



**Management's Discussion and Analysis  
For the nine-month period ended September 30, 2019**

## LETTER TO SHAREHOLDERS

Dear Fellow Shareholders,

I am pleased to report on the progress that we have made during the nine-month period ended September 30, 2019, highlighted by a 538% revenue growth against the same period in 2018 and top tier customer wins. We are executing well on our plans and gathering momentum in the market. Every day I hear customers and prospects saying that they must move away from the labour intensive manual paper processes that are slowing down their business and leaving them susceptible to data integrity and compliance issues. It gives me great pleasure to know that Kneat is becoming trusted by more and more of the largest global healthcare companies to address these challenges.

We are seeing strong growth in our recurring revenue streams of SaaS license fees and yearly maintenance. SaaS revenue for the three-months ended September 30, 2019 was \$225,486, an increase of 643% compared with the third quarter 2018 and SaaS revenue for the nine-months year to date in 2019 was \$499,595, an increase of 599% compared with the same period in 2018. Our existing customers are expanding into new work processes and new sites, delivering great opportunity for growth and expansion of our software. We are maturing our company structure and growing our ability to deploy and support our global customers. The whole Kneat team can be very proud as they continue to develop quality compliant software, continue to win top tier customers and continue to provide excellent end-to-end customer service.

The promotion of the SaaS platform which adds to our annual recurring revenue (“ARR”) base is a key strategy for Kneat. Progress on this front is reflected in the growth in ARR at September 30, 2019 to \$1.4m, a 215% increase compared to September 30, 2018.

We are focused on building strong foundations which are positioning us for success now and into the future. We are using the net proceeds of \$7.8 million raised from the equity financing in February 2019 to invest in building our team by hiring talented staff across all functions and key geographies.

We are also pleased to have Hugh Kavanagh join the team as Chief Financial Officer. Hugh brings a wealth of financial experience from both the software and life sciences industries, and broad funding experience including completing a European dual listing IPO and several rounds of equity and debt financing. We are equally pleased to have Rory Cameron join our Board of Directors in May. Rory has over 15 years of strategic experience in the software industry and an extensive background in mergers, acquisitions and go-to-market operations.

Our plan for the fourth quarter of 2019 is to continue to add and deploy new customers, expand to new work processes and new sites within our existing customer base and continue to build out the Kneat Gx platform.

(s) “Eddie Ryan”  
Eddie Ryan, CEO

**kneat.com, inc.**

**Nine-month period ended September 30, 2019**

## **MANAGEMENT'S DISCUSSION AND ANALYSIS**

*This Management's Discussion and Analysis ("MD&A") provides a review of the performance of kneat.com, inc. ("kneat.com" or the "Company" or "Kneat") and should be read in conjunction with the unaudited condensed interim consolidated financial statements of kneat.com (the "Financial Statements") for the nine-month period ended September 30, 2019 and the audited consolidated financial statements of kneat.com for the year ended December 31, 2018, which have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB").*

*The information presented in this MD&A is as of November 26, 2019. The reporting currency for kneat.com is the Canadian dollar. All of the financial information presented herein is expressed in Canadian dollars, unless otherwise stated. United States dollars are indicated by the symbol "US\$". Euros are indicated by the symbol "€". This MD&A contains "forward-looking statements" that are subject to risk factors set out in a cautionary note contained herein. The reader is cautioned not to place undue reliance on forward-looking statements.*

## **CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS AND INFORMATION**

This MD&A contains "forward-looking information", as such term is defined in applicable Canadian securities legislation. Forward-looking information is necessarily based on a number of estimates and assumptions that are inherently subject to significant business, economic and competitive uncertainties and contingencies. All statements other than statements which are reporting results, as well as statements of historical fact set forth or incorporated herein by reference, are forward looking information that may involve a number of known and unknown risks, uncertainties and other factors, many of which are beyond kneat.com's ability to control or predict. Forward-looking information can be identified by the use of words such as "may," "should," "expects," "plans," "anticipates," "believes," "estimates," "predicts," "intends," "continues," or the negative of such terms, or other comparable terminology.

This forward-looking information includes, but is not limited to, statements and comments regarding:

- the development plans for the Kneat Gx platform ("Kneat Gx");
- the Company's business strategy;
- the compliance of Kneat Gx under regulatory audit and inspection;
- the Company's strategy for protecting its intellectual property;
- the Company's ability to obtain necessary funding on favorable terms or at all;
- the Company's plan and ability to secure additional customers and additional revenues;
- the ability to scale Kneat Gx within the customers' sites and processes;
- the risk of competitors entering the market;
- the Company's ability to hire and retain skilled staff;
- the estimate of the market size and market potential for Kneat Gx;
- the ability to obtain financing to fund future expenditures, including product development and capital requirements;
- the use of Kneat Gx within the customers' sites and processes; and
- the impact of adoption of new accounting standards.

Although the Company believes that the plans, intentions and expectations reflected in this forward-looking information are reasonable, actual results, performance or achievements could differ materially from those contemplated, expressed or implied by the forward-looking information contained in this MD&A. Factors that could cause or contribute to such differences include, but are not limited to, unexpected changes in business and economic conditions, including the global financial and capital markets; the Company's inability to continually develop technologically advanced products; the inability of the Company's products and services to gain market acceptance; the Company's failure to protect its intellectual property; unauthorized disclosures and breaches of security data; changes in interest and currency exchange rates; changes in operating revenues and costs; political or economic instability, either globally or in the countries in which kneat.com operates; competitive factors; availability of external financing at reasonable rates or at all; and the other factors discussed in this MD&A under the heading *Risk*

*Factors.* Many of these factors are beyond kneat.com’s ability to control or predict. These factors are not intended to represent a complete list of the general or specific factors that may affect kneat.com. kneat.com may note additional factors elsewhere in this MD&A. All forward-looking statements and information speak only as of the date made. All subsequent written and oral forward-looking statements attributable to kneat.com, or persons acting on kneat.com’s behalf, are expressly qualified in their entirety by these cautionary statements. Readers are cautioned not to put undue reliance on forward-looking information due to the inherent uncertainty therein. kneat.com disclaims any intent or obligation to update publicly any forward-looking statements, whether as a result of new information, future events or results or otherwise, except as required by securities legislation.

## **COMPANY OVERVIEW**

kneat.com, inc. (the “Company” or “kneat.com” or “Kneat”), was incorporated on December 12, 2013 under the laws of the Canada Business Corporations Act. On June 27, 2016, the Company completed a transaction with Kneat Solutions Limited whereby kneat.com acquired 100% of the issued and outstanding ordinary shares of Kneat Solutions Limited by way of a scheme of arrangement in Ireland (the “Transaction”). The Company commenced trading on the TSX Venture Exchange as kneat.com on July 5, 2016 under the symbol KSI. kneat.com’s head office is located at Unit 7, Castletroy Park Business Centre, Castletroy, Limerick, Ireland. The registered office of kneat.com is located at Suite 2001, 1969 Upper Water Street, Halifax, Nova Scotia, Canada, B3J 3R7.

### *Operational overview*

Kneat designs, develops and supplies software for data and document management within regulated environments. The Company’s current product is Kneat Gx, a configurable, commercial, off-the-shelf application focused on validation lifecycle management and testing within the life sciences industry (i.e. biotechnology, pharmaceutical and medical device manufacturing). Complete and comprehensively documented validation of processes, products, equipment and software is a significant and costly regulatory requirement in this industry. Kneat Gx provides a compliant digital solution that enables companies in the life sciences industry to become efficient and compliant with an automated process that has traditionally been manual, inefficient and paper-based.

Every manufacturing process, piece of equipment and computer system involved in the manufacturing of pharmaceutical, biotechnology and medical device products must be validated in accordance with current Good Manufacturing Practice (“cGMP”) regulations. Validation necessitates extensive signed and time stamped documentary evidence that all aspects of these systems are designed and tested to ensure that they will repeatedly produce products to the approved specifications. This documentation is subject to audit by global regulatory authorities such as the United States of America Food and Drug Administration and the European Medicines Agency.

Traditionally, validation testing has been a manual, paper intensive activity whereby test documents had to be developed, printed, approved, executed, post approved and filed, ready for regulatory audit in the future. In many companies in the life sciences industry much of this is still done on paper using wet ink to record test results, apply proof of signature and date stamp. This process can leave life sciences companies susceptible to production delays, high costs associated with data and document management, and risk of non-compliance. Non-compliance can lead to regulatory recalls, threats to patient safety and delays to market. In addition, non-compliance may result in significant penalties, remediation costs and lost revenues.

The solution that Kneat Gx provides has taken a dedicated professional team of industry specialists years of research and development. Kneat’s customers cite Kneat Gx’s innovation, ease of use, its central and dynamic data management, its configurability, and its electronic records and signatures capabilities as the key differentiators that set it apart in the market. In addition, kneat.com’s team of developers, training manuals and customer support are considered best in class by its customers.

Kneat possesses a top tier quality management system (“QMS”) and is certified to ISO 9001:2015. In addition, it adheres to all applicable life sciences regulations such as all current cGMPs, GAMP5, International Conference on Harmonization ICH Q8, Q9 and Q10, EU Annex 11, FDA CFR Title 21 Part 11 governing Electronic Records and Electronic Signatures. Adhering to these regulations and guidelines is a mandatory requirement in order to supply to this highly regulated industry. Potential customers often perform extensive audits to verify compliance prior to purchasing the Company’s software and services.

The Company's focus is to service the facilities, equipment and computer systems ("CSV") validation market within the global life sciences industry. Kneat targets large Tier 1 companies in the life sciences industry primarily in the United States and Europe. The Company believes this market has significant potential for a digital solution due to a number of factors, including increased compliance standards required by regulators globally; and a push by manufacturers to reduce costs and increase control while maintaining data integrity to a high standard. As the Company continues to enhance the Kneat Gx platform through added functionality, management expects the potential market for the platform to increase. Using Kneat's current customer penetration rates, the estimated number of manufacturing sites globally, current list prices and other assumptions, Kneat estimates that the potential market size for Kneat Gx within the life sciences industry may be in excess of US\$600 million annual recurring revenues.

kneat.com's contracts with customers are typically three years in length plus renewal terms and include license subscriptions (on-premise or Software as a Service ("SaaS")), maintenance fees and other professional service fees. Once a new contract is signed, the deployment phase commences and currently takes an average of five to six months for the new customer to go-live on the platform. Some fees related to deployment, maintenance and licenses may be collected up front, however Kneat's revenue recognition criteria is such that revenue is only recognized on completion of the deployment phase when the licenses are available for use by the customer. This results in a time lag of five to six months from the date of a new customer announcement to the date of initial revenue recognition.

