Consolidated Financial Statements of

KWESST MICRO SYSTEMS INC.

Years ended September 30, 2024, 2023, and 2022
(Expressed in Canadian Dollars)

KWESST MICRO SYSTEMS INC.

Table of contents for the years ended September 30, 2024, 2023, and 2022

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of Kwesst Micro Systems Inc.

Opinion on the Consolidated Financial Statements

We have audited the accompanying consolidated statement of financial position of Kwesst Micro Systems Inc. (the "Company") as at September 30, 2024, and the related consolidated statements of net loss and comprehensive loss, changes in shareholders' equity (deficit), and cash flows for the year then ended, and the related notes (collectively referred to as the "consolidated financial statements").

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Company as at September 30, 2024, and the results of its consolidated operations and its consolidated cash flows for the year then ended, in conformity with IFRS® Accounting Standards as issued by the International Accounting Standards Board.

Material Uncertainty Related to Going Concern

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 2(a) to the consolidated financial statements, the Company has suffered a net loss and negative operating cash flows, negative working capital and has an accumulated deficit which raises substantial doubt about its ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 2(a). The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Basis for Opinion

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

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

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

MNP LLP

Chartered Professional Accountants;

Licensed Public Accountants

We have served as the Company's auditor since 2024.

Ottawa, Canada

December 27, 2024

MNP LLP

Suite 800, 1600 Carling Avenue, Ottawa ON, K1Z 1G3

T: 613.691.4200 F: 613.726.9009

KWESST MICRO SYSTEMS INC.
Consolidated Statements of Financial Position
At September 30, 2024 and 2023

In Canadian dollars	**Notes**	**September 30, 2024**	September 30, 2023
ASSETS			
Cash and cash equivalents		**$ 256,828**	$ 5,407,009
Restricted short-term investment	12	**30,000**	30,000
Trade and other receivables	5	**567,875**	300,269
Inventories	6	**533,163**	542,388
Prepaid expenses and other		**179,051**	562,408
Deferred costs	27	**275,438**	-
Current assets		**1,842,355**	6,842,074
Property and equipment	7	**311,712**	417,296
Right-of-use assets	8	**230,124**	361,036
Deposit		**28,806**	26,076
Intangible assets	9	**3,174,832**	4,112,350
Deferred costs		**29,319**	-
Non-current assets		**3,774,793**	4,916,758
Total Assets		**$ 5,617,148**	$ 11,758,832
LIABILITIES AND SHAREHOLDERS' EQUITY			
Liabilities			
Accounts payable and accrued liabilities	10	**$ 1,660,637**	$ 1,649,876
Accrued royalties liability	4(b)	**200,000**	150,000
Lease obligations	13	**147,078**	127,116
Contract liabilities	14	**120,571**	120,970
Warrant liabilities	15	**847,295**	4,335,673
Current liabilities		**2,975,581**	6,383,635
Accrued royalties liability	4(b)	**1,118,135**	1,137,170
Lease obligations	13	**155,145**	302,407
Non-current liabilities		**1,273,280**	1,439,577
Total Liabilities		**4,248,861**	7,823,212
Shareholders' Equity			
Share capital	16(a)	**37,822,725**	33,379,110
Warrants	16(b)	**1,084,687**	1,042,657
Contributed surplus	16(c)	**5,152,753**	4,769,115
Accumulated other comprehensive loss		**(38,520)**	(39,663)
Accumulated deficit		**(42,653,358)**	(35,215,599)
Total Shareholders' Equity		**1,368,287**	3,935,620
Total Liabilities and Shareholders' Equity		**$ 5,617,148**	$ 11,758,832

See Note 2(a) Going concern and Note 27 Commitments and contingencies.
See accompanying notes to the consolidated financial statements.

On behalf of the Board of Directors:

(signed) Jennifer Welsh, Director *(signed) David Luxton* , Director

KWESST MICRO SYSTEMS INC.

Consolidated Statements of Net Loss and Comprehensive Loss

Years ended September 30, 2024, 2023 and 2022

In Canadian dollars	**Notes**	**September 30, 2024**	September 30, 2023	September 30, 2022
Revenue	18	**$ 1,504,328**	$ 1,234,450	$ 721,519
Cost of sales		**(1,017,826)**	(1,425,828)	(536,735)
Gross profit (loss)		**486,502**	(191,378)	184,784
Operating expenses				
General and administrative		**6,269,257**	7,244,762	4,915,263
Selling and marketing		**1,538,882**	3,024,283	3,296,373
Research and development, net		**2,477,736**	1,644,565	2,064,493
Total operating expenses	19	**10,285,875**	11,913,610	10,276,129
Operating loss		**(9,799,373)**	(12,104,988)	(10,091,345)
Other income (expenses)				
Share issuance costs	16(a)	**(541,566)**	(1,985,074)	-
Net finance costs	21	**(196,323)**	(668,034)	(506,002)
Foreign exchange gain (loss)		**59,191**	(98,275)	28,780
Change in fair value of warrant liabilities	15	**3,047,568**	5,841,192	-
Loss on disposal of property and equipment		**(7,256)**	(291,181)	(1,165)
Total other income (expenses), net		**2,361,614**	2,798,628	(478,387)
Loss before income taxes		**(7,437,759)**	(9,306,360)	(10,569,732)
Income tax recovery				
Deferred tax recovery	22	**-**	-	49,442
Net loss		**$ (7,437,759)**	$ (9,306,360)	$ (10,520,290)
Other comprehensive income:				
Items that are or may be reclassified subsequently to profit or loss:				
Foreign currency translation differences		**1,143**	61,755	(92,427)
Total comprehensive loss		**$ (7,436,616)**	$ (9,244,605)	$ (10,612,717)
Net loss per share				
Basic and diluted	17	**$ (8.99)**	$ (22.80)	$ (144.05)
Weighted average number of shares outstanding				
Basic and diluted	17	**827,135**	408,223	73,030

See accompanying notes to the consolidated financial statements.

KWESST MICRO SYSTEMS INC.

Consolidated Statements of Changes in Shareholders' Equity (Deficit)

Years ended September 30, 2024, 2023 and 2022

In Canadian dollars	**Notes**	**Share capital**	**Contingent shares**	**Warrants**	**Contributed surplus**	**Translation reserve**	**Deficit**	**Total Shareholders' Equity (Deficit)**
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	16(a)	19,000	-	-	-	-	-	19,000
Shares and warrants issued on acquisition	4(a)	377,503	83,319	132,000	-	-	-	592,822
Shares and warrants issued for cash	16(a),(b)	272,000	-	72,000	-	-	-	344,000
Contingent shares converted to common shares	4(a)	83,319	(83,319)	-	-	-	-	-
Warrants exercised	16(b)	277,098	-	(61,173)	-	-	-	215,925
Warrants expired	16(b)	-	-	(31,420)	31,420	-	-	-
Share-based compensation	16(c)	-	-	-	1,960,072	-	-	1,960,072
Shares for vested RSUs and PSUs	16(c)	874,840	-	-	(874,840)	-	-	-
withholding taxes	16(c)	-	-	-	(23,533)	-	-	(23,533)
Shares issued for unsecured loans	12	411,692	-	-	-	-	-	411,692
Share offering costs	16(a)	(33,880)	-	-	-	-	-	(33,880)
Other comprehensive loss		-	-	-	-	(92,427)	-	(92,427)
Net loss		-	-	-	-	-	(10,520,290)	(10,520,290)
Balance, September 30, 2022		$ 19,496,640	$ -	$ 1,959,796	$ 3,551,330	$ (101,418)	$ (25,909,239)	$ (1,002,891)
Shares issued for public offering	16(a)	16,725,436	-	-	-	-	-	16,725,436
Share offering costs	16(a)	(3,671,791)	-	393,911	125,086	-	-	(3,152,794)
Shares issued for debt	16(a)	233,485	-	-	-	-	-	233,485
Options exercised	16(c)	5,836	-	-	(1,789)	-	-	4,047
Warrants exercised	16(b)	60,000	-	(60,000)	-	-	-	-
Warrants expired	16(b)	-	-	(1,251,050)	1,251,050			-
Share-based compensation	16(c)	-	-	-	373,554	-	-	373,554
Shares for vested RSUs and PSUs	16(c)	529,504	-	-	(529,504)	-	-	-
Vested RSUs and PSUs repurchased for withholding taxes		-	-	-	(612)	-	-	(612)
Other comprehensive income		-	-	-	-	61,755	-	61,755
Net loss		-	-	-	-	-	(9,306,360)	(9,306,360)
Balance, September 30, 2023		$ 33,379,110	$ -	$ 1,042,657	$ 4,769,115	$ (39,663)	$ (35,215,599)	$ 3,935,620
Shares issued for public offering	16(a)	3,608,154	-	133,907	-	-	-	3,742,061
Share offering costs	16(a)	(935,778)	-	-	-	-	-	(935,778)
Warrants exercised	16(b)	1,771,239	-	-	-	-	-	1,771,239
Warrants expired	16(b)	-	-	(91,877)	91,877	-	-	-
Share-based compensation	16(c)	-	-	-	291,761	-	-	291,761
Other comprehensive income		-	-	-	-	1,143	-	1,143
Net loss		-	-	-	-	-	(7,437,759)	(7,437,759)
Balance, September 30, 2024		**$ 37,822,725**	**$ -**	**$ 1,084,687**	**$ 5,152,753**	**$ (38,520)**	**$ (42,653,358)**	**$ 1,368,287**

See accompanying notes to the consolidated financial statements.

KWESST MICRO SYSTEMS INC.
Consolidated Statements of Cash Flows
Years ended September 30, 2024, 2023 and 2022

In Canadian dollars	**Notes**	**September 30, 2024**	September 30, 2023	September 30, 2022
OPERATING ACTIVITIES				
Net loss		**$ (7,437,759)**	$ (9,306,360)	$ (10,520,290)
Items not affecting cash:				
Depreciation and amortization	7, 8, 9 and 20	**1,277,911**	952,508	326,491
Share-based compensation	16(c)	**291,761**	373,554	1,960,072
Change in fair value of warrant liabilities (including related foreign exchange gain)	15	**(3,047,568)**	(5,786,593)	-
Net finance costs	21	**196,323**	668,034	506,002
Impairment of intangible assets	9	-	1,169,440	-
Loss on disposals		**7,256**	291,181	1,165
Deferred tax recovery	22	-	-	(49,442)
Changes in non-cash working capital items	24	**(343,671)**	(2,310,266)	3,639,822
Interest paid		**(4,997)**	(130,127)	(120,416)
Cash used in operating activities		**(9,060,744)**	(14,078,629)	(4,256,596)
INVESTING ACTIVITIES				
Additions of property and equipment	7	**(101,330)**	(176,949)	(187,478)
Investments in intangible assets	9	**(9,823)**	(1,123,186)	(1,176,664)
Deposit for advanced royalties	4(b)	-	(148,410)	-
Recognition of open orders from acquisition	9	-	7,811	87,802
Cash acquired on acquisition	4	-	-	162,547
Cash flows used in investing activities		**(111,153)**	(1,440,734)	(1,113,793)
FINANCING ACTIVITIES				
Proceeds from U.S. IPO and Canadian Offering, net	16(a)	-	16,346,768	-
Proceeds from the issuance of common shares and warrants	15 and 16(a)	**4,965,680**	7,357,012	344,000
Payments of share offering costs	16(a)	**(747,926)**	(542,591)	(33,880)
Proceeds from borrowings	12	-	-	2,543,230
Payments of deferred financing fees	12	-	-	(150,409)
Repayment of borrowings	12	-	(2,333,315)	-
Repayments of lease obligations	13	**(197,651)**	(75,487)	(42,504)
Proceeds from related party advances	11	-	-	60,000
Repayments to related party advances	11	-	-	(60,000)
Proceeds from exercise of warrants	16(b)	**1,613**	-	215,925
Proceeds from exercise of stock options		-	4,052	-
Repurchase of vested RSUs and PSUs for withholding taxes		-	(612)	(23,533)
Cash flows provided by financing activities		**4,021,716**	20,755,827	2,852,829
Net change in cash during the period		**(5,150,181)**	5,236,464	(2,517,560)
Cash and cash equivalents, beginning of year		**5,407,009**	170,545	2,688,105
Cash and cash equivalents, end of year		**$ 256,828**	$ 5,407,009	$ 170,545
Cash and cash equivalents consist of the following:				
Cash held in banks		**256,828**	4,407,009	170,545
Short-term guaranteed investment certificates		-	1,000,000	-
Cash and cash equivalents, end of year		**256,828**	5,407,009	170,545

See Note 24 Supplemental cash flow information.
See accompanying notes to the consolidated financial statements.

