% of revenues) for the three months ended September 30, 2018 compared to a negative margin of \$178,414 (negative 15.5% of revenues due to inventory write offs) for the three months ended September 30, 2017. Gross profit margins improved due to reduced labor costs, better supply chain pricing, new marketing and sales practices put in place in late 2017.

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EBITDA for the three months ended September 30, 2018 and 2017 has been calculated as follows:

	<b>Three months ended Sept 30, 2018</b>	Three months ended Sept 30, 2017
Net income (loss)	\$ 261,717	\$ (1,380,495)
Share-based expense	\$ 75,600	\$ Nil
Unrealized foreign exchange loss (gain)	\$ (9,530)	\$ (67,793)
Amortization	\$ 55,615	\$ 68,508
Income tax expense (recovery)	\$ 161	\$ -
Write down of inventory	\$ -	\$ 443,769
EBITDA (loss) for the quarter	\$ 383,563	\$ (936,011)

Quarterly expenses were in line with management expectations and remain consistent with prior quarters.

### LIQUIDITY AND CAPITAL RESOURCES

At September 30, 2018 the Company had cash on deposit in the amount of \$421,500, accounts receivable of \$1,754,749, prepaid expenses of \$145,908 and inventory of \$3,732,559 compared to cash on deposit in the amount of \$411,223, accounts receivable of \$653,445, prepaid expenses of \$183,966 and inventory of \$3,980,243 at December 31, 2017.

The working capital position of the Company at September 30, 2018 was \$3,711,142 compared to \$3,628,911 at December 31, 2017. Accounts receivable are collected within 30 days from invoicing shipments giving Kelso \$1,754,749 of additional cash flow plus \$421,500 of available cash to discharge liabilities of \$1,634,287 on a timely basis subsequent to September 30, 2018.

Net assets of the Company were \$7,483,152 at September 30, 2018 compared to \$7,565,233 at December 31, 2017. At September 30, 2018 the Company had no interest-bearing long-term liabilities or debt.

Kelso's primary source of revenue is from new rail tank car builders and retrofit/repair customers. The Company has seen a consistent upside shift in rail tank car production, retrofit and repair activity throughout 2018. Since early 2017 we have implemented new business processes, changed our corporate culture and revamped how we approach our marketing and sales processes. The result is that sales growth and business momentum is building. Management is encouraged that sales and backlog purchase orders for delivery in 2018 subsequent to September 30, 2018 have grown to exceed \$3,800,000 at the date of this report.

If sales volumes continue to grow at their current pace then the Company can, for the near term, generate the necessary capital resources required to finance operations. As part of its capital management program Kelso does not rule out the issuance of equity securities through private placements if external funding is deemed necessary by the Board of Directors of the Company.

Management takes all necessary precautions to minimize risks however additional risks could affect the future performance of the Company. Business risks are detailed in the Risks and Uncertainties section of this MD&A (Page 18).

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### SELECTED QUARTERLY INFORMATION

	Three months ended September 30, 2018	Three months ended June 30, 2018	Three months ended March 31, 2018	Three months ended December 31, 2017
Revenues	\$ 3,491,602	\$ 2,535,235	\$ 2,511,878	\$ 1,912,457
Cost of goods sold	\$ 1,947,607	\$ 1,496,781	\$ 1,622,649	\$ 1,714,228
Write down of inventory	\$ -	\$ -	\$ -	\$ 26,885
Gross profit (loss)	\$ 1,543,995	\$ 1,038,455	\$ 889,229	\$ 171,344
Net expenses including non-cash items	\$ 1,282,278	\$ 1,201,366	\$ 1,171,585	\$ 2,310,592
Income (loss) for the quarter	\$ 261,717	\$ (162,911)	\$ (279,143)	\$ (2,212,407)
Basic and diluted earnings (loss) per share	\$ 0.01	\$ (0.00)	\$ (0.01)	\$ (0.05)
Common shares outstanding	47,170,086	47,170,086	47,170,086	46,911,752

	Three months ended September 30,2017	Three months ended June 30, 2017	Three months ended March 31, 2017	Three months ended December 31, 2016
Revenues	\$ 1,153,341	\$ 1,433,663	\$ 1,563,317	\$ 1,877,128
Cost of goods sold	\$ 887,986	\$ 1,107,842	\$ 863,383	\$ 1,889,852
Write down of inventory	\$ 443,769			
Gross profit	\$ (178,414)	\$ 325,821	\$ 699,934	\$ (12,724)
Expenses including non-cash items	\$ 1,202,081	\$ 1,223,334	\$ 1,225,430	\$ (372,131)
Income(loss) for the quarter	\$ (1,380,495)	\$ (897,513)	\$ (525,496)	\$ (384,855)
Basic and diluted (loss) per share	\$ (0.03)	\$ (0.02)	\$ (0.01)	\$ (0.01)
Common shares outstanding	46,911,752	46,911,752	46,911,752	46,411,752

### SELECTED ANNUAL INFORMATION

	Year ended December 31 2017	Year ended December 31 2016	Year ended December 31 2015
Revenues	\$ 6,062,778	\$ 8,077,143	\$ 18,910,122
Cost of goods sold	\$ 5,044,093	\$ 6,098,902	\$ 13,809,993
Gross profit	\$ 1,018,685	\$ 1,978,241	\$ 5,100,129
Expenses including non cash items and before deferred income tax recovery	\$ 5,961,437	\$ 5,433,019	\$ 6,506,867
Deferred income tax recovery (expense)	\$ 172,433	\$ (259,365)	\$ 86,932
Income tax expense (recovery)	\$ 22,137	\$ (1,248,551)	\$ 1,191,020
Loss for the year	\$ (5,015,911)	\$ (2,465,592)	\$ (2,510,826)
Number of common shares outstanding	46,911,752	46,411,752	46,071,752
Loss per common share	\$ (0.11)	\$ (0.05)	\$ (0.05)
Cash	\$ 411,223	\$ 2,312,279	\$ 3,175,292
Working capital	\$ 3,628,911	\$ 8,511,809	\$ 10,099,390
Total assets	\$ 9,165,199	\$ 13,050,144	\$ 16,157,689
Shareholders' equity	\$ 7,565,233	\$ 11,771,944	\$ 13,606,719
Dividends paid per share	\$ 0.00	\$ 0.00	\$ 0.03

### OFF BALANCE SHEET TRANSACTIONS

There are no off-balance sheet arrangements which could have a material effect on current or future results of operations or on the financial condition of the Company.

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### FINANCIAL INSTRUMENTS

Financial instruments are agreements between two parties that result in promises to pay or receive cash or equity instruments. The Company classifies its financial instruments as follows: cash is classified as a financial asset at FVTPL; accounts receivable is classified as loans and receivables; and due to related parties and accounts payable are classified as other financial liabilities, which are measured at amortized cost. The carrying value of these instruments approximates their fair values due to their short term to maturity.

The Company has exposure to the following risks from its use of financial instruments:

- Credit risk;
- Liquidity risk; and
- Market risk.

#### (a) Credit risk

Credit risk is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation. Cash is placed with a major Canadian financial institution and the Company's concentration of credit risk for cash and maximum exposure thereto is \$421,500 at September 30, 2018 (December 31, 2017 - \$411,223).

With respect to its accounts receivable, the Company assesses the credit rating of all customers and maintains provisions for potential credit losses, and any such losses to date have been within management's expectations. The Company's credit risk with respect to accounts receivable and maximum exposure thereto is \$1,754,749 at September 30, 2018 (December 31, 2017 - \$653,445). The Company's concentration of credit risk for accounts receivable at September 30, 2018 with respect to Customer A is \$660,166 (2017 - \$94,114), while Customer B is \$250,500 (2017 - \$78,306). The Company has an allowance for doubtful accounts of \$40,336 at September 30, 2018.

#### (b) Liquidity risk

Liquidity risk is the risk that the Company will be unable to meet its financial obligations as they fall due. The Company's approach to managing liquidity risk is to ensure, as far as possible, that it will have sufficient liquid funds to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Company's reputation. At September 30, 2018, the Company has cash in the amount of \$421,500 (December 31, 2017 - \$411,223) to settle current liabilities of \$1,634,287 with the following due dates; trade accounts payable of \$1,614,787 (December 31, 2017 - \$799,254) are due within three months; and due to related party balances of \$19,500 (December 31, 2017 - \$45,262) are due on demand.

#### (c) Market risk

The significant market risks to which the Company is exposed are interest rate risk and currency risk.

##### (i) Interest rate risk

Interest rate risk is the risk that the fair value or future cash flows will fluctuate as a result of changes in market interest rates. The Company's cash consists of cash held in bank accounts that earn interest at variable rates. Due to the short-term nature of this financial instrument, fluctuations in market rates of interest do not have a significant impact on the estimated fair value or future cash flows.

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### (ii) Currency risk

The Company is exposed to currency risk to the extent expenditures incurred or funds received and balances maintained by the Company are denominated in Canadian dollars ("CAD"). The Company does not manage currency risk through hedging or other currency management tools.

At September 30, 2018 and December 31, 2017, the Company's net exposure to foreign currency risk is as follows (in US):

	<b>September 30, 2018</b>	December 31, 2017
Net assets	\$ (49,583)	\$ (31,142)

Based on the above, assuming all other variables remain constant, a 14% weakening or strengthening of the USD against the CAD would result in approximately \$6,940 (December 31, 2017 - \$4,400) foreign exchange loss or gain in the consolidated statements of operations.

### (iii) Other price risk

Other price risk is the risk that the future cash flows of a financial instrument will fluctuate due to changes in market prices, other than those arising from interest rate risk or currency risk. The Company is not exposed to other price risk.

