



KELSO TECHNOLOGIES INC.

ANNUAL REPORT

For the Year Ended

December 31, 2019



KELSO TECHNOLOGIES INC.

MANAGEMENT DISCUSSION & ANALYSIS

YEAR ENDED

December 31, 2019

(Expressed in US Dollars unless otherwise indicated)

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Management Discussion and Analysis

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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 year ended December 31, 2019. It should be read in conjunction with the audited consolidated financial statements of the Company together with the related notes thereto for the year ended December 31, 2019.

The audited consolidated financial statements for the year ended December 31, 2019 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 audited consolidated financial statements were approved by the Audit Committee and the Board of Directors on March 16, 2020.

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 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 not be able to break in to new markets because such markets are served by strong and embedded competitors or

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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 17). 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 or the Company's website at www.kelsotech.com.

DATE OF REPORT

March 16, 2020

SUMMARY OF THE YEAR ENDED DECEMBER 31, 2019

	2019	2018	CHANGE
Revenues	\$ 20,550,682	\$ 12,716,596	+ 62%
Gross profit	\$ 9,582,879	\$ 5,287,216	+ 81%
Gross profit margin	46.5%	41.6%	+ 12%
EBITDA	\$ 4,233,339	\$ 1,002,464	+ 324%
EBITDA margin	20.6%	7.8%	+ 165%
Non-cash expenses	\$ 792,727	\$ 571,536	+ 39%
Taxes	\$ 99,077	\$ 251,164	+ 139%
Net income	\$ 3,334,043	\$ 194,453	+1,615%
Common shares outstanding	47,170,086	47,170,086	No dilution
Basic earnings per share	\$ 0.07	\$ 0.00	+ 700%
Working capital	\$ 7,937,873	\$ 4,469,882	+ 78%
Cash	\$ 4,418,236	\$ 1,246,244	+ 255%
Interest bearing long-term debt	nil	nil	No change
Net equity	\$ 11,845,275	\$ 8,165,734	+ 45%
Total assets	\$ 13,731,571	\$ 9,944,990	+ 38%

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CORPORATE OVERVIEW

Kelso is an engineering 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 used in 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 releases. The Company offers specialized rail tank car and truck tanker equipment, no-spill fuel loading systems, first responder emergency response equipment and “road-to-no-road” suspension systems for motor vehicles being used in rugged wilderness terrains.

Over the last eight years the Company has established itself as a leading North American producer and supplier 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 tank car builders and shippers with a wide range of custom engineering and production services.

The Company's common shares are publicly traded on the Toronto Stock Exchange under the trading symbol KLS and the NYSE American Exchange under the trading symbol KIQ. The Company listed on the Toronto Stock Exchange on May 22, 2014 and on the NYSE American 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: \$20,550,682 for the year ended December 31, 2019; \$12,716,596 for the year ended December 31, 2018; \$6,062,778 for the year ended December 31, 2017; \$8,077,143 for the year ended December 31, 2016; and \$18,910,122 for the year ended December 31, 2015.

The Company's net earnings (loss) performance over the last five year end periods were as follows: net income of \$3,334,043 for the year ended December 31, 2019; net income of \$194,453 for the year ended December 31, 2018; 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.

Our primary market (hazmat rail tank cars) that slowed considerably during the rail recession in 2016 and 2017 improved in 2018 to restore the Company's financial health and remains profitable to the date of this report. Hazardous commodity businesses that were in cut back positions from 2015 to 2017 returned to healthier levels in 2018 with additional business momentum in 2019.

In North America industry rail tank car analysts expect tank car backlog to remain at healthy levels. Production in 2019 was approximately 21,000 tank cars and over 17,000 tank cars are projected in 2020. Overall tank car loadings increased 3.5% in 2019 and a 2.5% increase is expected in 2020. Kelso supplied its specialized tank car equipment to over 8,000 tank cars in 2018 and over 12,000 tank cars in 2019. Depending on the makeup of customers' specifications and the status of our AAR approvals, sales of our valves can range to over \$10,000 per tank car in future periods.

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Long AAR approval processes slow our ability to improve sales with additional rail tank car equipment. The Company continues to pursue AAR approvals for our ceramic ball bottom outlet valve ("BOV"), pressure car pressure relief valve ("PCH"), ball valve, manway covers and angle valve although the process takes considerable time to complete. 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 longer term health of Kelso.

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.

In response to a dismal performance in 2017 management actively looked for new diverse market opportunities outside of the rail industry to pursue. The goal was to spread our business risk to diminish the severe negative impact of the historic down cycles in the rail industry.

The growing challenges regarding the safety and access capabilities of emergency responders fighting wilderness fires motivated Kelso to begin the development of a unique vehicle suspension system. This innovative equipment provides new rapid response road-to-no-road capabilities regardless of weather, climate or the severity of the terrain. Known as the KXI™ Suspension System (KXI) it is based on thirty years of active wilderness research and experience.

In 2020 the Company is scheduled to complete two production prototype vehicles to prepare for the first commercial offering to the marketplace. The Company will then move into a pilot production model where we will produce and sell 24 vehicles before scaling to our production needs based on projected sales.

The catalyst to our interest in this business development were the requests to the engineering community from governments, firefighters, emergency responders and other stakeholders for the creation of new technologies that can better respond to threats to public safety and better protection of firefighters in the wilderness. These potential markets are multi-billion dollar opportunities. The automotive aftermarket conversion industry is valued at approximately \$44 billion annually.

MARKETS AND PRODUCTS

Kelso is working to become a leading developer and supplier of a wide range of proprietary tank car valves designed primarily for use in the hazmat shipment market. Our valves help shippers safely deliver hazmat commodities wherever they need to go in North America. Customer driven product development and business strategies now bring Kelso unique competitive advantages with customers as management pursues its goals of positive financial performance for years to come.

We keep our products smart, simple and focused on customer needs. We concentrate on sound business fundamentals, operational practices, EBITDA returns and careful capital management. Today, we invest in customer driven co-engineered product development to improve the probability of market adoption. This allows us to prepare marketing initiatives to capitalize on sales opportunities. We monitor industry trends and regulated technology requirements to select R&D projects that can be fruitful for our future revenue streams. The ambition is that our engineering team can proactively resolve issues for customers before reactionary measures are required.

Currently we offer a wide range of proprietary valves and other specialty equipment for rail tank cars and road tankers. In the 1990's Kelso's origins were based on unique inventions that better served problematic safety issues in the transport of hazmat commodities. Our commercial business evolution began with the adoption of our patented constant force pressure relief valves during the surge in crude-by-rail (CBR) shipments from 2012 to 2015. Since 2012 the Company has distributed over 65,000 valves that has generated over \$100 million in revenues.

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Our products provide a rewarding economic value proposition for all tank car stakeholders. This value includes reliable high-quality equipment, unprecedented warranties, high service standards and short lead times for delivery. Over the past decade Kelso has been able to develop a niche in the marketplace for many of our products. Key products include:

Rail and Road Transport Equipment

- Pressure relief valves
- Vacuum relief valves
- Bottom outlet valves (under AAR field service trials)
- Pressure car valves (under AAR field service trials)
- Ball valves (under AAR field service trials)
- One-bolt manways and related equipment
- Emergency response equipment for hazmat first responders
- No spill locomotive fueling equipment
- Other specialty valves, parts, equipment and services

Rail Tank Car Market Indicators

The rail tank car market in North America is not considered a growth industry but rather a cyclical commodity market that is historically unpredictable. Kelso is focused on growing its rail business through the sales of a wider range of pressure relief valves, vacuum relief valves, ball valves, bottom outlet valves, manway equipment, angle valves and other specialized equipment.

In order to measure and manage rail tank market opportunities the Company analyses the number of total tank car loadings annually to determine best business practices and key commodities to concentrate on in any given period. The key industry metrics are as follows:

Measure	2014	2015	2016	2017	2018	2019	Est. 2020
(In thousands)							
Total tank car loadings:	3,502	3,796	3,323	3,375	3,637	3,729	3,800
1. Chemicals(includes ethanol)	1,501	1,651	1,493	1,543	1,577	1,574	1,600
2. Petroleum	784	900	863	941	1,081	1,173	1,200
3. Food	439	452	433	438	452	432	444
4. Crude-by-rail	518	525	281	191	266	339	362
Number of tank cars delivered	35,293	36,065	17,841	8,948	10,455	21,122	16,700
(In thousands of \$)							
Kelso revenues	\$ 23,817	\$ 18,911	\$ 8,077	\$ 6,063	\$ 12,717	\$ 20,550	TBD
EBITDA (loss)	\$ 6,844	\$ 386	\$ (3,056)	\$ (4,609)	\$ 1,002	\$ 4,233	TBD
Earnings (loss)	\$ 4,026	\$ (2,511)	\$ (2,466)	\$ (5,016)	\$ 194	\$ 3,344	TBD

Based on current projections from industry analysts total tank car loading levels in 2020 are expected to be consistent with 2019 levels.