1. Corporate information

a) Corporate information

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

We develop and commercialize next-generation technology solutions that deliver a tactical advantage for military, public safety agencies and personal defense markets. Our core mission is to protect and save lives.

KWESST's common stock is listed on the TSX-Venture Exchange ("TSX-V'') under the stock symbol of KWE, on the Nasdaq Capital Market ("Nasdaq") under the stock symbol of KWE and on the Frankfurt Stock Exchange under the stock symbol of 62U. Additionally, warrants issued in the United States are also listed on the Nasdaq under the stock symbol of KWESW. Effective May 1, 2023, the warrants issued in Canada are listed on the TSX-V under the stock symbol of KWE.WT.U.

b) 2024 Reverse Stock Split

In October 2024, KWESST effected a ten for one (10-for-1) reverse stock split of its common stock on October 23, 2024 (the "2024 Reverse Split"). Accordingly, all shareholders of record at the opening of business on October 23, 2024, received one issued and outstanding common share of KWESST in exchange for ten outstanding common shares of KWESST. No fractional shares were issued in connection with the 2024 Reverse Split. All fractional shares created by the 2024 Reverse Split were rounded to the nearest whole number of common shares, with any fractional interest representing 0.5 or more common shares entitling holders thereof to receive one whole common share.

Effective on the date of the 2024 Reverse Split, the exercise price and number of common shares issuable upon the exercise of outstanding stock options and warrants were proportionately adjusted to reflect the 2024 Reverse Split. All information respecting outstanding common shares and other securities of KWESST, including net loss per share, in the current and comparative periods presented herein give effect to the 2024 Reverse Split.

c) 2022 Reverse Stock Split

In August 2022, we submitted a Form F-1 Registration Statement to the U.S. Securities and Exchange Commission and applied to have its common shares listed on the Nasdaq. In connection with KWESST's listing application on Nasdaq, we effected a seventy for one (70-for-1) reverse stock split of its common stock on October 28, 2022 (the "2022 Reverse Split"). Accordingly, all shareholders of record at the opening of business on October 28, 2022, received one issued and outstanding common share of KWESST in exchange for seventy outstanding common shares of KWESST. No fractional shares were issued in connection with the 2022 Reverse Split. All fractional shares created by the 2022 Reverse Split were rounded to the nearest whole number of common shares, with any fractional interest representing 0.5 or more common shares entitling holders thereof to receive one whole common share.

Effective on the date of the 2022 Reverse Split, the exercise price and number of common shares issuable upon the exercise of outstanding stock options were proportionately adjusted to reflect the 2022 Reverse Split. The restricted share units ("RSUs") and performance stock units ("PSUs") have also been adjusted for the 2022 Reverse Split. While the number of warrants has not changed as a result of the Reverse Split, the conversion rate for each warrant was adjusted from one common share to 0.01428571 common share.

2. Basis of preparation

(a) Going concern

These consolidated financial statements have been prepared assuming we will continue as a going concern. The going concern basis of presentation assumes we will continue in operation for the foreseeable future and can realize our assets and discharge our liabilities and commitments in the normal course of business.

As an early-stage company, we have not yet reached significant revenue levels for most of our products and have incurred significant losses and negative operating cash flows from inception that have primarily been funded from financing activities. We have incurred a $7.4 million net loss and negative operating cash flows of approximately $9.1 million for the year ended September 30, 2024 (2023 - $9.3 million net loss and negative operating cash flows of $14.1 million, 2022 - $10.5 million net loss and negative operating cash flows of $4.3 million). At September 30, 2024, we had negative working capital of $1.1 million (2023 - positive working capital of $0.5 million) and $42.7 million in deficit (September 30, 2023 - $35.2 million).

Our ability to continue as a going concern and realize our assets and discharge our liabilities in the normal course of business is dependent upon closing timely additional sales orders, timely commercial launch of new products, and the ability to raise additional debt or equity financing, when required. There are various risks and uncertainties affecting our future financial position and our performance including, but not limited to:

- The market acceptance and rate of sales of our product offerings;
- Ability to successfully execute our business plan;
- Ability to raise additional capital at acceptable terms;
- General local and global economic conditions, including the ongoing conflict in Gaza and the global disruption from Russia's invasion of Ukraine.
- Instability in Canada's elected leadership and the threatened tariffs from President Elect Donald Trump.

Our 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 our business plan could have a material adverse effect on our financial condition and/or financial performance. There is no assurance that we 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 our ability to continue as a going concern.

These consolidated 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.

(b) Statement of compliance

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") and interpretations of the IFRS Interpretations Committee ("IFRIC").

The consolidated financial statements were authorized for issue by the Board of Directors effective on December 27, 2024.

(c) Basis of consolidation

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

Control is achieved where we have 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 our 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 us 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 September 30, 2024, we have the following wholly owned subsidiaries:

	Location	Equity %
KWESST Inc.	Ottawa, Canada	100%
2720178 Ontario Inc.	Ottawa, Canada	100%
Police Ordnance Company Inc.	Ottawa, Canada	100%
KWESST U.S. Holdings Inc.	Delaware, United States	100%
KWESST Defense Systems U.S. Inc.	North Carolina, United States	100%
KWESST Public Safety Systems U.S. Inc.	North Carolina, United States	100%
KWESST Public Safety Systems Canada Inc.	Ottawa, Canada	100%

(d) Functional and presentation currency

The consolidated financial statements are presented in Canadian dollars ("CAD"), our functional and presentation currency.

While each of the Company's subsidiaries has its own functional currency, the functional currency of the parent company, KWESST Micro Systems Inc., is CAD as this is the currency of the primary economic environment in which the Company operates. Most of the revenues, cost of revenues and operating expenses from significant subsidiaries are denominated in CAD.

(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) Use of estimates and judgments

The preparation of the consolidated 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 is included in the following notes:

- Impairment: the Company is required to make a judgment regarding whether indicators of impairment exist at each reporting date by evaluating conditions specific to the organization that may lead to the impairment of assets.

<u>Estimates</u>

Information about assumptions and estimation uncertainties at September 30, 2024, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities in the next financial year is included in the following notes:

- Note 6 – *Inventories*: assumptions used in evaluating inventory obsolescence;
- Note 15 – *warrant liabilities*: whether the valuation assumptions used in the Black Scholes calculations for the warrant liabilities are reasonable;
- Note 16(c) - *share-based compensation*: whether the determination of KWESST's stock volatility, forfeiture rate, and expected life are reasonable in light of its limited operating history, all significant inputs in the valuation model to fair value options granted; and
- Note 18 – *Revenue*: key assumptions underlying the recognition of revenue based on percentage of completion, including remaining hours and costs to complete.

3. Material accounting policies

(a) Revenue recognition

Revenue is recognized upon transfer of control of products or services to customers at an amount that reflects the transaction price we expect to receive in exchange for the products or services. Our contracts with customers may include the delivery of multiple products and services, which are generally capable of being distinct and accounted for as separate performance obligations. The accounting for a contract or contracts with a customer that contain multiple performance obligations requires us to allocate the contract or contracts transaction price to the identified distinct performance obligations based on the stand-alone selling price of each performance obligation.

Revenue from contracts with customers is recognized, for each performance obligation, either over a period of time or at a point in time, depending on which method reflects the transfer of control of the goods or services underlying the particular obligation to the customer. Contracts based on task oriented, time and materials is measured based on agreed-upon hourly rates, direct labor hours expended and material costs incurred and billed and recognized on a monthly basis. For product sales, revenue is recognized when the Company transfers control of the product to the customer. Control of the product transfers when the customer takes delivery of the product.

For performance obligations satisfied over time, we recognize revenue over time using an input method, based on costs incurred to date relative to total estimated costs at completion, to measure progress toward satisfying such performance obligation (for non-recurring engineering services, the input method is based on hours). Under this method, costs that do not contribute to the performance of KWESST in transferring control of goods or services to the customer are excluded from the measurement of progress toward satisfying the performance obligation. In certain other situations, we might recognize revenue at a point in time, when the criteria to recognize revenue over time are not met. In any event, when the total anticipated costs exceed the total anticipated revenues on a contract, such a loss is recognized in its entirety in the period it becomes known.

We may enter into contractual arrangements with a customer to deliver services on one project with respect to more than one performance obligation, such as non-recurring engineering, procurement, and training. When entering into such arrangements, we allocate the transaction price by reference to the stand-alone selling price of each performance obligation. Accordingly, when such arrangements exist on the same project, the value of each performance obligation is based on its stand-alone price and recognized according to the respective revenue recognition methods described above. For example, for non-recurring engineering services rendered over a contract period the revenue is recognized using the percentage of completion method; whereas for training services the revenue is recognized after the training is delivered (i.e. point in time).

We account for a contract modification, which consists of a change in the scope or price (or both) of a contract, as a separate contract when the remaining goods or services to be delivered after the modification are distinct from those delivered prior to the modification and the price of the contract increases by an amount of consideration to a price which reflects KWESST's stand-alone selling price of the additional promised goods or services. When the contract modification is not accounted for as a separate contract, we recognize an adjustment to revenue on a cumulative catch-up basis at the date of contract modification.

The timing of revenue recognition often differs from performance payment schedules, resulting in revenue that has been earned but not billed. These amounts are included in unbilled receivables. Amounts billed in accordance with customer contracts, but not yet earned, are recorded and presented as part of contract liabilities.
When a contract includes a significant financing component, the value of such component is excluded from the transaction price and is recognized separately as finance income or expense, as applicable.