## CAPITAL MANAGEMENT

The Company considers its capital to be comprised of capital stock. The Company's objectives in managing its capital are to maintain its ability to continue as a going concern and to further develop its business. To effectively manage the Company's capital requirements, the Company has a planning and budgeting process in place to meet its strategic goals.

Our capital needs for the near term continue to be financed from operations and existing capital reserves with no interest-bearing debt to service. Management is assessing its future capital needs and may consider access to new equity capital to ensure that Kelso has adequate financial resources to complete its diversification programs and fund working capital requirements. Although the Company has been successful at raising funds in the past through the issuance of capital stock, it is uncertain whether it can utilize this method of financing due to the current difficult market conditions. The internal growth of the Company's revenues provides adequate capital reserves to fund our current business affairs in the near term.

In order to facilitate the management of its capital requirements, the Company prepares expenditure budgets that are updated as necessary depending on various factors, including successful capital deployment and general industry conditions. Management reviews the capital structure on a regular basis to ensure the above objectives are met. There have been no changes to the Company's approach to capital management during the year. There are no externally-imposed restrictions on the Company's capital.

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### DISCLOSURE CONTROLS AND PROCEDURES

The Company maintains appropriate information systems, procedures and controls to ensure that information used internally and disclosed externally is complete, accurate, reliable and timely. The disclosure controls and procedures (“DC&P”) are designed to provide reasonable assurance that information required to be disclosed in the annual filings, interim filings or other reports filed under securities legislation is recorded, processed, summarized and reported within the time periods specified in the securities legislation and include controls and procedures designed to ensure that information required to be disclosed is accumulated and communicated to Management, including its certifying officers, as appropriate to allow timely decisions regarding required disclosure.

The President and Chief Executive Officer and Chief Financial Officer of the Company have evaluated, or caused the evaluation of, under their direct supervision, the design effectiveness of the Company’s DC&P (as defined in Regulation 52-109 - Certification of Disclosure in Issuer’s Annual and Interim Filings) as at September 30, 2018, and have concluded that such DC&P were designed effectively.

### INTERNAL CONTROL OVER FINANCIAL REPORTING

Management is responsible for establishing and maintaining adequate internal controls over financial reporting (“ICFR”) to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS.

Management has evaluated the design of its ICFR as defined in Regulation 52-109 – Certification of Disclosure in Issuer’s Annual and Interim Filings. The evaluation was based on the criteria established in the “Internal Control-Integrated Framework” issued by the Committee of Sponsoring Organizations (2013) (“COSO”). This evaluation was performed by the President and Chief Executive Officer and Chief Financial Officer of the Company with the assistance of other Company management and staff to the extent deemed necessary. Based on this evaluation, the President and Chief Executive Officer and Chief Financial Officer concluded that the ICFR were effectively designed as at September 30, 2018.

In spite of its evaluation, management does recognize that any controls and procedures; no matter how well designed and operated, can only provide reasonable assurance and not absolute assurance of achieving the desired control objectives.

### RISKS AND UNCERTAINTIES

Our business operations involve a number of known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of the Company to be materially different from any future results expressed or implied by forward looking statements in this MD&A. The Company is diligent in minimizing exposure to business risk, but by the nature of its activities and size, will always involve some risk. These risks are not always quantifiable due to their uncertain nature.

*“Our products involve detailed proprietary and engineering knowledge and specific customer adoption criteria. If the Company is not able to effectively protect its intellectual property or cater to specific customer adoption criteria, our business may suffer a material negative impact and could fail.”*

The success of our company will be dependent on our ability to successfully develop; qualify under current AAR regulations; and protect our technologies by way of patents and trademarks.

The Company has obtained patents for its external constant force spring pressure relief valves and a one-bolt manway system, vacuum relief valve and bottom outlet valve. If we are unable to secure trademark and patent protection for our intellectual property in the future, or that protection is inadequate for future products, our business may be materially adversely affected.

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Further, there is no assurance that our railroad equipment products and other aspects of our business do not or will not infringe upon patents, copyrights or other intellectual property rights held by third parties. Although we are not aware of any such claims, we may become subject to legal proceedings and claims from time to time relating to the intellectual property of others in the ordinary course of our business. If we are found to have violated the intellectual property rights of others, we may be enjoined from using such intellectual property, and we may incur licensing fees or be forced to develop alternatives. In addition, we may incur substantial expenses and diversion of management time in defending against these third-party infringement claims, regardless of their merit. Successful infringement or licensing claims against us may result in substantial monetary liabilities, which may materially and adversely disrupt our business.

*“The Company may be unable to secure or maintain regulatory qualifications for its products.”*

The Association of American Railroads (the “AAR”) has specific adoption criteria that must be met before the Company’s products can be utilized by customers in the railroad industry. The Company has been successful in obtaining AAR approvals for its key products; however, there is no guarantee that the Company’s products will continue to meet AAR standards and adoption criteria as they evolve or that new products developed by the Company will receive AAR approval. In addition, certain customers may have specific adoption criteria beyond what is required by the AAR, and there is no guarantee that the Company will be able to cater to these specific adoption criteria. The Company’s failure to meet AAR and customer adoption criteria could have a material negative impact on the Company’s ability to obtain purchase orders and generate revenue.

*“The Company may not have sufficient capital in the future to meet rapid increases in production demands and may be unable to sustain its ability to grow its operations as quickly as anticipated.”*

Although the Company had a positive working capital in the amount of \$3,711,142 at September 30, 2018, the Company may, from time to time, face a working capital deficit. To maintain its activities, the Company may require access to additional capital through the sale of securities or obtaining debt financing. There can be no assurance that the Company will be successful in obtaining such additional financing and failure to do so could result in the inability of the Company to develop new products; meet production schedules; execute delivery orders; and continue its operations.

*“The Company has a limited operating history and may not be able to achieve its growth objectives.”*

The Company has a limited history of earnings. The Company is subject to all of the business risks and uncertainties associated with any business enterprise which is transitioning from product development to profitable operations, including the risk that it will not achieve its growth objectives. There is no assurance that the Company will be able to successfully complete its business development plans or operate profitably over the short or long term. The Company is dependent upon the good faith and expertise of management to identify, develop and operate commercially viable product lines. No assurance can be given that the Company’s efforts will result in the development of additional commercially viable product lines or that the Company’s current product lines will prove to be commercially viable in the long-term. If the Company’s efforts are unsuccessful over a prolonged period of time, the Company may have insufficient working capital to continue to meet ongoing obligations and its ability to obtain additional financing necessary to continue operations may also be adversely affected. Even if the Company is successful in developing one or more additional product lines, there is no assurance that these product lines or its existing product lines will be profitable.

*“New commercial markets for our products may not develop as quickly as anticipated or at all.”*

Markets for the Company’s products may not develop as quickly as anticipated, or at all, resulting in the Company being unable to meet its revenue and production targets. This may have a material negative impact on the Company, particularly if the Company has incurred significant expenses to cater to increased market demand and such market demand does not materialize.

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*“Unforeseen competition could affect our ability to grow our revenues as projected.”*

Although the Company has patents, trademarks and other protections in place to protect the proprietary technology on which the Company's business is dependent, competitive products may be developed in the future. Competition could adversely affect the Company's ability to acquire additional market share or to maintain revenue at current and projected levels.

*“Customer orders that are placed may be cancelled or rescheduled.”*

Although the Company makes efforts to ensure customers are satisfied with the Company's products, there is a risk that customers may cancel purchase orders before they are filled. This may have a material negative impact on the Company, particularly if the Company has already ordered the component parts required to assemble the finished products for that order or if the Company has assembled the required finished products. The negative impact may be mitigated by the Company's ability to utilize the component parts and finished products to satisfy other purchase orders, but there is no guarantee that the Company will be able to mitigate the risk of loss to the Company from cancelled orders in this manner.

*“The Company is dependent on a small number of OEM customers.”*

Although management is optimistic about the Company's future as a railway equipment supplier, the Company is dependent upon the five major customers that comprise the railroad tank car manufacturers for a significant portion of its revenue. In particular, the Company is dependent on three major US corporations and one Canadian corporation as customers. Although customers have displayed a pattern of consistent product orders over the past 24 months and timely payment of accounts owing, there is no guarantee that sales to these customers will continue at current levels or that these customers will continue to satisfy their payment obligations to the Company in a timely manner. The Company does not have any formal agreements for long term, large-scale purchase orders with these customers and only sells to them when purchase orders are received. The Company expects that this limited number of customers will continue to represent a substantial portion of its sales for the foreseeable future. The loss of any of these customers could have a material negative impact upon the Company and its results of operations.

*“Current products may not perform as well as expected.”*

There is a risk that the Company's products may not perform as well as expected, which may result in customer complaints, returned products, product recalls and/or loss of repeat customer orders. Any one of these effects may have a material negative impact on the Company's ability to generate revenue and continue operations.

*“There may be a shortage of parts and raw materials.”*

The Company currently has approximately three to five suppliers in the United States for each of the component parts and raw materials required to assemble the Company's finished products. There is a risk that the Company may face a shortage of parts and raw materials in the future if the Company's suppliers are unable to support current or increased customer demand for the Company's products. This could have a material negative impact on the Company, its revenues and continued operations.

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*“Production capacity may not be large enough to handle growth in market demand.”*

The Company's production facilities may not be large enough to handle growing market demand for the Company's products if market demand is beyond projected levels. The Company may not have sufficient capital to fund increased production at its existing facilities or to add new production facilities, and even if the Company did have sufficient funds for these purposes, the turnaround time to increase production may not be fast enough to meet market demand. This may have a material negative impact on the Company's ability to maintain existing customers and expand its customer base, and its ability to generate revenue at current and projected levels.

