



Condensed Consolidated Interim Financial Statements of  
**KWESST MICRO SYSTEMS INC.**

Three months ended December 31, 2021, and 2020

(Unaudited – Expressed in Canadian dollars)

**KWESST MICRO SYSTEMS INC.**

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**KWESST MICRO SYSTEMS INC.**  
**Condensed Consolidated Interim Statements of Financial Position**  
**At December 31, 2021 and September 30, 2021**  
*(Unaudited)*

<i>In Canadian dollars</i>	<b>Notes</b>	<b>December 31, 2021</b>	September 30, 2021
<b>ASSETS</b>			
Cash		\$ 733,984	\$ 2,688,105
Restricted short-term investment		30,000	30,000
Trade and other receivables	5	698,917	699,251
Inventories	6	421,113	90,299
Prepaid expenses and other		324,998	548,042
<b>Current assets</b>		<b>2,209,012</b>	<b>4,055,697</b>
Property and equipment		851,082	903,649
Right-of-use assets		251,693	266,214
Deposit		21,905	21,367
Intangible assets	7	3,819,820	3,470,919
<b>Non-current assets</b>		<b>4,944,500</b>	<b>4,662,149</b>
<b>Total Assets</b>		<b>\$ 7,153,512</b>	<b>\$ 8,717,846</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
<b>Liabilities</b>			
Accounts payable and accrued liabilities	8 and 9	\$ 1,180,189	\$ 1,127,202
Corporate tax payable		29,949	-
Lease obligations		48,767	32,288
Borrowings	10	80,783	-
Contract liabilities	11	2,465	-
<b>Current liabilities</b>		<b>1,342,153</b>	<b>1,159,490</b>
Accrued royalties liability		1,143,940	1,105,756
Lease obligations		258,974	275,621
Borrowings	10	-	53,251
<b>Non-current liabilities</b>		<b>1,402,914</b>	<b>1,434,628</b>
<b>Total Liabilities</b>		<b>2,745,067</b>	<b>2,594,118</b>
<b>Shareholders' Equity</b>			
Share capital	12(a)	17,668,904	17,215,068
Contingent shares	4	83,319	-
Warrants	12(b)	1,920,389	1,848,389
Contributed surplus	12(c)	3,373,241	2,458,211
Accumulated other comprehensive loss		(5,605)	(8,991)
Accumulated deficit		(18,631,803)	(15,388,949)
<b>Total Shareholders' Equity</b>		<b>4,408,445</b>	<b>6,123,728</b>
<b>Total Liabilities and Shareholders' Equity</b>		<b>\$ 7,153,512</b>	<b>\$ 8,717,846</b>

See Note 2(a) Going concern and Note 18 Commitments and contingencies.

See accompanying notes to the unaudited condensed consolidated interim financial statements.

On behalf of the Board of Directors:

*(signed) John McCoach*, Director

*(signed) David Luxton*, Director

**KWESST MICRO SYSTEMS INC.**  
**Condensed Consolidated Interim Statements of Net Loss and Comprehensive Loss**  
**Three months ended December 31, 2021 and 2020**  
*(Unaudited)*

<i>In Canadian dollars</i>	<b>Notes</b>	<b>Three months ended December 31, 2021</b>	Three months ended December 31, 2020
			(Adjusted - see Notes 2(f) and 12(c))
<b>Revenue</b>	14	\$ 17,465	\$ 146,349
Cost of sales		(25,479)	(71,564)
<b>Gross profit</b>		<b>(8,014)</b>	74,785
<b>Operating expenses</b>	2(f)		
General and administrative		1,055,140	539,631
Selling and marketing		1,346,391	534,863
Research and development, net		794,412	505,247
<b>Total operating expenses</b>		<b>3,195,943</b>	1,579,741
<b>Operating loss</b>		<b>(3,203,957)</b>	(1,504,956)
<b>Other income (expenses)</b>			
Net finance costs	15	(47,642)	(17,948)
Foreign exchange gain (loss)		8,745	(3,385)
<b>Total other expenses</b>		<b>(38,897)</b>	(21,333)
<b>Net loss</b>		<b>\$ (3,242,854)</b>	\$ (1,526,289)
<b>Other comprehensive income:</b>			
<i>Items that are or may be reclassified subsequently to profit or loss:</i>			
Foreign currency translation differences		3,386	-
<b>Total comprehensive loss</b>		<b>\$ (3,239,468)</b>	\$ (1,526,289)
<b>Net loss per share</b>			
Basic and diluted		<b>\$ (0.07)</b>	\$ (0.04)
<b>Weighted average number of shares outstanding</b>			
Basic and diluted	13	<b>49,022,129</b>	41,392,149