(b) Business combinations

We account for business combinations using the acquisition method. Goodwill arising on acquisitions is measured as the fair value of the consideration transferred less the net recognized amount of the estimated fair value of identifiable assets acquired and liabilities assumed, all measured as of the acquisition date. Transaction costs that we incur in connection with a business combination are expensed as incurred. We use our best estimates and assumptions to reasonably value assets acquired and liabilities assumed at the acquisition date as well as contingent consideration, where applicable, and these estimates are inherently uncertain and subject to refinement. As a result, during the measurement period, which may be up to one year from the acquisition date, we may record adjustments to the assets acquired and liabilities assumed with a corresponding offset to goodwill. Upon conclusion of the measurement period or final determination of the values of assets acquired or liabilities assumed, whichever comes first, any subsequent adjustments are recorded in profit or loss.

Where the total purchase consideration is less than the fair value of identifiable net assets, we recognize a gain on acquisition.

Acquisitions that do not meet the definition of a business are accounted for as asset acquisitions in accordance with the relevant IFRS standards and applicable to the type of asset acquired.

(c) Financial instruments

We recognize a financial asset or a financial liability when the Company becomes a party to the contractual provisions of the instrument.

Trade and other receivables without a significant financing component are initially measured at the transaction price. All other financial assets and financial liabilities are initially recognized at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at fair value through profit or loss ("FVTPL")) are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at fair value through profit or loss are recognized immediately in profit or loss.

Financial assets

All financial assets are recognized and de-recognized on trade date.
Financial assets are recognized at fair value and subsequently classified and measured at:

a) Amortized cost;
b) Fair value through other comprehensive income ("FVOCI"); or
c) Fair value though profit or loss ("FVTPL").

We determine the classification of our financial assets on the basis of both the business model for managing the financial assets and the contractual cash flows characteristics of the financial asset. Financial assets are not reclassified subsequent to their initial recognition unless we change our business model for managing financial assets.

A financial asset is measured at amortized cost if it is held within a business model whose objective is to hold assets to collect contractual cash flows, and its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest of the principal amount outstanding. Financial assets classified at amortized cost are measured using the effective interest method. At September 30, 2024, we classified the following as amortized cost:

- Cash and cash equivalents
- Restricted short-term investment
- Trade and other receivables (excluding sales tax recoverable)
- Lease deposit (non-current other asset)

All financial assets not classified and measured at amortized cost or FVOCI are measured at FVTPL. At September 30, 2024, we did not have financial assets classified as FVOCI or FVTPL.

Expected credit losses

We measure a loss allowance based on the lifetime expected credit losses. The Company has applied the simplified method approach to recognize the lifetime expected credit losses that are estimated based on factors such as our past experience of collecting payments, the number of delayed payments in the portfolio past the average credit period, observable changes in national or local economic conditions that correlate with default on receivables, financial difficulty of the borrower, and it becoming probable that the borrower will enter bankruptcy or financial re-organization.

Financial assets are written off when there is no reasonable expectation of recovery.

<u>Financial liabilities</u>

Financial liabilities are recognized at fair value and subsequently classified and measured at amortized cost or fair value though profit or loss (“FVTPL”).

We determine the classification of our financial liabilities at initial recognition. We have classified the following as amortized cost:

- Accounts payable and accrued liabilities
- Accrued royalties liability

The warrant liabilities are classified as FVTPL.

Financial liabilities at amortized cost are measured using the effective interest rate method.

De-recognition of financial liabilities
KWESST de-recognizes financial liabilities when its obligations are discharged, cancelled or they expire.

(d) Cash and cash equivalents

Cash and cash equivalents include cash investments in interest-bearing accounts and term deposits which can readily be redeemed for cash without penalty or are issued for terms of three months or less from date of acquisition.

(e) Inventories

KWESST's inventories may consist of raw materials, work-in-progress ("WIP") and finished goods. Inventories are measured at the lower of cost and net realizable value, with cost being determined using the weighted average cost method. The cost of WIP and finished goods includes the cost of raw materials, direct labour, and overhead. Net realizable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses. At each reporting period, management estimates the provision for obsolete and slow-moving inventory which may be reversed in subsequent periods, should the value subsequently be recovered.

(f) Property and equipment

Property and equipment are measured at cost less accumulated depreciation and accumulated impairment losses. Cost comprises the fair value of consideration given to acquire or construct an asset and includes the direct charges associated with bringing the asset to the location and condition necessary for putting it into use along with the future cost of dismantling and removing the asset. These assets are depreciated over their estimated useful lives using the straight-line method as this most closely reflects the expected pattern of consumption of the future economic benefits. Depreciation methods, useful lives and residual values are reviewed at each financial year end and adjusted prospectively, if appropriate.

The following table provides a summary of estimated useful lives for our property and equipment:

	Rate
Computer equipment	3 years
Computer software	3 years
Office furniture and equipment	5 years
Low-rate initial production equipment	5 years
R&D equipment	5 years
Sales demo equipment	2 years
Leasehold improvements	Shorter of useful life or remaining term of lease

At the end of each reporting period, we review the carrying amounts of its property and equipment to determine whether there is any indication of impairment. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). The recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For the purpose of impairment testing, assets that cannot be tested individually are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash flows of other assets or groups of assets (the "cash-generating unit, or CGU"). If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. An impairment loss is recognized immediately in profit or loss. Where an impairment loss subsequently reverses, the carrying amount of the CGU is increased to the revised estimate of its recoverable amount, so long as the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognized for the CGU in prior years.

Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

(g) Leases

At inception of a contract, we assess whether a contract is, or contains, a lease based on whether the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

We recognize a right-of-use asset and a lease liability at the lease commencement date. The lease obligation is measured at the present value of the lease payments that are not paid at the commencement date of the lease, discounted using its incremental borrowing rate at the inception of the lease. The right-of-use asset is initially measured based on 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 and an estimate of costs to dismantle and remove the underlying asset or to restore the underlying asset or the site on which it is located, less any lease incentives received. The assets are depreciated to the earlier of the end of the useful life of the right-of-use asset or the lease term using the straight-line method as this most closely reflects the expected pattern of consumption of the future economic benefits. The lease term includes periods covered by an option to extend if we are reasonably certain to exercise that option. In addition, the right-of-use asset is periodically reduced by impairment losses, if any, and adjusted for certain remeasurements of the lease liability.

The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted using the interest rate implicit in the lease or, if that rate cannot be readily determined, our incremental borrowing rate. Variable lease payments that do not depend on an index or rate are not included in the measurement of the lease liability.

The lease liability is measured at amortized cost using the effective interest method. It is remeasured when there is a change in future lease payments arising from a change in an index or rate, if there is a change in our estimate of the amount expected to be payable under a residual value guarantee, or if we change our assessment of whether it will exercise a purchase, extension, or termination option. When the lease liability is remeasured in this way, a corresponding adjustment is made to the carrying value of the right-of-use asset or, is recorded in profit or loss if the carrying amount of the right-of-use asset has been reduced to zero.

We have elected to apply the practical expedient not to recognize right-of-use assets and lease liabilities for short-term leases that have a lease term of 12 months or less and leases of low-value assets. The lease payments associated with these leases are recognized as an expense on a straight-line basis over the lease term.

(h) Intangible assets

(i) Research and development (“R&D”) costs

Expenditure on research activities, undertaken with the prospect of gaining new scientific or technical knowledge and understanding, is recognized in profit or loss when incurred.

Development expenditure is capitalized only if development costs can be measured reliably, the product or process is technically and commercially feasible, future economic benefits are probable, and we have the intention and sufficient resources to complete the development and to use or sell the asset. The expenditure capitalized in respect of development activities includes the cost of materials, direct labor and overhead costs that are directly attributable to preparing the asset for its intended use, and capitalized borrowing costs. Other development expenditures are recognized in profit or loss when incurred.

(ii) Subsequent expenditure

Subsequent expenditure is capitalized only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditures, including expenditure on internally generated goodwill and brands, is recognized in profit or loss as incurred.

(iii) Acquired intangible assets

Acquired intangible assets consist of open customer orders, tradenames, customer relationships, patents, and technology assets acquired either through an asset purchase or a business combination transaction. These intangible assets are recorded at their fair value at the acquisition date.

After initial recognition, intangible assets are measured at cost less any accumulated amortization and impairment losses. For open customer orders, we reduce the amount when we have delivered under the customer contract, with an offset to accounts receivable (i.e. there is no revenue recognized for acquired open customer orders). Intangible assets with finite useful lives are amortized on a straight-line basis over their estimated useful lives. Amortization begins when the related acquired technology is commercialized. We anticipate the estimated useful life for the current technology assets to be five years once commercialized.

(iv) Amortization

Amortization is a systematic allocation of the amortizable amount of an intangible asset of its useful life. The amortizable amount is the cost of the asset less its estimated residual value. We recognize in profit or loss on a sales-based rate over the estimated useful lives of the intangible assets from the date they are available for use, since this method most closely reflects the expected pattern of consumption of the future economic benefits embodied in each asset. Where a sales-based rate could not be determined, the straight-line approach is used.

Internally generated intangible assets are not systematically amortized as long as they are not available for use i.e. they are not yet in working condition for their intended use. Accordingly, intangible assets such as development costs are assessed for impairment at least once a year, until such date as they are available for use.

(v) Impairment

All intangible assets are periodically reviewed for impairment. Management assesses intangible assets for triggers of impairment, including ability to produce future cash flows and the investments required to reach marketability. The estimated present value of future cash flows associated with the intangible asset is determined and an impairment loss is recognized for the difference between this amount and the carrying amount as follows: the carrying amount of the asset is reduced to estimated present value of the future cash flows associated with the asset, discounted at the financial asset's original effective interest rate, and the resulting loss is directly recognized in profit or loss for the period.

(i) Provisions

A provision is recognized if, as a result of a past event, we have a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risk specific to the liability. The accretion of the discount is recognized as a finance cost.

(j) Income taxes

Income tax expense comprises of current income tax expense and deferred income tax expense. Current and deferred income taxes are recognized as an expense and included in profit or loss for the period, except to the extent that the tax arises from a transaction which is recognized in other comprehensive income or directly in shareholder's equity.

Current income tax

Current tax expense is the amount of income taxes payable (recoverable) in respect of the taxable income (tax loss) for a period. Current liabilities (assets) for the current and prior periods are measured at the amount expected to be paid to (recovered from) the taxation authorities, using the tax rates that have been enacted or substantively enacted by the end of the reporting period.

Deferred income tax

Deferred tax assets and liabilities are recognized for the temporary differences between transactions and carrying amounts of assets and liabilities that have been included in the consolidated financial statements and the amounts used for taxation purposes. Deferred income taxes are provided for using the liability method. Under the liability method, deferred income taxes are recognized for all significant temporary differences between the tax and financial statement bases of assets and liabilities and for certain carry-forward items. Deferred income tax assets are recognized only to the extent that it is probable that the deferred income tax assets will be realized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent it is no longer probable that the related tax benefit will be realized.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the year when the asset is realized or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the reporting period. Deferred income tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of the enactment or substantive enactment. Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority, and we intend to settle our current tax assets and liabilities on a net basis.

Investment tax credits

Investment tax credits relating to scientific research and experimental development expenditures are recorded in the fiscal period the qualifying expenditures are incurred based on management's interpretation of applicable legislation in the Income Tax Act of Canada. Credits are recorded provided there is reasonable assurance that the tax credit will be realized. Credits claimed are subject to review by the Canada Revenue Agency.

Credits claimed in connection with R&D activities are accounted for using the cost reduction method. Under this method, assistance and credits relating to current expenditures, which are primarily salaries and related benefits, are included in the determination of profit or loss as a reduction of the R&D expenses.