*“The Company's product development efforts may not result in new qualified commercial products.”*

The Company's efforts to research and develop new products for the railroad industry and to develop applications for the Company's products in other industries, such as the trucking industry, may not result in commercially viable products or applications. This may have a negative impact on the Company as its current products may cease to be best-available technology and the Company would not have a replacement or alternative product offering. Also, this may result in the Company's investment into such research and development being a loss.

*“The Company may face uninsurable or underinsured risks.”*

In the course of development and production of railroad equipment products, certain risks, and in particular, destruction of production facilities by a natural disaster, acts of terrorism, acts of war or patent infringement may occur. It is not always possible to fully insure against such risks and the Company may decide not to take out insurance against such risks as a result of high premiums or other reasons. Should such liabilities arise, they could reduce or eliminate any future profitability and result in increasing costs and a decline in the value of the securities of the Company. Of the above listed risks, only an act of war is truly uninsurable. The Company maintains commercial general liability insurance for claims up to \$4,000,000 in aggregate and \$1,000,000 per incident, as well as product liability insurance for claims up to \$4,000,000 in aggregate and \$1,000,000 per incident. Although the Company believes that the insurance policies currently in place adequately insure the Company given the size of its customer base and revenues from product sales, there is a risk that the Company's insurance coverage may not be sufficient to cover future products claims.

*“Raw materials used by the Company for the production of its products are subject to price fluctuations which could change profitability expectations.”*

Many of the materials used in our Company's products are common raw materials such as steel and rubber. These raw materials can be subject to significant price fluctuations. A steep rise in the price of such raw materials may have an adverse effect on the pricing of our products and our operating results. As our Company does not have any purchase agreements with customers, we are able to mitigate the risks associated with price fluctuations in our raw materials by adjusting the pricing of our products accordingly. However, there is no guarantee that customers will continue to purchase our products if prices are adjusted due to the fluctuation in the price of raw materials.

*“The success of the Company's business depends substantially on the continuing efforts of its senior executives, and its business may be severely disrupted if the Company loses their services.”*

The future success of the Company heavily depends upon the continued services of its senior executives and other key employees. In particular, the Company relies on the expertise and experience of its Chief Executive Officer and Chief Financial Officer and the Chief Operating Officer of Kelso Technologies Inc., Kelso Technologies (USA) Inc., KIQ X Industries Inc., KIQ Industries Inc. and Kel-Flo Industries Inc. (formerly Kelso Innovative Solutions Inc.). These individuals are under contractual obligations to the Company expiring on December 31, 2020, however if one or more of the Company's senior executives were unable or unwilling to continue in their present positions, the

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Company might not be able to replace them easily or at all. If any of the Company's senior executives joins a competitor or forms a competing company, the Company may lose clients, suppliers, key professionals, technical know-how and staff members.

Should one or more of these risks and uncertainties materialize, or should underlying assumptions prove incorrect, then actual results may vary materially from those described on forward-looking statements.

### RELATED PARTY TRANSACTIONS

Related party transactions not otherwise described in these consolidated financial statements are shown below. The remuneration of the Company's directors and three members of key management, being the Chief Executive Officer, Chief Financial Officer and Chief Operating Officer who have the authority and responsibility for planning, directing and controlling the activities of the Company, consist of the following amounts:

	<b>Nine months ended September 30, 2018</b>	Nine months ended September 30, 2017
Management compensation	<b>\$ 404,843</b>	\$ 409,014
Management bonus*	-	-
Share-based expense	-	-
Directors fees	<b>\$ 53,500</b>	\$ 50,500

\* The Company has management bonus agreements whereby 10% of the annual income before taxes and share-based expense is equally distributed to management.

As at September 30, 2018, amounts due to related parties include accounts payable which are unsecured and have no interest or specific terms of payments, are \$19,500 (2017 - \$16,500) consisting of \$19,500 (2017 - \$16,500) for directors' fees.

### DISCLOSURE OF OUTSTANDING SHARE DATA

As of November 8, 2018, the Company had the following number of securities outstanding:

- 1) Common shares issued and outstanding: 47,170,086
- 2) Share purchase options outstanding: 3,053,571
- 3) Share purchase warrants outstanding: Nil

### SUBSEQUENT EVENTS

There have been no material events subsequent to September 30, 2018.

### OUTLOOK

Our team of dedicated stakeholders have actively pulled together to turnaround our business capabilities and improve our financial performance during very difficult recessionary challenges over the past three years. Our strategic plan has been focused on re-branding Kelso as a reliable American made supplier of high-quality performance equipment for the rail tank car industry. This was imperative and we believed that this process would eventually lead to a healthy financial turnaround. Under these established initiatives we have experienced improved sales results providing a steady return to our available capital reserves. This turn of events has allowed us to survive and keep our ambitions of business growth, product development and pursuit of regulatory approvals on course.

## **Kelso Technologies Inc.**

Management Discussion and Analysis  
Nine Months Ended September 30, 2018  
(Expressed in US Dollars unless otherwise indicated)

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Management has been encouraged by sales-to-date growth for 2018 and the revenue prospects for 2019. Crude oil, ethanol and chemicals are the key commodities that are leading the way in the resurgence of tank car market activity. This stimulus has led rail tank car analysts to expect average new-build production rates to grow from approximately 12,000 tank cars in 2018 to 19,000 tank cars in 2019. Based on these new-build predictions and our historic retrofit/repair business Kelso expects to supply its specialized tank car equipment to over 8,000 tank cars in 2018 and over 10,000 tank cars in 2019.

A key dynamic for our growth of financial performance will be getting a wider variety of our tank car products adopted by hazmat shippers. Once this adoption trend can be established we expect customers to begin to specify combinations of our One-Bolt Manway, VRV and BOV along with our proven PRV. Our long-term goal is to improve tank car revenues from approximately \$1,400 per tank car to in excess of \$10,000 per tank car.

The key hurdle for sales growth is the achievement of full AAR regulatory approvals that are required for full commercial adoption. Currently our VRV is in the final stages of full AAR approval. Once final approvals are received sales of VRV are expected to commence.

There is no mandatory requirement for any company to participate in service trials of new technology which means we have to source volunteer companies to participate in service trial programs. This is a difficult circumstance but Kelso has successfully found these technology partners and service trials for our ceramic ball BOV, high pressure PRV and angle valve are in process. Customer s' willingness to participate in this process is an encouraging indication that these products will be in demand once approvals are completed.

Our R&D model has delivered an array of promising new products that include specialized truck tanker equipment, rail wheel cleaning systems, fuel loading systems, military applications, first responder emergency response kits and an ASCS suspension system for motor vehicles being used in rugged outback terrain applications.

We continue to prioritize promising product development initiatives to build future value propositions for Kelso's stakeholders even though R&D projects are often complex, expensive and the timing of revenue streams are unpredictable and not guaranteed. Although many operational and human resource expenses have been reduced our capital management remains challenging but recent improvements in cash flows from sales growth in 2018 have been adequate to fund current business activities. The Company can currently operate without immediate access to new equity capital or debt and the Company remains free of interest-bearing long-term debt.

In 2017 we began re-branding our organization by implementing new business processes, new personnel, changing our corporate culture and revamping our approach to customer service, marketing and sales processes. In 2018 the results have been encouraging with growth in sales, improved financial performance and business momentum seems to be building for future periods. The key objectives of our strategic plans are the eventual satisfaction of all Kelso stakeholders with reliable growth of profitability, improved financial health and market valuation.

## **Kelso Technologies Inc.**

James R. Bond,  
President and Chief Executive Officer



**KELSO TECHNOLOGIES INC.**

Consolidated Interim Financial Statements  
For the Nine months ended September 30, 2018  
(Unaudited – Prepared by Management)  
(Expressed in US Dollars)

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## **NOTICE OF NO AUDITOR REVIEW OF INTERIM FINANCIAL REPORT**

The accompanying unaudited interim financial report of the Company has been prepared by and is the responsibility of the Company's management. The Company's independent auditor has not performed a review or audit of this financial report.

**Kelso Technologies Inc.**

## Consolidated Interim Statements of Financial Position

September 30,

(Unaudited – Prepared by Management)

(Expressed in US Dollars)

	September 30, 2018	December 31, 2017
<b>Assets</b>		
<b>Current</b>		
Cash and cash equivalents (Note 11)	\$ 421,500	\$ 411,223
Accounts receivable	1,754,749	653,445
Prepaid expenses	145,908	183,966
Inventory (Note 6)	3,732,559	3,980,243
	6,054,716	5,228,877
Property, plant and equipment (Note 7)	2,834,038	2,991,546
Intangible assets (Note 8)	937,972	944,776
	\$ 9,826,726	\$ 9,165,199
<b>Liabilities</b>		
<b>Current</b>		
Accounts payable and accrued liabilities (Note 10)	\$ 1,634,287	\$ 878,699
Income tax payable	709,287	721,267
	2,343,574	1,599,966
<b>Shareholders' Equity</b>		
<b>Capital Stock</b> (Note 9)	23,365,279	23,231,252
<b>Obligation to issue shares</b> (Note 8 and 9)	-	131,527
<b>Reserves</b> (Note 9 (b))	3,586,283	3,490,526
<b>Deficit</b>	(19,468,410)	(19,288,072)
	7,483,152	7,565,233
	\$ 9,826,726	\$ 9,165,199

Approved on behalf of the Board:

"Peter Hughes" (signed)

Peter Hughes, Director

"Phil Dyer" (signed)