The Company continues to develop new rail products that are anticipated to provide new financial growth opportunities. We focus on core design objectives that are:

- To ensure public safety by mitigating the potential negative environmental impacts of non-accidental releases of hazardous materials in transit.
- To manage negative and positive pressure within the tank thereby reducing the risks of implosion or explosion ensuring the safe containment of hazardous materials while being loaded, transported and unloaded.

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- To improve the customers' operating effectiveness and economic rewards with proven reliable equipment.
 - To build reliable equipment featuring high quality milled parts eliminating problematic cast parts that cause a high level of negative performance issues that lead to complex expensive repair logistics for customers.
 - To ensure that customers benefit with more profitable in-service time for tank cars.

Wilderness Response Transportation Technologies

Kelso through its wholly owned subsidiary KIQ X Industries is working to become a leading developer of a new generation of specialized wilderness response transportation equipment. Products in development now include proprietary KXI vehicle suspension system, ordinance trailers, custom tires and other specialty equipment.

In 2017 in response to the growing problems and the safety of emergency responders fighting wilderness fires Kelso began the development of a unique vehicle suspension system that provided new rapid response road-to-no-road capabilities regardless of the climate or the severity of the terrain. Known as the KXI™ Suspension System (KXI) it is a unique technology based on thirty years of active wilderness research and experience.

In 2020 the Company is scheduled to complete two KXI equipped production prototype vehicles to prepare for the first commercial offering to the marketplace. The Company will then move into a pilot production model where we will produce and sell 24 KXI equipped vehicles before scaling to our production needs based on projected sales and reserved orders.

The catalyst to our interest in this business development opportunity were the requests to the engineering community from governments, firefighters, emergency responders and other stakeholders for the creation of better technologies that can better respond to threats to public safety and better protection of firefighters in the wilderness. These potential markets are multi-billion dollar opportunities. The automotive aftermarket conversion industry valued at approximately \$44 billion annually.

We considered the engineering challenge and ambition worth their pursuit as environmental experts warn that the net damage costs of climate change events are likely to significantly increase in the upcoming years due to intensified weather events such as wildfires, hurricanes, tornadoes, flooding and drought. Wilderness and populated areas will be in harms way and society will have to respond to these events with better capabilities, faster response times and improved effectiveness.

The basic design premise of KXI is to manage the center-of-gravity to better balance a wheeled vehicle with automated gyroscopic controlled air suspension. This ensures that the driver, passengers and payload remain in a stable level position when driving in difficult remote wilderness terrains including extreme hills and side-hill challenges. Our testing has confirmed that commercial stakeholders can expect the KXI to provide:

- All weather – all terrain “Road-To-No-Road” emergency response capabilities that eliminates time consuming trailer transportation costs for heavy equipment needed in difficult service areas.
- Better mobility capabilities for commercial customers who must operate in extreme rough wilderness terrains in wheeled vehicles for the purpose of safely reaching remote destinations with multiple passengers and maximum payload with minimal negative impact on the environment.
- Low environmental impact where KXI reduces nominal ground pressure of the vehicle (floatation weight) to under the government's recommended 2 PSI resulting in no traceable disturbance or negative impact on the ground, wildlife or plant life.

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- Gyroscopic balanced ride improves access in heavily sloped wilderness provides higher speed of response to emergency events.
- Cost reductions when helicopters, track-based vehicles and heavy equipment transport can be diminished by less expensive KXI technologies.

KXI is designed for the aftermarket conversion of existing vehicles. We do not build vehicles - we retrofit the KXI on currently available vehicles. The rollout plan for the KXI initially will be distribution to our development partners in Canada that operate in environmentally sensitive terrain before moving into the USA and other world markets.

PRODUCTION FACILITIES

Kelso currently operates two rail equipment production and R&D 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 AAR.

KXI production operations are located in Kelowna, British Columbia, Canada. The Company is currently producing two KXI equipped production prototypes that will form the foundation of our pilot production program. Production drawings and tooling will be completed and ready to be tested in a 24 vehicle limited pilot production run scheduled in 2020.

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 American 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 cyclical 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 year ended December 31, 2019 are representative of an engineering organization that continues to develop into a viable industrial transportation equipment supplier.

Kelso has experienced a consistent upside shift in rail tank car production, retrofit and repair activity for the past two years which accounts for the improved financial performance and financial health of our organization. Management has substantially completed the implementation of its new business processes, new management personnel, changes to our corporate culture and revamping how we approach our marketing and sales processes. The result is that the Company operates more effectively with profitable sales and encouraging growth prospects. Our business momentum continued to grow throughout 2019 and reflects a significant improvement in financial performance for the year ended December 31, 2019.

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Revenues, corresponding expenses, financial performance and capital management during the year ended December 31, 2019 reflects Kelso's ability to carefully manage its capital resources during difficult recessionary times while still making progress in the execution of its strategic business plans. Financial results reflect the revenues and related operational costs of marketing, producing and distributing its proven line of rail tank equipment and key investments in new product development and production capability associated with a more diverse product mix in rail and automotive markets 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 public company administration processes in Canada and the United States; pre-sales production planning and tooling for our growing portfolio of rail and automotive products. These costs are written off in the period when they occur and their impact is reflected in the reported profitability of the Company in the period in which they were incurred.

Year ended December 31, 2019

For the year ended December 31, 2019, the Company reported growth of net income to \$3,334,043 (\$0.07 per share) against revenues of \$20,550,682 compared to a net income of \$194,453 (\$0.00 per share) against revenues of \$12,716,596 for the year ended December 31, 2018.

Gross profit margin grew to \$9,582,879 (47% of revenues) for the year ended December 31, 2019 compared to \$5,287,216 (42% of revenues) for the year ended December 31, 2018. Gross profits reflect our new business processes, new human resources, changes to our corporate culture; and our improved approach to customer service, marketing and sales processes.

Total operational expenses rose to \$6,087,357 during the year ended December 31, 2019 which were in line with management's expectations to facilitate the current rail business growth and the business development of our wholly owned subsidiary KIQ X Industries compared to \$4,955,448 for the year ended December 31, 2018.

EBITDA for the years ended December 31, 2019 and 2018 has been calculated as follows:

	2019	2018
Net income	\$ 3,334,043	\$ 194,453
Share-based expense	\$ 345,498	\$ 403,548
Unrealized foreign exchange loss	\$ 27,698	\$ 4,257
Amortization	\$ 384,827	\$ 277,580
Bad debt recovery	\$ (20,206)	\$ (14,689)
Inventory write off	\$ 62,402	\$ 26,031
Intangible assets write off	\$ -	\$ 328,010
Property, plant and equipment write off	\$ -	\$ 34,438
Income taxes (recovery)	\$ 99,077	\$ (251,164)
EBITDA	\$ 4,233,339	\$ 1,002,464

Factors in the reported income for the year ended December 31, 2019 include expenses related to ongoing marketing initiatives in the amount of \$288,893 (2018 - \$266,152) and related travel costs of \$197,293 (2018 - \$159,800). These expenses are related to ongoing marketing programs for existing and new products entries. Our new customer service and marketing initiatives and sales processes have proven to be more effective and economically beneficial compared to past years. These changes delivered a 62% increase in sales volume with above average 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 year ended December 31, 2019 our industrial product design and development costs were \$1,129,007 (2018 - \$1,352,817). In addition to our ongoing rail equipment R&D the majority of these expenses relates to design and continuing testing of our KXI wilderness response technologies and includes the development expenses of production infrastructure to convert multiple vehicles for customers. New product developments are necessary to provide diverse opportunities for Kelso to grow its future revenues from new markets and diminish the financial affects of a historically cyclical rail tank car market.

Management continues to expand its rail operations and its new subsidiary KIQ X Industries featuring our KXI product development that is focused on the generation of new diverse business growth. This is reflected in our investments in human resources, marketing, sales and production operations for the year ended December 31, 2019. The Company recorded office and administrative costs of \$2,219,711 (2018 - \$1,667,646), management compensation was \$1,037,586 (2018 - \$610,570). Management compensation includes an accrual for contractual management performance bonuses for the year ended December 31, 2019 of \$496,894 (2018 - \$70,035). Management bonuses are accrued by quarter and are paid based upon the audited year end balance not later than May 15 of the year following. Consulting and filing fees were \$386,661 (2018 - \$196,823) while investor relations remained unchanged at \$84,000 (2018 - \$84,000).

Accounting, audit and legal fees are cost components of our corporate development strategies and the required administration functions of a publicly listed industrial company listed on two stock exchanges. Costs for these professional audit and legal services were \$321,945 for the year ended December 31, 2019 (2018 - \$194,282). This includes ongoing US tax and audit requirements. Other legal costs relate to patent applications, public company administration including reorganization costs, the preparation and filing of press releases, documentation and reviewing possible acquisition targets and new business arrangements. Also included are the costs of complying with the rules and regulations of both the Toronto Stock Exchange and NYSE American Exchange including the complexities of regulatory documentation and 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 \$27,698 for the year ended December 31, 2019.

The Company has recorded an income tax expense of \$99,077 for the year ended December 31, 2019 compared to an income tax recovery of \$251,164 for the year ended December 31, 2018.