Generally new customer contracts start with licenses for one process at one site with the ability to use the same contract to purchase additional licenses at the customers' request. Kneat's goal for each customer is to see them scale across various sites and processes through its "land and expand" strategy over a number of years. Potential expansion within Kneat's existing customer base represents a revenue opportunity and continues to be a focus for the sales and support teams. The ease at which a customer can increase the number of users, sites and regulated processes once deployed has been a benefit that a number of customers have experienced within their global operations.

## **BUSINESS OBJECTIVES**

Kneat plans to use its financial resources for the following key business objectives:

- add new features and functionality to Kneat Gx to enable fast and efficient onboarding and expansion of customers, further penetration of the supply chain sector and easy integration with resellers and partners;
- further advancement of the Kneat Gx SaaS platform toward the product vision of a total quality management platform for all sizes of customers;
- increase the awareness of Kneat Gx through direct selling, digital and print marketing and trade show attendance;
- secure additional contracts with key customer targets and further expand to new sites and processes within the current customer base; and
- expand the team needed to support a growing list of customers through pre and post sales and account management.

## **2019 RECENT ANNOUNCEMENTS**

On September 20, 2019, the Company announced that it appointed Mr. Hugh Kavanagh as its Chief Financial Officer ("CFO") effective September 23, 2019 following the resignation of Ms. Sarah Oliver. Mr. Kavanagh held senior positions at several multinational companies in the software and life sciences industries, most recently as Chief Financial Officer of Mainstay Medical during which time he completed an initial public offering and several rounds of funding.

On September 17, 2019, the Company announced that it signed a three-year contract with one of the world's largest pharmaceutical companies to enable digital transformation for its many validation work processes. This master service agreement allows the customer and its affiliates to expand Kneat Gx across its 100+ global manufacturing sites and represents an opportunity for growth and expansion of Kneat's software.

On July 22, 2019, the Company announced that a global contract development and manufacturing organization selected Kneat's platform to digitize their commissioning, qualification and validation work processes. This customer contracted with Kneat for on-premise perpetual licenses on July 12, 2019 and is expected to go live at a European site on multiple processes by the end of the year. Expansion to all global sites is expected in the future.

On June 17, 2019, the Company announced that a leading company in the field of messenger RNA ("mRNA") has selected Kneat's software as a service platform for its validation lifecycle management work processes. Initially this customer will configure its computer system validation work process on the platform and expand to other validation processes in the future.

On May 1, 2019, the Company announced that Mr. Rory Cameron was appointed to its Board of Directors. Mr. Cameron has over 15 years of experience in the software industry and an extensive background in mergers, acquisitions and go-to-market operations within global cloud companies. Mr. Cameron recently joined Medallia as Executive Vice President, Corporate Development where he is focusing on accelerating Medallia's growth through new technology partnerships and acquisitions. Prior to joining Medallia, Mr. Cameron was Executive Vice President of Corporate Development at CallidusCloud until its sale to SAP.

On March 11, 2019, the Company announced that an international leader in biotechnology chose Kneat Gx to facilitate its transition to paperless validation processes. With over 20,000 employees globally and manufacturing facilities in four continents, this company develops innovative therapies for patients around the world. Kneat Gx will initially be launched for facilities, utilities and equipment commissioning and qualification at a manufacturing plant in the United States.

On February 21, 2019, Kneat announced that it signed a partnership agreement with HCL Technologies ("HCL"), a leading global technology company, to provide innovative end-to-end digital validation solutions to customers in the life sciences industry. This partnership represents a key element in Kneat's strategy to deliver greater value to its current customers and to grow and scale to new customers. Kneat and HCL will work together on projects to provide and implement next generation digital solutions for facilities, equipment and computer systems validation processes using Kneat's paperless software platform and HCL's experience delivering innovative digital solutions to the life sciences industry.

On February 20, 2019, Kneat announced that it closed its short form prospectus offering, including the full exercise of the over-allotment option. As such, a total of 6,037,500 common shares of the Company were sold at a price of \$1.05 per common share for aggregate gross proceeds of \$6,339,376. This financing was completed by a syndicate of underwriters led by Cormark Securities Inc. and included Echelon Wealth Partners Inc. and Mackie Research Capital Corporation. The Company also completed a non-brokered private placement of 2,074,437 common shares at the price of \$1.05 per common share for aggregate gross proceeds of \$2,178,160. The common shares issued pursuant to the non-brokered private placement are subject to a statutory four month hold period in accordance with applicable securities laws.

On February 14, 2019, the Company announced that a top tier global healthcare customer is expanding their use of Kneat Gx to a new manufacturing site. This customer was signed in July 2018, went live at their primary European site in December 2018 and is now expanding to a second site located in the United States.

On February 13, 2019, Kneat announced that a leading laboratory services customer is expanding its user base on Kneat Gx within its flagship site in the United States. This expansion doubled the customer's license numbers. This customer first implemented the Kneat platform in December 2018 with the ultimate goal of creating a standardized, compliant and automated equipment and instrument validation process globally.

## SELECTED QUARTERLY INFORMATION

Expressed in thousands of Canadian dollars, except for per common share amounts, and prepared in accordance with IFRS:

	Q3 2019	Q2 2019	Q1 2019	Q4 2018	Q3 2018	Q2 2018	Q1 2018	Q4 2017**
	\$	\$	\$	\$	\$	\$	\$	\$
Total revenue*	1,586	529	414	465	249	132	462	77
Total expenses*	(2,951)	(2,279)	(2,384)	(1,085)	(2,188)	(1,610)	(1,022)	(1,107)
Total net loss*	(1,365)	(1,750)	(1,970)	(620)	(1,939)	(1,478)	(560)	(1,030)
Total net loss per common share *	(0.02)	(0.03)	(0.04)	(0.01)	(0.04)	(0.03)	(0.01)	(0.02)
Cash dividends per common share	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A

\* Cumulative totals vary nominally as a result of foreign exchange differences between quarters.

\*\* The results for Q4 2017 have not been adjusted to reflect the impact of adopting IFRS 15.

Total revenues fluctuate quarter over quarter due mainly to the sale of one-time on-premise licenses and the delivery of the related professional services. As the Company pursues sales of the SaaS platform, revenues may become more stable quarter over quarter based on the recurring subscription revenue model. Total expenses are driven primarily by the cost of labour which fluctuates quarter over quarter based on the hiring plan and the amount of qualifying labour capitalized to the intangible asset. In addition, expenses quarter over quarter are impacted by the foreign exchange rate between the Canadian dollar and the Euro and the United States dollar as the majority of the Company's costs and intercompany loans are denominated in the Euro and the United States dollar. Foreign currency gains and losses are recognized as exchange rates fluctuate on financial assets and financial liabilities denominated in currencies other than the functional currency of the entity in which they are held. Generally, there are no quarterly or seasonal trends associated with the Company's business.

kneat.com expects to record losses until such time as it secures additional customer contracts. Refer to the *Risk Factors* section of this MD&A and note 1, *Nature of operations and going concern*, of the unaudited condensed interim consolidated financial statements for the nine-month period ended September 30, 2019 for further details.

## SELECTED ANNUAL INFORMATION

Expressed in thousands of Canadian dollars, except for per common share amounts, and prepared in accordance with IFRS:

	2018	2017	2016
	\$	\$	\$
Total revenue	1,307	421	820
Total expenses	(5,916)	(4,416)	(7,836)
Total net loss	(4,609)	(3,995)	(7,016)
Total net loss per common share	(0.09)	(0.09)	(0.21)
Cash dividends per common share	N/A	N/A	N/A
Total assets	10,114	8,795	9,571
Total non-current financial liabilities	-	978	923

### *Selected historical annual information*

#### Financial year ended December 31, 2018

Throughout 2018 Kneat focused on product advancement and new customer acquisition. Kneat announced seven new customers and scaling at two existing customers. The profile of the new customers is large, multinational enterprises; five being multinational life sciences companies and two being customers in the supply chain to the life sciences industry. These new customers added to Kneat's potential target sites within existing customers, which is in excess of 200 sites and up from approximately 15 sites at the end of 2017. These potential sites within existing customers represent a revenue opportunity and area of potential growth for Kneat. One of Kneat's goals and objectives is to convert these potential sites within signed customers to license sales in the coming years. A summary of key announcements made during fiscal 2018 are outlined below:

On December 20, 2018, the Company announced that it signed a master service agreement with a new customer in the life sciences supply chain. This multinational customer provides sample lifecycle and logistics management, infrastructure and consumables, including cold storage of biological assets, to global pharmaceutical companies and will now use Kneat Gx to automate and simplify their validation processes in the delivery of these services.

On November 14, 2018, the Company announced it has signed a multi-year, global contract with one of the largest logistics suppliers in the world. This new customer will implement Kneat's SaaS platform to enable a compliant, paperless process for its CSV activities in the life sciences industry.

On August 22, 2018, Kneat announced that one of its tier one pharmaceutical customers is expanding their use of Kneat Gx to two new processes: test method and metrology CSV; and commissioning and qualifications process refresh procedures. The contract with this customer was announced in February 2018.

On July 23, 2018, the Company announced that its customer, a leader in molecular diagnostics, further expanded its user base of Kneat Gx by purchasing additional on-premise licenses. This order represents a twenty-eight percent increase in licenses purchased and it follows a fifty percent expansion which occurred earlier in the year.

On July 16, 2018, Kneat announced that it will be deploying its SaaS platform to the biotechnology division of a multinational pharmaceutical manufacturer with more than 70 manufacturing sites worldwide.

On July 12, 2018 Kneat announced that one of the world's leading research-based developers of pharmaceuticals has chosen Kneat's technology to digitize its commissioning, qualification and validation processes. The initial scope of this on-premise license and maintenance agreement is for global capital projects with the opportunity to scale to other processes across multiple sites over several years. This tier one pharmaceutical company has more than 70 manufacturing plants and 90,000 employees operating in over 120 countries.

On June 14, 2018, the Company announced that a global leader in biotechnology is deploying Kneat Gx to a number of their sites after successfully completing product trials at an initial test site. The customer will utilize Kneat Gx for both capital and operational validation projects during the next phase of their rollout. This customer, with an estimated 20,000 employees working across multiple sites, will transition their existing paper-based validation process to one that is completely digital.

On April 10, 2018, the Company completed a brokered private placement for gross proceeds of \$6,184,647. Through a syndicate of agents, the Company issued 6,871,830 common shares at an issue price of \$0.90 per common share.