(k) Related party transactions

Parties are considered to be related if one party has the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial and operating decisions. Parties are also considered to be related if they are subject to common control or common significant influence. Related parties may be individuals or corporate entities. A transaction is considered to be a related party transaction when there is a transfer of resources or obligations between related parties. Related party transactions are in the normal course of business and have commercial substance.

(l) Share-based compensation

We have a Long-Term Incentive Plan ("LTIP") in which we may grant stock options, restricted share units ("RSUs"), performance stock units ("PSUs"), deferred stock units ("DSUs"), and stock appreciation rights ("SARs") to directors, employees, and consultants. We measure share-based compensation at fair value for all share-based awards granted under the LTIP.

Equity-settled service award

The grant date fair value of equity-settled share-based awards is recognized as an expense on a straight-line basis over the requisite service period, with a corresponding increase in equity, over the vesting period of the awards. For stock options, the grant date fair value is determined using the Black-Scholes option model. For share units, the grant date fair value is based on KWESST's closing stock price. Each tranche of an award is considered a separate award with its own vesting period and grand date fair value. The amount recognized as an expense is adjusted for estimated forfeitures.

Equity-settled performance award

The accounting for equity-settled performance award is the same as above, except compensation expense is subject to periodic adjustment based on the achievement of establishment performance criteria.

Modified award

Where the terms of an equity-settled transaction award are modified, the minimum expense recognized is the expense as if the terms had not been modified and if the original terms of the award are met. An additional expense is recognized for any modification that increases the total fair value of the share-based payment transaction or is otherwise beneficial to the employees as measured at the date of acquisition.

(m) Equity

Share capital represents the amount received for shares that have been issued less transaction costs directly attributable to the issuance of common shares net of any related income tax benefits.

Valuation of equity instruments

The Company has adopted a residual method with respect to the measurement of common shares and warrants issued as units. Warrants attached to units are valued based on the fair value of the warrants using the Black Scholes option pricing model and the share price at the time of financing, and the difference between the proceeds raised and the value assigned to the warrants is the residual fair value of the shares. The proceeds from the issue of the units are allocated between share capital and warrants. In situations when the warrants are categorized as FVTPL the value associated with the warrants is presented as a liability. If and when the warrants are exercised, the applicable amounts of warrants or liability are transferred to share capital. Any consideration paid on the exercise of the warrants is credited to share capital.

Broker warrants

The Company uses the fair value method based on the Blach-Scholes pricing model to determine the fair value of the warrants issued to brokers and records a debit to share issuance costs with a corresponding credit to warrants. Warrants within equity are included in the warrants outstanding.

(n) Foreign currency

Foreign currency transactions

The financial statements of KWESST and its Canadian wholly owned subsidiaries are measured using CAD as the functional currency. Transactions in currencies other than in CAD are translated at the exchange rates prevailing at the dates of the transactions. At the end of each reporting period, monetary items denominated in foreign currencies are translated to the functional currency at the rates prevailing at that date. Exchange differences on monetary items are recognized in profit or loss in the period in which they arise. Non-monetary items carried at fair value that are denominated in foreign currencies are translated to the functional currency at the rates prevailing at the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the rates at the date of the transaction and are not subsequently retranslated.

Foreign operations

The financial statements of KWESST's U.S. owned subsidiaries are measured using the United States dollar ("USD") as its functional currency. Assets and liabilities have been translated into USD using exchange rates prevailing at the end of each reporting period. Income and expense items are translated at the average exchange rates for the period, unless exchange rates fluctuate significantly during that period, in which cases the exchange rates at the dates of the transactions are used. Exchange differences arising, if any, are recognized in other comprehensive income and accumulated in shareholders' equity.

(Expressed in Canadian dollars, except share amounts)

(o) Earnings (loss) per share

Basic earnings (loss) per share is computed using net earnings (loss) over the weighted average number of common shares outstanding during the period. We use the treasury stock method to compute the dilutive effect of options, warrants, and similar instruments. Under this method, the dilutive effect on earnings per share is calculated presuming the exercise of outstanding options, warrants, and similar instruments. It assumes that the proceeds of such exercise would be used to repurchase common shares at the average market price during the period.

However, the calculation of diluted loss per share excludes the effects of various conversions and exercises of options and warrants that would be anti-dilutive.

4. Acquisitions

a) Police Ordnance

On December 15, 2021, we 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^{TM} product line of launchers, and a proprietary line of 37 mm cartridges designed for riot control and tactical teams. Police Ordnance has law enforcement customers across Canada, the United States, and abroad. The Police Ordnance Acquisition provides us with a strategic opportunity to leverage its law enforcement customer base to accelerate growth within its specialty ordnance business.

We accounted for the acquisition of Police Ordinance pursuant to IFRS 3, *Business Combinations*.

Consideration Transferred:

The purchase consideration comprised of the following:

	Number		Fair Value
Common shares	396	$	377,503
Warrants	20,000	$	132,000
Contingent shares	87	$	83,319
Total fair value purchase consideration		**$**	**592,822**

The warrants are exercisable at $17.20 each and expired on December 15, 2024. As a result of the 2022 Reverse Split (see Note 1(c)), each warrant converts into 0.01428571 common share or 70 warrants to receive one common share of KWE.

We issued the 87 contingent common shares to the sellers in April 2022 following the fulfillment of the financial milestone as defined in the share purchase agreement.

We have 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 $17.20, 1/70 of the underlying stock price of $13.60, risk free rate of 1.04%, 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.

(Expressed in Canadian dollars, except share amounts)

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		-
Net cash inflow on acquisition	**$**	**162,547**

Net Assets Acquired:

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

Total purchase consideration at fair value	**$**	**592,822**
Police Ordnance's net assets:		
Cash		162,547
Trade and other receivables		104,432
Inventories		352,685
Intangible assets:		
Purchase orders		100,000
Customer relationships		50,000
ARWEN™ tradename		44,000
Accounts payable and accrued liabilities		82,963
Corporate tax liability		32,338
Contract liabilities		29,861
Borrowings		26,238
Deferred tax liabilities		49,442
Net assets at fair value	**$**	**592,822**

As a result of the above purchase price allocation, we have recorded no goodwill for the Police Ordnance Acquisition.

Impact on KWESST's Results of Operations:

The results of operations of Police Ordnance are included in these consolidated statements of net loss and comprehensive loss from December 16, 2021. For the year ended September 30, 2024, Police Ordnance contributed revenue of $466,211 (2023 - $375,758, 2022 - $355,296) and net loss of $219,220 (2023 - $505,733, 2022 - $198,353) to our consolidated results.

If the acquisition had occurred on October 1, 2021, management estimates that Police Ordnance would have contributed approximately $846,600 of revenue and approximately $31,000 of net profit to our operating results for the year ended September 30, 2022, respectively. In determining these amounts, we have 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.

We incurred immaterial acquisition-related costs.

b) LEC System

On April 29, 2021, we acquired the Low Energy Cartridge technology from DEFSEC, a proprietary non-lethal cartridge-based firing system (subsequently branded as PARA OPS™ system). This technology acquisition includes all intellectual property rights for the PARA OPS™ system. With this acquisition, we will target the following four market segments that currently use a variety of dated "non-lethal" or "less-lethal" systems:

(Expressed in Canadian dollars, except share amounts)

(i) public order (riots and control of dangerous subjects);
(ii) military and law enforcement training (realistic force-on-force training);
(iii) personal defence (home, car, boat, RV, camping, hiking); and
(iv) high-action gaming.

As DEFSEC is a private company owned by our Executive Chairman, this asset acquisition is a related party transaction. We relied on exemptions from the formal valuation and minority shareholder approval requirements available under Multilateral Instrument 61-101, *Protection of Minority Security Holders in Special Transactions.* However, we obtained approval from over 51% disinterested shareholders as well as from the TSX-V prior to closing the acquisition.
We accounted for the acquisition of the PARA OPS™ pursuant to IFRS 2, *Share-Based Payment.*

The purchase consideration consisted of:

- 1,428 common shares of KWESST; and
- 50,000 warrants to purchase our common shares at $7.00 each per 1/70 of a common share (70 warrants for one common share); 25% vesting on the first anniversary of the closing of the acquisition and 25% per annum thereafter. These warrants will expire on April 29, 2026.

Additionally, we will pay 7% royalty on annual sales of the PARA OPS™ system to DEFSEC, net of taxes and duties, up to a maximum of $10 million, subject to minimum annual royalty payments starting in 2022. At the closing of the acquisition, we made an upfront payment of $150,000 as an advance on future royalty payments.

The minimum annual royalty payments are as follows:

Date	Amount
April 29 2023	$ 150,000
April 29 2024	$ 150,000
April 29 2025	$ 200,000
April 29 2026	$ 200,000
April 29 2027	$ 250,000
April 29 2028	$ 250,000
April 29 2029	$ 300,000
April 29 2030	$ 300,000
April 29 2031	$ 350,000
April 29 2032	$ 350,000
Total	$ 2,500,000

The royalty payment obligation of the Purchase Agreement ("Agreement") will expire in 20 years unless terminated earlier under the terms set out in the Agreement. At our sole discretion, we may terminate this Agreement for convenience, including if market conditions for sales of the PARA OPS™ system become unfavorable subject to 60 day's prior written notice. Upon termination, we will be fully released and discharged by DEFSEC including the outstanding future royalties and any unvested warrants shall be immediately cancelled. In return, we will return all intellectual property rights relating to the PARA OPS™ system to DEFSEC.

The purchase price was determined as follows:

(Expressed in Canadian dollars, except share amounts)

	Number		Fair Value
Common shares	1,428	$	1,290,000
Warrants	50,000	$	425,000
Minimum royalty payments		$	1,191,219
Total		**$**	**2,906,219**

Identifiable intangible assets		
Technology asset	**$**	**2,906,219**

We estimated the fair value as follows:

- *Common shares*: based on KWESST's closing stock price on April 29, 2021.
- *Warrants*: based on using the Black Scholes option model with the following key inputs:
    - a) exercise price of $7.00, 1/70 of the underlying stock price of $12.90;
    - b) risk free rate of 0.48%;
    - c) expected life of three years; and
    - d) expected volatility of 80%.
- *Minimum royalty payments*: based on the income approach, specifically discounted cash flows, using a discount rate of 13.7% per annum.

During the year ended September 30, 2024, we recorded $180,965 of accretion cost relating to the discounted minimum royalty payments, which is included in net finance costs in the consolidated statements of net loss and comprehensive loss (2023 - 170,373, 2022 - $159,451). As at September 30, 2024, $1,318,135 of accrued royalties liability was outstanding (2023 - $1,287,170, 2022 - $1,265,207).

5. Trade and other receivables

The following table presents a breakdown of our trade and other receivables:

		September 30, 2024		September 30, 2023
Trade receivables	**$**	**455,049**	$	68,530
Unbilled revenue		**42,248**		5,211
Sales tax recoverable		**70,578**		226,528
Total	**$**	**567,875**	$	300,269

There was no impairment of trade and other receivables during the year ended September 30, 2024 (2023 - $nil).