CRITICAL ACCOUNTING ESTIMATES

The preparation of 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 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.

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.

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(a) Impairment of long-lived assets

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

Determining the amount of impairment of intangible assets requires an estimation of the recoverable amount, which is defined as the higher of fair value less the cost of disposal or value in use. Many factors used in assessing recoverable amounts are outside of the control of management and it is reasonably likely that assumptions and estimates will change from period to period.

(b) 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.

(c) 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.

(d) Share-based expense

The Company grants share-based awards to certain officers, employees, directors and other eligible persons. 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 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.

(e) 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. At December 31, 2019, the Company has made no allowance for doubtful accounts (2018 - \$27,653).

LIQUIDITY AND CAPITAL RESOURCES

At December 31, 2019 the Company had cash on deposit in the amount of \$4,418,236, accounts receivable of \$1,824,563, prepaid expenses of \$96,627 and inventory of \$3,394,192 compared to cash on deposit in the amount of \$1,246,244, accounts receivable of \$1,224,235, prepaid expenses of \$110,258 and inventory of \$3,668,401 at December 31, 2018.

The Company has accrued income tax payable of \$71,341 for the year ended December 31, 2019 compared to an income tax payable of \$466,739 at December 31, 2018.

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The working capital position of the Company at December 31, 2019 was \$7,937,873 compared to \$4,469,882 at December 31, 2018. The majority of accounts receivable are collected within 30 days from invoicing shipments giving Kelso \$1,824,563 of additional cash flow plus \$4,418,236 of available cash to discharge accounts payable and accrued liabilities of \$1,795,745 on a timely basis subsequent to December 31, 2019. Income taxes payable are due mid 2020.

Net assets of the Company improved to \$11,845,275 at December 31, 2019 compared to \$8,165,734 at December 31, 2018. The Company had no interest-bearing long-term liabilities or debt at December 31, 2019.

The Company has seen a consistent upside shift in rail tank car production, retrofit and repair activity throughout 2019 with an increase in the number of customers that we sell to. Since early 2017 we have implemented new business processes, changed management personnel, changed our corporate culture and revamped how we approach our marketing and sales processes. The result is that sales growth and business momentum have improved significantly.

If sales volume continues to grow or maintains at the current pace then the Company can, for the time being, generate the necessary capital resources required to finance all operations including R&D. As part of its capital management program Kelso does not rule out the possibility of the issuance of new equity securities through private placements if external funding is deemed necessary or beneficial 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 17).

SELECTED QUARTERLY INFORMATION

	Three months ended December 31, 2019	Three months ended September 30, 2019	Three months ended June 30, 2019	Three months ended March 31, 2019
Revenues	\$ 5,303,193	\$ 5,596,031	\$ 3,977,170	\$ 5,674,288
Gross profit	\$ 2,553,236	\$ 2,576,579	\$ 1,708,129	\$ 2,744,935
Expenses including non-cash items	\$ 1,149,218	\$ 1,816,866	\$ 1,467,242	\$ 1,654,031
Net income for the quarter	\$ 1,242,539	\$ 759,713	\$ 240,887	\$ 1,090,904
Basic earnings per share	\$ 0.03	\$ 0.02	\$ 0.00	\$ 0.02
EBITDA	\$ 1,071,276	\$ 1,257,077	\$ 367,282	\$ 1,537,704
Common shares outstanding	47,170,086	47,170,086	47,170,086	47,170,086

	Three months ended December 31, 2018	Three months ended September 30, 2018	Three months ended June 30, 2018	Three months ended March 31, 2018
Revenues	\$ 4,177,880	\$ 3,491,602	\$ 2,535,236	\$ 2,511,878
Gross profit	\$ 1,815,537	\$ 1,543,995	\$ 1,038,455	\$ 889,229
Expenses including non-cash items	\$ 1,300,219	\$ 1,282,278	\$ 1,201,366	\$ 1,171,585
Net income(loss) for the quarter	\$ 374,790	\$ 261,717	\$ (162,911)	\$ (279,143)
Basic earnings (loss) per share	\$ 0.01	\$ 0.00	\$ (0.00)	\$ (0.01)
EBITDA (loss)	\$ 954,958	\$ 383,563	\$ (88,344)	\$ (233,024)
Common shares outstanding	47,170,086	47,170,086	47,170,086	47,170,086

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SELECTED ANNUAL INFORMATION

	Year ended December 31 2019	Year ended December 31 2018	Year ended December 31 2017
Revenues	\$ 20,550,682	\$ 12,716,596	\$ 6,062,778
Cost of goods sold	\$ 10,967,803	\$ 7,429,380	\$ 5,044,093
Gross profit	\$ 9,582,879	\$ 5,287,216	\$ 1,018,685
Expenses including non cash items	\$ 6,087,357	\$ 4,955,448	\$ 5,961,437
Deferred income tax recovery (expense)	\$ -	\$ -	\$ 172,433
Income tax expense (recovery)	\$ 99,077	\$ (251,164)	\$ 22,137
Net income (Loss) for the year	\$ 3,334,043	\$ 194,453	\$ (5,015,911)
Number of common shares outstanding	47,170,086	47,170,086	46,911,752
Basic earnings (Loss) per common share	\$ 0.07	\$ 0.00	\$ (0.11)
EBITDA(Loss)	\$ 4,233,339	\$ 1,017,153	\$ (4,608,683)
Cash	\$ 4,418,236	\$ 1,246,244	\$ 411,223
Working capital	\$ 7,937,873	\$ 4,469,882	\$ 3,628,911
Total assets	\$ 13,731,571	\$ 9,944,990	\$ 9,165,199
Shareholders' equity	\$ 11,845,275	\$ 8,165,734	\$ 7,565,233
Dividends paid per share	\$ 0.00	\$ 0.00	\$ 0.00

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.

CHANGES IN ACCOUNTING POLICIES INCLUDING INITIAL ADOPTION**(a) IFRS 16 Leases**

Effective January 1, 2019, the Company adopted IFRS 16 using the modified retrospective approach. The comparative figures for the 2018 and 2017 reporting periods have not been restated and are accounted for under IAS 17 *Leases*, and IFRIC 4 *Determining Whether an Arrangement Contains a Lease*, as permitted under the specific transitional provisions in the standard.

The Company applied the exemption not to recognize a right-of-use asset ("ROU asset") and lease liability for leases with less than 12 months of lease term and leases for low-value assets when applying IFRS 16 to leases previously classified as operating leases under IAS 17.

As at January 1, 2019, the Company did not have any leases that were classified as operating leases under IAS 17. As a result, there was no impact on the consolidated statement of financial position at the date of initial application.

The following is the new accounting policy for leases under IFRS 16:

At inception, the Company assesses whether a contract contains an embedded lease. A contract contains a lease when the contract conveys a right to control the use of an identified asset for a period of time in exchange for consideration.

The Company, as lessee, is required to recognize a ROU asset, representing its right to use the underlying asset, and a lease liability, representing its obligation to make lease payments.

The Company recognizes a ROU asset and a lease liability at the commencement of the lease. The ROU asset is initially measured based on the present value of lease payments, plus initial direct cost, less any incentives received. It is subsequently measured at cost less accumulated amortization, impairment losses and adjusted for certain remeasurements of the lease liability. The

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ROU asset is amortized from the commencement date over the shorter of the lease term or the useful life of the underlying asset. The ROU asset is subject to testing for impairment if there is an indicator of impairment.

The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted by the interest rate implicit in the lease, or if that rate cannot be readily determined, the incremental borrowing rate. The incremental borrowing rate is the rate which the operation would have to pay to borrow over a similar term and with similar security, the funds necessary to obtain an asset of similar value to the ROU asset in a similar economic environment.

Lease payments included in the measurement of the lease liability are comprised of:

- fixed payments, including in-substance fixed payments;
- variable lease payments that depend on an index or a rate, initially measured using the index or rate as at the commencement date;
- amounts expected to be payable under a residual value guarantee;
- the exercise price under a purchase option that the Company is reasonably certain to exercise;
- lease payments in an optional renewal period if the Company is reasonably certain to exercise an extension option; and
- penalties for early termination of a lease unless the Company is reasonably certain not to terminate early.

The lease liability is subsequently increased by the interest cost on the lease liability and decreased by lease payments made. It is remeasured when there is a change in future lease payments arising from a change in an index or a rate, a change in the estimate of the amount expected to be payable under a residual value guarantee, or as appropriate, changes in the assessment of whether a purchase or extension option is reasonably certain to be exercised or a termination option is reasonably certain not to be exercised.

Variable lease payments that do not depend on an index or a rate not included in the initial measurement of the ROU asset and lease liability are recognized as an expense in profit or loss in the period in which they are incurred.

The ROU assets are presented within "Property, plant and equipment" and the lease liabilities are presented in "Lease liability" on the consolidated statements of financial position.