Phil Dyer, Director

See notes to consolidated interim financial statements

**Kelso Technologies Inc.**

Consolidated Interim Statements of Changes in Equity  
For the Nine months ended September 30, 2018 and 2017  
(Unaudited – Prepared by Management)  
(Expressed in US Dollars)

	Capital Stock		Obligation to Issue Shares	Reserve	Deficit	Total
	Number of shares	Amount				
<b>Balance, December 31, 2016</b>	46,411,759	\$ 22,839,820	\$ 192,946	\$ 3,021,339	\$ (14,272,161)	\$ 11,771,944
Shares issued for project	500,000	401,432	-	-	-	401,432
Shares to be issued	-	-	(192,946)	-	-	(192,946)
Net loss for the period	-	-	-	-	(2,803,514)	(2,803,514)
<b>Balance, September 30, 2017</b>	46,911,752	\$ 23,331,252	\$ -	\$ 3,021,339	\$ (17,075,675)	\$ 9,176,916
<b>Balance, December 31, 2017</b>	46,911,752	\$ 23,231,252	\$ 131,527	\$ 3,490,526	\$ (19,288,072)	\$ 7,565,233
Exercise of options	8,334	2,500	-	-	-	2,500
Shares issued	250,000	131,527	(131,527)	95,757	-	95,757
Net loss for the period	-	-	-	-	(180,338)	(180,338)
<b>Balance, September 30, 2018</b>	<b>47,170,086</b>	<b>\$ 23,365,279</b>	<b>\$ -</b>	<b>\$ 3,586,283</b>	<b>\$ (19,468,410)</b>	<b>\$ 7,483,152</b>

See notes to consolidated interim financial statements

**Kelso Technologies Inc.**

## Consolidated Interim Statements of Operations and Comprehensive Loss

For the Nine months ended September 30, 2018 and 2017

(Unaudited – Prepared by Management)

(Expressed in US Dollars)

	<b>Three months ended September 30, 2018</b>	Three months ended September 30, 2017	<b>Nine months ended September 30, 2018</b>	Nine months ended September 30, 2017
<b>Revenues</b>	<b>\$ 3,491,602</b>	\$ 1,153,341	<b>\$ 8,538,716</b>	\$ 4,150,321
<b>Cost of Goods Sold</b>	<b>1,947,607</b>	1,331,755	<b>5,067,037</b>	3,302,990
<b>Gross Profit</b>	<b>1,543,995</b>	(178,414)	<b>3,471,679</b>	847,331
<b>Expenses</b>				
Share-based expense (Note 9 (b))	<b>75,600</b>	-	<b>95,757</b>	-
Management fees (Note 10)	<b>135,000</b>	135,594	<b>404,843</b>	409,014
Consulting and filing fees	<b>47,138</b>	47,917	<b>158,863</b>	188,903
Investor relations	<b>21,000</b>	21,000	<b>63,000</b>	63,000
Accounting and legal	<b>27,977</b>	83,198	<b>133,484</b>	333,299
Office and administration	<b>393,512</b>	399,404	<b>1,229,306</b>	1,335,374
Research	<b>469,872</b>	335,274	<b>1,225,822</b>	645,251
Travel	<b>44,284</b>	118,051	<b>127,574</b>	340,115
Marketing	<b>69,636</b>	122,307	<b>208,024</b>	439,111
Unrealized foreign exchange loss (gain)	<b>(9,530)</b>	(67,793)	<b>(14,485)</b>	(117,987)
Amortization	<b>7,627</b>	3,072	<b>22,880</b>	6,901
	<b>1,282,117</b>	1,198,025	<b>3,655,067</b>	3,642,982
Income (Loss) before the following	<b>261,878</b>	(1,376,440)	<b>(183,388)</b>	(2,795,652)
Interest income (loss)	-	(4,054)	-	9,995
Income tax	<b>161</b>	-	<b>(3,052)</b>	(17,856)
<b>Net Income (Loss) and Comprehensive Income (Loss) for the Period</b>	<b>\$ 261,717</b>	\$ (1,380,495)	<b>\$ (180,336)</b>	\$ (2,803,514)
<b>Basic and Diluted Earnings (Loss) Per Share</b>	<b>\$ 0.01</b>	\$ (0.03)	<b>\$ 0.00</b>	\$ (0.06)
<b>Weighted Average Number of Common Shares Outstanding</b>				
<b>Basic</b>	<b>47,051,547</b>	46,724,765	<b>47,051,547</b>	46,724,765
<b>Diluted</b>	<b>47,051,547</b>	46,724,765	<b>47,051,547</b>	46,724,765

See notes to consolidated interim financial statements

**Kelso Technologies Inc.**

## Consolidated Interim Statements of Cash Flows

For the Nine months ended September 30, 2018 and 2017

(Unaudited – Prepared by Management)

(Expressed in US Dollars)

	September 30, 2018	September 30, 2017
<b>Operating Activities</b>		
Net income (loss)	\$ (180,336)	\$ (2,803,514)
Items not involving cash		
Amortization of equipment and patent	164,311	203,765
Write-down of inventory	-	443,769
Share-based expense	95,757	-
Unrealized foreign exchange	(14,485)	(117,987)
	<b>65,247</b>	<b>(2,273,967)</b>
Changes in non-cash working capital		
Accounts receivable	(1,101,304)	153,134
Prepaid expenses and deposit	38,059	538,309
Inventory	247,684	109,952
Income tax receivable	-	753,223
Accounts payable and accrued liabilities	755,588	101,905
Income tax payable	(11,980)	(113,348)
	<b>(71,954)</b>	<b>1,543,175</b>
<b>Cash Used in Operating Activities</b>	<b>(6,708)</b>	<b>(730,792)</b>
<b>Investing Activities</b>		
Intangible assets	-	(233,486)
Deferred assets	-	(1,109,057)
<b>Cash Used in Investing Activities</b>	<b>-</b>	<b>(1,342,543)</b>
<b>Financing Activities</b>		
Issue of common shares	2,500	401,432
Dividend paid	-	(192,946)
<b>Cash Used in Financing Activities</b>	<b>2,500</b>	<b>208,486</b>
Foreign exchange effect on cash	14,485	117,987
<b>Inflow (Outflow) of Cash</b>	<b>10,277</b>	<b>(1,746,862)</b>
<b>Cash, Beginning of Period</b>	<b>411,223</b>	<b>2,312,279</b>
<b>Cash, End of Period</b>	<b>\$ 421,500</b>	<b>\$ 565,417</b>

Supplemental Cash Flow Information (Note 12)

See notes to consolidated interim financial statements

## **KELSO TECHNOLOGIES INC.**

Notes to Consolidated Interim Financial Statements

For the Nine months ended September 30, 2018 and 2017

(Unaudited – Prepared by Management)

(Expressed in US Dollars)

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### **1. NATURE OF OPERATIONS**

Kelso Technologies Inc. (the “Company”) was incorporated under the laws of British Columbia on March 16, 1987. The Company designs, engineers, markets, produces and distributes various proprietary pressure relief valves and manway securement systems designed to reduce the risk of environmental harm due to non-accidental events in the transportation of hazardous commodities via railroad tank cars. In addition, the Company is an engineering development company specializing in proprietary service equipment used in transportation applications. The Company trades on the Toronto Stock Exchange (“TSX”) under the symbol “KLS”, and the NYSE (“NYSE”) under the trading symbol “KIQ”. The Company listed on the TSX on May 22, 2014 and on the NYSE on October 14, 2014. The Company’s head office is located at 13966 18B Avenue, South Surrey, British Columbia, V4A 8J1.

### **2. BASIS OF PREPARATION**

#### **(a) Statement of compliance**

These unaudited interim consolidated financial statements of the Company have been prepared in accordance with International Financial Reporting Standards (“IFRS”), as issued by the International Accounting Standards Board (“IASB”), applicable to the preparation of interim financial statements, including International Accounting Standards (“IAS”) 34 *Interim Financial Reporting*. The condensed unaudited interim financial statements do not include all of the disclosures required for a complete set of annual financial statements and should be read in conjunction with the audited annual consolidated financial statements for the year ended December 31, 2017, which have been prepared in accordance with IFRS as issued by the IASB.

#### **(b) Basis of presentation and consolidation**

The unaudited interim consolidated financial statements include the accounts of the Company and its integrated wholly owned subsidiaries, Kelso Technologies (USA) Inc., Kel-Flo Industries Inc. (formerly Kelso Innovative Solutions Inc.) and KIQ Industries Inc., which are all Nevada, USA, corporations. KIQ X Industries is a British Columbia Company incorporated on December 12, 2017. Intercompany transactions and balances have been eliminated on consolidation. A subsidiary is consolidated from the date upon which control is acquired by the Company and all material intercompany transactions and balances have been eliminated on consolidation.

Control is achieved when the Company is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.

#### **(c) Functional and presentation currency**

The functional and presentation currency of the Company and its subsidiaries is the US dollar (“USD”).

**KELSO TECHNOLOGIES INC.**  
Notes to Consolidated Interim Financial Statements  
For the Nine months ended September 30, 2018 and 2017  
(Unaudited – Prepared by Management)  
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**2. BASIS OF PREPARATION (Continued)**

(d) Significant management judgments and estimation uncertainty

The preparation of unaudited interim consolidated financial statements in conformity with IFRS requires the Company's management to undertake a number of judgments, estimates and assumptions that affect amounts reported in the unaudited interim consolidated financial statements and notes thereto. Actual amounts may ultimately differ from these estimates and assumptions. The Company reviews its estimates and underlying assumptions on an ongoing basis. Revisions are recognized in the period in which the estimates are revised and may impact future periods.