The following table presents changes in unbilled receivables:

(Expressed in Canadian dollars, except share amounts)

	September 30, 2024	September 30, 2023
Balance, beginning of year	**$ 5,211**	$ 8,881
Revenue billed during the year	**(5,211)**	(3,670)
Revenue in excess of billings, net of amounts transferred to trade receivables	**42,248**	-
Balance, end of year	**$ 42,248**	$ 5,211
Current	**$ 42,248**	$ 5,211
Non-current	**$ -**	$ -

6. Inventories

The following table presents a breakdown of our inventories:

	September 30, 2024	September 30, 2023
Finished goods	**$ 55,754**	$ 62,730
Work-in-progress	**417,890**	116,435
Raw materials	**59,519**	363,223
Total	**$ 533,163**	$ 542,388

In Fiscal 2024, a total of $139,813 (2023 - $528,890) of inventories was included in profit or loss as an expense as part of cost of sales.

The Company identified inventory items that were obsolete, no longer in use, or otherwise non-viable for production purposes. These items were specifically considered impaired and subsequently written off to reflect their reduced value. $113,283 of inventory was written off during the year ended September 30, 2024 (2023 – $nil).

7. Property and equipment

The following is a summary of changes in our property and equipment:

(Expressed in Canadian dollars, except share amounts)

Cost	Computer equipment	Computer software	Office furniture and equipment	LRIP equipment[1]	R&D equipment	Leasehold improvements	Sales demo equipment	Total
Balance at September 30, 2022	$ 106,806	$ 5,129	$ 100,933	$ 77,559	$ 239,804	$ 137,037	550,086	$ 1,217,354
Additions	37,047	-	8,645	20,099	-	2,680	108,478	176,949
Disposals	-	-	-	-	-	(7,925)	(549,330)	(557,255)
Balance at September 30, 2023	$ 143,853	$ 5,129	$ 109,578	$ 97,658	$ 239,804	$ 131,792	109,234	$ 837,048
Additions	46,254	-	14,000	41,076	-	-	-	101,330
Disposals	(1,799)	-	(8,645)	-	(26,387)	-	-	(36,831)
Balance at September 30, 2024	**$ 188,308**	**$ 5,129**	**$ 114,933**	**$ 138,734**	**$ 213,417**	**$ 131,792**	**$ 109,234**	**$ 901,547**

Accumulated depreciation	Computer equipment	Computer software	Office furniture and equipment	LRIP equipment[1]	R&D equipment	Leasehold improvements	Sales demo equipment	Total
Balance at September 30, 2022	$ 42,525	$ 1,254	$ 59,431	$ 7,002	$ 84,506	$ 44,449	145,706	$ 384,873
Depreciation	34,937	1,710	20,753	18,749	50,618	21,141	153,045	300,953
Disposals	-	-	-	-	-	(7,925)	(258,149)	(266,074)
Balance at September 30, 2023	$ 77,462	$ 2,964	$ 80,184	$ 25,751	$ 135,124	$ 57,665	40,602	$ 419,752
Depreciation	37,788	1,710	15,342	36,760	32,289	21,371	54,398	199,658
Disposals	(1,799)	-	(8,645)	-	(19,131)	-	-	(29,575)
Balance at September 30, 2024	**$ 113,451**	**$ 4,674**	**$ 86,881**	**$ 62,511**	**$ 148,282**	**$ 79,036**	**$ 95,000**	**$ 589,835**
Carrying value at September 30, 2023	$ 66,391	$ 2,165	$ 29,394	$ 71,907	$ 104,680	$ 74,127	$ 68,632	$ 417,296
Carrying value at September 30, 2024	**$ 74,857**	**$ 455**	**$ 28,052**	**$ 76,223**	**$ 65,135**	**$ 52,756**	**$ 14,234**	**$ 311,712**

(1) Low-rate initial production equipment ("LRIP") includes moulds for developing PARA OPS™ device samples.

8. Right-of-use assets

The following table presents our right-of-use assets:

	Offices
Balance at September 30, 2022	$ 208,131
Additions	228,020
Depreciation	(75,115)
Balance at September 30, 2023	$ 361,036
Additions	-
Depreciation	(130,912)
Balance at September 30, 2024	**$ 230,124**

In connection with our current lease, we made a total deposit of $33,726 to be released only at the end of these leases. This was initially recorded at fair value, discounted using the implied interest rate in the lease. At September 30, 2024, $28,806 (2023 - $26,076, 2022 - $23,604) was the carrying value and reported as non-current deposit in the consolidated statements of financial position.

9. Intangible assets

The following table shows a breakdown of our intangible assets:

(Expressed in Canadian dollars, except share amounts)

Cost	Phantom™ System	PARA OPS™ System	PARA OPS™ Patent	ARWEN™ Tradename	Customer Relationships	Purchase Orders	Total
Balance at September 30, 2022	$ 1,149,585	$ 3,469,215	$ 28,783	$ 37,032	$ 46,041	$ 12,198	$ 4,742,854
Additions	19,855	1,091,819	11,512	-	-	-	1,123,186
Impairment charge	(1,169,440)	-	-	-	-	-	(1,169,440)
Amortization	-	(562,639)	-	(8,800)	(5,000)	-	(576,439)
Recognition of open orders	-	-	-	-	-	(7,811)	(7,811)
Balance at September 30, 2023	$ -	$ 3,998,395	$ 40,295	$ 28,232	$ 41,041	$ 4,387	$ 4,112,350
Additions	-	9,823	-	-	-	-	9,823
Impairment charge	-	-	-	-	-	-	-
Amortization	-	(933,541)	-	(8,800)	(5,000)	-	(947,341)
Balance at September 30, 2024	**$ -**	**$ 3,074,677**	**$ 40,295**	**$ 19,432**	**$ 36,041**	**$ 4,387**	**$ 3,174,832**

The balance at September 30, 2024 for PARA OPS™ represents the acquired technology asset (i.e. intellectual properties), coupled with additional capitalized development costs. As it is available for its intended use, amortization charge was recorded for the year ended September 30, 2024 of $933,541 (2023 - $562,639, 2022 - $nil).

PARA OPS™ was tested for indicators of impairment at September 30, 2024 as it was available for use. The Company determined that there were no indicators of impairment and therefore did not test for impairment. In fiscal 2023, the Company began amortizing the system then stopped as further development was done on the products. As a result, the Company was required to test for impairment in fiscal 2023. The key assumptions used in determining the recoverable amount was that commercialization was reached in fiscal 2024 and that market penetration would be achieved at prices that would be accepted by the marketplace in fiscal 2025

During the fourth quarter of 2023, the Company determined that the Phantom System was impaired and the asset was written off. The required investment to advance the system to commercialization is considered to be too high and the technology is no longer viable for the Company's operations. The carrying amount of the Phantom System at the beginning of the fiscal year 2023 was $1,149,585 and additions of $19,855 were made in the fiscal year 2023. The entire carrying amount of $1,169,440 was written off as an impairment to intangible assets included in the general and administrative expenses in the Consolidated Statement of Net Loss and Comprehensive Loss for the fiscal year 2023. This has resulted in an expense in the consolidated statement of net loss.

In connection with Police Ordnance Acquisition in 2021 (see Note 4(a)), we have recorded the following intangible assets at fair value: ARWEN™ tradename, customer relationships and open purchase orders. During the year ended September 30, 2024, we did not deliver on open purchase orders (2023 - $7,811, 2022 - $87,802). Management has estimated the useful lives of tradename and customer relationships of five and ten years, respectively.

10. Accounts payable and accrued liabilities

The following table presents a breakdown of our accounts payable and accrued liabilities:

	September 30, 2024	September 30, 2023
Trade payable	**$ 881,835**	$ 367,128
Accrued liabilities	**610,558**	1,189,678
Salary and vacation payable	**168,244**	93,070
Total	**$ 1,660,637**	$ 1,649,876

(Expressed in Canadian dollars, except share amounts)

11. Related party transactions

Key management personnel compensation

Key management personnel are those having authority and responsibility for planning, directing and controlling the activities of KWESST directly or indirectly, including any of our directors (executive and non-executive).

Key management personnel compensation comprised the following:

	Year ended September 30, 2024	Year ended September 30, 2023	Year ended September 30, 2022
Wages and benefits	**$ 907,288**	$ 505,026	$ 641,338
Consulting fees	**397,500**	628,264	529,529
Directors compensation	**228,387**	130,000	70,000
Share-based compensation	**126,314**	167,027	860,400
Total	**$ 1,659,489**	$ 1,430,317	$ 2,101,267

The consulting fees relate to compensation to our Executive Chairman (via his private corporation, DEFSEC Corp), as well as compensation to our previous Vice President who was an employee prior to fiscal year 2023 and was included in wages and benefits for fiscal year 2022. Fiscal year 2022 also included a bonus to the Executive Chairman, which was approved by our Board of Directors and paid only after the U.S. IPO and Canadian Offering.

Other related party transactions:

- In March 2022, two directors, the Executive Chairman, and the CFO of KWESST participated in the March 2022 Loans for an aggregate amount of $74,000 and received a total of 52 bonus common shares (see Note 12).
- In July 2022, one director, the Executive Chairman, and the CFO of KWESST participated in the July 2022 Offering (see Note 16(a)); collectively, they purchased 581 Units for a total consideration of $87,500. This transaction was recorded at fair value.
- In August 2022, our Executive Chairman and CFO advanced a total of $60,000 to KWESST for employee payroll purposes. This advance was repaid on August 30, 2022.

At September 30, 2024 there was $471,465 (2023 - $216,730) outstanding amount in accounts payable and accrued liabilities due to our officers and directors for unpaid wages, director fees and expense reimbursements.

12. Borrowings

(Expressed in Canadian dollars, except share amounts)

	CEBA Term Loans	March 2022 Loans	August 2022 Loans	Total Borrowings
Balance, September 30, 2022	$ 78,796	$ 1,764,630	$ 435,348	$ 2,278,774
Accrued interest and accretion expense	11,204	274,887	179,096	465,187
Interest paid	-	(39,517)	(63,661)	(103,178)
Repayment of principal	(70,000)	(1,988,000)	(275,315)	(2,333,315)
Settled in equity	-	(12,000)	(275,468)	(287,468)
Forgivable amount	(20,000)	-	-	(20,000)
Balance, September 30, 2023	$ -	$ -	$ -	$ -
Balance, September 30, 2024	**$ -**	**$ -**	**$ -**	**$ -**

August 2022 Loans

On August 25, 2022, we closed two unsecured loans in the amount of USD$200,000 per loan with a third-party lender ("Lender") for an aggregate amount of USD$400,000 (the "August 2022 Loans").

The August 2022 Loans bear interest at a rate of 6.0% per annum, compounded monthly and not in advance, and have a maturity of twelve months, with KWESST having the option to repay the whole or any part of the August 2022 Loans, without penalty or premium, at any time prior to the close of business on the maturity date. On repayment of the August 2022 Loans, we will pay 110% of the principal amount plus accrued interest on the August 2022 Loans. As part of the terms of one of the August 2022 Loans, we issued an aggregate of 423 common shares to the Lender (the "Bonus Shares"), being an amount equal to twenty percent (20%) of USD$200,000, converted to CAD$ at an exchange rate of $1.2983, divided by the market price of our common shares on the TSX-V at market close on August 24, 2022, being $122.50. The Bonus Shares were issued in accordance with applicable prospectus exemptions under Canadian securities laws.