FINANCIAL INSTRUMENTS

Financial instruments are agreements between two parties that result in promises to pay or receive cash or equity instruments. The carrying values of cash, accounts receivable and accounts payable and accrued liabilities 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 is placed with a major Canadian financial institution and the Company's concentration of credit risk for cash and maximum exposure thereto is \$4,418,236 at December 31, 2019 (December 31, 2018 - \$1,246,244).

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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 \$1,824,563 at December 31, 2019 (December 31, 2018 - \$1,224,235).

The Company's concentration of credit risk for accounts receivable at December 31, 2019 with respect to Customer A is \$476,341 (2018 - \$271,564) and Customer B is \$172,841 (2018 - \$161,556). The Company has an allowance for doubtful accounts of \$Nil at December 31, 2019 (2018 - \$27,653).

To reduce the credit risk of accounts receivable, the Company regularly reviews the collectability of accounts receivable to ensure there is no indication that these amounts will not be fully recovered.

(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 December 31, 2019, the Company has cash in the amount of \$4,418,236 (December 31, 2018 - \$1,246,244) and accounts receivable of \$1,824,563 (December 31, 2018 - \$1,224,235) to settle accounts payable and accrued liabilities of \$1,638,020 (December 31, 2018 - \$1,312,517) with the following due dates; trade accounts payable of \$1,100,376 (December 31, 2018 - \$1,222,982) are due within three months; and due to related party balances of \$537,644 (December 31, 2018 - \$19,500) are payable not later than May 15th, of the following year.

(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.

(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.

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At December 31, 2019 and December 31, 2018, the Company's net exposure to foreign currency risk is as follows (in US):

	December 31, 2019	December 31, 2018
Net (liabilities)	\$ (55,554)	\$ (147,910)

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 \$7,776 (December 31, 2018 - \$20,700) 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 to operate as a going concern and to further develop its business goals. 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 potentially difficult market conditions. The recent 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 2019. There are no externally-imposed restrictions on the Company's capital.

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.

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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 December 31, 2019, 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 December 31, 2019.

In spite of its evaluation, management does recognize that any controls and procedures; no matter how well designed and administrated, 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 industry 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.

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.

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

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 \$7,937,873 at December 31, 2019, 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 history of earnings 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.

“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.

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“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 three major customers that comprise the railroad tank car manufacturers for a significant portion of its revenue. 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 multiple suppliers in the United States and Canada for each of the component parts and raw materials required to assemble the Company's finished products. There is a potential risk that, from time to time, the Company could 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 business development plans of the Company, its revenues and continued operations.

“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 above 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.

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

The Company’s ambition to design, research and develop new products for the railroad industry and outback terrain vehicle suspension market and to successfully develop new markets for the Company’s products in other industries, such as the trucking industry, may not result in commercially accepted 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 may not have a replacement or alternative product offering. The Company’s investment in new product research and development is written off in the period in which it is incurred to account for the unpredictable nature of R&D projects.

“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 financial returns of our products and could negatively impact 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 per quoted purchase order. 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 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.

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RELATED PARTY TRANSACTIONS

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:

		Year ended Dec 31, 2019		Year ended Dec 31, 2018
Management compensation	\$	540,692	\$	540,535
Management bonus*	\$	496,894	\$	70,035
Share-based expense	\$	255,902	\$	262,261
Directors fees	\$	120,500	\$	73,000

* The Company has management bonus agreements whereby 10% of the annual income before taxes, amortization and share-based expense is equally distributed to management. This bonus is accrued by quarter and is paid based upon the audited year end balance not later than May 15 of the year following.

At December 31, 2019, amounts due to related parties include accounts payable which are unsecured and have no interest or specific terms of payments, are \$537,644 (2018 - \$19,500) consisting of \$40,750 (2018 - \$19,500) for directors' fees and \$496,894 (2018 - \$73,035) for management bonuses.

DISCLOSURE OF OUTSTANDING SHARE DATA

As of March 16, 2020, the Company had the following number of securities outstanding:

- 1) Common shares issued and outstanding: 47,170,086
- 2) Share purchase options outstanding: 3,845,000
- 3) Share purchase warrants outstanding: Nil

SUBSEQUENT EVENTS

On February 13, 2020 the Company announced the appointment of Mr. Frank C. Busch to the Board of Directors to replace Mr. Phil Dyer who has stepped down from the Board of Directors as of February 13, 2020.

OUTLOOK

The results for 2019 demonstrated stronger sales results and corresponding earnings growth. Our concentration on products with proven economic benefits for customers in a highly competitive rail market increased demand for our products from a growing number of rail tank car manufacturers, retrofitters, repair operations and tank car owners.

Over the past several years our reputation has been re-earned as a reliable supplier of a wide assortment of proprietary rail tank car valves and other specialized equipment. The key design element for all of our products is the improvement of public safety in transportation applications and mitigating potential negative impacts of technologies on the environment.

Since a dismal 2017 Kelso has been able to refocus its efforts to rebuild its brand through a better "customer driven" business model that has led to co-engineered product development initiatives with customers. This shift has significantly broadened customer support and created a streamlined market platform to thrive on.

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Our value proposition for customers is to produce and timely deliver precision milled equipment that features quality craftsmanship and long-term reliable performance. We have distinguished ourselves from our competition by using only North American suppliers that allow us to have shortest delivery and service lead times in the industry. Our products significantly diminish the expensive and complex logistics of repairing tank cars in service – an economic benefit that customers have welcomed and embraced.

In 2019 strong contribution margins from sales have provided a steady growth of positive cash flows that has improved our financial strength and ability to grow our business. Working capital improved to a healthy \$7,937,873 at December 31, 2019. We currently operate without the need for new equity capital or credit facilities. Our capital management allows us to finance operations and R&D from the sales of our products thus avoiding the need for dilutive new equity funding or interest-bearing long-term debt.

We continue to invest in promising product development initiatives to build the next generation of revenue opportunities even though R&D projects continue to be complex and expensive. As with all new ventures the timing of new revenue streams remains unpredictable and not guaranteed to develop. Our R&D model has delivered an array of promising new products that include new rail tank car equipment, specialized truck tanker equipment, fuel loading systems, first responder emergency response technologies and our KXI™ suspension system used in rugged wilderness applications.

Although there are many market challenges and COVID-19 healthcare concerns around the world our business momentum appears to be consistent with 2019. Based on our operational momentum, the introduction of a number of our new products to market and our healthy debt free financial position it is our belief that our present business activities will continue to add to the positive stature of the Company.

Kelso Technologies Inc.

James R. Bond,
President and Chief Executive Officer



KELSO TECHNOLOGIES INC.

Consolidated Financial Statements
For the years ended December 31, 2019, 2018 and 2017
(Expressed in US Dollars)

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM
TO THE SHAREHOLDERS AND DIRECTORS OF KELSO TECHNOLOGIES INC.**

Opinion on the Consolidated Financial Statements

We have audited the accompanying consolidated statements of financial position of Kelso Technologies Inc. as of December 31, 2019 and 2018, and the related consolidated statements of operations and comprehensive income (loss), changes in equity and cash flows for the years ended December 31, 2019, 2018 and 2017, and the related notes (collectively referred to as the "consolidated financial statements"). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2019 and 2018, and the results of its operations and its cash flows for the years ended December 31, 2019, 2018 and 2017, in conformity with International Financial Reporting Standards (IFRS), as issued by the International Accounting Standards Board.

Change in Accounting Principle

As discussed in Note 3 to the consolidated financial statements, the Company has changed its accounting policy for leases as of January 1, 2019 due to the adoption of IFRS 16 *Leases*.

Basis for Opinion

These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's consolidated financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits, we are required to obtain an understanding of internal control over financial reporting, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.

Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

Smythe LLP

Chartered Professional Accountants

We have served as the Company's auditor since 2006.

Vancouver, Canada
March 16, 2020

Kelso Technologies Inc.

Consolidated Statements of Financial Position

December 31

(Expressed in US Dollars)

	2019	2018
Assets		
Current		
Cash and cash equivalents	\$ 4,418,236	\$ 1,246,244
Accounts receivable (Note 5)	1,824,563	1,224,235
Prepaid expenses	96,627	110,258
Inventory (Notes 6 and 7)	3,394,192	3,668,401
	9,733,618	6,249,138
Property, plant and equipment (Note 7)	3,389,994	3,087,893
Intangible assets (Note 8)	607,959	607,959
	\$ 13,731,571	\$ 9,944,990
Liabilities		
Current		
Accounts payable and accrued liabilities (Note 11)	\$ 1,638,020	\$ 1,312,517
Income tax payable (Note 12)	71,341	466,739
Current portion of lease liability (Note 9)	86,384	-
	1,795,745	1,779,256
Long term portion of lease liability (Note 9)	90,551	-
	1,886,296	1,779,256
Shareholders' Equity		
Capital Stock (Note 10)	23,366,542	23,366,542
Reserves (Note 10 (b))	4,238,309	3,892,811
Deficit	(15,759,576)	(19,093,619)
	11,845,275	8,165,734
	\$ 13,731,571	\$ 9,944,990

Approved on behalf of the Board:

"Peter Hughes" (signed)

Peter Hughes, Director

"Paul Cass" (signed)

Paul Cass, Director

See notes to consolidated financial statements

Kelso Technologies Inc.