*See accompanying notes to the unaudited condensed consolidated interim financial statements.*

**KWESST MICRO SYSTEMS INC.**

**Condensed Consolidated Interim Statements of Changes in Shareholders' Equity**

**Three months ended December 31, 2021, and 2020**

*(Unaudited)*

*In Canadian dollars*

	Notes	Share capital	Contingent shares	Warrants	Contributed surplus	Translation reserve	Deficit	Total Shareholders' Equity
Balance, September 30, 2020		\$ 9,374,563	\$ -	\$ 277,170	\$ 306,708	\$ -	\$ (6,102,058)	\$ 3,856,383
Shares issued for debt		64,138	-	-	-	-	-	64,138
Stock options exercised		265,344	-	-	(69,387)	-	-	195,957
Warrants exercised		60,000	-	(60,000)	-	-	-	-
Share-based compensation	12(c)	-	-	-	273,615	-	-	273,615
Net loss	12(c)	-	-	-	-	-	(1,526,289)	(1,526,289)
<b>Balance, December 31, 2020</b>		<b>\$ 9,764,045</b>		<b>\$ 217,170</b>	<b>\$ 510,936</b>	<b>\$ -</b>	<b>\$ (7,628,347)</b>	<b>\$ 2,863,804</b>
Balance, September 30, 2021		17,215,068	-	1,848,389	2,458,211	(8,991)	(15,388,949)	6,123,728
Shares issued for debt		19,000	-	-	-	-	-	19,000
Shares and warrants issued on acquisition	4	377,503	83,319	132,000	-	-	-	592,822
Stock options exercised		-	-	-	-	-	-	-
Warrants exercised		60,000	-	(60,000)	-	-	-	-
Share-based compensation	12(c)	-	-	-	927,530	-	-	927,530
Shares for vested RSUs		7,151	-	-	(7,151)	-	-	-
Vested RSUs repurchased for withholding taxes		-	-	-	(5,349)	-	-	(5,349)
Share offering costs		(9,818)	-	-	-	-	-	(9,818)
Other comprehensive income		-	-	-	-	3,386	-	3,386
Net loss		-	-	-	-	-	(3,242,854)	(3,242,854)
<b>Balance, December 31, 2021</b>		<b>\$ 17,668,904</b>	<b>\$ 83,319</b>	<b>\$ 1,920,389</b>	<b>\$ 3,373,241</b>	<b>\$ (5,605)</b>	<b>\$ (18,631,803)</b>	<b>\$ 4,408,445</b>

*See accompanying notes to the unaudited condensed consolidated interim financial statements.*

**KWESST MICRO SYSTEMS INC.**  
**Condensed Consolidated Interim Statements of Cash Flows**  
**Three months ended December 31, 2021, and 2020**  
*(Unaudited)*

<i>In Canadian dollars</i>	<b>Notes</b>	<b>Three months ended December 31, 2021</b>	Three months ended December 31, 2020
			(Adjusted - see Note 12 (c))
<b>OPERATING ACTIVITIES</b>			
Net loss		\$ (3,242,854)	\$ (1,526,289)
<i>Items not affecting cash:</i>			
Depreciation and amortization		72,037	38,734
Share-based compensation	12(c)	927,530	273,615
Net finance costs		46,572	17,028
Changes in non-cash working capital items	17	334,521	(28,091)
Interest paid		(2,566)	(4,873)
<b>Cash used in operating activities</b>		<b>(1,864,760)</b>	<b>(1,229,876)</b>
<b>INVESTING ACTIVITIES</b>			
Additions of property and equipment		(4,949)	(9,864)
Investments in intangible assets	7	(226,558)	(319,452)
Cash acquired on acquisition	4	162,547	-
<b>Cash flows used in investing activities</b>		<b>(68,960)</b>	<b>(329,316)</b>
<b>FINANCING ACTIVITIES</b>			
Payments of share offering costs		(9,818)	-
Proceeds from borrowings		-	20,000
Repayment of borrowings		-	(21,252)
Repayments of lease obligations		(5,234)	(7,910)
Proceeds from exercise of stock options		-	195,957
Repurchase of vested RSUs for withholding taxes		(5,349)	-
<b>Cash flows provided by (used in) financing activities</b>		<b>(20,401)</b>	<b>186,795</b>
<b>Net change in cash during the period</b>		<b>(1,954,121)</b>	<b>(1,372,397)</b>
<b>Cash, beginning of period</b>		<b>2,688,105</b>	<b>3,073,760</b>
<b>Cash, end of period</b>		<b>\$ 733,984</b>	<b>\$ 1,701,363</b>

See Note 17 Supplemental cash flow information.