As a result of issuing common shares and debt for the first loan of USD$200,000 (or $260,698), in Fiscal 2022 we allocated the gross proceeds to these two financial instruments based on their relative fair value. To measure the fair value of the loan, we used the income approach and estimated a market discount rate of 24% to discount the future cash flows of the loan resulting in an estimated fair value of $214,893. Accordingly, we allocated $214,893 of the $260,698 to the first loan and $45,804 to share capital for the bonus common shares issued (see Note 16(a)).

Concurrently with the closing of the August 2022 Loans, our Executive Chairman and President and Chief Executive Officer (the "KWESST Principals") entered into call option agreements with the Lender whereby the Lender will have the option, pursuant to the terms and conditions of the call option agreements, to purchase 1,059 common shares held by the KWESST Principals at a price of $122.50 for a period of five years. Additional free-trading common shares may be offered by the KWESST Principals to the Lender should we elect to proceed with a share-for-debt transaction in connection with one of the Loans. KWESST is not a party to the call option agreements.

In connection with the August 2022 Loans, we paid a cash finder's fee to a third-party intermediary in the amount of USD$32,000.

March 2022 Loans

On March 11, 2022, we closed an unsecured loan financing with various lenders in an aggregate amount of $1,800,000 and an additional $200,000 on March 15, 2022, for a total of $2,000,000 (the "March 2022 Loans"). Certain directors and officers participated in this financing for an aggregate amount of $74,000. The March 2022 Loans bear interest at a rate of 9.0% per annum, compounded monthly and not in advance, and have a maturity of thirteen months, with KWESST having the option to repay the whole or any part of the March 2022 Loans, without penalty or premium, at any time prior to the close of business on the maturity date. The principal amount is due only at maturity. As part of the terms of the March 2022 Loans, we issued an aggregate of 1,428 bonus common shares to the lenders.

As a result of issuing common shares and debt for a total combined cash consideration of $2,000,000, we allocated the gross proceeds to these two financial instruments based on their relative fair value. To measure the fair value of the March 2022 Loans, we used the income approach and estimated a market discount rate of 22% to discount the future cash flows of the March 2022 Loans resulting in an estimated fair value of $1,634,112. Accordingly, we allocated $1,634,112 of the $2,000,000 to March 2022 Loans and $365,888 to share capital for the bonus common shares issued (see Note 16(a)).

The total offering costs were $90,636, $74,055 of which was allocated to deferred financing fees and $16,581 allocated to share offering costs. The deferred financing fees are recognized as a reduction of the gross borrowings to be accreted over the life of the March 2022 Loans as a financing cost and the share offering costs were recognized as a reduction to common shares.

CEBA Term Loans

In December 2020, the Canadian Federal Government amended the CEBA Term Loan program to increase the loan amount by $20,000 to $60,000. We borrowed $40,000 during the nine-month period ended September 30, 2020, and an additional $20,000 during the fiscal year ended September 30, 2021. As a result of the Police Ordnance Acquisition (see Note 4(a)), we assumed an additional CEBA Term Loan of $40,000 during fiscal year ended September 30, 2022.

The CEBA Term Loans are initially recorded at fair value, discounted based on our estimated incremental borrowing rate. This resulted in recording a gain on government grant of $3,514 for the year ended September 30, 2021 (2020 - $9,096).

Effective January 1, 2021, the CEBA Term Loans were automatically converted to a 2-year interest free term loan. This was further amended on January 12, 2022, where the government of Canada announced the repayment deadline for the CEBA Term Loans to qualify for partial loan forgiveness is being extended from December 31, 2022, to December 31, 2023, for all eligible borrowers in good standing. Repayment on or before the new deadline of December 31, 2023, will result in loan forgiveness of up to a third of the loans.

Loan Repayments

In December 2022, the Company repaid the remaining balance on the March 2022, August 2022, and CEBA Term Loans, including accrued unpaid interest, net of the total forgivable amount on the CEBA Term loan of $20,000 and a 10% premium on the August 2022 loan. The loans were repaid with a combination of cash and equity.

RBC Credit Facility

We maintain corporate credit cards for our key employees with Royal Bank of Canada (“RBC”). To provide security, we entered into a cash collateral agreement for $30,000 and a general security agreement providing a first lien on all assets. The $30,000 was invested in a short-term guaranteed investment certificate.

13. Lease obligation

We have entered into long-term office lease contracts which expire on April 30, 2026, May 31, 2026, and October 31, 2026, respectively. The office leases include the right to renew for an additional term following its expiry. Management has not included the renewal option because it was deemed too uncertain whether we would renew at September 30, 2024.

Under the current office lease agreements, we have benefited from the following lease inducements:

(Expressed in Canadian dollars, except share amounts)

- Free rent from inception March 1, 2020 to November 1, 2020;
- Free rent from November 1, 2021, to March 1, 2022; and
- Free rent from August 1, 2023, to October 31, 2023.

The following table presents the movement in our lease obligation for the respective periods:

	Offices	Current Portion	Non-current portion
Balance at September 30, 2022	$ 275,621	$ 69,150	$ 206,471
Additions	228,020	-	-
Lease payments (including interest)	(111,903)	-	-
Interest expense	37,785	-	-
Balance at September 30, 2023	**$ 429,523**	**$ 127,116**	**$ 302,407**
Additions	-	-	-
Lease payments (including interest)	(197,651)	-	-
Interest expense	70,351	-	-
Balance at September 30, 2024	**$ 302,223**	**$ 147,078**	**$ 155,145**

The following table presents the contractual undiscounted cash flows for the lease obligations:

	September 30, 2024	September 30, 2023
Less than one year	**$ 206,828**	$ 197,367
One to five years	**154,445**	361,388
Total	**$ 361,272**	$ 558,755

14. Contract Liabilities

The following table presents the changes in contract liabilities:

	September 30, 2024	September 30, 2023
Balance, beginning of fiscal year	**$ 120,970**	$ 47,271
Amounts invoiced and revenue deferred	**108,573**	120,970
Recognition of deferred revenue included in the balance at the beginning of period	**(108,972)**	(47,271)
Balance, end of fiscal year	**$ 120,571**	$ 120,970

15. Warrant liabilities

The following table shows a breakdown and balance of warrant liabilities at September 30, 2024:

	U.S. IPO and Canadian Offering			Private Placement		Debt Settlement	Public Offering	Direct Offering	
	2022 Warrants	Over-allotment Pre-Funded Warrants	Over-allotment Warrants	2023 Warrants	Pre-Funded Warrants	Warrants	Pre-Funded Warrants	Warrants	Total
Balance, beginning of period	$ 1,042,538	$ 414,334	$ 121,173	$ 798,573	$ 1,940,914	$ 18,141	$ -	$ -	**$ 4,335,673**
Initial recognition	-	-	-	-	-	-	708,054	647,039	**1,355,093**
Exercised	-	(119,257)	-	-	(829,720)	-	(820,649)	-	**(1,769,626)**
(Gain) Loss on revaluation of financial instruments	(973,396)	(295,186)	(113,022)	(728,282)	(1,069,466)	(16,996)	104,227	44,553	**(3,047,568)**
Exchange (gain) loss on revaluation	(3,377)	109	(507)	(9,918)	(10,390)	-	8,368	(10,562)	**(26,277)**
Balance, end of period	**$ 65,765**	**$ -**	**$ 7,644**	**$ 60,373**	**$ 31,338**	**$ 1,145**	**$ -**	**$ 681,030**	**$ 847,295**
Number of outsanding securities as at September 30, 2024	**322,639**	**-**	**37,500**	**154,219**	**15,173**	**5,614**	**-**	**471,500**	**1,006,645**

The following table shows a breakdown and balance of warrant liabilities at September 30, 2023:

	U.S. IPO and Canadian Offering			Private Placement		Debt Settlement	
	2022 Warrants	Over-allotment Pre-Funded Warrants	Over-allotment Warrants	2023 Warrants	Pre-Funded Warrants	Warrants	Total
Balance, beginning of period	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Initial recognition	4,617,451	832,698	536,681	1,528,160	2,778,534	80,617	10,374,141
(Gain) Loss on revaluation of financial instruments	(3,553,175)	(415,996)	(412,247)	(765,212)	(883,961)	(62,476)	(6,093,067)
Exchange gain on revaluation	(21,738)	(2,368)	(3,261)	35,625	46,341	-	54,599
Balance, end of period	**$ 1,042,538**	**$ 414,334**	**$ 121,173**	**$ 798,573**	**$ 1,940,914**	**$ 18,141**	**$ 4,335,673**
Number of outsanding securities as at September 30, 2023	**322,639**	**19,900**	**37,500**	**154,219**	**93,054**	**5,614**	**632,926**

U.S. IPO and Canadian Offering

On December 9, 2022, we closed an underwritten U.S. public offering (the "U.S. IPO") and an underwritten Canadian offering (the "Canadian Offering") for aggregate gross proceeds of CAD$19.4 million (US$14.1 million) (see Note 16(a)). As part of the U.S. IPO and Canadian Offering, we have issued 322,639 warrants (the "2022 Warrants") with an exercise price of US$50.00 per share. Additionally, the U.S. underwriter exercised its over-allotment option to purchase:

- 19,900 Pre-Funded Warrants with an exercise price of US$0.10 per share for $38.10 per pre-funded warrant (net of underwriter discount); and
- 37,500 warrants with exercise price of US$50.00 per share for $0.001 per warrant.

Refer to Note 16(a) for further information on the U.S. IPO and Canadian Offering.

In accordance with IFRS, the above securities are classified as financial liabilities (referred herein as "warrant liabilities") because the exercise price is denominated in U.S. dollars, which is different to our functional currency (Canadian dollars). Accordingly, the ultimate proceeds in Canadian dollars from the potential exercise of the above securities are not known at inception. These financial liabilities are classified and measured at FVTPL (see Note 3(c)). Gains on revaluation of the warrant liabilities are presented in Other income (expenses) on the consolidated statements of net loss and comprehensive loss.

Warrant liabilities

While the warrants issued in the U.S. IPO were listed on Nasdaq and closed at US$9.00 per warrant on December 9, 2022, management concluded that this closing price was not reflective of an active market due to short trading window and therefore not representative of fair value. Accordingly, at inception, the 2022 Warrants were measured at fair value using the Black Scholes option pricing model (Level 2). We used the following assumptions:

(Expressed in Canadian dollars, except share amounts)

	2022 Warrants (1)	Over-allotment Pre-Funded Warrants (2)	Over-allotment Warrants (3)
Number of dilutive securities	328,253	19,900	37,500
Exercise price (in USD)	$ 50.00	$ 0.10	
Share price (in USD)	$ 41.30	$ 30.80	
Expected life	2.50		
Dividend	$ -		
Volatility	75%		
Risk free rate	4.20%		
Exchange rate (USD/CAD)	$ 1.363		
Fair value per warrant (CAD)	**$ 14.31**	**$ 41.84**	**$ 14.31**

(1) Includes debt settlement warrants.

(2) Fair value is measured at the underlying common share closing price on Nasdaq on December 9, 2022, less US$0.10 exercise price.