On February 26, 2018, kneat.com announced that a leader in laboratory services to the life sciences industry selected Kneat Gx to streamline and automate its equipment and instrumentation validation processes. The customer's goal is to convert to an end-to-end paperless process that enhances compliance, increases productivity and enables greater transparency and control. The initial deployment will be at one of its flagship laboratories in the United States which has more than 1,000 employees focused on biopharmaceutical laboratory services.

On February 15, 2018, the Company announced that a leading Tier 1 pharmaceutical company, headquartered in the United States and with over thirty manufacturing and laboratory sites globally, had selected Kneat Gx to replace the customer's paper-based C&Q process with one that is end-to-end paperless.

On January 19, 2018, kneat.com announced that one of its customers, a leading molecular diagnostics company, increased its number of licenses by fifty percent. This growth is in response to the customer's desire to scale the Kneat Gx platform to a wider global workforce.

#### Financial year ended December 31, 2017

During the year ended December 31, 2017, the focus of the Company continued to develop the technology and successfully launch and deploy the SaaS version of Kneat Gx. Headcount continued to increase across all functions of Kneat, including the addition of a sales director in the United States. A summary of key announcements made during fiscal 2017 are outlined below:



On September 18, 2017, kneat.com announced that it partnered with a key customer to publish a case study entitled “Newly Optimized Laboratory Asset Lifecycle Management System supports QC Laboratory of the Future” which is published in the Parent Drug Association (“PDA”) Letter. The case study outlines the key features of the Kneat Gx platform that enabled the conversion of a manual, paper-based process to a globally centralized electronic system for all QC laboratory asset lifecycle management.

On August 30, 2017, kneat.com announced that the case study entitled “Validation Process Innovation in Molecular Diagnostics” was published in the Journal of Validation Technology. This case study highlights substantial productivity and compliance improvements that a leading and pioneering molecular diagnostics customer gained by transitioning their overall validation process from paper-based to a compliant, fully electronic system which was made possible by the Company's software.

On May 31, 2017, the Company closed a non-brokered private placement for aggregate gross proceeds of \$3,000,000. The Company issued 5,000,000 common shares at an issue price of \$0.60 per share.

On February 22, 2017, the Company announced that the Journal of Validation Technology published the article “Case Study: Implementation of an Electronic Life Cycle Management System for Validation ...and Beyond” which outlines the value of the Kneat Gx software. The case study concludes that Kneat Gx assisted a multinational company to create best practices across its global network, providing productivity gains of up to 100% and cycle time improvements of up to 50% in validation, with the prospect of leveraging the technology across many other testing processes.

On January 4, 2017, kneat.com announced that a large multinational customer deployed the Kneat Gx platform to replace many of its paper-based validation and GxP testing processes within their highly regulated manufacturing facilities worldwide. This initial contract is for a period of three years and is valued at a minimum of \$1.1 million.

#### Financial year ended December 31, 2016

The Company financed its operations in 2016 through the completion of the Transaction, resulting in a net \$8 million cash investment and through revenues from customers of approximately \$0.8 million. During the year ended December 31, 2016, the focus of the Company was to advance customer relationships and increase functionality of Kneat Gx, including development of the SaaS version. In addition, Kneat hired additional software developers, testers, customer support and members of the operational and management team. This included hiring the first dedicated sales team member in the fourth quarter of 2016.

## **RESULTS OF OPERATIONS**

Certain comparative figures in the unaudited condensed interim consolidated statements of loss and comprehensive loss have been reclassified in order to conform with the current period classification.

### **Annual recurring revenue**

Annualized recurring revenue (“ARR”) at September 30, 2019 increased by 215% to \$1,438,022 from \$456,547 at September 30, 2018. Specifically, ARR from SaaS licenses fees increased by 372% and ARR from maintenance fees increased by 107% from September 30, 2018. The increase in SaaS license fees reflects the increase in the number of customers purchasing the SaaS version of Kneat Gx, which results in recurring revenue over time rather than a one-time upfront on-premise license fee. The increase in recurring maintenance fee revenue is a result of new on-premise license sales where Kneat provides ongoing, front-line support. ARR is a non-GAAP measure used by Kneat to assess the expected annual recurring revenues from the customers that are live on Kneat Gx at the end of the period. Refer to section *Non-GAAP measures* for further details.

In addition to the year over year increase, the Company has increased the ARR from June 30, 2019 by 36.6% or \$385,503, primarily due to a new customer going live and two customers purchasing additional licenses of Kneat Gx during the three months ended September 30, 2019.

### Three-month period ended September 30, 2019

#### Revenues for the three-month period ended September 30,

	2019	2018	\$ change in 2019	% change in 2019
SaaS license fees	\$225,486	\$35,051	\$190,435	543.3%
On-premise license fees	805,534	89,170	716,364	803.4%
Maintenance fees	129,579	67,805	61,774	91.1%
Professional services and other	425,434	56,640	368,794	651.1%
<b>Total revenues</b>	<b>\$1,586,033</b>	<b>\$248,666</b>	<b>\$1,337,367</b>	<b>537.8%</b>

SaaS licenses entitle a specified number of users to utilize Kneat Gx hosted on a secure cloud server. SaaS license fee revenue is recognized over time, on a recurring monthly basis, as the services are performed. For the three-month period ended September 30, 2019 SaaS license fees were \$225,486 as compared to \$35,051 for the three-month period ended September 30, 2018. The increase of \$190,435 in SaaS license fees was the result of onboarding new SaaS customers quarter over quarter, including the scaling of the number of licences purchased by existing customers.

On-premise licenses entitle a customer to use Kneat Gx for a set number of users, hosted on the customers' servers. These license fees are one-time-per license and paid upfront. In order to increase the number of licenses, the customer must pay additional license fees in advance of the license being granted. On-premise license fee revenue for the three-month period ended September 30, 2019 was \$805,534 as compared to \$89,170 for the three-month period ended September 30, 2018. The increase in on-premise license fees is due the timing of delivery of new customer licenses.

Maintenance fees are set annually for on-premise licenses. Maintenance fees entitle the customer to front line support and software upgrades, are paid up front and are generally recurring annually. Maintenance fee revenue for the three-month period ended September 30, 2019 was \$129,579 as compared to \$67,805 for the three-month period ended September 30, 2018. The increase of \$61,774 was due to an increased number of purchased on-premise licenses for which revenue was recognised during the last three months of 2018 and in the first nine months of 2019, resulting in an increase in associated maintenance fees.

Professional services and other revenue vary by customer depending on the customer's specific needs. Service fees may include special training, development of tailored reports, upgrades, pilots for potential customers, and implementation and deployment services. Professional services and other revenues for the three-month period ended September 30, 2019 were \$425,434 as compared to \$56,640 for the three-month period ended September 30, 2018. This increase of \$368,794 was primarily due to the timing of service milestones being met related to software deployments and pilots.

#### Cost of revenues for the three-month period ended September 30,

	2019	2018	\$ change in 2019	% change in 2019
Cost of revenues	\$601,015	\$266,146	\$334,869	125.8%

Cost of revenues consists primarily of employees' salaries and benefits and associated expenses including allocated other overhead costs related to the professional service team supporting customer deployment, training, maintenance and other services costs; and costs associated with third-party hosting services related to the Company's SaaS platform. Cost of revenue for the three-month period ended September 30, 2019 was \$601,015 compared to \$266,146 for the three-month period ended September 30, 2018. The increase of \$334,869 was due mainly to an increase in salaries, benefits and related costs associated with increased headcount and general salary increases for individuals on the professional services team who service new and existing customers.

*Gross margin for the three-month period ended September 30,*

	<b>2019</b>	<b>2018</b>	<b>\$ change in 2019</b>	<b>% change in 2019</b>
Gross margin	\$985,018	(\$17,480)	\$1,002,498	5,735.1%

Gross margin for the three-month period ended September 30, 2019 was \$985,018 compared to (\$17,480) for the three-month period ended September 30, 2018. The increase of \$1,002,498 in gross margin is due primarily to the increase in revenue over the same quarter of 2018 offset by the increase in cost of revenues associated with the professional services team as discussed above. Members of the professional services team are generally hired in advance of signing new customers and in preparation for anticipated expansions to have resources in place to service new customers as they come on-board and to support existing customers as they scale. Thus, costs related to the increase in headcount are often incurred in advance of revenue recognition.

*Research and development expenses for the three-month period ended September 30,*

	<b>2019</b>	<b>2018</b>	<b>\$ change in 2019</b>	<b>% change in 2019</b>
Research and development	\$856,788	\$641,454	\$215,334	33.6%

Research and development expenses consist of employee salaries and benefits for members of the research and development team that do not meet the criteria for capitalization to the intangible asset, amortization of the intangible asset, hosting costs associated with development servers and other allocated overhead costs associated with the team responsible for the research and development of Kneat Gx, net of any associated research and development tax credits earned during the period. Research and development expenses for the three-month period ended September 30, 2019 were \$856,788 compared to \$641,454 for the three-month period ended September 30, 2018. The increase of \$215,334 is due primarily to an increase in salaries and benefits and related allocated overhead costs associated with increased headcount and general salary increases for individuals on the research and development team net of the research and development tax credit. In addition, the amortization of the intangible asset increased during the quarter ended September 30, 2019 due to additions to the intangible asset made throughout 2018 and the first nine months of 2019, consisting mainly of the salaries and benefits of the development team, which increased the carrying value of the intangible asset and thus the amortization expense.

*Sales and marketing expenses for the three-month period ended September 30,*

	<b>2019</b>	<b>2018</b>	<b>\$ change in 2019</b>	<b>% change in 2019</b>
Sales and marketing	\$397,560	\$458,434	(\$60,874)	(13.3%)

Sales and marketing expenses consist of employee salaries and benefits for members of the sales team, amortization of contract acquisition costs, advertising, trade shows, consultancy fees and other allocated overhead costs associated with the team responsible for sales and marketing globally. Sales and marketing expenses for the three-month period ended September 30, 2019 were \$397,560 compared to \$458,434 for the three-month period ended September 30, 2018. The decrease of \$60,874 was due primarily to a decrease in salaries and consultancy fees due to the timing of headcount changes in the sales team, offset by an increase in share-based compensation.

*General and administrative expenses for the three-month period ended September 30,*

	<b>2019</b>	<b>2018</b>	<b>\$ change in 2019</b>	<b>% change in 2019</b>
General and administrative	\$652,462	\$424,376	\$228,086	53.7%

General and administrative expenses consist primarily of employee salaries and benefits for members of the management and administrative teams, legal and audit professional services, regulatory fees, recruitment fees and other allocated overhead costs associated with the management and administrative teams. General and administrative expenses for the three-month period ended September 30, 2019 were \$652,462 compared to \$424,376 for the three-month period ended September 30, 2018. The increase of \$228,086 is due primarily to an increase in salaries, benefits, and related allocated overhead costs associated with increased headcount on the administrative team; recruitment costs; and share-based compensation.