See accompanying notes to the unaudited condensed consolidated interim financial statements.

# KWESST MICRO SYSTEMS INC.

Notes to Unaudited Condensed Consolidated Interim Financial Statements  
Three months ended December 31, 2021, and 2020  
(Expressed in Canadian dollars, except share amounts)

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## 1. Corporate information

KWESST Micro Systems Inc. (the "Company" or "KWESST") was incorporated on November 28, 2017, under the laws of the Province of British Columbia. The Company's registered office is located at 550 Burrard Street, Suite 2900, Vancouver, British Columbia, Canada. Its corporate office is located at Unit 1, 155 Terrence Matthews Crescent, Ottawa, Ontario, Canada. It also has representative offices in the following foreign locations: Washington DC (United States), London (United Kingdom), and Abu Dhabi (United Arab Emirates).

KWESST develops and commercializes next-generation tactical systems. Key market segments and solutions addressed by KWESST technologies are: (i) breakthrough technology in non-lethal systems with broad application, including law enforcement and personal defence, (ii) modernized digitization of tactical forces for shared situational awareness and targeting, and (iii) counter-measures against threats such as drones, lasers and electronic detection.

KWESST's common stock is listed on the TSX-Venture Exchange ("TSX-V") under the stock symbol of KWE and on the OTCQB® Venture Market under the stock symbol of KWEMF.

## 2. Basis of preparation

### (a) *Going concern*

These unaudited condensed consolidated interim financial statements have been prepared assuming KWESST will continue as a going concern.

As an early-stage company, KWESST has not yet reached commercial production for most of its products and has incurred significant losses and negative operating cash flows from inception that have primarily been funded from financing activities. KWESST incurred \$3.2 million net loss and negative operating cash flows of \$1.9 million for the three months ended December 31, 2021 (2020 - \$1.5 million net loss and negative operating cash flows of \$1.2 million).

The Company's ability to continue as a going concern and realize its assets and discharge its liabilities in the normal course of business is dependent upon closing timely additional sales orders and the ability to raise additional debt or equity financing, as required. There are various risks and uncertainties affecting KWESST's future financial position and its performance including, but not limited to:

- The market acceptance and rate of commercialization of the KWESST's product offerings;
- Ability to successfully execute its business plan;
- Ability to raise additional capital at acceptable terms ;
- General local and global economic conditions, including the ongoing COVID-19 pandemic.

KWESST's strategy to mitigate these material risks and uncertainties is to execute timely a business plan aimed at continued focus on revenue growth, product development and innovation, improving overall gross profit, managing operating expenses and working capital requirements, and securing additional capital, as needed.

Failure to implement the Company's business plan could have a material adverse effect on the Company's financial condition and/or financial performance. There is no assurance that that the Company will be able to raise additional capital as they are required in the future. Accordingly, there are material risks and uncertainties that may cast significant doubt about KWESST's ability to continue as a going concern.

These condensed consolidated interim financial statements do not include any adjustments to the carrying amounts and classification of assets, liabilities and reported expenses that may otherwise be required if the going concern basis was not appropriate.

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## ***(b) Statement of compliance***

These unaudited condensed consolidated interim financial statements have been prepared in accordance with IAS 34, Interim Financial Reporting, ("IAS 34") as issued by the International Accounting Standards Board ("IASB"). They do not include all the information required for a complete set of financial statements prepared in accordance with International Financial Reporting Standards ("IFRS") and should be read in conjunction with the annual consolidated financial statements of the Company for the year ended September 30, 2021. However, selected explanatory notes are included to explain events and transactions that are significant to an understanding of the changes in the Company's financial position and performance since the last annual consolidated financial statements as at and for the year ended September 30, 2021.

These unaudited condensed consolidated interim financial statements were authorized for issue by the Board of Directors on February 28, 2022.

## ***(c) Basis of consolidation***

These unaudited condensed consolidated interim financial statements incorporate the financial statements of KWESST and the entities it controls.