Consolidated Statements of Changes in Equity

For the years ended December 31, 2019, 2018 and 2017

(Expressed in US Dollars)

	Capital Stock					
	Number of common shares	Amount	Obligation to issue shares	Reserves	Deficit	Total
Balance, December 31, 2016	46,411,752	\$ 22,829,820	\$ 192,946	\$ 3,021,339	\$ (14,272,161)	\$ 11,771,944
Shares issued	500,000	401,432	(192,946)	-	-	208,486
Share-based expense	-	-	-	469,187	-	469,187
Shares to be issued	-	-	131,527	-	-	131,527
Net loss for the year	-	-	-	-	(5,015,911)	(5,015,911)
Balance, December 31, 2017	46,911,752	\$ 23,231,252	\$ 131,527	\$ 3,490,526	\$ (19,288,072)	\$ 7,565,233
Exercise of options	8,334	3,763	-	(1,263)	-	2,500
Shares issued	250,000	131,527	(131,527)	-	-	-
Share-based expense	-	-	-	403,548	-	403,548
Net income for the year	-	-	-	-	194,453	194,453
Balance, December 31, 2018	47,170,086	\$ 23,366,542	\$ -	\$ 3,892,811	\$ (19,093,619)	\$ 8,165,734
Share-based expense	-	-	-	345,498	-	345,498
Net income for the year	-	-	-	-	3,334,043	3,334,043
Balance, December 31, 2019	47,170,086	\$ 23,366,542	\$ -	\$ 4,238,309	\$ (15,759,576)	\$ 11,845,275

See notes to consolidated financial statements

Kelso Technologies Inc.

Consolidated Statements of Operations and Comprehensive Income (Loss)

For the years ended December 31

(Expressed in US Dollars)

	2019	2018	2017
Revenues (Note 15)	\$ 20,550,682	\$ 12,716,596	\$ 6,062,778
Cost of Goods Sold (Notes 6 and 7)	10,967,803	7,429,380	5,044,093
Gross Profit	9,582,879	5,287,216	1,018,685
Expenses			
Office and administration (Note 6)	2,219,711	1,667,646	1,701,723
Management compensation (Note 11)	1,037,586	610,570	544,014
Research (Note 7)	1,129,007	1,352,817	1,572,714
Marketing	288,893	266,152	554,458
Travel	197,293	159,800	430,304
Accounting and legal	321,945	194,282	370,495
Share-based expense (Notes 10 (b) and 11)	345,498	403,548	469,187
Consulting	386,661	196,823	251,055
Investor relations	84,000	84,000	84,000
Foreign exchange (gain) loss	27,698	4,257	(115,643)
Amortization (Notes 7 and 8)	69,271	30,242	17,088
Bad debts	(20,206)	(14,689)	82,042
	6,087,357	4,955,448	5,961,437
Income (Loss) Before the Following:	3,495,522	331,768	(4,942,752)
Interest income	-	-	3,875
Write-off of inventory (Note 6)	(62,402)	(26,031)	(197,729)
Write-off of property, plant and equipment (Note 7)	-	(34,438)	(29,601)
Write-off of intangible assets (Note 8)	-	(328,010)	-
Income (Loss) Before Taxes:	3,433,120	(56,711)	(5,166,207)
Income Tax Expense (Recovery) (Note 12)			
Current	99,077	(251,164)	22,137
Deferred	-	-	(172,433)
	99,077	(251,164)	(150,296)
Net Income (Loss) and Comprehensive Income (Loss) for the year	\$ 3,334,043	\$ 194,453	\$ (5,015,911)
Basic Gain (Loss) Per Share (Note 14)	\$ 0.07	\$ 0.00	\$ (0.11)
Diluted Gain (Loss) Per Share (Note 14)	\$ 0.07	\$ 0.00	\$ (0.11)
Weighted Average Number of Common Shares Outstanding			
Basic (Note 14)	47,170,086	47,117,369	46,848,053
Diluted (Note 14)	48,186,522	47,451,644	46,848,053

See notes to consolidated financial statements

Kelso Technologies Inc.
Consolidated Statements of Cash Flows
For the years ended December 31
(Expressed in US Dollars)

	2019	2018	2017
Operating Activities			
Net income (loss)	\$ 3,334,043	\$ 194,453	\$ (5,015,911)
Items not involving cash:			
Deferred income tax recovery	-	-	(172,433)
Amortization (Notes 7 and 8)	384,827	277,580	203,980
Write-off of inventory (Note 6)	62,402	26,031	668,383
Write-off of property, plant and equipment (Note 7)	-	34,438	29,601
Write-off of intangible assets (Note 8)	-	328,010	-
Share-based expense	345,498	403,548	469,187
Bad debts (recovery)	(20,206)	(14,689)	82,042
Unrealized foreign exchange loss (gain)	(1,669)	4,257	(115,643)
	4,104,895	1,253,628	(3,850,794)
Changes in non-cash working capital			
Accounts receivable	(580,122)	(556,101)	(97,642)
Income tax receivable	-	-	753,223
Prepaid expenses	13,631	73,708	527,897
Inventory	213,283	291,713	567,764
Accounts payable and accrued liabilities	262,725	399,416	582,099
Income tax payable	(395,398)	(254,528)	(112,900)
	(485,881)	(45,792)	2,220,441
Cash Provided by (Used in) Operating Activities	3,619,014	1,207,836	(1,630,353)
Investing Activities			
Intangible assets	-	-	(353,010)
Proceeds from disposition of property, plant and equipment	-	700	(33,336)
Acquisition of property, plant and equipment	(428,954)	(371,758)	-
Cash Used in Investing Activities	(428,954)	(371,058)	(386,346)
Financing Activities			
Issue of common shares, net of share issue costs	-	2,500	-
Lease liability payments	(19,737)	-	-
Cash Provided by (Used in) Financing Activities	(19,737)	2,500	-
Foreign Exchange Effect on Cash	1,669	(4,257)	115,643
Inflow (Outflow) of Cash and Cash Equivalents	3,171,992	835,021	(1,901,056)
Cash and Cash Equivalents, Beginning of Year	1,246,244	411,223	2,312,279
Cash and Cash Equivalents, End of Year	\$ 4,418,236	\$ 1,246,244	\$ 411,223

Supplemental Cash Flow Information (Note 13)
See notes to consolidated financial statements

KELSO TECHNOLOGIES INC.

Notes to Consolidated Financial Statements

For the years ended December 31, 2019, 2018 and 2017

(Expressed in US Dollars)

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 New York Stock Exchange ("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 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").

These consolidated financial statements have been prepared under the historical cost basis, except for financial instruments, which are stated at their fair values. These consolidated financial statements have been prepared using the accrual basis of accounting, except for cash flow information.

Effective January 1, 2019, the Company adopted IFRS 16 *Leases* ("IFRS 16"). IFRS 16 was adopted retrospectively with no restatement of comparative periods, as permitted by the transition provisions of the standard.

(b) Basis of presentation and consolidation

The 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 and KIQ X Industries Inc., which 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").

2. BASIS OF PREPARATION (Continued)

(d) Significant management judgments and estimation uncertainty

The preparation of 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 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 generating 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 and its subsidiaries is the currency of the primary economic environment in which the entity operates. The Company has determined its functional currency and that 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) 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 probable that 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.

(iv) 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.

2. BASIS OF PREPARATION (Continued)

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

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.

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.

2. BASIS OF PREPARATION (Continued)

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

Estimation uncertainty (Continued)

(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 statements 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 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.

(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. At December 31, 2019, the Company has an allowance for doubtful accounts of \$Nil (2018 - \$27,653).

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 the Company for year ended December 31, 2019 were approved and authorized for issue by the Board of Directors on March 16, 2020.

(f) New accounting standards issued but not yet effective

The Company has performed an assessment of new standards issued by the IASB that are not yet effective. The Company has assessed that the impact of adopting these accounting standards on its consolidated financial statements would not be significant.

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 90 days or less, are readily convertible into known amounts of cash and which are subject to insignificant changes in value.

KELSO TECHNOLOGIES INC.

Notes to Consolidated Financial Statements

For the years ended December 31, 2019, 2018 and 2017

(Expressed in US Dollars)

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

(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 as follows:

Patents - 5 years
Rights - 2 years

Amortization begins when the intangible asset is ready for use. Product and technology development costs, which meet the criteria for deferral and are expected to provide future economic benefits with reasonable certainty are deferred and amortized over the estimated life of the products or technology once commercialization commences.

(d) Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated amortization. Leasehold improvements and prototypes are amortized on a straight-line basis over the lease term and estimated useful life respectively. 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
Prototypes	– 2 year straight-line

KELSO TECHNOLOGIES INC.

Notes to Consolidated Financial Statements

For the years ended December 31, 2019, 2018 and 2017

(Expressed in US Dollars)

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(e) Revenue recognition

Revenues from the sale of pressure relief valves, manway securement systems and related products is recognised when all the performance obligations identified in the customer contract, typically consisting of a purchase order, are satisfied. The performance obligations in a typical purchase order are the manufacture of the pressure relief valve, manway securement system and related accessories and delivery of those items. The Company recognizes revenue when collection is reasonably assured.