*Other expenses (recoveries) for the three-month period ended September 30,*

	<b>2019</b>	<b>2018</b>	<b>\$ change in 2019</b>	<b>% change in 2019</b>
Interest expense	\$17,029	\$6,110	\$10,919	178.7%
Interest income	(\$786)	(\$1,128)	\$342	(30.3%)
Other recoveries	(\$67,031)	\$-	(\$67,031)	100.0%
Foreign exchange loss	\$493,497	\$393,012	\$100,485	25.6%

The foreign currency loss of \$493,497 arose in the current period due primarily to the impact of changes in exchange rates on financial assets and financial liabilities denominated in currencies other than the functional currency of the entity in which they are held.

Interest expense has increased over the prior quarter by \$10,919 as a result of the interest accretion from the lease liabilities following the adoption of IFRS 16, *Leases*. See “*New accounting standards adopted during the period*” for further details.

The other recoveries of \$67,031 included in the three-month period ended September 30, 2019 relate to a recovery of amounts paid to the Irish Revenue Commissioners but not claimed by certain former Kneat Solutions Limited shareholders who took part in the employment and investment incentive scheme (“EIIS”) proposal (“EIIS proposal”), as outlined in the Management Information Circular of Fortune Bay Corp. dated May 13, 2016. The expense connected to the EIIS proposal was determined to be \$425,285 at December 31, 2016.

**Nine-month period ended September 30, 2019**

*Revenues for the nine-month period ended September 30,*

	<b>2019</b>	<b>2018</b>	<b>\$ change in 2019</b>	<b>% change in 2019</b>
SaaS license fees	\$499,595	\$83,392	\$416,203	499.1%
On-premise license fees	994,435	245,431	749,004	305.2%
Maintenance fees	321,332	188,551	132,781	70.4%
Professional services and other	732,625	324,751	407,874	125.6%
<b>Total revenues</b>	<b>\$2,547,987</b>	<b>\$842,125</b>	<b>\$1,705,862</b>	<b>202.6%</b>

For the nine-month period ended September 30, 2019 SaaS license fees were \$499,595 as compared to \$83,392 for the nine-month period ended September 30, 2018. The increase of \$416,203 in SaaS license fees was a result of onboarding new SaaS customers quarter over quarter, including customers that were signed in late 2018 and were deployed during the nine-month period ended September 30, 2019; and an increase in the number of licenses purchased by existing customers.

On-premise license fee revenue for the nine-month period ended September 30, 2019 was \$994,435 as compared to \$245,431 for the nine-month period ended September 30, 2018. The increase in on-premise license fees is due to the timing of delivery of licences for new customers and new customer sites.

Maintenance fee revenue for the nine-month period ended September 30, 2019 was \$321,332 as compared to \$188,551 for the nine-month period ended September 30, 2018. The increase of \$132,781 was due to an increased number of purchased on-premise licenses for which revenue was recognised during the last three months of 2018 and in the first nine months of 2019 resulting in an increase in associated maintenance fees.

Professional services and other revenues for the nine-month period ended September 30, 2019 were \$732,625 as compared to \$324,751 for the nine-month period ended September 30, 2018. This increase of \$407,874 was primarily due to the timing of service milestones being met related to software deployments and pilots.

*Cost of revenues for the nine-month period ended September 30,*

	<b>2019</b>	<b>2018</b>	<b>\$ change in 2019</b>	<b>% change in 2019</b>
Cost of revenues	\$1,351,426	\$643,849	\$707,577	109.9%

Cost of revenue for the nine-month period ended September 30, 2019 was \$1,351,426 compared to \$643,849 for the nine-month period ended September 30, 2018. The increase of \$707,577 was due mainly to an increase in salaries, benefits and related allocated overhead costs associated with increased headcount and general salary increases for individuals on the professional services team and an increase in hosting fees.

*Gross margin for the nine-month period ended September 30,*

	<b>2019</b>	<b>2018</b>	<b>\$ change in 2019</b>	<b>% change in 2019</b>
Gross margin	\$1,196,561	\$198,276	\$998,285	503.5%

Gross margin for the nine-month period ended September 30, 2019 was \$1,196,561 compared to \$198,276 for the nine-month period ended September 30, 2018. The increase of \$998,285 in gross margin is due primarily to the increase in revenue over the same quarter of 2018 offset by the increase in cost of revenues associated with the professional services team as discussed above. Members of the professional services team are generally hired in advance of signing new customers and in preparation for anticipated expansions to have resources in place to service new customers as they come on-board and to support existing customers as they scale. Thus, costs related to the increase in headcount are often incurred in advance of revenue recognition.

*Research and development expenses for the nine-month period ended September 30,*

	<b>2019</b>	<b>2018</b>	<b>\$ change in 2019</b>	<b>% change in 2019</b>
Research and development	\$2,276,372	\$1,680,891	\$595,481	35.4%

Research and development expenses for the nine-month period ended September 30, 2019 were \$2,276,372 compared to \$1,680,891 for the nine-month period ended September 30, 2018. The increase of \$595,481 is due primarily to an increase in hosting fees, salaries and benefits and related allocated overhead costs associated with increased headcount and general salary increases for individuals on the research and development team, net of the research and development tax credit. In addition, the amortization of the intangible asset increased during the nine-month period ended September 30, 2019 due to additions to the intangible asset made throughout 2018 and the first nine months of 2019, consisting mainly of the salaries and benefits of the development team, which increased the carrying value of the intangible asset and thus the amortization expense.

*Sales and marketing expenses for the nine-month period ended September 30,*

	<b>2019</b>	<b>2018</b>	<b>\$ change in 2019</b>	<b>% change in 2019</b>
Sales and marketing	\$1,196,430	\$1,234,805	(\$38,375)	(3.1%)

Sales and marketing expenses for the nine-month period ended September 30, 2019 were \$1,196,430 compared to \$1,234,805 for the nine-month period ended September 30, 2018. The decrease of \$38,375 was due primarily to the change in estimate for contract acquisition costs, a decrease in salaries, consultancy fees due to a change in headcount on the sales team, offset by increased costs associated with trade shows, other marketing initiatives and share-based compensation.

*General and administrative expenses for the nine-month period ended September 30,*

	<b>2019</b>	<b>2018</b>	<b>\$ change in 2019</b>	<b>% change in 2019</b>
General and administrative	\$1,532,446	\$1,172,923	\$359,523	30.7%

General and administrative expenses for the nine-month period ended September 30, 2019 were \$1,532,446 compared to \$1,172,923 for the nine-month period ended September 30, 2018. The increase of \$359,523 is due primarily to an increase in recruitment fees, salaries, benefits, related allocated overhead costs and share-based compensation associated with increased headcount on the administrative.

*Other expenses (recoveries) for the nine-month period ended September 30,*

	<b>2019</b>	<b>2018</b>	<b>\$ change in 2019</b>	<b>% change in 2019</b>
Interest expense	\$51,128	\$18,344	\$32,784	178.7%
Interest income	(\$5,324)	(\$13,098)	\$7,774	(59.4%)
Other recoveries	(\$67,031)	\$-	(\$67,031)	100.0%
Foreign exchange loss	\$1,285,878	\$86,441	\$1,199,437	1,387.6%

The foreign currency loss of \$1,285,878 arose in the current period due primarily to the impact of changes in exchange rates on financial assets and financial liabilities denominated in currencies other than the functional currency of the entity in which they are held.

Interest expense has increased over the prior quarter by \$32,784, this is as a result of the interest accretion from the lease liabilities following the adoption of IFRS 16, *Leases*. See “*New accounting standards adopted during the period*” for further details.

The other recoveries of \$67,031 relates to a refund from the Irish Revenue Commissioners for amounts paid for the EIIS proposal. See “*Other expenses (recoveries) for the three-month period ended September 30, 2019*” for further details.

## **LIQUIDITY AND CAPITAL RESOURCES**

kneat.com’s liquidity depends on existing cash reserves, revenue generated from customers supplemented as necessary by equity or debt financings. As of September 30, 2019, kneat.com had cash of \$6,961,424 compared to \$2,765,507 as at December 31, 2018. During the nine-month period ended September 30, 2019, the Company closed a public equity financing for gross proceeds of \$6,339,376 and a concurrent non-brokered private placement equity financing for gross proceeds of \$2,178,160. The net cash proceeds raised, of approximately \$7.8 million, during these financings is being used to increase the headcount of the professional service team to service its existing and new customers; grow the Company’s sales and marketing function to further expand the customer pipeline; accelerate the development of Kneat Gx to increase its functionality and to fund ongoing operating costs and working capital requirements.

The Company’s debt relates to the loan payable held by Enterprise Ireland. During the nine-month period ended September 30, 2019, Enterprise Ireland and Kneat agreed to a revised loan repayment schedule which resulted in payments being deferred and made over a three-year period. The minimum annual principal repayments of the loan payable over the next three years as of September 30, 2019 are as follows:

<u>Within 1 year</u>	<u>2 years</u>	<u>3 years</u>	<u>Total</u>
\$ 235,358	\$ 392,264	\$ 235,358	\$ 862,980

The working capital balance at September 30, 2019 was \$5,857,815 at September 30, 2019 as compared to \$1,696,489 at December 31, 2018. Changes during the period relate primarily to the cash flows described below, the equity financing that was completed during the current period, the reclassification of a portion of the loan payable balance to long-term due to the revised payment terms, cash collected from customers and the research and development tax credit less the operating and investing costs incurred through the normal course of operations.

During the nine-month period ended September 30, 2019, kneat.com used net cash of \$713,120 to fund operating activities. Investing activities focused mainly on development of Kneat Gx resulting in net cash outflows from investing activities of \$2,809,400 for the nine-month period ended September 30, 2019. In addition, kneat.com raised net funds through financing activities of \$8,022,126 during the nine-month period ended September 30, 2019.

Kneat’s business to date has focused on the development of Kneat Gx which has generated limited revenues. Kneat has historically relied primarily on funding through the issuance of common shares, debt and the receipt of research and development tax credits.

Liquidity risk is the risk that the Company will not meet its financial obligations as they become due. The Company has a planning and budgeting process to monitor operating cash requirements, including amounts projected for

capital expenditures, which are adjusted as input variables change. These variables include, but are not limited to, the ability of the Company to generate revenue from current and prospective customers, general and administrative requirements of the Company and the availability of capital markets. As these variables change, liquidity risks may necessitate the need for the Company to issue equity or obtain debt financing.