Control is achieved where KWESST has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities, are exposed to, or have rights to, variable returns from the Company's involvement with the entity and have the ability to affect those returns through its power over the entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Company until the date on which control ceases. Profit or loss of subsidiaries acquired during the year are recognized from the date of acquisition or effective date of disposal as applicable. All intercompany transactions and balances have been eliminated.

At December 31, 2021, the Company has the following wholly-owned subsidiaries:

	Location	Equity %
KWESST Inc.	Ottawa, Canada	100%
KWESST U.S. Inc.	Virginia, United States	100%
2720178 Ontario Inc.	Bowmanville, Canada	100%
Police Ordnance Company Inc.	Bowmanville, Canada	100%

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

These financial statements are presented in Canadian dollars ("CAD"), KWESST's functional currency and presentation currency.

## ***(e) Basis of measurement***

The consolidated financial statements have been prepared on the historical cost basis except for certain financial instruments measured at fair value. Historical cost is generally based on the fair value of the consideration given in exchange for assets.

## ***(f) Comparative figures***

For the year ended September 30, 2021, KWESST changed the presentation of its expenses in the consolidated statements of net loss and comprehensive loss from by nature to by function. KWESST made this change in presentation to provide more relevant financial information to facilitate peer benchmarking, particularly with peers in the United States. As a result, KWESST's operating expenses for the three months ended December 31,



# KWESST MICRO SYSTEMS INC.

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2021 and 2020 are now presented as follows: general and administration (“G&A”), selling and marketing (“S&M”), and net research and development (“R&D”).

## ***(g) Use of estimates and judgments***

The preparation of the unaudited condensed consolidated interim financial statements in accordance with IFRS requires management to make judgments, estimates, and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities, income, expenses, and disclosure of contingent liabilities. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to estimates are recognized prospectively.

### Judgments

Information about judgments made in applying accounting policies that have the most significant effects on the amounts recognized in these consolidated financial statements are the same as disclosed in Note 2(g) of the consolidated financial statements for the year ended September 30, 2021.

### Estimates

Information about assumptions and estimation uncertainties at December 31, 2021 that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities in the next financial year are the same as disclosed in Note 2(g) of the consolidated financial statements for the year ended September 30, 2021.

### COVID-19 Uncertainties

While COVID-19 has not had a material impact to our business to date, the following is a summary of what we believe may impact our future business given the persistency of COVID-19: disruptions to business operations resulting from quarantines of employees, customers, manufacturers and other third-party service providers in areas affected by the outbreak; disruptions to business operations resulting from travel restrictions, including travel to industry tradeshows; and uncertainty around the duration of the virus' impact.

Despite the global vaccination efforts underway, the extent to which COVID-19 could impact our operations, financial condition, results of operations, and cash flows is highly uncertain and cannot be predicted. Negative financial results, uncertainties in the market, and a tightening of credit markets, caused by COVID-19, or a recession, could have a material adverse effect on our liquidity and ability to obtain financing in the future.

## **3. Significant accounting policies**

During the three months ended December 31, 2021, the accounting policies in these condensed consolidated interim financial statements are the same as those applied in KWESST's consolidated financial statements as at and for the year ended September 30, 2021.

## **4. Acquisition**

### *Police Ordnance*

On December 15, 2021, KWESST acquired 2720178 Ontario Inc., an Ontario (Canada) corporation, which owns all of the issued and outstanding shares of Police Ordnance Company Inc., an Ontario (Canada) corporation (together, “Police Ordnance”), herein referred as the “Police Ordnance Acquisition”. Located in Bowmanville, Ontario, with ancillary operations in Florida, Police Ordnance owns all intellectual properties to the ARWEN product line of less-lethal launchers, and a proprietary line of 37 mm less-lethal cartridges designed for riot

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control and tactical teams. Police Ordnance has law enforcement customers across Canada, the United States, and abroad. The Police Ordnance Acquisition provides KWESST with a strategic opportunity to leverage its law enforcement customer base to accelerate growth within its specialty ordnance business.

### *Consideration Transferred:*

The purchase consideration comprised of the following:

	Number		Fair Value
Common shares	277,576	\$	377,503
Warrants	200,000	\$	132,000
Contingent shares	61,264	\$	83,319
<b>Total fair value purchase consideration</b>		<b>\$</b>	<b>592,822</b>

The warrants are exercisable at \$1.72 each and will expire on December 15, 2024.

KWESST will issue 61,264 common shares to the sellers subject to fulfillment of a financial milestone in Fiscal 2022 as defined in the share purchase agreement.