(3) Same fair value as calculated for Warrants

The share price (in USD) for the over-allotment pre-funded warrants was based on the estimated fair value of the common shares issued on December 9, 2022, by deducting the fair value of the warrants of US$10.50 from the US$41.30 Unit price and the exercise price of US$0.10 (see Note 16(a)).

Based on the above fair value, the issuance of the over-allotment pre-funded warrants and warrants to the underwriter resulted in a non-cash charge of $251,877, which is included in the change in fair value of warrant liabilities in the consolidated statements of net loss and comprehensive loss.

During fiscal year 2024, the 19,900 pre-funded warrants were fully exercised at a weighted average price of US$0.10 (2023 – nil).

At September 30, 2024, we remeasured the fair value of these warrants using the following assumptions:

	2022 Warrants (1)	Over-allotment Pre-Funded Warrants	Over-allotment Warrants (1)
Number of securities	328,253	-	37,500
Nasdaq closing price (in USD)	$ 0.151	$ -	$ 0.151
Exchange rate (USD/CAD)	$ 1.3499	$ -	$ 1.3499
Fair value per warrant (CAD)	**$ 0.20**	**$ -**	**$ 0.20**

(1) Fair value is based on the Nasdaq closing pricing on September 30, 2024, for the warrants.

At September 30, 2023, we remeasured the fair value of these warrants using the following assumptions:

	2022 Warrants (1) (2)		Over-allotment Pre-Funded Warrants (3)		Over-allotment Warrants (1)	
Number of securities		328,253		19,900		37,500
Nasdaq closing price (in USD)	$	2.39	$	15.50	$	2.39
Exchange rate (USD/CAD)	$	1.352	$	1.352	$	1.352
Fair value per warrant (CAD)	**$**	**3.23**	**$**	**20.94**	**$**	**3.23**

(1) Fair value is based on the Nasdaq closing pricing on September 30, 2023, for the warrants.

(2) Includes debt settlement warrants.

(3) Fair value is measured at the Nasdaq closing price on September 30, 2023, for the underlying common stock less US$0.10 exercise price.

We recognized a gain of $1,381,604 (excludes the December 2022 Debt Settlement fair value described below) in fair value of warrant liabilities during the year ended September 30, 2024, which was reported in the consolidated statements of net loss and comprehensive loss.

December 2022 Debt Settlement

On December 13, 2022, we entered into share for debt arrangements with existing lenders (see Note 16(a)), which resulted in issuing 5,614 Units, same terms as the Units as issued in the Canadian Offering except that the underlying securities are subject to a four-month hold period. Accordingly, this resulted in issuing 5,614 common shares and 5,614 warrant liabilities with an exercise price of US$50.00 per share and maturing on December 13, 2027. We initially recorded the fair value of the warrant liabilities using the Black Scholes option pricing model with an underlying stock price equivalent to the unit price of US$41.30.

At September 30, 2024, we remeasured the fair value of these warrant liabilities using the Nasdaq closing price on September 30, 2024, of US$0.151. The remeasurement resulted in a change in fair value of warrant liabilities $16,996 for the year ended September 30, 2024 (2023 - $62,476), which was reported in the consolidated statements of net loss and comprehensive loss.

Private Placement (July 2023)

On July 21, 2023, we closed an underwritten U.S. private placement for gross proceeds of CAD$7.4 million (US$5.59 million) (see Note 16(a)). As part of the private placement, we have issued 154,219 warrants (the “2023 Warrants”) with an exercise price of US$26.60 per share. Additionally, 93,054 pre-funded Warrants with an exercise price of US$0.01 per share for US$22.59 per pre-funded warrant were issued.

Refer to Note 16(a) for further information on the private placement.

Under IFRS, the above securities are classified as financial liabilities (referred herein as “warrant liabilities”) because the exercise price is denominated in U.S. dollars, which is different to our functional currency (Canadian dollars). Accordingly, the ultimate proceeds in Canadian dollars from the potential exercise of the above securities are not known at inception. These financial liabilities are classified and measured at FVTPL (see Note 3(c)). Gains on revaluation of the warrant liabilities are presented in other income (expenses) on the consolidated statements of net loss and comprehensive loss.

Warrant liabilities

The 2023 warrants issued in the private placement were not listed on Nasdaq and does not represent an active market Level 1 input. Accordingly, at inception, the 2023 Warrants were measured at fair value using the Black Scholes option pricing model (Level 2). We used the following assumptions:

(Expressed in Canadian dollars, except share amounts)

	2023 Warrants	Pre-Funded Warrants (1)
Number of dilutive securities	154,219	93,054
Exercise price (in USD)	$ 26.60	$ 0.010
Share price (in USD)	$ 20.80	$ 20.80
Expected life	2.50	
Dividend	$ -	
Volatility	67%	
Risk free rate	4.44%	
Exchange rate (USD/CAD)	$ 1.321	$ 1.321
Fair value per warrant (CAD)	**$ 9.91**	**$ 19.82**

(1) Fair value is measured at the underlying common share closing price on Nasdaq on July 21, 2023, less US$0.01 exercise price.

The share price (in USD) for the pre-funded warrants was based on the estimated fair value of the common shares issued on July 21, 2023, by deducting the fair value of the warrants of US$7.50 from the US$22.60 Unit price and the exercise price of US$0.01 (see Note 16(a)).

During fiscal year 2024, 77,881 of the 93,054 pre-funded warrants were exercised at a weighted average price of US$0.01 (2023 – nil).

At September 30, 2024, we remeasured the fair value of these warrants using the following assumptions:

	2023 Warrants (1)	Pre-Funded Warrants (2)
Number of securities	154,219	15,173
Exercise price (in USD)	$ 26.60	$ 0.01
Nasdaq closing price (in USD)	$ -	$ 1.540
Black Scholes fair value (in USD)	$ 0.29	$ -
Volatility	98%	$ -
Risk free rate	3.03%	$ -
Exchange rate (USD/CAD)	$ 1.3499	$ 1.3499
Fair value per warrant (CAD)	**$ 0.39**	**$ 2.07**

(1) Fair value is based on the Black Scholes model on September 30, 2024, for the warrants.

(2) Fair value is measured at the Nasdaq closing price on September 30, 2024, for the underlying common stock less US$0.10 exercise price.

At September 30, 2023, we remeasured the fair value of these warrants using the following assumptions:

		2023 Warrants [1]		Pre-Funded Warrants [2]
Number of securities		154,219		93,054
Exercise price (in USD)	$	26.60	$	0.01
Nasdaq closing price (in USD)	$	-	$	15.50
Black Scholes fair value (in USD)	$	3.83	$	-
Exchange rate (USD/CAD)	$	1.3520	$	1.3520
Fair value per warrant (CAD)	**$**	**5.18**	**$**	**20.82**

(1) Fair value is based on the Black Scholes model on September 30, 2023, for the warrants.

(2) Fair value is measured at the Nasdaq closing price on September 30, 2023, for the underlying common stock less US$0.01 exercise price.

We recognized a gain of $1,797,748 in fair value of warrant liabilities during the year ended September 30, 2024, which was reported in the consolidated statements of net loss and comprehensive loss.

US Public Offering (April 2024)

On April 9, 2024, we closed an underwritten U.S. public offering for gross proceeds of CAD$1.4 million (US$1 million) (see Note 16(a)). In this offering, 80,350 pre-funded Warrants with an exercise price of US$0.01 per share for US$6.49 per pre-funded warrant were issued.

Refer to Note 16(a) for further information on the offering.

Under IFRS, the above securities are classified as financial liabilities (referred herein as "warrant liabilities") because the exercise price is denominated in U.S. dollars, which is different to our functional currency (Canadian dollars). Accordingly, the ultimate proceeds in Canadian dollars from the potential exercise of the above securities are not known at inception. These financial liabilities are classified and measured at FVTPL. Gains on revaluation of the warrant liabilities are presented in other income (expenses) on the consolidated statements of net loss and comprehensive loss.

Warrant liabilities

All 80,350 warrants were subsequently exercised at a weighted average exercise price of US$0.01 and we recognized a loss of $104,227 in fair value of warrant liabilities during the year ended September 30, 2024, which was reported in the consolidated statements of net loss and comprehensive loss.

US Registered Direct Offering (August 2024)

On August 13, 2024, we closed a direct offering for the purchase and sale of 471,500 common shares at a purchase price of US$2.00 per common share for gross proceeds of CAD$1.3 million (US$0.9 million) (see Note 16(a)). In a concurrent private placement, we issued unregistered warrants to purchase up to 471,500 common shares at an exercise price of US$2.50. This was a unit offering consisting of a share and a warrant. The fair value of the warrants attached to the units are valued based on the Black-Scholes model and the difference between the proceeds raised and the value assigned to the warrants is the residual fair value of the shares.

Refer to Note 16(a) for further information on the offering.

Under IFRS, the above securities are classified as financial liabilities (referred herein as "warrant liabilities") because the exercise price is denominated in U.S. dollars, which is different to our functional currency (Canadian dollars). Accordingly, the ultimate proceeds in Canadian dollars from the potential exercise of the above securities are not known at inception. These financial liabilities are classified and measured at FVTPL. Gains on revaluation of the warrant liabilities are presented in other income (expenses) on the consolidated statements of net loss and comprehensive loss.

(Expressed in Canadian dollars, except share amounts)

Warrant liabilities

At September 30, 2024, we remeasured the fair value of these warrants using the following assumptions:

		2024 Warrants (1)
Number of securities		471,500
Exercise price (in USD)	$	2.50
Nasdaq closing price (in USD)	$	-
Black Scholes fair value (in USD)	$	1.07
Volatility		102%
Risk free rate		3.03%
Exchange rate (USD/CAD)	$	1.3499
Fair value per warrant (CAD)	**$**	**1.44**

(1) Fair value is based on the Black Scholes model on September 30, 2024, for the warrants.

16. Share capital and Contributed Surplus

As disclosed in Note 1(b) and Note 1(c), the Reverse Splits have been applied retrospectively herein.

a) Share capital

Authorized

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

Issued Common Shares

	September 30, 2024			September 30, 2023			September 30, 2022		
	Number		Amount	Number		Amount	Number		Amount
Balance, beginning of year	561,673	$	33,379,110	77,319	$	19,496,640	69,951	$	17,215,068
Issued for U.S. IPO and Canadian Offering	-	$	-	322,639	$	13,675,120	-	$	-
Issued in private placement	-	$	-	154,219	$	3,050,316	2,285	$	272,000
Issued for debt settlements	4,670	$	97,615	5,614	$	233,485	14	$	19,000
Issued for U.S. public offerings	835,000	$	3,608,154	-	$	-	-	$	-
Issued for conversion of share units	-	$	-	1,413	$	529,504	834	$	874,840
Issued for exercise of warrants	177,831	$	1,771,239	357	$	60,000	1,900	$	277,098
Issued for exercise of stock options	-	$	-	112	$	5,836	-	$	-
Issued for bonus shares relating to borrowings (Note 12)	-	$	-	-	$	-	1,852	$	411,692
Issued for acquisition (Note 4(a))	-	$	-	-	$	-	396	$	377,503
Issued for conversion of contingent shares (Note 4(a))	-	$	-	-	$	-	87	$	83,319
Less: share offering costs for the year	-	$	(1,033,393)	-	$	(3,671,791)	-	$	(33,880)
Balance, end of year	**1,579,174**	**$**	**37,822,725**	**561,673**	**$**	**33,379,110**	**77,319**	**$**	**19,496,640**

<u>2024 Activities</u>

(Expressed in Canadian dollars, except share amounts)

Debt Settlement (January 2024)

On January 10, 2024, we issued 4,670 common shares in a settlement of debt in an amount of approximately $97,615. The debt resulted from a tail obligation relating to services rendered by a third-party consultant, which the Company has elected to pay in common shares. The common shares issued pursuant to the Debt Settlement (signed October 31, 2023) are subject to a four-month hold period pursuant to applicable securities legislation and the policies of the TSX Venture Exchange.