The Company is currently negotiating contracts with several customers and evaluates financing alternatives in line with the goals of the business. There can be no assurance that additional customer revenues will be generated, or additional future financings will be available on acceptable terms or at all. If the Company is unable to obtain additional financing when required, the Company may have to substantially reduce or eliminate planned expenditures. Refer to note 1, *Nature of operations and going concern*, in the unaudited condensed interim consolidated financial statements for the nine-month period ended September 30, 2019 for further details.

## **COMMITMENTS AND CONTINGENCIES**

The Company is from time to time involved in various claims, legal proceedings and complaints arising in the ordinary course of business. The Company does not believe that adverse decisions in any pending or threatened proceedings related to any matter, or any amount which it may be required to pay by reason thereof, will have a material effect on the financial conditions or future results of operations of the Company.

The Company has committed to conferences and other services which will result in the Company paying \$82,135 within in one year, \$78,114 in two to three years and \$21,374 in four to five years.

The Company has employment arrangements with the Chief Executive Officer, Director of Quality and Director of Research and Development which provide that, should a change in control event occur, as defined in the employment arrangements, these individuals will receive lump sum payments equal to 24 months of their then current base salary.

## **OFF-BALANCE SHEET ARRANGEMENTS**

kneat.com has no off-balance sheet arrangements such as guarantee contracts, contingent interest in assets transferred to an entity, derivative instruments obligations or any obligations that trigger financing, liquidity, market or credit risk to kneat.com.

## **OUTSTANDING SHARE INFORMATION**

The Company has authorized an unlimited number of common shares without par value. As of November 26, 2019, the Company had 60,118,673 common shares outstanding (September 30, 2019 – 60,012,407). No common shares are subject escrow agreements.

As of November 26, 2019, the Company has 3,332,372 (September 30, 2019 – 3,347,039) stock options outstanding at an average exercise price of \$0.92 per common share with varying expiry dates. In addition, as at November 26, 2019 and September 30, 2019, the Company has 448,445 deferred share units outstanding.

As of November 26, 2019, there were a total of 343,860 (September 30, 2019 – 462,662) common share purchase warrants outstanding with a weighted average exercise price of \$1.05 per share and an expiry date of February 20, 2021.

## **RELATED PARTY TRANSACTIONS**

During the nine-month period ended September 30, 2019, the Company incurred costs for accounting services from a related party, Numus Financial Inc. (“Numus”), a company controlled by a director of kneat.com, in the amount of \$23,034 (nine-month period ended September 30, 2018 – \$23,034) and reimbursed rent and office costs to Numus in the amount of \$19,125 (nine-month period ended September 30, 2018 – \$20,790). As at September 30, 2019, the amount owing to Numus was \$6,123 (December 31, 2018 – \$12,021).

As at September 30, 2019, the Company had \$16,432 receivable from Beek Investment Limited (“Beek”), a company controlled by directors and officers of kneat.com, relating to professional fees paid on behalf of Beek during the year ended December 31, 2016 (year ended December 31, 2018 – \$17,699).

During the nine-month period ended September 30, 2019, the Company accrued directors’ fees of \$27,914 for the directors who are not employees or officers of the Company (nine-month period ended September 30, 2018 – \$86,448). During the nine-month period ended September 30, 2019, outstanding directors’ fee of \$306,800 were settled through the issuance of 255,666 DSUs and \$42,247 were paid in cash. As at September 30, 2019, the amount owing to directors included in accounts payable and accrued liabilities was \$nil (December 31, 2018 – \$336,510).

During the period ended September 30, 2019, the Company issued a total of 448,445 DSUs to members of the Board of Directors who are not employees or officers of the Company.

On February 20, 2019, directors of the Company subscribed to 761,905 common shares for gross proceeds of \$799,999. In addition, Numus Capital Corp., a company controlled by a director of the Company, acted as selling agent in the non-brokered private placement and received 124,466 broker warrants and \$130,689 in cash finders’ fees.

On April 10, 2018, directors of the Company subscribed to an aggregate of 599,999 of the common shares for gross proceeds of \$539,999. In addition, Numus Capital Corp. acted as a selling agent in the brokered private placement and received 106,266 broker warrants and \$95,640 in cash commissions.

Amounts receivable from officers and directors were \$nil as at September 30, 2019 (December 31, 2018 – \$115).

## FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

### Market Risk

#### *Currency risk*

Currency risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. Currency risk exposure arises from the Company entering into transactions which are denominated in currencies other than its functional currency.

The Company is exposed to currency risk on cash, intercompany balances, accounts payable and accrued liabilities balances, and the loan payable balance that are held in currencies that are not in the transacting entities functional currencies. As at September 30, 2019, a 5% decrease in the exchange rate between the functional currencies and foreign currencies would increase the net loss by approximately \$1.1 million for the nine-month period ended September 30, 2019; a 5% increase would decrease the net loss by approximately \$1.1 million for the nine-month period ended September 30, 2019. The Company currently does not hedge its currency risk.

The majority of the Company’s revenues and expenses are denominated in Euro and the United States dollar. As a result, revenues and expenses are affected by a change in the value of the Euro and the United States dollar relative to the Canadian dollar. The following table summarizes the effects on revenues, expenses and the net loss as a result of a 5% strengthening of the Euro and the United States dollar when compared to the Canadian dollar <sup>(1)</sup>:

	Nine-month period ended September 30, 2019			Nine-month period ended September 30, 2018		
	As reported	Exchange rate effect	5% Stronger	As reported	Exchange rate effect	5% Stronger
	\$	\$	\$	\$	\$	\$
Revenues	2,547,987	127,399	2,675,386	842,125	42,106	884,231
Expenses	(7,621,325)	(290,472)	(7,911,797)	(4,824,155)	(213,961)	(5,038,116)
Net loss	(5,073,338)	(163,073)	(5,236,411)	(3,982,030)	(171,855)	(4,153,885)

- (1) A 5% weakening of the of the Euro and the United States dollar when compared to the Canadian dollar would have an equal and opposite impact on the Company’s revenues, expenses and net loss as presented in the table.



### *Interest rate risk*

Interest risk is the risk that the fair value or future cash flows of financial instruments will fluctuate because of changes in market interest rates. An immaterial amount of interest rate exposure exists in respect of cash balances and the loan payable on the unaudited condensed interim consolidated statements of financial position. The Company holds a loan payable with a fixed interest rate. This is privately issued, with no secondary market. It is measured at amortized cost. As a result, the Company is not exposed to cash flow interest rate risk on its loan payable.

### *Credit risk*

Credit risk is the risk that a counterparty to a financial instrument will fail to discharge an obligation or commitment that it has entered into with the Company. The carrying amounts of financial assets best represent the maximum credit risk exposure at the reporting date. At September 30, 2019 and December 31, 2018, the Company's financial assets exposed to credit risk amounted to the following:

	September 30, 2019	December 31, 2018
	\$	\$
Cash	6,961,424	2,765,507
Amounts receivable and other	344,329	470,794

During the nine-month period ended September 30, 2019 and the year ended December 31, 2018 the Company did not hold any financial assets that were more than 30 days past their payment terms or impaired. Trade debtors of \$78,396 are included in amounts receivable as at September 30, 2019 (December 31, 2018 – \$227,538). Trade debtors are monitored on a regular basis, with reference to the expected credit loss impairment model, in order to minimize material aging and to ensure adequate collection. Historically there have been no significant trade debtor collection issues and the Company does not believe it is subject to significant concentration of credit risk.

Cash is held with reputable banks in Ireland, the United States and Canada. The long-term credit rating, as determined by Standard and Poor's was BBB+, A and A respectively.

## **RISK FACTORS**

The Company's operations and financial performance are subject to the normal risks of its industry and are subject to various factors which are beyond the control of the Company. Certain of these risk factors are described below. The risks described below are not the only ones facing the Company. Additional risks not currently known to the Company, or that it currently considers immaterial, may also adversely impact the Company's business, operations, financial results or prospects, should any such other events occur.

### *kneat.com has a limited operating history and its future profitability is uncertain*

kneat.com has a limited operating history and its business is subject to all of the risks inherent in the establishment of a new business enterprise. The Company's likelihood of success must be considered in light of the problems, expenses, difficulties, complications and delays frequently encountered in connection with establishing a new software development company. If kneat.com continues to incur operating losses and fails to become a profitable company, it may be unable to continue its operations. kneat.com may continue to operate at a net loss for the next several years, as it continues its software development efforts and continues to further develop its sales, marketing and distribution capabilities.

### *kneat.com needs to raise additional capital to operate its business*

kneat.com is an early commercial-stage company focused on product development and commercialization and has generated only limited revenues to date. For the foreseeable future, kneat.com may have to fund all of its operations and capital expenditures primarily from the net proceeds of future offerings and grants of securities. kneat.com's actual capital requirements will depend on many factors. If kneat.com experiences unanticipated cash requirements, it may need to seek additional sources of financing, which may not be available on favorable terms, if at all. If kneat.com does not succeed in raising additional funds on acceptable terms, it may be forced to discontinue product development and/or commercialization, reduce or forego sales and marketing efforts and attractive business opportunities or discontinue operations.

*kneat.com has a history of losses and may never achieve or sustain profitability*

kneat.com has incurred substantial losses since its inception, and it may not achieve profitability in the foreseeable future, if at all. kneat.com expects to incur net losses and negative cash flows due in part to increasing research and development expenses, marketing expenses, hiring additional personnel and other hosting costs. As a result, kneat.com will need to generate additional revenues in order to achieve and maintain profitability. kneat.com may not be able to generate these revenues or achieve profitability in the future. Even if kneat.com does achieve profitability, it may not be able to sustain or increase profitability.

*kneat.com has limited access to the capital markets, and, even if it can raise additional funding, it may be required to do so on terms that are dilutive to shareholders*

kneat.com has limited access to the capital markets to raise capital. The capital markets have been unpredictable in recent years for other software development companies and unprofitable companies such as kneat.com. In addition, it is generally difficult for early commercial-stage companies to raise capital. The amount of capital that a company such as kneat.com is able to raise often depends on variables that are beyond its control. As a result, kneat.com may not be able to secure financing on terms attractive to it, or at all. If kneat.com is able to consummate a financing arrangement, the amount raised may not be sufficient to meet its future needs. If adequate funds are not available on acceptable terms, or at all, kneat.com's business, results of operations, financial condition and its continued viability may be materially adversely affected.