KWESST estimated the fair value as follows:

- *Common shares*: based on KWESST's closing stock price on December 15, 2021.
- *Warrants*: based on using the Black Scholes option model with the following key inputs: a) exercise price of \$1.72, underlying stock price of \$1.36, risk free rate of 0.01%, expected life of three years, and expected volatility of 84.7%.
- *Contingent shares*: based on KWESST's closing stock price on December 15, 2021, and high probability of achieving the financial milestone as defined in the share purchase agreement.

The net cash inflow as at the closing of the acquisition was as follows:

Cash assumed on acquisition	\$	162,547
less: consideration paid in cash		-
<b>Net cash inflow on acquisition</b>	<b>\$</b>	<b>162,547</b>

### *Net Assets Acquired:*

The purchase consideration was allocated to Police Ordnance's net assets as follows:

<b>Total purchase consideration at fair value</b>	<b>\$</b>	<b>592,822</b>
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### *Police Ordnance's net assets:*

Cash	162,547
Trade and other receivables	113,483
Inventories	330,413
Intangible assets	125,529
Accounts payable and accrued liabilities	82,963
Corporate tax liability	29,949
Borrowings	26,238
<b>Net assets at fair value</b>	<b>\$ 592,822</b>

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The fair value of inventories and intangible assets in the above allocation is preliminary due to the timing of closing the acquisition near quarter end and the need for additional information related to custom raw materials, which is subject to further valuation review. This will be finalized by September 30, 2022.

### *Impact on KWESST's Results of Operations:*

The results of operations of Police Ordnance are included in these unaudited condensed consolidated interim statements of net loss and comprehensive loss from December 16, 2021. If the acquisition had occurred on October 1, 2021, management estimates that Police Ordnance would have contributed approximately \$154,000 of revenue and approximately \$11,800 of net loss to KWESST's quarterly operating results. In determining these amounts, management has assumed that the fair value adjustments that arose on the date of the acquisition would have been the same if the acquisition had occurred on October 1, 2021.

KWESST incurred acquisition-related costs of \$2,304 which are recorded as an expense in the unaudited condensed consolidated interim statements of net loss and comprehensive as part of general and administrative expenses. Share offering costs of \$4,150 in relation to the acquisition are recorded against share capital on the unaudited condensed consolidated interim statements of financial position.

### 5. Trade and other receivables

The following table presents trade and other receivables for KWESST:

	December 31, 2021	September 30, 2021
Trade receivables	\$ 353,149	\$ -
Unbilled revenue	-	308,728
Sales tax recoverable	139,006	183,761
Investment tax credits refundable	206,762	206,762
<b>Total</b>	<b>\$ 698,917</b>	<b>\$ 699,251</b>

There was no impairment of trade and other receivables during the three months ended December 31, 2021 (2020 – \$nil).

The following table presents changes in unbilled receivables:

	December 31, 2021	September 30, 2021
Balance, beginning of period	\$ 308,728	\$ -
Revenue in excess of billings, net of amounts transferred to trade receivables	-	308,728
Transferred to trade receivables	(308,728)	-
<b>Balance, end of period</b>	<b>\$ -</b>	<b>\$ 308,728</b>
Current	\$ -	\$ 308,728
Non-current	\$ -	\$ -

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### 6. Inventories

The following table presents a breakdown of inventories:

	December 31, 2021	September 30, 2021
Finished goods	\$ 54,687	\$ -
Work-in-progress	28,848	-
Raw materials	337,578	90,299
<b>Total</b>	<b>\$ 421,113</b>	<b>\$ 90,299</b>

There was no impairment of inventories during the three months ended December 31, 2021 (2020 - \$nil).

### 7. Intangible assets

The following table presents intangible assets for KWESST:

Cost	Phantom™ System	PARA Ops System <sup>(1)</sup>	Patent	ARWEN™	Total
Balance at September 30, 2021	\$ 564,700	\$ 2,906,219	\$ -	\$ -	\$3,470,919
Additions	89,543	108,232	28,783	-	226,558
Acquisition	-	-	-	122,343	122,343
<b>Balance at December 31, 2021</b>	<b>\$ 654,243</b>	<b>\$ 3,014,451</b>	<b>\$ 28,783</b>	<b>\$ 122,343</b>	<b>\$3,819,820</b>

(1) In January 2022, we have branded the technology known as the Low Energy Cartridge system as PARA Ops system.