*Significant management judgments*

The following are significant management judgments in applying the accounting policies of the Company that have the most significant effect on recognition and measurement of assets, liabilities, income and expenses:

(i) Income taxes

The extent to which deferred tax assets can be recognized is based on an assessment of the probability of the Company's future taxable income against which the deferred tax assets can be utilized. In addition, significant judgment is required in classifying transactions and assessing probable outcomes of tax positions taken, and in assessing the impact of any legal or economic limits or uncertainties in various tax jurisdictions.

(ii) Functional currency

The functional currency for the Company's subsidiaries is the currency of the primary economic environment in which the entity operates. The Company has determined the functional currency of its subsidiaries is the USD. Determination of functional currency may involve certain judgments to determine the primary economic environment and the Company reconsiders the functional currency of its entities if there is a change in events and conditions that determined the primary economic environment.

(iii) Assessment of the transaction as an asset acquisition or business combination

Management applied judgments relating to the acquisition of intellectual property to assess if the acquisition was a business combination or an asset acquisition. Management applied a three-element process to determine whether a business or an asset was purchased, considering inputs, processes and outputs of each acquisition in order to reach a conclusion (Note 8).

**KELSO TECHNOLOGIES INC.**  
Notes to Consolidated Interim Financial Statements  
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**2. BASIS OF PREPARATION (Continued)**

(d) Significant management judgments and estimation uncertainty (Continued)

*Significant management judgments (Continued)*

(iv) Research and development expenditures

The application of the Company's accounting policy for research and development expenditures requires judgment in determining whether an activity is determined to be research or development, and if deemed to be development, whether it is likely that the future economic benefits will flow to the Company, which may be based on assumptions about future events or circumstances. Estimates and assumptions may change if new information becomes available. If new information becomes available indicating that it is unlikely that future economic benefits will flow to the Company, the amount capitalized is written off to profit or loss in the period the new information becomes available.

(v) Going concern assumption

The assessment of whether the going concern assumption is appropriate requires management to take into account all available information about the future, which is at least, but not limited to, twelve months from the end of the reporting period.

*Estimation uncertainty*

Information about estimates and assumptions that have the most significant effect on the recognition and measurement of assets, liabilities, income and expenses is provided below. Actual results may be substantially different.

(i) Impairment of long-lived assets

Long-lived assets consist of intangible assets and property, plant and equipment.

At the end of each reporting period, the Company reviews the carrying amounts of its long-lived assets to determine whether there is any indication that the carrying amount is not recoverable. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). When an individual asset does not generate independent cash flows, the Company estimates the recoverable amount of the cash-generating unit to which the asset belongs. 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 groups of assets. When a reasonable and consistent basis of allocation can be identified, corporate assets are also allocated to individual cash-generating units, or otherwise they are allocated to the smallest group of cash-generating units for which a reasonable and consistent allocation basis can be identified.

## **KELSO TECHNOLOGIES INC.**

Notes to Consolidated Interim Financial Statements

For the Nine months ended September 30, 2018 and 2017

(Unaudited – Prepared by Management)

(Expressed in US Dollars)

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### **2. BASIS OF PREPARATION (Continued)**

#### (d) Significant management judgment and estimation uncertainty (Continued)

##### *Estimation uncertainty (Continued)*

##### (i) Impairment of long-lived assets (Continued)

Recoverable amount is the higher of fair value less costs of disposal and value in use. Fair value is determined as the price that would be received to sell an asset in an orderly transaction between market participants at the measurement date. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

##### (ii) Useful lives of depreciable assets

The Company reviews its estimate of the useful lives of depreciable assets at each reporting date, based on the expected utilization of the assets. Uncertainties in these estimates relate to technical obsolescence that may change the utilization of certain intangible assets and equipment.

##### (iii) Inventories

The Company estimates the net realizable value of inventories, taking into account the most reliable evidence available at each reporting date. The future realization of these inventories may be affected by future technology or other market-driven changes that may reduce future selling prices. A change to these assumptions could impact the Company's inventory valuation and impact gross margins.

##### (iv) Share-based expense

The Company grants share-based awards to certain officers, employees, directors and other eligible persons. For equity settled awards, the fair value is charged to the consolidated statement of operations and comprehensive income (loss) and credited to the reserves, over the vesting period using the graded vesting method, after adjusting for the estimated number of awards that are expected to vest.

The fair value of the equity-settled awards is determined at the date of the grant using the Black-Scholes option pricing model. Option pricing models require the input of highly subjective assumptions, including the expected price, expected volatility and expected life of the options. Changes in these assumptions can materially affect the fair value estimate, and therefore, the existing models do not necessarily provide a reliable measure of the fair value of the Company's stock options.

**KELSO TECHNOLOGIES INC.**  
Notes to Consolidated Interim Financial Statements  
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**2. BASIS OF PREPARATION (Continued)**

(d) Significant management judgment and estimation uncertainty (Continued)

*Estimation uncertainty (Continued)*

(v) Allowance for credit losses

The Company provides for doubtful debts by analyzing the historical default experience and current information available about a customer's credit worthiness on an account by account basis. Uncertainty relates to the actual collectability of customer balances that can vary from the Company's estimation.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

(e) Approval of the consolidated financial statements

The consolidated financial statements of Kelso Technologies Inc. for the nine month period ended September 30, 2018 were approved and authorized for issue by the Board of Directors on November 8, 2018.

(f) New accounting standards issued but not yet effective

The standards listed below include only those which the Company reasonably expects may be applicable to the Company at a future date. The Company is currently assessing the impact of these future standards on the consolidated financial statements.

*IFRS 9 Financial Instruments*

IFRS 9 will replace IAS 39 *Financial Instruments: Recognition and Measurement* and IFRIC 9 *Reassessment of Embedded Derivatives*. The final version of this new standard supersedes the requirements of earlier versions of IFRS 9.

The main features introduced by this new standard compared with predecessor IFRS are as follows:

- Classification and measurement of financial assets:

Debt instruments are classified and measured on the basis of the entity's business model for managing the asset and its contractual cash flow characteristics as either: "Amortized cost", "Fair value through other comprehensive income" or "Fair value through profit or loss" (default). Equity instruments are classified and measured as "Fair value through profit or loss" unless upon initial recognition elected to be classified as "Fair value through other comprehensive income".

## **KELSO TECHNOLOGIES INC.**

Notes to Consolidated Interim Financial Statements

For the Nine months ended September 30, 2018 and 2017

(Unaudited – Prepared by Management)

(Expressed in US Dollars)

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### **2. BASIS OF PREPARATION (Continued)**

#### (f) New accounting standards issued but not yet effective (Continued)

- Classification and measurement of financial liabilities:

When an entity elects to measure a financial liability at fair value, gains or losses due to changes in the entity's own credit risk is recognized in other comprehensive income (as opposed to previously profit or loss). This change may be adopted early in isolation of the remainder of IFRS 9.

- Impairment of financial assets:

An expected credit loss impairment model replaced the incurred loss model and is applied to financial assets at "Amortized cost" or "Fair value through other comprehensive income", lease receivables, contract assets or loan commitments and financial guarantee contracts. An entity recognizes 12-month expected credit losses if the credit risk of a financial instrument has not increased significantly since initial recognition, and lifetime expected credit losses otherwise.

- Hedge accounting:

Hedge accounting remains a choice, however is now available for a broader range of hedging strategies. Voluntary termination of a hedging relationship is no longer permitted. Effectiveness testing now needs to be performed prospectively only. Entities may elect to continue to applying IAS 39 hedge accounting on adoption of IFRS 9 (until the IASB has completed its separate project on the accounting for open portfolios and macro hedging).

Applicable to the Company's annual period beginning January 1, 2018.

#### *IFRS 2 Share-based Expense*

The amendments provide guidance on the accounting for:

- the effects of vesting and non-vesting conditions on the measurement of cash-settled share-based expenses;
- share-based expense transactions with a net settlement feature for withholding tax obligations; and
- a modification to the terms and conditions of a share-based expense that changes the classification of the transaction from cash-settled to equity-settled.

Applicable to the Company's annual period beginning January 1, 2018.

**KELSO TECHNOLOGIES INC.**  
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**2. BASIS OF PREPARATION** (Continued)

(f) New accounting standards issued but not yet effective (Continued)

*IAS 7 Statement of Cash Flows*

The amendments require entities to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities.

Applicable to the Company's annual period beginning January 1, 2017.

*IAS 12 Income Taxes*

The amendments clarify how to account for deferred tax assets related to debt instruments measured at fair value.

Applicable to the Company's annual period beginning January 1, 2017.

*IFRS 15 Revenue from Contracts with Customers*

IFRS 15 provides a single, principles based five-step model to be applied to all contracts with customers.

The five steps in the model are as follows:

- Identify the contract with the customer
- Identify the performance obligations in the contract
- Determine the transaction price
- Allocate the transaction price to the performance obligations in the contracts
- Recognize revenue when (or as) the entity satisfies a performance obligation.

Guidance is provided on topics such as the point in which revenue is recognized, accounting for variable consideration, costs of fulfilling and obtaining a contract and various related matters. New disclosures about revenue are also introduced.

Applicable to the Company's annual period beginning on January 1, 2018.

**KELSO TECHNOLOGIES INC.**  
Notes to Consolidated Interim Financial Statements  
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(Expressed in US Dollars)

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**2. BASIS OF PREPARATION (Continued)**

(f) New accounting standards issued but not yet effective (Continued)

*IFRS 16 Leases*

This new standard sets out the principles for the recognition, measurement, presentation and disclosure of leases for both the lessee and the lessor. The new standard introduces a single lessee accounting model that requires the recognition of all assets and liabilities arising from a lease.