(f) Impairment of long-lived assets

The Company's tangible and intangible assets are reviewed for any 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 and comprehensive income (loss). 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.

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.

KELSO TECHNOLOGIES INC.

Notes to Consolidated Financial Statements

For the years ended December 31, 2019, 2018 and 2017

(Expressed in US Dollars)

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(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) Non-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.

(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.

KELSO TECHNOLOGIES INC.

Notes to Consolidated Financial Statements

For the years ended December 31, 2019, 2018 and 2017

(Expressed in US Dollars)

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(j) Share-based expense (Continued)

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

Initial recognition and measurement

A financial asset is measured initially at fair value plus, for an item not at fair value through profit or loss, transaction costs that are directly attributable to its acquisition or issue. On initial recognition, a financial asset is classified as measured at amortized cost or fair value through profit or loss. A financial asset is measured at amortized cost if it meets the conditions that i) the asset is held within a business model whose objective is to hold assets to collect contractual cash flows, ii) the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding, and iii) is not designated as fair value through profit or loss.

Subsequent measurement

The subsequent measurement of financial assets depends on their classification as follows:

Financial assets at fair value through profit or loss

Financial assets measured at fair value through profit and loss are carried in the consolidated statements of financial position at fair value with changes in fair value therein, recognized in the consolidated statements of operations and comprehensive income (loss).

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(l) Financial instruments (Continued)

(i) Financial assets (Continued)

Subsequent measurement (Continued)

Financial assets measured at amortized cost

A financial asset is subsequently measured at amortized cost, using the effective interest method and net of any impairment allowance.

Derecognition

A financial asset or, where applicable a part of a financial asset or part of a group of similar financial assets is derecognized when:

- the contractual rights to receive cash flows from the asset have expired; or
- the Company has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a 'pass-through' arrangement; and either (a) the Company has transferred substantially all the risks and rewards of the asset, or (b) the Company has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

(ii) Financial liabilities

Financial liabilities are recognized when the Company becomes a party to the contractual provisions of the financial instrument. A financial liability is derecognized when it is extinguished, discharged, cancelled or when it expires. Financial liabilities are classified as either financial liabilities at fair value through profit or loss or financial liabilities subsequently measured at amortized cost. All interest-related charges are reported in profit or loss within interest expense, if applicable.

(iii) 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.

(m) Leases

Effective January 1, 2019, the Company adopted IFRS 16 using the modified retrospective approach. The comparative figures for the 2018 and 2017 reporting periods have not been restated and are accounted for under IAS 17 *Leases*, and IFRIC 4 *Determining Whether an Arrangement Contains a Lease*, as permitted under the specific transitional provisions in the standard.

KELSO TECHNOLOGIES INC.

Notes to Consolidated Financial Statements

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3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(m) Leases (Continued)

The Company applied the exemption not to recognize a right-of-use asset ("ROU asset") and lease liability for leases with less than 12 months of lease term and leases for low-value assets when applying IFRS 16 to leases previously classified as operating leases under IAS 17.

As at January 1, 2019, the Company did not have any leases that were classified as operating leases under IAS 17. As a result, there was no impact on the consolidated statement of financial position at the date of initial application.

The following is the new accounting policy for leases under IFRS 16:

At inception, the Company assesses whether a contract contains an embedded lease. A contract contains a lease when the contract conveys a right to control the use of an identified asset for a period of time in exchange for consideration.

The Company, as lessee, is required to recognize a ROU asset, representing its right to use the underlying asset, and a lease liability, representing its obligation to make lease payments.

The Company recognizes a ROU asset and a lease liability at the commencement of the lease. The ROU asset is initially measured based on the present value of lease payments, plus initial direct cost, less any incentives received. It is subsequently measured at cost less accumulated amortization, impairment losses and adjusted for certain remeasurements of the lease liability. The ROU asset is amortized from the commencement date over the shorter of the lease term or the useful life of the underlying asset. The ROU asset is subject to testing for impairment if there is an indicator of impairment.

The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted by the interest rate implicit in the lease, or if that rate cannot be readily determined, the incremental borrowing rate. The incremental borrowing rate is the rate which the operation would have to pay to borrow over a similar term and with similar security, the funds necessary to obtain an asset of similar value to the ROU asset in a similar economic environment.

Lease payments included in the measurement of the lease liability are comprised of:

- fixed payments, including in-substance fixed payments;
- variable lease payments that depend on an index or a rate, initially measured using the index or rate as at the commencement date;
- amounts expected to be payable under a residual value guarantee;
- the exercise price under a purchase option that the Company is reasonably certain to exercise;
- lease payments in an optional renewal period if the Company is reasonably certain to exercise an extension option; and
- penalties for early termination of a lease unless the Company is reasonably certain not to terminate early.

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(m) Leases (Continued)

The lease liability is subsequently increased by the interest cost on the lease liability and decreased by lease payments made. It is remeasured when there is a change in future lease payments arising from a change in an index or a rate, a change in the estimate of the amount expected to be payable under a residual value guarantee, or as appropriate, changes in the assessment of whether a purchase or extension option is reasonably certain to be exercised or a termination option is reasonably certain not to be exercised.

Variable lease payments that do not depend on an index or a rate not included in the initial measurement of the ROU asset and lease liability are recognized as an expense in profit or loss in the period in which they are incurred.

The ROU assets are presented within "Property, plant and equipment" and the lease liabilities are presented in "Lease liability" on the consolidated statements of financial position.

4. CAPITAL MANAGEMENT

The Company considers its capital to be comprised of shareholders' equity.

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 year ended December 31, 2019. There are no externally imposed restrictions on the Company's capital.

5. FINANCIAL INSTRUMENTS

Financial instruments are agreements between two parties that result in promises to pay or receive cash or equity instruments. The carrying values of accounts receivable and accounts payable and accrued liabilities 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 maximum exposure thereto is \$4,418,236 (2018 - \$1,246,244).

KELSO TECHNOLOGIES INC.

Notes to Consolidated Financial Statements

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5. FINANCIAL INSTRUMENTS (Continued)**(a) Credit risk (Continued)**

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 \$1,824,563 (2018 - \$1,224,235). The Company's concentration of credit risk for accounts receivable with respect to its significant customers is as follows: Customer A is \$476,341 (2018 - \$271,564), Customer B is \$172,841 (2018 - \$161,556) (Note 15). The Company has provided for an allowance for doubtful accounts amounting to \$Nil at December 31, 2019 (2018 - \$27,653).

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.

(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 December 31, 2019, the Company has \$4,418,236 (2018 - \$1,246,244) of cash and cash equivalents to settle current liabilities of \$1,795,745 (2018 - \$1,779,256) consisting of the following: accounts payable and accrued liabilities of \$1,100,376 (2018 - \$1,222,982), due to related party balance of \$537,644 (2018 - \$89,535), income tax payable of \$71,341 (2018 - \$466,739) and current portion of lease liability of \$86,384 (2018 - \$Nil). All payables are due within a year.

(c) Market risk

The significant market risks to which the Company could be 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 is not exposed to significant interest rate risk.

(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.

KELSO TECHNOLOGIES INC.

Notes to Consolidated Financial Statements

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5. FINANCIAL INSTRUMENTS (Continued)

(c) Market risk (Continued)

(ii) Currency risk (Continued)

As at December 31, 2019 and 2018, the Company had the following assets denominated in CAD (amounts presented in USD):

	December 31, 2019	December 31, 2018
Cash and cash equivalents	\$ 76,389	\$ 15,666
Accounts receivable	66,035	46,979
Accounts payable	(197,967)	(210,555)
	\$ (55,544)	\$ (147,910)

Based on the above, assuming all other variables remain constant, a 14% (2018 - 14%) weakening or strengthening of the USD against the CAD would result in approximately \$7,776 (2018 - \$20,700) foreign exchange loss or gain in the consolidated statements of operations and comprehensive income (loss).

6. INVENTORY

	December 31, 2019	December 31, 2018
Finished goods	\$ 100,675	\$ 230,315
Raw materials and supplies	3,293,517	3,438,086
	\$ 3,394,192	\$ 3,668,401

Included in cost of goods sold is \$9,443,243 (2018 - \$5,974,854; 2017 - \$3,376,123) of direct material costs recognized as expense.

Inventory write-off during the year was \$62,402 (2018 - \$26,031; 2017 - \$668,383) of which \$Nil (2018 - \$Nil; 2017 - \$470,654) is included in cost of goods sold and \$62,402 (2018 - \$26,031; 2017 - \$197,729) is included in general and administrative expenses.

KELSO TECHNOLOGIES INC.