As Phantom™ and PARA OPS products have not yet reached commercialization, no amortization charge was recorded for the three months ended December 31, 2021 (2020 - \$nil). Management anticipates the estimated useful life to be five years for both technology assets subsequent to then expected commercialization date and the estimated useful life of the patent will be determined subsequent to the approval of the patent.

At December 31, 2021, management concluded there was no impairment on the intangible assets (2020 - \$nil).

### 8. Accounts payable and accrued liabilities

The following table presents the accounts payable and accrued liabilities for KWESST:

	December 31, 2021	September 30, 2021
Trade payable	\$ 629,589	\$ 620,041
Accrued liabilities	346,162	384,239
Salary and vacation payable	169,789	122,230
Payroll taxes payable	34,649	692
<b>Total</b>	<b>\$ 1,180,189</b>	<b>\$ 1,127,202</b>

### 9. Related party transactions

In November 2019, KWESST hired SageGuild LLC to assist the Company in promoting its product offerings in the United States. In January 2021, the Acting CEO and sole shareholder of SageGuild LLC agreed to serve as director of KWESST U.S. Inc. and as a result SageGuild LLC became a related party to KWESST. The total

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cash and share-based remuneration amounted to \$75,608 for the three months ended December 31, 2021. Except for the cash consideration recorded at the exchange amount, the share-based compensation was recorded at fair value.

At December 31, 2021, \$42,615 (September 30, 2021 - \$23,187) was owed to KWESST's Executive Chairman for business expense reimbursements, which was included in accounts payable and accrued liabilities and paid in January 2022. There was no other outstanding amount in accounts payable and accrued liabilities due to officers and directors of KWESST.

### 10. Borrowings

The following is a reconciliation of borrowings since September 30, 2021:

	<b>CEBA Term Loan</b>
Balance, September 30, 2021	\$ 53,251
Assumed from acquisition (Note 4)	26,238
Accrued interest	1,294
<b>Balance, December 31, 2021</b>	<b>\$ 80,783</b>
Current	\$ 80,783
Non-current	-
<b>Total</b>	<b>\$ 80,783</b>

There were no changes to KWESST's RBC Credit Facility since September 30, 2021.

### 11. Contract Liabilities

The following is a reconciliation of contract liabilities since September 30, 2021:

Balance, September 30, 2021	\$ -
Additions	2,465
<b>Balance, December 31, 2021</b>	<b>\$ 2,465</b>

### 12. Share capital and Contributed Surplus

#### a) Share capital

##### *Authorized*

KWESST is authorized to issue an unlimited number of common shares.

##### *Issued Common Shares*

The following is a summary of changes in outstanding common shares since September 30, 2021:

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	Number	Amount
Balance at September 30, 2021	48,965,631	\$ 17,215,068
Issued for acquisition (Note 4)	277,576	\$ 377,503
Issued for debt settlements	10,000	\$ 19,000
Issued for exercise of warrants	250,000	\$ 60,000
Issued for conversion of stock units	5,790	\$ 7,151
Less: share offering costs for the year		\$ (9,818)
<b>Balance at December 31, 2021</b>	<b>49,508,997</b>	<b>\$ 17,668,904</b>

## b) Warrants

The following is a summary of changes in outstanding warrants since September 30, 2021:

	Number of warrants	Weighted average exercise price
Outstanding at September 30, 2021	13,901,640	\$ 0.74
Issued (Note 4)	200,000	\$ 1.72
Exercised	(250,000)	\$ 0.50
Outstanding at December 31, 2021	13,851,640	\$ 0.76
Exercisable at December 31, 2021	13,101,640	\$ 0.76

The following table provides additional information on the total outstanding warrants at December 31, 2021:

	Number outstanding	Fair value <sup>(1)</sup>	Expiry Date
<i>Founders' warrants:</i>			
Exercise price of \$0.20	6,500,000	\$ 1,192	January 1, 2024
Exercise price of \$0.20	2,000,000	\$ 19,858	June 14, 2024
<i>GhostStep's warrants:</i>			
Exercise price of \$0.50	250,000	\$ 60,000	January 15, 2023
<i>April 2021 equity financing:</i>			
Exercise price of \$1.75	3,274,657	\$ 785,918	April 29, 2023
Exercise price of \$1.75	40,000	\$ 9,600	August 25, 2023
<i>LEC's warrants:</i>			
Exercise price of \$0.70	500,000	\$ 425,000	April 29, 2026
<i>September 2021 equity financing:</i>			
Exercise price of \$2.35	750,000	\$ 390,000	September 16, 2023
<i>Broker warrants:</i>			
Exercise price of \$0.45	84,622	\$ 17,162	May 8, 2022
Exercise price of \$0.70	69,862	\$ 14,259	July 9, 2022
Exercise price of \$1.75	137,499	\$ 33,000	April 29, 2023
Exercise price of \$2.00	45,000	\$ 32,400	September 16, 2023
<i>Acquisition of Police Ordnance (Note 4):</i>			
Exercise price of \$1.72	200,000	\$ 132,000	December 15, 2024
	<b>13,851,640</b>	<b>\$ 1,920,389</b>	