The main features of the new standard are as follows:

- An entity identifies as a lease a contract that conveys the right to control the use of an identified asset for a period of time in exchange for consideration.
- A lessee recognizes an asset representing the right to use the leased asset, and a liability for its obligation to make lease payments. Exceptions are permitted for short-term leases and leases of low-value assets.
- A lease asset is initially measured at cost, and is then depreciated similarly to property, plant and equipment. A lease liability is initially measured at the present value of the unpaid lease payments.
- A lessee presents interest expense on a lease liability separately from depreciation of a lease asset in the statement of profit or loss and other comprehensive income.
- A lessor continues to classify its leases as operating leases or finance leases, and to account for them accordingly.
- A lessor provides enhanced disclosures about its risk exposure, particularly exposure to residual-value risk.

Applicable to the Company's annual period beginning January 1, 2019.

The impact of the above new accounting standards on the Company's unaudited interim consolidated financial statements has not yet been determined.

**3. SIGNIFICANT ACCOUNTING POLICIES**

The following is a summary of significant accounting policies.

(a) Cash equivalents

Cash equivalents include short-term liquid investments with maturities of one year or less, are readily convertible into known amounts of cash and which are subject to insignificant changes in value.

(b) Inventory

Inventory components include raw materials and supplies used to assemble valves and manway covers, as well as finished valves and manway covers. All inventories are recorded at the lower of cost on a weighted average basis and net realizable value. The stated value of all inventories includes purchase and assembly costs of all raw materials and supplies, and attributable overhead and amortization. A regular review is undertaken to determine the extent of any provision for obsolescence.

**KELSO TECHNOLOGIES INC.**  
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**3. SIGNIFICANT ACCOUNTING POLICIES (Continued)**

(c) Intangible assets

Intangible assets acquired separately are measured on initial recognition at cost. Following initial recognition, intangible assets are carried at cost less any accumulated amortization and accumulated impairment losses, if any. The useful lives of intangible assets are assessed as either finite or indefinite.

Intangible assets with finite lives are amortized over the useful economic life and assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortization period and the amortization method for an intangible asset with a finite useful life are reviewed at least at the end of each reporting period. A change in the expected useful life of the expected pattern of consumption of future economic benefits embodied in the asset is accounted for by changing the amortization period or method, as appropriate, and treated as changes in accounting estimates. Intangible assets with indefinite useful lives are not amortized, but are tested for impairment annually, either individually or at the cash-generating unit level. The assessment of indefinite life is reviewed annually to determine whether the indefinite life continues to be supportable. If not, the change in useful life from indefinite to finite is made on a prospective basis.

The Company amortizes intangible assets with finite lives on a straight-line basis over their estimated useful lives:

Patents - 5 years  
Rights - 2 years

Product and technology development costs, which meet the criteria for deferral and are expected to provide future benefits with reasonable certainty are deferred and amortized over the estimated life of the products or technology. The Company commenced deferring development costs associated with the manway securement systems. The costs were amortized on a straight-line basis over a ten-year period based on the estimated useful life of the product.

(d) Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated amortization. Leasehold improvements are amortized on a straight-line basis over the lease term. Amortization is calculated over the estimated useful life of the property, plant and equipment at the following annual rates:

Building	– 4% declining-balance
Production equipment	– 20% declining-balance
Vehicles	– 30% declining-balance
Leasehold improvements	– 5 year straight-line

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**3. SIGNIFICANT ACCOUNTING POLICIES (Continued)**

(e) Revenue recognition

Revenues are recognized when the risks and rewards of ownership have passed to the customer based on the terms of the sale, collection of the relevant receivable is probable, evidence of an arrangement exists and the sales price is fixed or determinable. Risks and rewards of ownership pass to the customer upon shipment of the pressure relief valves and/or manway securement systems. Provisions for sales discounts and returns from customers are made at the time of sale.

(f) Impairment of non-current assets

The Company's tangible and intangible assets are reviewed for an indication of impairment at each statement of financial position date. If indication of impairment exists, the asset's recoverable amount is estimated. An impairment loss is recognized when the carrying amount of an asset, or its cash-generating unit, exceeds its recoverable amount. A cash-generating unit is the smallest identifiable group of assets that generates cash inflows that are largely independent of cash inflow from other assets or groups of assets.

The recoverable amount is the greater of the asset's fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the assets. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

(g) Income taxes

(i) Current and deferred income taxes

Income tax expense, consisting of current and deferred tax expense, is recognized in the consolidated statements of operations. Current tax expense is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at period-end, adjusted for amendments to tax payable with regard to previous years.

Deferred tax assets and liabilities and the related deferred income tax expense or recovery are recognized for deferred tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using the enacted or substantively enacted tax rates expected to apply when the asset is realized or the liability settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income (loss) in the period that substantive enactment occurs.

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### **3. SIGNIFICANT ACCOUNTING POLICIES (Continued)**

#### (g) Income taxes (Continued)

##### (i) Current and deferred income taxes (Continued)

A deferred tax asset is recognized to the extent that it is probable that future taxable profits will be available against which the asset can be utilized. To the extent that the Company does not consider it probable that a deferred tax asset will be recovered, the deferred tax asset is reduced. Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the Company intends to settle its current tax assets and liabilities on a net basis.

##### (ii) Texas margin tax

Effective January 1, 2007, the state of Texas enacted an annual franchise tax known as the Texas margin tax, which is equal to 1% of the lesser of: (a) 70% of a taxable entity's revenue; and (b) 100% of total revenue less, at the election of the taxpayer: (i) cost of goods sold; or (ii) compensation. A provision for the margin tax owing has been recorded in the consolidated statements of operations and comprehensive income (loss).

#### (h) Foreign currency translation

The accounts of foreign balances and transactions are translated into USD as follows:

- (i) Monetary assets and liabilities, at the rate of exchange in effect at the consolidated statement of financial position date;
- (ii) on-monetary assets and liabilities, at the exchange rates prevailing at the time of the acquisition of the assets or assumption of the liabilities; and
- (iii) Revenue and expense items (excluding amortization, which is translated at the same rate as the related asset), at the rate of exchange prevailing at the transaction date.

Gains and losses arising from translation of foreign currency are included in the determination of net income (loss).

#### (i) Earnings per share

The Company presents basic earnings per share data for its common shares, calculated by dividing the earnings attributable to common shareholders of the Company by the weighted average number of shares outstanding during the period. The Company uses the treasury stock method for calculating diluted earnings per share. Under this method the dilutive effect on earnings per share is calculated on the use of the proceeds that could be obtained upon exercise of options, warrants and similar instruments. It assumes that the proceeds of such exercise would be used to purchase common shares at the average market price during the period. However, the calculation of diluted loss per share excludes the effects of various conversions and exercise of options and warrants that would be anti-dilutive.

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**3. SIGNIFICANT ACCOUNTING POLICIES (Continued)**

(j) Share-based expense

The Company grants share options to acquire common shares of the Company to directors, officers, employees and consultants. The fair value of share-based expense to employees is measured at grant date, using the Black-Scholes option pricing model, and is recognized over the vesting period for employees using the graded vesting method. Fair value of share-based expenses for non-employees is recognized and measured at the date the goods or services are received based on the fair value of the goods or services received. If it is determined that the fair value of goods and services received cannot be reliably measured, the share-based expense is measured at the fair value of the equity instruments issued using the Black-Scholes option pricing model.

For both employees and non-employees, the fair value of share-based expense is recognized on the consolidated statements of operations and comprehensive income (loss), with a corresponding increase in reserves. The amount recognized as expense is adjusted to reflect the number of share options expected to vest. Consideration received on the exercise of stock options is recorded in capital stock and the related share-based expense in reserves is transferred to capital stock.

(k) Capital stock

Proceeds from the exercise of stock options and warrants are recorded as capital stock in the amount for which the option or warrant enabled the holder to purchase a share in the Company. Any previously recorded share-based expense included in the share-based expenses reserve is transferred to capital stock on exercise of options. Capital stock issued for non-monetary consideration is valued at the closing market price at the date of issuance. The proceeds from the issuance of units are allocated between common shares and warrants based on the residual value method. Under this method, the proceeds are allocated first to capital stock based on the fair value of the common shares at the time the units are priced and any residual value is allocated to the warrants reserve. Consideration received for the exercise of warrants is recorded in capital stock, and any related amount recorded in warrants reserve is transferred to capital stock.

(l) Financial instruments

(i) Financial assets

The Company classifies its financial assets into one of the following categories, depending on the purpose for which the asset was acquired. The Company's accounting policy for each category is as follows:

*Fair value through profit or loss ("FVTPL")*

This category comprises derivatives, or assets acquired or incurred principally for the purpose of selling or repurchasing it in the near term. They are carried at fair value with changes in fair value recognized through profit or loss.

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**3. SIGNIFICANT ACCOUNTING POLICIES (Continued)**

(l) Financial instruments (Continued)

(i) Financial assets (Continued)

*Loans and receivables*

These assets are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are carried at cost less any provision for impairment. Individually significant receivables are considered for impairment when they are past due or when other objective evidence is received that a specific counterparty will default.

*Held to maturity*

These assets are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Company's management has the positive intention and ability to hold to maturity. HTM investments are initially recognized on their trade-date at fair value, and subsequently are measured at amortized cost using the effective interest rate method. If there is objective evidence that the investment is impaired, determined by reference to external credit ratings and other relevant indicators, the financial asset is measured at the present value of estimated future cash flows. Any changes to the carrying amount of the investment, including impairment losses, are recognized in profit or loss.