Notes to Consolidated Financial Statements

For the years ended December 31, 2019, 2018 and 2017

(Expressed in US Dollars)

7. PROPERTY, PLANT AND EQUIPMENT

Cost	Land	Building	Leasehold Improvements	Production Equipment	Vehicles	Prototypes	ROU Asset	Total
Balance, December 31, 2017	\$ 12,558	\$2,955,901	\$ 43,715	\$ 809,982	\$ 61,517	\$ -	\$ -	\$3,883,673
Additions	-	-	-	-	-	406,160	-	406,160
Disposition	-	-	-	-	(61,517)	-	-	(61,517)
Balance, December 31, 2018	\$ 12,558	\$2,955,901	\$ 43,715	\$ 809,982	\$ -	\$ 406,160	\$ -	\$4,228,316
Additions	-	-	-	7,166	-	564,234	117,004	688,404
Balance, December 31, 2019	\$ 12,558	\$2,955,901	\$ 43,715	\$ 817,148	\$ -	\$ 970,394	\$ 117,004	\$4,916,720
Accumulated Amortization								
Balance, December 31, 2017	\$ -	\$ 410,037	\$ 32,924	\$ 424,664	\$ 24,502	\$ -	\$ -	\$ 892,127
Amortization	-	106,080	2,698	96,327	1,877	67,693	-	274,675
Disposition	-	-	-	-	(26,379)	-	-	(26,379)
Balance, December 31, 2018	\$ -	\$ 516,117	\$ 35,622	\$ 520,991	\$ -	\$ 67,693	\$ -	\$1,140,423
Amortization	-	97,592	1,619	58,515	-	216,365	12,212	386,303
Balance, December 31, 2019	\$ -	\$ 613,709	\$ 37,241	\$ 579,506	\$ -	\$ 284,058	\$ 12,212	\$1,526,726
Carrying Value								
December 31, 2019	\$ 12,558	\$2,342,192	\$ 6,474	\$ 237,642	\$ -	\$ 686,336	\$ 104,792	\$3,389,994
December 31, 2018	\$ 12,558	\$2,439,784	\$ 8,093	\$ 288,991	\$ -	\$ 338,467	\$ -	\$3,087,893

Included in cost of goods sold is \$131,617 (2018 - \$179,645; 2017 - \$186,892) of amortization related to property, plant and equipment.

Included in expenses is \$69,271 (2018 - \$21,435; 2017 - \$9,528) of amortization related to property, plant and equipment.

Included in inventory is \$1,476 (2018 - \$5,902; 2017 - \$10,261) of amortization related to property, plant and equipment.

Included in research is \$183,939 (2018 - \$67,693; 2017 - \$Nil) of amortization related to property, plant and equipment, of which \$11,433 (2018 - \$Nil; 2017 - \$Nil) relates to vehicles under lease.

Included in prototype additions are vehicles under lease of \$79,668 (2018 - \$Nil; 2017 - \$Nil) (Note 9).

KELSO TECHNOLOGIES INC.

Notes to Consolidated Financial Statements

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8. INTANGIBLE ASSETS

Cost	Patent	Rights	Product Development Costs	Total
Balance, December 31, 2017	\$ 40,840	\$ 672,959	\$ 328,010	\$ 1,041,809
Impairment	-	-	(328,010)	(328,010)
Balance, December 31, 2018 and 2019	\$ 40,840	\$ 672,959	\$ -	\$ 713,799
Accumulated Amortization				
Balance, December 31, 2017	\$ 32,033	\$ 65,000	\$ -	\$ 97,033
Amortization	8,807	-	-	8,807
Balance, December 31, 2018 and 2019	\$ 40,840	\$ 65,000	\$ -	\$ 105,840
Carrying Value				
December 31, 2018 and 2019	\$ -	\$ 607,959	\$ -	\$ 607,959

During the year ended December 31, 2010, the Company entered into an agreement to acquire a patent related to their manway securement systems. The Company is obligated to pay a 5% royalty in accordance with the agreement (Note 15).

On November 10, 2016, the Company entered into a technology development agreement to acquire all intellectual property rights (the "Products") of G & J Technologies, Inc. (the "Vendor") for consideration of \$217,946, consisting of \$25,000 in cash and 250,000 common shares with a fair value of \$192,946. The shares were issued during the year ended December 31, 2017. On November 10, 2016, the Vendor also entered into a consulting agreement with the Company for a fee of \$10,000 per month.

In addition, the Company will pay an additional \$75,000 in cash and issue 750,000 common shares of the Company to the Vendor based on the following milestones:

- \$25,000 cash and 250,000 common shares issuable on the filing of the first new patent application related to the Products (the Company paid the cash and issued the shares with a fair value of \$208,486 during the year ended December 31, 2017);
- \$25,000 cash and 250,000 common shares issuable on the successful completion of a commercially viable production prototype for the first Product (the Company accrued for the cash payment and shares to be issued with a fair value of \$131,527 at December 31, 2017); the cash and shares were issued during the year ended December 31, 2018; and
- \$25,000 cash and 250,000 common shares issuable on the completion of the sale of the first ten commercial vehicles incorporating the Products.

The Company is also required to pay a royalty to the Vendor of 2.5% of the net sales earned by the Company, to be paid within 30 days of the end of each calendar quarter. As at December 31, 2019 the Company has not earned any revenue from the sale of the Products.

KELSO TECHNOLOGIES INC.

Notes to Consolidated Financial Statements

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8. INTANGIBLE ASSETS (Continued)

At December 31, 2017, the Company had capitalized \$328,010 of internal product development costs related to the construction of equipment. During the year ended December 31, 2018, as part of the testing phase, the equipment was destroyed and accordingly, management impaired the product development costs and recognized an impairment loss of \$328,010.

9. LEASE LIABILITY

The Company has lease agreements for its warehouse space in Kelowna, British Columbia and for vehicles used in the development of prototypes (Note 7).

The continuity of the lease liability for the years ended December 31, 2019 and 2018 is as follows:

Lease liability	Warehouse	Vehicles	Total
Lease liability recognized as of December 31, 2017 and 2018	\$ -	\$ -	\$ -
Lease liability recognized	117,004	79,668	196,672
Lease payments	(12,728)	(7,746)	(20,474)
Lease interest	509	228	737
Lease liability recognized as of December 31, 2019	\$ 104,785	\$ 72,150	\$ 176,935
Current portion	\$ 73,106	\$ 13,278	\$ 86,384
Long-term portion	31,679	58,872	90,551
	\$ 104,785	\$ 72,150	\$ 176,935

10. 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. No preferred shares have been issued.

Unlimited common shares without par value.

Issued:

(a) Common shares

During the year ended December 31, 2018, the Company issued 250,000 shares with a fair value of \$131,527 pursuant to achieving the third milestone of the technology development agreement (Note 8). These common shares were recorded as shares to be issued at December 31, 2017.

During the year ended December 31, 2018, the Company issued 8,334 common shares pursuant to the exercise of stock options for gross proceeds of \$2,500. Fair value previously recognized on options exercised of \$1,263 was reclassified from reserves to capital stock.

KELSO TECHNOLOGIES INC.

Notes to Consolidated Financial Statements

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10. CAPITAL STOCK (Continued)

(a) Common shares (Continued)

During the year ended December 31, 2017, the Company issued 250,000 common shares with a fair value of \$192,946 pursuant to the technology development agreement (Note 8) and 250,000 shares with a fair value of \$208,486 pursuant to achieving the second milestone of the technology development agreement (Note 8).

(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.

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

Exercise Price	Expiry Date	December 31, 2018	Granted	Exercised	Expired	December 31, 2019
\$0.70(CAD)	October 7, 2019	28,571	-	-	(28,571)	-
\$6.85(CAD)	November 14, 2019	100,000	-	-	(100,000)	-
\$1.30(USD)	August 18, 2021	1,175,000	-	-	-	1,175,000
\$0.90(USD)	July 6, 2022	50,000	-	-	-	50,000
\$0.30(USD)	November 28, 2022	750,000	-	-	-	750,000
\$0.50(USD)	August 20, 2023	750,000	-	-	-	750,000
\$0.57(USD)	April 17, 2023	200,000	-	-	-	200,000
\$1.45(USD)	May 17, 2024	-	10,000	-	-	10,000
\$0.78(USD)	August 19, 2024	-	700,000	-	-	700,000
\$0.82(USD)	November 8, 2024	-	10,000	-	-	10,000
Total outstanding		3,053,571	720,000	-	(128,571)	3,645,000
Total exercisable		1,353,571				2,831,667

Exercise Price	Expiry Date	December 31, 2017	Granted	Exercised	Expired	December 31, 2018
\$0.30(USD)	November 28, 2022	825,000	-	(8,334)	(66,666)	750,000
\$0.90(USD)	July 6, 2022	50,000	-	-	-	50,000
\$0.70(CAD)	October 7, 2019	28,571	-	-	-	28,571
\$6.85(CAD)	November 14, 2019	100,000	-	-	-	100,000
\$1.30(USD)	August 18, 2021	1,325,000	-	-	(150,000)	1,175,000
\$0.50(USD)	August 20, 2023	-	750,000	-	-	750,000
\$0.57(USD)	April 17, 2023	-	200,000	-	-	200,000
Total outstanding		2,328,571	950,000	(8,334)	(216,666)	3,053,571
Total exercisable		845,238				1,353,571

KELSO TECHNOLOGIES INC.