(1) Fair value is calculated based on the grant date fair value and number outstanding at December 31, 2021. It does not represent the fair value at December 31, 2021.

The fair value for the warrants issued during the three months ended December 31, 2021, was determined using the Black-Scholes option model and key inputs:

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	<b>Acquisition of POC</b>
<b>Exercise Price</b>	<b>\$ 1.72</b>
Stock price	\$ 1.36
Volatility	84.7%
Dividend Yield	Nil
Risk-free interest rate	0.0104%
Expected life	3
<b>Weighted average fair value per warrant</b>	<b>\$ 0.66</b>

### e) Contributed Surplus

#### *Share-based compensation*

##### (i) Stock Options

The following is summary of changes in outstanding options since September 30, 2021.

	<b>Number of options</b>	<b>Weighted average exercise price</b>
Outstanding at September 30, 2021	4,167,516	\$ 1.37
Granted	265,000	1.79
Forfeited	(15,157)	0.91
<b>Outstanding at December 31, 2021</b>	<b>4,417,359</b>	<b>\$ 1.39</b>
<b>Options exercisable at December 31, 2021</b>	<b>2,606,984</b>	<b>\$ 1.26</b>

At December 31, 2021, there were 405,786 stock options available for grant under KWESST's LTIP.

For the three months ended December 31, 2021, KWESST recorded stock-based compensation expenses of \$927,530 (2020 – \$273,615). For the options granted during the three months ended December 31, 2021, the per share weighted-average fair value of stock options was \$0.97 using the Black-Scholes option model with the following weighted-average assumptions:

Stock price	\$1.70 to \$1.81
Exercise price	\$1.70 to \$1.81
Volatility	84.81%
Dividend Yield	Nil
Risk-free interest rate	1.03%
Expected life (years)	2.95
<b>Weighted-average fair value per option</b>	<b>\$ 0.97</b>

#### *Stock option grant amended*

During the three months ended December 31, 2021, KWESST amended a stock option grant to accelerate the vesting schedule, resulting in no additional charge.

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During the period, management made an adjustment in the three months ended December 31, 2020, for a correction in share-based compensation expenses of \$77,430 related to the cancellation of 250,000 options. The correction resulted in an increase of \$77,430 in contributed surplus, operating loss and net loss. This resulted in no change to KWESST's cash flows for the three months ended December 31, 2020.

### (ii) Share Units

The following is summary of changes in share units since September 30, 2021.

	RSUs	PSUs	SARs	Total
Outstanding at September 30, 2021	1,139,072	200,000	150,000	1,489,072
Granted	-	36,000	36,000	72,000
Vested and converted to common shares	(5,790)	-	-	(5,790)
Vested and repurchased for withholding taxes	(3,900)	-	-	(3,900)
<b>Outstanding at December 31, 2021</b>	<b>1,129,382</b>	<b>236,000</b>	<b>186,000</b>	<b>1,551,382</b>

At December 31, 2021, there were 2,655,977 Share Units available for grant under KWESST's LTIP.

### 13. Earnings (loss) per share

The following table summarizes the calculation of the weighted average basic number of basic and diluted common shares to calculate the earnings (loss) per share as reported in the condensed consolidated interim statements of net loss and comprehensive loss:

	Three months ended December 31, 2021	Three months ended December 31, 2020
Issued common shares, beginning of period	48,965,631	41,266,176
<i>Effect of shares issued from:</i>		
Acquisition of Police Ordnance (Note 4)	48,272	-
Exercise of options	-	106,325
Exercise of warrants	-	2,717
Debt settlements	7,282	16,931
Conversion of stock units	944	-
<b>Weighted average number of basic common shares</b>	<b>49,022,129</b>	<b>41,392,149</b>
<i>Dilutive securities:</i>		
<b>Weighted average number of dilutive common shares</b>	<b>49,022,129</b>	<b>41,392,149</b>

At December 31, 2021 and 2020, all dilutive securities were anti-dilutive because of KWESST's net loss for both of the above periods.