*Available-for-sale financial assets*

AFS financial assets are non-derivatives that are either designated as available-for-sale or not classified in any of the other financial asset categories. Changes in the fair value of AFS financial assets are recognized as other comprehensive income (loss) and classified as a component of equity. AFS assets include investments in equities of other entities with the exception of marketable securities.

Management assesses the carrying value of AFS financial assets at least annually and any impairment charges are also recognized in profit or loss. When financial assets classified as AFS are sold, the accumulated fair value adjustments recognized in other comprehensive income (loss) are included in profit or loss.

(ii) Financial liabilities

The Company classifies its financial liabilities in the following categories:

*Financial liabilities at FVTPL*

Financial liabilities at FVTPL are initially recognized at fair value with changes in fair value recorded through profit or loss.

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### **3. SIGNIFICANT ACCOUNTING POLICIES (Continued)**

(l) Financial instruments (Continued)

(ii) Financial liabilities (continued)

#### *Other financial liabilities*

Other financial liabilities are non-derivatives and are recognized initially at fair value, net of transaction costs incurred, and are subsequently stated at amortized cost using the effective interest rate method. Any difference between the amounts originally received, net of transaction costs, and the redemption value is recognized in profit or loss over the period to maturity using the effective interest method. Other financial liabilities are classified as current or non-current based on their maturity date.

(m) Fair value hierarchy

The Company categorizes financial instruments measured at fair value at one of three levels according to the reliability of the inputs used to estimate fair values. The fair value of financial assets and financial liabilities included in Level 1 are determined by reference to quoted prices in active markets for identical assets and liabilities. Financial assets and liabilities in Level 2 are valued using inputs other than quoted prices for which all significant inputs are based on observable market data. Level 3 valuations are based on inputs that are not based on observable market data.

### **4. CAPITAL MANAGEMENT**

The Company considers its capital to be comprised of capital stock.

The Company's objectives in managing its capital are to maintain its ability to continue as a going concern and to further develop its business. To effectively manage the Company's capital requirements, the Company has a planning and budgeting process in place to meet its strategic goals.

In order to facilitate the management of its capital requirements, the Company prepares expenditure budgets that are updated as necessary depending on various factors, including successful capital deployment and general industry conditions. Management reviews the capital structure on a regular basis to ensure the above objectives are met. There have been no changes to the Company's approach to capital management during the period. There are no externally imposed restrictions on the Company's capital.

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### **5. FINANCIAL INSTRUMENTS**

Financial instruments are agreements between two parties that result in promises to pay or receive cash or equity instruments. The Company classifies its financial instruments as follows: cash and cash equivalents are classified as a financial asset at FVTPL; accounts receivable is classified as loans and receivables; and accounts payable and accrued liabilities are classified as other financial liabilities, which are measured at amortized cost. The carrying values of these instruments approximate their fair values due to their short term to maturity.

The Company has exposure to the following risks from its use of financial instruments:

- Credit risk;
- Liquidity risk; and
- Market risk.

#### **(a) Credit risk**

Credit risk is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation. Cash and cash equivalents are placed with major Canadian and US financial institutions and the Company's concentration of credit risk for cash and cash equivalents and maximum exposure thereto is \$421,500 (2017 - \$411,223).

With respect to its accounts receivable, the Company assesses the credit rating of all customers and maintains provisions for potential credit losses, and any such losses to date have been within management's expectations. The Company's credit risk with respect to accounts receivable and maximum exposure thereto is \$1,754,749 (2017 - \$653,445). The Company's concentration of credit risk for accounts receivable with respect to its significant customers is as follows: Customer A is \$660,166 (2017 - \$94,114), while Customer B is \$250,500 (2017 - \$78,306) (Note 13).

To reduce the credit risk of accounts receivable, the Company regularly reviews the collectability of the accounts receivable to ensure there is no indication that these amounts will not be fully recoverable. As at September 30, 2018, allowance for doubtful accounts balance is \$40,336 (2017 - \$82,042).

#### **(b) Liquidity risk**

Liquidity risk is the risk that the Company will be unable to meet its financial obligations as they fall due. The Company's approach to managing liquidity risk is to ensure, as far as possible, that it will have sufficient liquid funds to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Company's reputation.

At September 30, 2018, the Company has \$421,500 (2017 - \$411,223) of cash and cash equivalents to settle current liabilities of \$1,634,287 (2017 - \$878,699) consisting of the following: trade accounts payable of \$1,614,787 (2017 - \$799,254) and due to related party balance of \$19,500 (2017 - \$45,262). All payables are due within a year.

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**5. FINANCIAL INSTRUMENTS (Continued)**

(c) Market risk

The significant market risks to which the Company is exposed are interest rate risk and currency risk.

(i) Interest rate risk

Interest rate risk is the risk that the fair value or future cash flows will fluctuate as a result of changes in market interest rates. The Company's cash and cash equivalents consist of cash held in bank accounts and short-term liquid investments that earn interest at variable rates. Due to the short-term nature of these financial instruments, fluctuations in market rates of interest do not have a significant impact on the estimated fair value or future cash flows.

(ii) Currency risk

The Company is exposed to currency risk to the extent expenditures incurred or funds received and balances maintained by the Company are denominated in Canadian dollars ("CAD"). The Company does not manage currency risk through hedging or other currency management tools.

As at September 30, 2018 and December 31, 2017, the Company's had the following assets denominated in CAD (amounts presented in USD):

	<b>September 30, 2018</b>	December 31, 2017
Cash and cash equivalents	\$ 10,417	\$ 15,882
Accounts receivable	-	32,976
Accounts payable	<b>(60,000)</b>	(80,000)
	<b>\$ (49,583)</b>	\$ (31,142)

Based on the above, assuming all other variables remain constant, a 14% weakening or strengthening of the USD against the CAD would result in approximately \$6,940 (2017 - \$4,400) foreign exchange loss or gain in the consolidated statements of operations and comprehensive income (loss).

(iii) Other price risk

Other price risk is the risk that the future cash flows of a financial instrument will fluctuate due to changes in market prices, other than those arising from interest rate risk or currency risk. The Company is not exposed to other price risk.

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**6. INVENTORY**

	September 30, 2018	December 31, 2017
Finished goods	\$ 162,716	\$ 256,185
Raw materials and supplies	3,569,843	3,724,058
	<b>\$ 3,732,559</b>	<b>\$ 3,980,243</b>

Included in cost of goods sold is \$4,006,521 (2017 - \$2,545,065) of direct material costs recognized as expense.

**7. PROPERTY, PLANT AND EQUIPMENT**

Cost	Land	Building	Leasehold Improvements	Production Equipment	Vehicles	Total
Balance, December 31, 2016	\$ 12,588	\$2,955,901	\$ 43,715	\$ 809,982	\$ 61,517	\$3,883,673
Additions	-	-	-	-	-	-
Balance, December 31, 2017 and September 30, 2018	\$ 12,558	\$2,955,901	\$ 43,715	\$ 809,982	\$ 61,517	\$3,883,673
<b>Accumulated Amortization</b>						
Balance, December 31, 2016	\$ -	\$ 303,959	\$ 30,228	\$ 328,334	\$ 22,925	\$ 685,446
Amortization	-	106,078	2,696	96,330	1,577	206,681
Balance, December 31, 2017	\$ -	\$ 410,037	\$ 32,924	\$ 424,664	\$ 24,502	\$ 892,127
Amortization	-	79,559	2,034	72,245	3,680	157,508
Balance, September 30, 2018	\$ -	\$ 489,596	\$ 34,948	\$ 496,909	\$ 28,182	\$1,049,635
<b>Carrying Value</b>						
September 30, 2018	\$ 12,558	\$2,466,305	\$ 8,767	\$ 313,073	\$ 33,335	\$2,834,038
December 31, 2017	\$ 12,558	\$2,545,864	\$ 10,791	\$ 385,318	\$ 37,015	\$2,991,546

Included in cost of goods sold is \$139,630 (2017 - \$196,864) of amortization related to property, plant and equipment.

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**8. INTANGIBLE ASSETS**

<b>Cost</b>	Patent	Rights	Product Development Costs	Total
Balance, December 31, 2016	\$ 40,840	\$ 282,946	\$ -	\$ 323,786
Additions	-	-	718,023	718,023
Balance, December 31, 2017	40,840	282,946	718,023	1,041,809
Additions	-	-	-	-
Balance, September 30, 2018	\$ 40,840	\$ 282,946	\$ 718,023	\$ 1,041,809
<b>Accumulated Amortization</b>				
Balance, December 31, 2016	\$ 24,473	\$ 65,000	\$ -	\$ 89,473
Amortization	7,560	-	-	7,560
Balance, December 31, 2017	32,033	65,000	-	97,033
Amortization	6,804	-	-	6,804
Balance, September 30, 2018	\$ 38,837	\$ 65,000	\$ -	\$ 103,837
<b>Carrying Value</b>				
September 30, 2018	\$ 2,003	\$ 217,946	\$ 718,023	\$ 937,972
December 31, 2017	\$ 8,807	\$ 217,946	\$ 718,023	\$ 944,776

On November 10, 2016, the Company signed a technology development agreement to acquire all intellectual property rights (the “Products”) of G & J Technologies (the “Vendor”). During the year ended December 31, 2016, acquisition costs of \$217,946 were incurred, consisting of \$25,000 in cash and 250,000 common shares with a fair value of \$192,946. The shares were issued subsequent to December 31, 2016. The Vendor entered into a consulting agreement with the Company for a fee of \$10,000 per month. The Company is obligated to pay a 2.5% royalty on the net sales earned by the Company. As further consideration for the Products of the Vendor, the Company will pay \$75,000 in cash and issue 750,000 common shares of the Company as follows:

- \$25,000 cash and 250,000 shares issuable on the filing of the first new patent application related to the Products. The shares were issued on March 13, 2017;
- \$25,000 cash and 250,000 shares issuable on the successful completion of a commercially viable production prototype for the first Product. The shares were issued on March 16, 2018; and
- \$25,000 cash and 250,000 shares issuable on the completion of the sale of the first ten commercial vehicles incorporating the Products.