Notes to Consolidated Financial Statements

For the years ended December 31, 2019, 2018 and 2017

(Expressed in US Dollars)

10. CAPITAL STOCK (Continued)

(b) Stock options (Continued)

A summary of the Company's stock options as at December 31, 2019 and 2018, and changes for the years then ended are as follows:

	Number	Weighted Average Exercise Price
Outstanding, December 31, 2017	2,328,571	\$1.11
Granted	950,000	\$0.51
Exercised	(8,334)	\$0.30
Expired	(216,666)	\$0.99
Outstanding, December 31, 2018	3,053,571	\$0.92
Granted	720,000	\$0.79
Expired	(128,571)	\$4.22
Outstanding, December 31, 2019	3,645,000	\$0.78

The weighted average contractual life for the remaining options at December 31, 2019 is 3.0 years (2018 - 3.49).

Share-based expense

Share-based expense of \$345,498 (2018 - \$403,548; 2017 - \$469,187) was recognized in the year ended December 31, 2019 for stock options. The share-based expense relates to options granted during December 31, 2019, 2018, 2017 and 2016, which vest over time.

The fair value of stock options is estimated using the Black-Scholes option pricing model with the following weighted average assumptions:

	Year ended December 31, 2019	Year ended December 31, 2018	Year ended December 31, 2017
Risk-free interest rate (average)	1.32%	2.15%	1.56%
Estimated volatility (average)	69.93%	66.56%	61.95%
Expected life in years	5.00	5.00	5.00
Expected dividend yield	0.00%	0.00%	0.00%
Estimated forfeitures	0.00%	0.00%	0.00%
Grant date fair value per option	\$0.45	\$0.29	\$0.17

Option pricing models require the use of highly subjective estimates and assumptions. The expected volatility assumption is based on the historical and implied volatility of the Company's common share price on the TSX. The risk-free interest rate assumption is based on yield curves on Canadian government zero-coupon bonds with a remaining term equal to the stock options' expected life. The Company uses historical data to estimate option exercise, forfeiture and employee termination within the valuation model.

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11. 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 Chief Operating Officer who have the authority and responsibility for planning, directing and controlling the activities of the Company, consist of the following amounts:

	December 31, 2019	December 31, 2018	December 31, 2017
Management compensation	\$ 540,692	\$ 540,535	\$ 544,014
Management bonus*	496,894	70,035	-
Share-based expense**	255,902	262,261	264,172
Directors' fees	120,500	73,000	67,000
	\$ 1,413,988	\$ 945,831	\$ 875,186

* The Company has management bonus agreements whereby 10% of the annual income before taxes, amortization 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 December 31, 2019, amounts due to related parties included accounts payable and accrued liabilities, which are unsecured and have no interest or specific terms of payments, of \$537,644 (2018 - \$19,500) consisting of \$40,750 (2018 - \$19,500) for directors' fees and \$496,894 (2018 - \$70,035) for management bonus.

12. INCOME TAXES

The Company has approximately \$1,200,000 in non-capital losses in the US that may be applied against future taxable income (expiring in 2032 or later).

The tax effect items that give rise to significant portions of the deferred income tax assets and deferred income tax liabilities at December 31, 2019 and 2018 are as follows:

	December 31, 2019	December 31, 2018
Deferred income tax assets		
Non-capital loss carry-forwards	\$ 221,178	\$ 137,251
Deferred income tax assets	\$ 221,178	\$ 137,251
Deficiency (excess) of carrying value over tax value of property, plant and equipment	\$ (195,048)	\$ (112,422)
Excess of carrying value over tax value of intangible assets	(26,130)	(24,829)
Deferred income tax liability	\$ (221,178)	\$ (137,251)
Net deferred tax asset (liability)	\$ -	\$ -

KELSO TECHNOLOGIES INC.

Notes to Consolidated Financial Statements

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12. INCOME TAXES (Continued)

Significant unrecognized tax benefits and unused tax losses for which no deferred tax assets is recognized as of December 31, 2019 and 2018 are as follows:

	December 31, 2019	December 31, 2018
Excess of tax value over carrying value of mineral properties	\$ 9,333	\$ 12,708
Non-capital losses carried forward	264,989	4,660,241
Lease liability	79,896	-
Unrecognized deductible temporary differences	\$ 354,218	\$ 4,672,949

Income tax expense differs from the amount that would be computed by applying the Canadian statutory income tax rate of 27.00% (2018 - 27.00%; 2017 - 26.00%) to income (loss) before income taxes as follows:

	December 31, 2019	December 31, 2018	December 31, 2017
Income (loss) before income taxes	\$ 3,334,043	\$ (56,711)	\$ (5,166,207)
Statutory income tax rate	27.00%	27.00%	26.00%
Income tax (benefit) liability computed at statutory tax rate	900,192	(15,312)	(1,343,214)
Items not deductible for income tax purposes	(12,564)	77,417	(100,626)
Under provision of taxes in prior years	36,225	-	-
Change in timing differences	135,130	(80,965)	187,473
Impact of foreign exchange on tax assets and liabilities	(39,116)	(90,212)	117,313
Difference between Canadian and foreign taxes	-	3,403	(464,959)
Effect of change in tax rates	-	(42,564)	-
Unused tax losses and tax offsets not recognized	(983,204)	148,233	1,431,580
Income tax expense (recovery)	36,663	-	(172,433)
Penalties and interest included in income tax expense (recovery)	27,989	(290,818)	-
Texas margin tax and branch tax	34,425	39,654	22,137
Income tax expense (recovery)	\$ 99,077	\$ (251,164)	\$ (150,296)

KELSO TECHNOLOGIES INC.

Notes to Consolidated Financial Statements

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13. SUPPLEMENTAL CASH FLOW INFORMATION

	December 31, 2019	December 31, 2018	December 31, 2017
Obligation to issue shares for acquisition of intangible asset	\$ -	\$ -	\$ 131,527
Shares issued for intangible assets	\$ -	\$ 131,527	\$ 401,432
Intangible assets in accounts payable and accrued liabilities	\$ -	\$ -	\$ 25,000
Property, plant and equipment in accounts payable and accrued liabilities	\$ 97,180	\$ 34,402	\$ -
Interest paid	\$ 737	\$ -	\$ -
Income taxes paid (recovered)	\$ 487,206	\$ (3,907)	\$ -

14. EARNINGS PER SHARE

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

	December 31, 2019	December 31, 2018	December 31, 2017
Net income (loss) for the year	\$ 3,334,043	\$ 194,453	\$ (5,015,911)
Basic weighted average number of common shares outstanding	47,170,086	47,117,369	46,848,053
Effect on dilutive securities:			
Options	1,016,436	334,275	-
Diluted weighted average number of common shares outstanding	48,186,522	47,451,644	46,848,053
Basic income (loss) per share	\$ 0.07	\$ 0.00	\$ (0.11)
Diluted income (loss) per share	\$ 0.07	\$ 0.00	\$ (0.11)

15. SIGNIFICANT CUSTOMERS

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

	December 31, 2019	December 31, 2018	December 31, 2017
Customer A	\$ 11,043,962	\$ 6,158,718	\$ 2,934,404
Customer B	\$ 2,660,840	\$ 1,524,550	\$ 896,965

The customers are major US and Canadian corporations who have displayed a pattern of consistent timely payment of amounts owing from sales.

The Company is obligated to pay a 5% royalty from sales of their manway securement systems until 2023 in accordance with the original acquisition agreement. During the year ended December 31, 2019, there were revenues from sales of the manway securement systems totalling \$133,486 (2018 - \$13,301; 2017 - \$183,337).

KELSO TECHNOLOGIES INC.**Notes to Consolidated Financial Statements****For the years ended December 31, 2019, 2018 and 2017****(Expressed in US Dollars)**

16. EMPLOYEE BENEFITS

Total employee benefit expenses, including salary and wages, management compensation, share-based expense and benefits for the year ended December 31, 2019 amounted to \$4,451,529 (2018 - \$3,275,011; 2017 - \$3,448,877).

17. SEGMENTED INFORMATION

The Company operates in two business segments with operations and long-term assets in United States and Canada. The two business segments include the design, production and distribution of various proprietary products for the rail sector and active suspension control system for no road vehicles. At December 31, 2019, long term assets of \$1,399,087 (2018 - \$946,426) relates to the active suspension control system located in Canada and \$2,347,234 (2018 - \$2,749,426) relates to the rail sector located in the United States. During the year ended December 31, 2019, 2018 and 2017 there was no revenue related to the active suspension control system.

18. SUBSEQUENT EVENT

Subsequent to the year ended December 31, 2019, the Company granted incentive stock options to a director for the purchase of up to 200,000 common shares in the capital stock of the Company. The options are exercisable on or before February 25, 2025 at a price of \$0.76. The options vest 1/3 on grant date, 1/3 on the first anniversary of the grant date, and 1/3 on the second anniversary of the grant date.



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
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
Frank Busch
Audit Committee
Corporate Governance and
Nominating Committee

AUDITORS

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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