### 14. Revenue

The following table, revenue from contracts with customers is disaggregated by primary geographical market, major products and service lines, and timing of revenue recognition.



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	Three months ended December 31, 2021	Three months ended December 31, 2020
<b>Major products / service lines</b>		
Digitization and counter threat systems	\$ 16,640	\$ 138,934
Other	825	7,415
	<b>\$ 17,465</b>	<b>\$ 146,349</b>
<b>Primary geographical markets</b>		
United States	\$ 16,640	\$ 138,934
Canada	825	7,415
	<b>\$ 17,465</b>	<b>\$ 146,349</b>
<b>Timing of revenue recognition</b>		
Products and services transferred over time	\$ 16,640	\$ 138,934
Products transferred at a point in time	825	7,415
	<b>\$ 17,465</b>	<b>\$ 146,349</b>

At December 31, 2021, KWESST's contracted not yet recognized revenue was \$nil (2020 - \$1.1 million).

For the three months ended December 31, 2021, one customer accounted for 100% of the revenue based in the United States (2020 – one customer accounted for 100%).

### 15. Net finance costs

The following table presents a breakdown of net finance costs for the following periods:

	Three months ended December 31, 2021	Three months ended December 31, 2020
Interest expense from:		
Accretion cost - accrued royalties liability	\$ 38,184	\$ -
Lease obligations	7,632	14,895
Other	3,625	3,053
Total interest expense	49,441	17,948
Interest income	(1,799)	-
<b>Net finance costs</b>	<b>\$ 47,642</b>	<b>\$ 17,948</b>

### 16. Financial instruments

#### *Financial risk management*

The Company is exposed to a number of financial risks arising through the normal course of business as well as through its financial instruments. The Company's overall business strategies, tolerance of risk and general risk management philosophy are determined by the directors in accordance with prevailing economic and operating conditions.

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For the three months ended December 31, 2021, there were no material changes to KWESST's financial risks as disclosed in Note 22 of the audited consolidated financial statements for the year ended September 30, 2021.

At December 31, 2021, KWESST contractual obligations were as follows:

<b>Payment due:</b>	<b>Total</b>	<b>Within 1 Year</b>	<b>1 to 3 years</b>	<b>3 to 5 years</b>
Minimum royalty commitments	\$ 2,500,000	\$ -	\$ 150,000	\$ 2,350,000
Accounts payable and accrued liabilities	1,180,189	1,180,189	-	-
Lease obligations	382,200	78,000	187,200	117,000
Short-term rental obligations	25,938	25,938	-	-
Other commitments	50,712	50,712	-	-
Borrowings	90,000	30,000	60,000	-
<b>Total contractual obligations</b>	<b>\$ 4,229,039</b>	<b>\$ 1,364,839</b>	<b>\$ 397,200</b>	<b>\$ 2,467,000</b>

At December 31, 2021, KWESST had \$866,859 in working capital (current assets less current liabilities).

### 17. Supplemental cash flow information

The following table presents changes in non-cash working capital:

	<b>Three months ended December 31, 2021</b>	Three months ended December 31, 2020
Trade and other receivables	\$ 113,817	\$ (27,030)
Inventories	(401)	-
Prepaid expenses and other	223,044	(123,978)
Intangible assets	3,186	-
Accounts payable and accrued liabilities	(7,590)	129,970
Contract liabilities	2,465	(7,053)
	<b>\$ 334,521</b>	<b>(28,091)</b>

The following is a summary of non-cash items that were excluded from the Statements of Cash Flows for the three months ended December 31, 2021:

- \$19,000 debt settlement via common shares;
- \$60,000 fair value of warrants exercised and transferred to share capital from warrants; and
- \$125,000 for 250,000 warrants exercised in connection with the GhostStep™ acquisition in June 2020.

### 18. Commitments and contingencies

There was no change to the commitments and contingencies as disclosed in Note 26 of the audited consolidated financial statements for the year ended September 30, 2021.

### 19. Segmented information

KWESST's Executive Chairman has been identified as the chief operating decision maker. The Executive Chairman evaluates the performance of the Company and allocates resources based on the information provided by KWESST's internal management system at a consolidated level. KWESST has determined that it has only one operating segment.

## **KWESST MICRO SYSTEMS INC.**

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At December 31, 2021, and 2020, all of KWESST's property and equipment are located in Canada, including the right-of-use assets.