The Company is obligated to pay a 5% royalty from sales of their manway securement systems. During the period ended September 30, 2018, there were revenues from sales of the manway securement systems totalling \$13,301 (2017 - \$177,517). The Company also holds a number of other patents, which have been fully amortized as at September 30, 2018.

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### **9. CAPITAL STOCK**

Authorized:

Unlimited Class A non-cumulative, preferred shares without par value, of which 5,000,000 are designated Class A, convertible, voting, preferred shares

Unlimited common shares without par value

Issued:

#### **(a) Common shares**

During the period ended September 30, 2018, the Company issued 258,334 shares with a value of \$134,027. 250,000 shares were issued pursuant to an agreement with G & J Technologies as well as the exercise of 8,334 share purchase options.

During the year ended December 31, 2017, the Company issued 250,000 shares with a fair value of \$192,946 pursuant to the acquisition of intellectual property rights of G&J Technologies and 250,000 shares with a fair value of \$208,486 pursuant to achieving the second milestone of the G&J Technologies technology development agreement. At the year end, the Company has an obligation to issue 250,000 shares with a fair value of \$131,527 pursuant to the agreement for achieving the third milestone of the G&J Technologies technology development agreement

#### **(b) Stock options**

The Company has a stock option plan (the "Plan") available to employees, directors, officers and consultants with grants under the Plan approved from time to time by the Board of Directors. Under the Plan, the Company is authorized to issue options to purchase an aggregate of up to 10% of the Company's issued and outstanding common shares. Each option can be exercised to acquire one common share of the Company. The exercise price for an option granted under the Plan may not be less than the market price at the date of grant less a specified discount dependent on the market price.

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**9. CAPITAL STOCK** (Continued)

(b) Stock options (Continued)

Options to purchase common shares have been granted to directors, employees and consultants as follows:

Exercise Price	Expiry Date	Year Ended December 31, 2017	Granted	Exercised	Expired	Period Ended September 30, 2018
\$0.50	August 20, 2023	-	750,000	-	-	750,000
\$0.70(CAD)	October 7, 2019	28,571	-	-	-	28,571
\$6.85(CAD)	November 14, 2019	100,000	-	-	-	100,000
\$1.30	August 18, 2021	1,325,000	-	-	150,000	1,175,000
\$0.90	July 6, 2022	50,000	-	-	-	50,000
\$0.30	November 28, 2022	825,000	-	8,334	66,666	750,000
\$0.57	April 17, 2023	-	200,000	-	-	200,000
<b>Total outstanding</b>		<b>2,328,571</b>	<b>950,000</b>	<b>8,334</b>	<b>216,666</b>	<b>3,053,571</b>
<b>Total exercisable</b>		<b>1,473,571</b>	<b>316,666</b>	<b>-</b>	<b>-</b>	<b>1,790,237</b>

Exercise Price	Expiry Date	Year Ended December 31, 2016	Granted	Exercised	Expired	Period Ended December 31, 2017
\$1.45	March 31, 2017	670,000	-	-	670,000	-
\$0.70(CAD)	October 7, 2019	28,571	-	-	-	28,571
\$6.85(CAD)	November 14, 2019	100,000	-	-	-	100,000
\$1.30	August 18, 2021	1,325,000	-	-	-	1,325,000
\$2.12	August 25, 2017	400,000	-	-	400,000	-
\$0.90	July 6, 2022	-	50,000	-	-	50,000
\$0.30	November 28, 2022	-	825,000	-	-	825,000
<b>Total outstanding</b>		<b>2,523,571</b>	<b>875,000</b>	<b>-</b>	<b>(1,070,000)</b>	<b>2,328,571</b>
<b>Total exercisable</b>		<b>1,198,571</b>	<b>275,000</b>	<b>-</b>	<b>-</b>	<b>845,238</b>

A summary of the Company's stock options as at September 30, 2018 and December 31, 2017, and changes for the periods then ended are as follows:

	Number	Weighted Average Exercise Price
Outstanding, December 31, 2016	2,523,571	\$1.61
Granted	875,000	\$0.33
Expired	(1,070,000)	\$1.20
Outstanding, December 31, 2017	2,328,571	\$1.11
Granted	950,000	\$0.51
Expired	(216,666)	\$1.30
Exercised	(8,334)	\$0.30
Outstanding, September 30, 2018	3,053,571	\$0.97

The weighted average contractual life for the remaining options at September 30, 2018 is 3.65 (2017 – 3.80) years.

**KELSO TECHNOLOGIES INC.**

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**10. RELATED PARTY TRANSACTIONS**

Related party transactions not otherwise described in these consolidated financial statements are shown below. The remuneration of the Company's directors and other members of key management, being the Chief Executive Officer, Chief Financial Officer and the Chief Operating Officer who have the authority and responsibility for planning, directing and controlling the activities of the Company, consist of the following amounts:

	<b>September 30, 2018</b>	September 30, 2017
Management compensation	\$ 404,843	\$ 409,014
Management bonus*	\$ -	\$ -
Share-based expense**	\$ -	\$ -
Directors' fees	\$ 53,500	\$ 50,500

\* The Company has management bonus agreements whereby 10% of the annual income before taxes and share-based expense is equally distributed to management.

\*\* Share-based expense consists of the key management portion of the fair value of options granted calculated using the Black-Scholes option pricing model and does not include any cash compensation.

As at September 30, 2018, amounts due to related parties included accounts payable, which are unsecured and have no interest or specific terms of payments, of \$19,500 (2017 - \$16,500) consisting of \$19,500 (2017 - \$16,500) for directors fees.

**11. SUPPLEMENTAL CASH FLOW INFORMATION**

	<b>September 30, 2018</b>	September 30, 2017
Amortization of property and equipment allocated to cost of goods sold	\$ 141,731	\$ 196,864
Amortization allocated to expenses	\$ 22,880	6,901

	<b>September 30, 2018</b>	December 31, 2017
<b>Cash and Cash Equivalents is comprised of:</b>		
Cash	\$ 421,500	\$ 411,223
Guaranteed investment certificates	-	-
	<b>\$ 421,500</b>	<b>\$ 411,223</b>

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**12. EARNINGS PER SHARE**

The calculation of basic and diluted earnings (loss) per share for the relevant periods is based on the following:

	<b>September 30, 2018</b>	December 31, 2017
Net income (loss) for the year	<b>\$ (180,336)</b>	\$ (5,015,911)
Basic weighted average number of common shares outstanding	<b>47,051,547</b>	46,848,053
Effect on dilutive securities:		
Options	-	-
Warrants	-	-
Diluted weighted average number of common shares outstanding	<b>47,051,547</b>	46,848,053
Basic earnings (loss) per share	<b>\$ (0.00)</b>	\$ (0.11)
Diluted earnings (loss) per share	<b>\$ (0.00)</b>	\$ (0.11)

**13. SIGNIFICANT CUSTOMERS**

The following table represents sales to individual customers exceeding 10% of the Company's quarterly revenues:

	<b>September 30, 2018</b>	2017
Customer A	<b>\$ 4,242,059</b>	\$ 1,649,940
Customer B	<b>\$ -</b>	\$ 570,145

All Customers are major US and Canadian corporations who have displayed a pattern of consistent timely payment of accounts owing.

**14. EMPLOYEE BENEFITS**

Total employee benefit expenses, including salary and wages, management compensation, share-based expense and benefits for the period ended September 30, 2018 amounted to \$2,174,117 (2017 - \$2,194,119).

**15. SEGMENTED INFORMATION**

The Company operates in two business segments with operations and long-term assets in United States. The two business segments include the design, production and distribution of various proprietary pressure relief valves, and active suspension control system for no road vehicles. At September 30, 2018, long term assets of \$1,044,771 (2017 - \$1,044,771) relates to the active suspension control system and the remaining balance relates to pressure relief valves. During the period ended September 30, 2018 and December 31, 2017 there was no revenue related to the active suspension control system.



## CORPORATE DIRECTORY

### OFFICERS

James R. Bond  
President  
Chief Executive Officer  
Richard Lee  
Chief Financial Officer  
Anthony J. Andrukaitis  
Chief Operating Officer  
Executive Vice President  
Business Development  
Kathy Love  
Corporate Secretary

### DIRECTORS

James R. Bond  
Peter Hughes  
Lead Director  
Compensation Committee  
Anthony J. Andrukaitis  
Phil Dyer  
Audit Committee  
Corporate Governance and  
Nominating Committee  
Paul Cass  
Audit Committee  
Compensation Committee  
Laura Roach  
Compensation Committee  
Corporate Governance and  
Nominating Committee  
Jesse V. Crews  
Audit Committee  
Corporate Governance and  
Nominating Committee

### AUDITORS

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### LEGAL COUNSEL

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Canada

### CORPORATE OFFICE

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### REGISTERED OFFICE

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### RECORDS OFFICE

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Vancouver, British Columbia  
Canada V6C 3H1

### REGISTRAR AND TRANSFER AGENT

Computershare Investor Services  
Toronto, Ontario and Vancouver British  
Columbia Canada  
Computershare Trust Company  
Denver, Colorado USA

### SHARE LISTING

Toronto Stock Exchange:  
Symbol: KLS  
NYSE American:  
Symbol: KIQ  
CUSIP No.: 48826D201  
ISIN: CA48826D2014