*The length of kneat.com's sales cycle can fluctuate significantly which could result in significant fluctuations in license and other revenues being recognized from quarter to quarter*

The decision by a customer to purchase licenses for kneat.com's software product or purchase its services often involves a comprehensive implementation process across the customer's network or networks. As a result, the licensing and implementation of kneat.com's software product and any related services may entail a significant commitment of resources by prospective customers, accompanied by the attendant risks and delays frequently associated with significant technology implementation projects. Given the significant investment and commitment of resources required by an organization to implement kneat.com's software product, its sales cycle may be longer compared to other companies within kneat.com's own industry, as well as companies in other industries. Also because of changes in customer spending habits, it may be difficult for kneat.com to budget, forecast and allocate its resources properly. In weak economic environments, it is not uncommon to see reduced information technology spending. It may take several months, or even several quarters, for marketing opportunities to materialize. If a customer's decision to license kneat.com's software is delayed or if the implementation of the software product takes longer than originally anticipated, the date on which kneat.com may recognize revenues from these licenses would be delayed. Such delays and fluctuations could cause kneat.com's revenues to be lower than expected in a particular period and kneat.com may not be able to adjust its costs quickly enough to offset such lower revenues, potentially negatively impacting its business, operating results and financial condition.

*If kneat.com does not continue to develop technologically advanced product functionality, future revenues and its operating results may be negatively affected*

kneat.com's success depends upon its ability to design, develop, test, market, license and support new software functionality, services and enhancements of current functionality and services on a timely basis in response to both competitive threats and marketplace demands. Examples of significant trends in the software industry include cloud computing, mobility and social media. In addition, kneat.com's software product, services and enhancements must remain compatible with standard platforms and file formats. Moreover, if new industry standards emerge that kneat.com does not anticipate or adapt to, or with rapid technological change occurring, if alternatives to its services and solutions are developed by its competitors, kneat.com's software and services could be rendered obsolete, causing kneat.com to lose market share and, as a result, harm its business and operating results and its ability to compete in the marketplace.

*If kneat.com's software and services do not gain market acceptance, its operating results may be negatively affected*

kneat.com intends to pursue the goal for Kneat Gx to be the global standard for regulated data and documentation management across industries where sound data management, documentation practices and regulatory compliance are keys to success. kneat.com intends to pursue its strategy through, among other things, its proprietary research and the development of new software functionality and service offerings. In response to customer demand, it is important to kneat.com's success that it continues to enhance its software product and services and to seek to set the

standard for Kneat Gx capabilities. The primary market for its software product and services is rapidly evolving, which means that the level of acceptance of software functionality and services that have been released recently or that are planned for future release by the marketplace is not certain. If the markets for kneat.com's software product and services fail to develop, develop more slowly than expected or become subject to increased competition, its business may suffer. As a result, kneat.com may be unable to: (i) successfully market its current product and services; (ii) develop new software product functionalities and services and enhancements to current software product functionalities and services; (iii) complete customer implementations on a timely basis; or (iv) complete software upgrades and services currently under development. In addition, increased competition could put significant pricing pressures on kneat.com's product which could negatively impact its margins and profitability. If kneat.com's software product and services are not accepted by its customers or by other businesses in the marketplace, kneat.com's business, operating results and financial condition will be materially affected.

*kneat.com's investment in its current research and development efforts may not provide a sufficient, timely return*  
The development of Kneat Gx is a costly, complex and time-consuming process and the investment in kneat.com's software product development often involves a long wait until a return is achieved on such an investment. kneat.com is making, and will continue to make, significant investments in software research and development and related product opportunities. Investments in new technology and processes are inherently speculative. Commercial success depends on many factors, including the degree of innovation of the software product and services developed through kneat.com's research and development efforts, sufficient support from its strategic partners and effective distribution and marketing. Accelerated software product introductions and short product life cycles require high levels of expenditures for research and development. These expenditures may adversely affect kneat.com's operating results if they are not offset by revenue increases. kneat.com believes that it must continue to dedicate a significant amount of resources to its research and development efforts in order to maintain its competitive position. However, significant revenues from new software product and service investments may not be achieved for a number of years, if at all. Moreover, new software functionality and services may not be profitable, and even if they are profitable, operating margins for new software product functionality and services may not be as high as projected.

*Failure to protect kneat.com's intellectual property could harm its ability to compete effectively*  
kneat.com is highly dependent on its ability to protect its proprietary technology. kneat.com relies on a combination of trade secret laws, copyright protection, as well as non-disclosure agreements and other contractual provisions to establish and maintain its proprietary rights. kneat.com currently does not own any patents or have any patents pending. kneat.com intends to protect its intellectual property rights vigorously; however, there can be no assurance that these measures will, in all cases, be successful. Software piracy has been, and is expected to be, a persistent problem for the software industry and piracy of its software product may represent a loss of revenue to kneat.com. Where applicable, certain of kneat.com's license arrangements have required it to place such source code into escrow for the protection of another party. Despite the precautions kneat.com has taken, unauthorized third parties, including its competitors, may be able to copy certain portions of kneat.com's software product or reverse engineer or obtain and use information that kneat.com regards as proprietary. Also, kneat.com's competitors could independently develop technologies that are perceived to be substantially equivalent or superior to its technologies. kneat.com's competitive position may be adversely affected by its possible inability to effectively protect kneat.com's intellectual property. In addition, certain of its products may from time to time contain open source software. Licensees of open source software may be required to make public certain source code or to make certain derivative works available to others. While kneat.com monitors and controls the use of open source software in its product and in any third party software that is incorporated into its product, and kneat.com tries to ensure that no open source software is used in such a way as to require it to disclose the source code to the related product or service, there can be no guarantee that such use could not inadvertently occur. If this happened it could harm kneat.com's intellectual property position and have a material adverse effect on its business, results of operations and financial condition.

*Other companies may claim that kneat.com infringes their intellectual property, which could materially increase costs and materially harm its ability to generate future revenues and profits*  
Claims of infringement are becoming increasingly common as the software industry develops and as related legal protections, including patents, are applied to software products. Although kneat.com does not believe that its products infringe on the rights of third parties, third parties may assert infringement claims against it in the future.

Although most of kneat.com's technology is proprietary in nature, kneat.com may include certain third party and/or open source software in its software product. In the case of third-party software, kneat.com believes this software is licensed from the entity holding the intellectual property rights. Although kneat.com believes that it has secured proper licenses for all third-party intellectual property that is integrated into its product, third parties may assert infringement claims against kneat.com in the future, including the sometimes aggressive and opportunistic actions of non-practicing entities whose business model is to obtain patent-licensing revenues from operating companies such as kneat.com. Any such assertion, regardless of merit, may result in litigation or may require kneat.com to obtain a license for the intellectual property rights of third parties. Such licenses may not be available or they may not be available on commercially reasonable terms. In addition, as kneat.com continues to develop software product functionality and expand its portfolio using new technology and innovation, kneat.com's exposure to threats of infringement may increase. Any infringement claims and related litigation could be time-consuming, disruptive to kneat.com's ability to generate revenues or enter into new market opportunities and may result in significantly increased costs as a result of kneat.com's defense against those claims or its attempt to license the intellectual property rights or rework kneat.com's product to avoid infringement of third party rights. Typically, kneat.com's agreements with its partners and customers contain provisions which require kneat.com to indemnify them for damages sustained by them as a result of any infringement claims involving kneat.com's product. Any of the foregoing infringement claims and related litigation could have a significant adverse impact on kneat.com's business and operating results as well as its ability to generate future revenues and profits.

#### *Impact of laws*

kneat.com operates offices in Canada, the United States and Ireland and continues to offer its product and services in the European Union, Canada, the United States and other countries. kneat.com is and will be subject to a variety of laws in the European Union, Canada, the United States and abroad, including laws regarding consumer protection, privacy, intellectual property, taxation and content suitability, distribution and antitrust, that are continuously evolving and developing. The scope, enforcement and interpretation of the laws that are or may be applicable to kneat.com and its subsidiaries are often uncertain and may be conflicting, particularly laws outside of Ireland, Canada and the United States. It is also likely that as business grows and evolves to a greater number of countries, kneat.com will become subject to laws and regulations in additional jurisdictions. Compliance with applicable laws or regulations could be very difficult or liability could arise under these laws or regulations due to amendments to or evolving interpretation and enforcement of such laws and regulations. As a result, kneat.com could be directly harmed, and may be forced to implement new measures to reduce the exposure to this liability. This may require substantial resources to be expended or a modification of its product and services, which would harm the business, financial condition and results of operations of kneat.com.

#### *Foreign currency and exchange rate risk*

kneat.com currently reports its results in the Canadian dollar. Fluctuations in the exchange rates between the European Euro, United States dollar and Canadian dollar may have a material adverse effect on the business, financial condition and operating results of the Company. The vote of the United Kingdom to leave the European Union ("Brexit") has resulted in many political and economic uncertainties including exchange rate risk associated with the British Pound Sterling. One of Kneat's customers is headquartered in the United Kingdom and has a contract priced in British Pound Sterling, therefore there is risk associated with Kneat's ability to manage this contract profitability should there be a significant reduction in the value of the British Pound Sterling. To date, kneat.com has not engaged in exchange rate hedging activities and may not do so in the foreseeable future.

#### *Current and future competitors could have a significant impact on kneat.com's ability to generate future revenues and profits*

The markets for kneat.com's software product and services are competitive and are subject to technological change and other pressures created by changes in its industry. The convergence of many technologies may result in unforeseen competitors arising from companies that were traditionally not viewed as threats to kneat.com's marketplace. kneat.com expects competition to increase and intensify in the future as the pace of technological change and adaptation quickens and as additional companies enter its markets, including those competitors who offer similar solutions as kneat.com does, but offer it through a different form of delivery. kneat.com could lose market share if its current or prospective competitors: (i) introduce new competitive products or services; (ii) add new functionality to its existing product and services; (iii) acquire competitive products and services; (iv) reduce

prices; and/or (v) form strategic alliances with other companies. If other businesses were to engage in aggressive pricing policies with respect to competing products, or if the dynamics in kneat.com's marketplace resulted in increasing bargaining power by the consumers of kneat.com's software product and services, kneat.com would need to lower the prices it charges for the product and services it offers. This could result in lower revenues or reduced margins, either of which may materially and adversely affect kneat.com's business and operating results. Additionally, if prospective consumers choose other methods of data and document management within regulated environments, different from that which we offer, kneat.com business and operating results could also be materially and adversely affected.

*kneat.com must continue to manage its internal resources during periods of company growth or its operating results could be adversely affected*

kneat.com's growth, coupled with the rapid evolution of its markets, may place significant strains on kneat.com's administrative and operational resources and increased demands on its internal systems, procedures and controls. kneat.com's administrative infrastructure, systems, procedures and controls may not adequately support its operations. In addition, kneat.com's management may not be able to achieve the rapid, effective execution of the product and business initiatives necessary to successfully implement kneat.com's operational and competitive strategy. If kneat.com is unable to manage growth effectively, its operating results will likely suffer which may, in turn, adversely affect its business.

*If kneat.com loses the services of its executive officers or other key employees or if it is not able to attract or retain top employees, kneat.com's business could be significantly harmed*

kneat.com's performance is substantially dependent on the performance of its executive officers and key employees. kneat.com does not maintain "key person" life insurance policies on any of its employees. kneat.com's success is also highly dependent on its continuing ability to identify, hire, train, retain and motivate highly qualified management, technical, sales and marketing personnel. In particular, the recruitment of top developers and experienced salespeople remains critical to its success. Competition for such people is intense, substantial and continuous, and kneat.com may not be able to attract, integrate or retain highly qualified technical, sales or managerial personnel in the future. In addition, in its effort to attract and retain critical personnel, kneat.com may experience increased compensation costs that are not offset by either improved productivity or higher prices for its software product or services.

*kneat.com may fail to achieve its financial forecasts due to inaccurate sales forecasts or other factors*

kneat.com's revenues, particularly its software license revenues, are difficult to forecast and as a result its quarterly operating results can fluctuate substantially. kneat.com uses a "pipeline" system, a common industry practice, to forecast sales and trends in its business. By reviewing the status of outstanding sales proposals to its customers and potential customers, kneat.com makes an estimate as to when a customer will make a purchasing decision involving its software product. These estimates are aggregated periodically to make an estimate of kneat.com's sales pipeline, which kneat.com uses as a guide to plan its activities and make financial forecasts. kneat.com's sales pipeline is only an estimate and may be an unreliable predictor of actual sales activity, both in a particular quarter and over a longer period of time. Many factors may affect actual sales activity, such as weakened economic conditions, which may cause kneat.com's customers and potential customers to delay, reduce or cancel software and service related purchasing decisions and the tendency of some of kneat.com's customers to wait until the end of a fiscal period in the hope of obtaining more favourable terms from kneat.com. If actual sales activity differs from kneat.com's pipeline estimate, then kneat.com may have planned its activities and budgeted incorrectly and this may adversely affect its business, operating results and financial condition.

*kneat.com's software product and services may contain defects that could harm its reputation, be costly to correct, delay revenues, and expose kneat.com to litigation*

kneat.com's software product and services are highly complex and sophisticated and, from time to time, may contain design defects, software errors, hardware failures or other computer system failures that are difficult to detect and correct. If these defects are discovered, kneat.com may not be able to successfully correct such errors in a timely manner. In addition, despite the extensive tests kneat.com conducts on all its software product or services, kneat.com may not be able to fully simulate the environment in which its product or services will operate and, as a result, kneat.com may be unable to adequately detect the design defects or software or hardware errors which may become apparent only after the product is installed in an end-user's network, and users have transitioned to kneat.com's

services. The occurrence of errors and failures in kneat.com's software product or services could result in the delay or the denial of market acceptance of its product and alleviating such errors and failures may require kneat.com to make significant expenditure of its resources. Customers often use kneat.com services and solutions for critical business processes and as a result, any defect or disruption in kneat.com's solutions, any data breaches or misappropriation of proprietary information, or any error in execution, including human error or intentional third-party activity such as denial of service attacks or hacking, may cause customers to reconsider renewing their contract with kneat.com. The errors in or failure of kneat.com's software product and services could also result in kneat.com losing customer transaction documents and other customer files, causing significant customer dissatisfaction and possibly giving rise to claims for monetary damages. The harm to kneat.com's reputation resulting from product and service errors and failures may be materially damaging. Since kneat.com regularly provides a warranty with its software product, the financial impact of fulfilling warranty obligations may be significant in the future. kneat.com's agreements with its strategic partners and end-users typically contain provisions designed to limit its exposure to claims. However, such provisions may not effectively protect kneat.com against claims and the attendant liabilities and costs associated with such claims. Any claims for actual or alleged losses to kneat.com's customers' businesses may require kneat.com to spend significant time and money in litigation or arbitration or to pay significant settlements or damages. Defending a lawsuit, regardless of merit, can be costly and would divert management's attention and resources. Although kneat.com maintains insurance coverage, such coverage may not be adequate to cover all such claims. Accordingly, any such claim could negatively affect its business, operating results or financial condition.

*Unauthorized disclosures and breaches of security data may adversely affect kneat.com's operations*

kneat.com relies heavily on its information technology systems including, without limitation, its networks, equipment, hardware, software, telecommunications, and other information technology (collectively, "IT systems"), and the IT systems of its vendors and third-party service providers, to operate its business as a whole. kneat.com has strict measures to protect its IT systems against unauthorized access and disclosure of personal information and of kneat.com's confidential information and confidential information belonging to its customers. kneat.com has policies and procedures in place dealing with data security and records retention. However, there is no assurance that the security measures kneat.com has put in place will be effective in every case. Breaches in security could result in a negative impact for kneat.com and for its customers, affecting kneat.com's and its customers' businesses, assets, revenues, brands and reputations and resulting in penalties, fines, litigation and other potential liabilities, in each case depending on the nature of the information disclosed. Security breaches could also affect kneat.com's relations with its customers, injure kneat.com's reputation and harm its ability to keep existing customers and to attract new customers. These risks to kneat.com's business may increase as it expands the number of web-based and cloud-based product and services kneat.com offers.

*kneat.com may become involved in litigation that may materially adversely affect it*

From time to time in the ordinary course of kneat.com's business, it may become involved in various legal proceedings, including commercial, product liability, employment, class action and other litigation and claims, as well as governmental and other regulatory investigations and proceedings. Such matters can be time-consuming, divert management's attention and resources and cause kneat.com to incur significant expenses. Furthermore, because litigation is inherently unpredictable, the results of any such actions may have a material adverse effect on kneat.com's business, operating results or financial condition.

*kneat.com's operating results could be adversely affected by any weakening of economic conditions*

kneat.com's overall performance depends in part on worldwide economic conditions. Certain economies have experienced periods of downturn as a result of a multitude of factors, including, but not limited to, turmoil in the credit and financial markets, concerns regarding the stability and viability of major financial institutions, declines in gross domestic product, increases in unemployment and volatility in commodity prices and worldwide stock markets, and excessive government debt. The severity and length of time that a downturn in economic and financial market conditions may persist, as well as the timing, strength and sustainability of any recovery, are unknown and are beyond kneat.com's control. During such downturns, many customers may delay or reduce technology purchases. Contract negotiations may become more protracted or conditions could result in reductions in the licensing of kneat.com's software product and the sale of cloud and other services, longer sales cycles, pressure on kneat.com's margins, difficulties in collection of accounts receivable or delayed payments, increased default risks

associated with kneat.com's accounts receivables, slower adoption of new technologies and increased price competition. In addition, deterioration of the global credit markets could adversely impact kneat.com's ability to complete licensing transactions and services transactions, including maintenance and support renewals. Any of these events, as well as a general weakening of, or declining corporate confidence in, the global economy, or a curtailment in government or corporate spending could delay or decrease kneat.com's revenues, and therefore have a material adverse effect on its business, operating results and financial condition. Brexit has created economic and political uncertainty and the impact of it may not be fully known for several years. Brexit may cause some of our customers or potential customers to reduce spending and/or may result in new regulatory and cost challenges for Kneat and its customers in that region. These adverse conditions could result in reductions in revenues from our United Kingdom based customers, slower adoption of new technologies as new regulations are put in place, and increased price competition if tariffs are implemented. Any of these events may have an adverse effect on Kneat's operating results and financial position.

## **DISCLOSURE CONTROLS AND PROCEDURES AND INTERNAL CONTROLS OVER FINANCIAL REPORTING**

### **Disclosure Controls and Procedures**

Disclosure controls and procedures (as such term is defined in Multilateral Instrument 52-109 – *Certification of Disclosure in Issuers' Annual and Interim Filings*) have been designed by the Company to provide reasonable assurance that:

- (a) material information relating to the Company is made known to the Chief Executive Officer (“CEO”) and Chief Financial Officer (“CFO”) by others, particularly during the period in which the annual filings are being prepared; and
- (b) information required to be disclosed by the Company in its annual filings, interim filings or other reports that it files or submits under securities legislation is recorded, processed, summarized and reported within the time periods specified in securities legislation and is accumulated and communicated to management, including the CEO and CFO, to allow timely decisions regarding required disclosures.

The CEO and CFO have concluded that, as of September 30, 2019, the design and operation of the disclosure controls and procedures are effective to ensure that information required to be disclosed in reports that it files or submits to regulatory authorities is recorded, processed, summarized and reported within the time periods specified by regulation and is accumulated and communicated to management, including the CEO and CFO, to allow timely decisions regarding required disclosures.

### **Internal Control over Financial Reporting**

The Company's management, with the participation of its CEO and CFO, has designed, established and is maintaining a system of internal control over financial reporting. Under the supervision of the CFO, as at September 30, 2019, the Company's internal control over financial reporting is a process designed to provide reasonable assurance that the financial information prepared by the Company for external purposes is reliable and has been recorded, processed and reported in an accurate and timely manner and in accordance with IFRS.

Management, with the participation of its CEO and CFO, has used the Internal Control – Integrated Framework to evaluate the effectiveness of internal control over financial reporting, which is a recognized and suitable framework issued by the Committee of Sponsoring Organizations (“COSO Framework”) published by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”). The Company's controls include policies and procedures that:

- pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company;
- provide reasonable assurance that transactions are recorded as necessary to permit preparation of unaudited condensed interim financial statements in accordance with IFRS; and
- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the annual consolidated financial statements or unaudited condensed interim consolidated financial statements.

There have been no changes to the controls during the period that materially affected or are reasonably likely to materially affect the Company's internal control over financial reporting.

## **Limitations of Controls and Procedures**

The Company's management, including the CEO and CFO, believe that any disclosure controls and procedures or internal controls over financial reporting, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, they cannot provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been prevented or detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by unauthorized override of the control. The design of any systems of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Accordingly, because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

## **CRITICAL ACCOUNTING POLICIES**

kneat.com's significant accounting policies are disclosed in note 2, *Summary of Significant Accounting Policies*, of the annual consolidated financial statements for the year ended December 31, 2018. kneat.com has identified certain accounting policies that it believes are most critical in understanding the judgments that are involved in producing the unaudited condensed interim consolidated financial statements and the estimates made that could impact results of the operations, which are discussed below.

### **Intangible asset**

Expenditures on research activities undertaken with the prospect of gaining new technical knowledge and understanding is recognized in the consolidated statements of loss and comprehensive loss as an expense as incurred.

The intangible asset consists of the internally generated software platform, Kneat Gx. The development costs of the software platform, net of research and development tax credits, are capitalized as they can be measured reliably, the platform is technically and commercially feasible, future economic benefits are probable and the Company intends to, and has sufficient resources to, complete development and to use or sell the product. Expenditures capitalized include the cost of direct labour and other costs that are directly attributable to preparing the asset for its intended use.

The intangible asset is amortized based on the cost of the asset less its residual value. Amortization is charged to the consolidated statements of loss and comprehensive loss on a straight-line basis over the estimated useful economic life, from the date the asset is available for use, at an annual rate of 20%.

The estimated useful life, residual value and amortization rate are reviewed annually and no changes to estimates were made in 2019 or 2018.

### **Revenue Recognition**

#### *Revenue from contracts*

The Company derives its revenues under license agreements from the sale of proprietary software licenses and provides software-related services including training, installation, upgrades, consulting and maintenance, which include product support services. Revenues are recognized when control of these licenses and services is transferred to the customer, in an amount that reflects the consideration the Company expects to be entitled to in exchange for those services.

Revenue recognition is determined through the following five steps:

- Identification of the contract with the customer;
- Identification of the performance obligations in the contract;
- Determination of the transaction price;
- Allocation of the transaction price to the performance obligations in the contract; and
- Recognition of revenue when, or as, the Company satisfies a performance obligation.



Revenues generated by the Company include the following:

i) *On-premise license fees*

On-premise license fees entitle the customer to deploy the Kneat Gx platform on the customers' own servers. Revenues from on-premise perpetual license sales are recognized at a point in time, upon delivery, when transfer of control of the software has passed to the customer, there are no uncertainties surrounding product acceptance and consideration is known and considered collectible.

ii) *Software as a service ("SaaS") license fees*

SaaS license agreements (also referred to as "subscription fees") entitle the customer to utilize the Kneat Gx platform, which is hosted by the Company on a cloud server, for a specified number of users without taking possession. SaaS license fee revenue is recognized rateably over the contract term, commencing on the date when Kneat's services are made available to the customer. Customers are typically invoiced and pay annually in advance for subscription fees upon execution of the initial contract or subsequent renewals.

iii) *Maintenance fees*

Maintenance fees for on-premise software licenses generally require the Company to provide technical support and unspecified software updates to customers. Maintenance revenues for technical support and unspecified software update rights are recognized rateably over the term of the contract. The Company typically invoices and collects maintenance fees annually in advance.

iv) *Professional services and other*

The Company provides consulting, training and other services to its customers that are distinct from the sale of licenses. Revenues from such services are generally recognized at the point in time when performance obligations are satisfied.

The Company also performs services related to implementation. Services related to implementation are not a distinct performance obligation and thus are recognized consistent with the licenses for which they relate but are classified as professional services and other in the consolidated statements of loss and comprehensive loss.

v) *Contracts with multiple performance obligations*

Many of the Company's contracts involve multiple performance obligations that include licenses, maintenance and various professional services. The Company evaluates each product and service in a contract to determine if they represent distinct performance obligations and thus require separate accounting treatment. For these contracts, the transaction price is allocated to the separate performance obligations based on their estimated stand-alone selling prices. The stand-alone selling prices of each performance obligation in these contracts is based on such factors as historical selling prices for these performance obligations in similar transactions, current pricing practices and other factors.

*Deferred contract acquisition costs*

Deferred contract acquisition costs are incremental selling costs that are associated with acquiring customer contracts and consist of sales commissions paid or due to the sales team. Capitalized contract acquisition costs are amortized consistently with the pattern of transfer to the customer for the goods and services to which the asset relates. The amortization period includes specifically identifiable contract renewals where there is no substantive renewal commission. The Company determines the amortization period by considering the customer specific contract deliverables, term and other factors. Amortization of deferred contract acquisition costs is included in sales and marketing expenses in the consolidated statements of loss and comprehensive loss. The Company applies the practical expedient available under IFRS 15 and does not capitalize incremental costs of obtaining contracts if the amortization period is one year or less.

*Contract liabilities*

Contract liabilities consist of deferred revenue for payments received in advance of revenue recognition from contracts with customers and are recognized in the consolidated statements of loss and comprehensive loss as revenue recognition criteria are met.

## **SIGNIFICANT ACCOUNTING JUDGMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY**

The preparation of the unaudited condensed interim consolidated financial statements in conformity with IFRS requires management to make judgments and estimates that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results could differ from these estimates. Estimates 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. Information about critical accounting judgments and estimates in applying accounting policies that have the most significant impact on the amounts recognized in the unaudited condensed interim consolidated financial statements are outlined below.

### *Recognition of revenue*

Contracts with customers often include promises to deliver multiple products and services. Determining whether these products and services represent distinct performance obligations may require significant judgment. In addition, the determination of the stand-alone selling price for distinct performance obligations may also require judgment and estimates. As the Company does not have a significant history of generating revenue, management uses judgment, based on customer specific contracts and comparable sales, to determine the appropriate stand-alone selling value for each performance obligation. In addition, certain of these performance obligations have a term of more than one year and thus the identification and stand-alone selling price of the individual performance obligations impacts the timing of revenue recognition. A change in the stand-alone selling price allocated to each performance obligation could materially impact the revenue recognized in the current and future periods and the contract asset and liability balance at period-end.

### *Internally generated intangible asset*

The Company capitalizes certain costs incurred for the development of its Kneat Gx software platform in accordance with IAS 38, *Intangible Assets*. The capitalized costs include the costs directly attributable to preparing the intangible asset for its intended use, net of any qualifying research and development tax credits which are subject to audit by tax authorities. Management estimates the expected term over which the Company will receive benefits from the software application to be five years. A change in these estimates would have a significant impact on the carrying value of the intangible asset, the amounts receivable for the research and development tax credit and the amortization and expenses recognized in the consolidated statements of loss and comprehensive loss.

## **NEW ACCOUNTING STANDARDS ADOPTED DURING THE PERIOD**

Effective January 1, 2019, the Company adopted the following new accounting standard. This change in accounting policy will also be reflected in the Company's subsequent quarters and annual financial statements as at and for the year ended December 31, 2019.

### *IFRS 16, Leases ("IFRS 16")*

The Company adopted IFRS 16 effective January 1, 2019. IFRS 16 was applied using the modified retrospective approach whereby 2018 figures were not restated and the cumulative effect of initial application was recognized in retained earnings at January 1, 2019.

On transition to IFRS 16, the Company elected to apply the practical expedient to grandfather the assessment of which transactions are leases. IFRS 16 was applied only to contracts that were previously identified as leases. Contracts that were not identified as leases under IAS 17 were not reassessed for whether there is a lease. In addition, the Company applied section C8(b)(ii) of the standard and recognized leased assets at an amount equal to the lease liability, adjusted for prepayments recognized before initial application. As a result of the adoption of IFRS 16, \$423,625 of right-of-use assets and \$630,444 of lease liabilities were recognized at January 1, 2019 based on leases that were in place at December 31, 2018. The difference in amounts recognized with respect to right-of-use assets and lease liabilities relates to lease incentives that reduce the right-of-use asset value under IFRS 16. The right-of-use assets and lease liabilities recognized are for the Company's office spaces that were previously classified as operating leases.

When measuring lease liabilities, the Company discounted lease payments using its incremental borrowing rate at the date of adoption. The incremental borrowing rate was estimated by assessing the amount of the total lease payments, the underlying assets and the term of each lease. The weighted average incremental borrowing rate for lease liabilities initially recognized as of January 1, 2019 was 5.7%.

The reconciliation of commitments disclosed in the December 31, 2018 financial statements to the lease liability recognized on transition to IFRS 16 is:

	\$
Commitments as at December 31, 2018	895,028
Recognition exemptions for:	
Leases of low value assets	(8,033)
Non-lease commitments	(79,997)
Extension option reasonably certain to be recognized	107,802
Modified lease effective January 1, 2019	(182,449)
Impact of discount using incremental borrowing rate at January 1, 2019	(101,907)
Lease liability recognized on transition at January 1, 2019	<u>630,444</u>

Effective January 1, 2019 in accordance with IFRS 16, the Company assesses whether a contract is or contains a lease based on the criteria outlined in the standard. When a contract meets the definition of a lease, the Company recognizes a right-of-use asset and a lease liability at the lease commencement date.

The right-of-use asset is initially measured at cost, which includes the initial amount of the lease liability adjusted for any lease payments made at or before the commencement date, plus any initial direct costs incurred, less any incentives received. The right-of-use asset is then depreciated on a straight-line basis from the commencement date to the end of the lease term. The carrying amount of the right-of-use asset may be reduced by impairment losses or adjusted for certain remeasurements of the lease liability, if any.

The lease liability is initially measured at the present value of future lease payments, discounted using the Company's incremental borrowing rate. The lease liability is subsequently measured at amortized cost using the effective interest method. It is remeasured if the Company changes its assessment of whether it will exercise a purchase, extension or termination options.

The Company has elected not to recognize assets and lease liabilities for short-term leases with a term of 12 months or less, and leases of low value assets. The lease payments associated with these leases are recognized as an expense in the unaudited interim consolidated statement of loss and comprehensive loss over the lease term. Low value assets consist primarily of computers.

## NON-GAAP MEASURES

Kneat uses annualized recurring revenues ("ARR") to evaluate and assess its performance, identify trends affecting its business, formulate financial projections and make financial decisions. ARR does not have a standardized meaning, and therefore may not be comparable to similar measures presented by other companies. As a non-GAAP measure, it should be considered as a supplement to, and not as a substitute for, or superior to, measures calculated in accordance with GAAP, mainly Kneat's revenue.

ARR is used by Kneat to assess the expected ARR from the customers that are live on the Kneat Gx platform at the end of the period. ARR is calculated as the licenses delivered to customers at the period end, multiplied by the expected customer retention rate of 100% and multiplied by the contracted annual SaaS license fee or maintenance fee at the related quarter end. Since many of the customer contracts are in currencies other than the Canadian dollar, the Canadian dollar equivalent is calculated using the related period end exchange rate multiplied by the contracted currency amount. Kneat had \$1,438,022 of ARR at September 30, 2019 as compared to \$456,547 at September 30, 2018.

## DIRECTOR CHANGES AND OTHER INFORMATION

Mr. Rory Cameron was elected to the Company's Board of Directors on May 1, 2019.

Additional information regarding the Company is available on SEDAR at [www.sedar.com](http://www.sedar.com) and on the Company's website at [www.kneat.com](http://www.kneat.com).