US Public Offering (April 2024)

On April 9, 2024, we closed a brokered US public offering, resulting in the issuance of 73,500 common shares of KWESST, for aggregate gross proceeds of $1.4M (US$1.0M) (the "April 2024 Public Offering").

As a part of the April 2024 Public Offering, the Company issued 73,500 common shares and 80,350 pre-funded warrants with an exercise price of $0.01 ("Pre-funded Warrants") at a public offering price of $8.80 (US$6.50) per share and $8.81 (US$6.49) per Pre-funded Warrant, less the underwriting discount.

Brokers' Compensation and Share Offering Costs

ThinkEquity acted as sole book-running manager for the April 2024 Public Offering. As compensation for services rendered, the placement agent fees represent $0.4875 per unit (being an aggregate of $101,838 (US$75,002) or 7.5% of the public offering price of the securities). In addition, the Company issued 7,692 warrants to purchase a number of Common Shares (the "Placement Agent Warrants"), representing 5% of the Common Shares and Pre-Funded Warrants sold in the April 2024 Public Offering. The Placement Agent Warrants will be exercisable, in whole or in part, immediately upon issuance and will expire 60 months after the closing date of the April 2024 Public Offering at an initial exercise price of $11.032 (US$8.125) per Common Share. The share offering costs related to the April 2024 Public Offering that was recognized in the consolidated financial statements of net loss and comprehensive loss was $339,324 and recognized in equity was $269,400.

The fair value of the broker compensation warrants at the closing of the April 2024 Public Offering was $43,868, calculated using the Black Scholes model, and total share offering costs were $608,724.

		Initial Recognition
Number of Warrants		7,692
Stock price (in USD)	$	7.45
Exercise price (in USD)	$	8.12
Black Scholes fair value (in USD)	$	4.20
Volatility		66%
Dividend Yield		Nil
Risk-free interest rate		3.86%
Expected life		5
Exchange rate (USD/CAD)		1.3578
Weighted average fair value per warrant (CAD)	**$**	**5.70**

US Public Offering (June 2024)

(Expressed in Canadian dollars, except share amounts)

On June 14, 2024, we closed a brokered US public offering, resulting in the issuance of 290,000 common shares of KWESST, for aggregate gross proceeds of approximately $2.3M (US$1.7M) (the "June 2024 Public Offering").

As a part of the June 2024 Public Offering, the Company issued 290,000 common shares at a public offering price of $8.00 (US$5.80) per share, less the placement agent fees.

Brokers' Compensation and Share Offering Costs

ThinkEquity acted as sole book-running manager for the June 2024 Public Offering. As compensation for services rendered, the placement agent fees represent $0.435 per common share (being an aggregate of $173,469 (US$126,150) or 7.5% of the public offering price of the securities). In addition, the Company issued to the placement agent 14,500 common share purchase warrants with an exercise price of $10.00 (US$7.25) per Common Share, exercisable, in whole or in part, immediately upon issuance and will expire 60 months after the closing date of the June 2024 Public Offering. All of the share offering costs related to the June 2024 Public Offering were recognized in equity.

The fair value of the broker compensation warrants at the closing of the June 2024 Public Offering was $61,213, calculated using the Black Scholes model, and total share offering costs were $384,509.

		Initial Recognition
Number of Warrants		14,500
Stock price (in USD)	$	5.77
Exercise price (in USD)	$	7.25
Black Scholes fair value (in USD)	$	3.07
Volatility		66%
Dividend Yield		Nil
Risk-free interest rate		3.86%
Expected life		5
Exchange rate (USD/CAD)		1.3751
Weighted average fair value per warrant (CAD)	**$**	**4.22**

US Registered Direct Offering (August 2024)

On August 13, 2024, we closed a registered direct offering for the purchase and sale of 471,500 common shares at a purchase price of $2.74 (US$2.00) per common share for gross proceeds of $1.4M (US$0.9M) (the "August 2024 Offering"). In a concurrent private placement, the Company issued unregistered warrants to purchase up to 471,500 common shares at an exercise price of $3.43 (US$2.50) per share that are immediately exercisable upon issuance and will expire five years following the date of issuance.

Brokers' Compensation and Share Offering Costs

H.C. Wainwright & Co. acted as the exclusive placement agent for the August 2024 Offering. As compensation for services rendered, the placement agent fees were US$70,725 or 7.5% of the public offering price of the securities). In connection with the closing of the August 2024 Offering, we issued Wainwright or its designees warrants to purchase up to an aggregate of 35,362 common shares at an exercise price of US$2.50 per share, the warrants are exercisable upon issuance and have a expiry date of August 9, 2029. The shares offered as Brokers' Compensation related to the August 2024 Offering were recognized in equity.

(Expressed in Canadian dollars, except share amounts)

In connection with the August 2024 Offering, Wainwright was also granted a tail obligation resulting in earning 7.5% on any equity financing raised from investors introduced to the Company as part of the offering. The November 1, 2024 and November 12, 2024 financings described in Note 27 fell entirely within the scope of the tail obligation and resulted in a payment of 7.5% of the gross proceeds to Wainright upon closing of those transactions.

The fair value of the broker compensation warrants at the closing of the August 2024 Offering was $28,632, calculated using the Black Scholes model. The share offering costs related to the August 2024 Offering that was recognized in the consolidated financial statements of net loss and comprehensive loss was $202,242 and recognized in equity was $281,869.

		Initial Recognition
Number of Warrants		35,362
Stock price (in USD)	$	1.43
Exercise price (in USD)	$	2.50
Black Scholes fair value (in USD)	$	0.59
Volatility		91%
Dividend Yield		Nil
Risk-free interest rate		3.12%
Expected life		2.5
Exchange rate (USD/CAD)		1.3723
Weighted average fair value per warrant (CAD)	**$**	**0.81**

2023 Activities

Share Consolidation

On October 28, 2022. we finalized the consolidation of our common shares on the basis of one post-consolidation common share for every seventy pre-consolidation common shares issued and outstanding.

U.S. IPO and Canadian Offering

On December 9, 2022, we closed the U.S. IPO and the Canadian Offering. In the U.S. IPO, we sold 250,000 units at a public offering price of USD$41.30 per unit (the "Unit"), consisting of one share of common stock and one warrant to purchase one share of common stock ("Warrant"). The Warrants have a per share exercise price of USD$50.00 and can be exercised immediately. In connection with the closing of the U.S. IPO, the underwriter partially exercised its over-allotment option to purchase an additional 19,900 pre-funded common share purchase warrants ("Pre-Funded Warrants") at USD$41.20 (before underwriter discount) and 37,500 option warrants to purchase common shares at USD$0.001 each. A Pre-Funded Warrant is a financial instrument that requires the holder to pay little consideration (exercise price of USD$0.10) to receive the common share upon exercise of the Pre-Funded Warrant (see Note 15). The holder of Pre-Funded Warrants has no voting rights. All of these warrants expire on December 9, 2027.

In the Canadian Offering, we sold 72,639 units, each consisting of one common share and one warrant to purchase one common share, at a price to the public of USD$41.30 per unit. The warrants will have a per common share exercise price of USD$50.00, are exercisable immediately and expire in five years on December 9, 2027. Effective May 1, 2023, the warrants are listed on the TSX-V under the stock symbol of KWE.WT.U.

The closing of the U.S. IPO and Canadian Offering resulted in aggregate gross proceeds of $19.4 million (USD $14.1 million), before deducting underwriting discounts and offering expenses.
The common shares of KWESST and the Warrants sold in the U.S. IPO began trading on the Nasdaq Capital Market under the symbols "KWE" and "KWESW", respectively, on December 7, 2022.

ThinkEquity acted as sole book-running manager for the U.S. IPO and PI Financial acted as sole book-running manager for the Canadian Offering.

Accounting Treatment

Refer to Note 15 for the accounting of the warrants issued in the U.S. IPO and Canadian Offering and the July 2023 Private Placement accounted for as warrant liabilities.

The U.S. underwriter warrants as well as the Canadian broker options from the U.S. IPO and Canadian Offering, 13,495 warrants and 5,084 warrants respectively, were accounted for as equity on initial recognition. The U.S. underwriter warrants from the July 2023 Private Placement, 12,363 warrants, was accounted for as equity on initial recognition.

Brokers' Compensation and Share Offering Costs

As consideration for the services provided in connection with the U.S. IPO, ThinkEquity received: (a) a broker-dealer cash commission of US$835,000 (or CAD$1,138,105) equal to 7.5% of the gross offering proceeds of the U.S. Offering; and (b) underwriter warrants (the "U.S. Underwriter Warrants") to purchase up to 13,495 common shares equal to 5% of the common shares and pre-funded common share purchase warrants issued under the U.S. Offering. Each U.S. Underwriter Warrant is exercisable to acquire one common share at a price of US$51.625, exercisable as of June 4, 2023, and expiring on December 9, 2027.

As consideration for the services provided in connection with the Canadian Offering, PI Financial received: (a) a cash commission of approximately US$210,000 (or CAD$286,230); and (b) 5,084 compensation options (the "Canadian Compensation Options"). Each Canadian Compensation Option is exercisable to acquire one Canadian Unit at a price of US$41.30 and expiring on December 9, 2024.

In addition to the above brokers' compensation, we also incurred US$2.1 million share offering costs (or CAD$2.8 million) for the U.S. IPO and Canadian Offering, of which CAD$628,262 was incurred and deferred at September 30, 2022.

The total brokers compensation (including fair value of U.S. Underwriter Warrants and Canadian Compensation Options) and share offering costs was US$3.2 million (or CAD$4.4 million). This total was allocated proportionately to the fair value of common shares and to share offering costs for the portion allocated to warrants accounted for as warrant liabilities.

Shares for Debt Settlement (December 2022)

We entered into share for debt arrangements with existing lenders, which closed on December 13, 2022, following TSXV's conditional approval. This resulted in issuing 5,614 Units to settle $12,000 of the March 2022 Loans and USD$223,321 (or CAD$302,197) of the August 2022 Loans, including unpaid accrued interest and 10% premium at maturity (the "Debt Settlements") (see Note 12). The terms of the Units are the same as the Units issued in the Canadian Offering.

Private Placement (July 2023)

On July 21, 2023, we closed a brokered private placement, resulting in the issuance of 154,219 common shares of KWESST, for aggregate gross proceeds of USD$5,588,397 (approximately CAD$7.4M) (the "July 2023 Offering").

As a part of the July 2023 Offering, the Company issued 154,219 common shares at a price of US$22.60 (CAD$29.80) per common share (each a "Common Share") and 93,054 pre-funded warrants at a price of US$22.59 (CAD$29.79) per pre-funded warrant (each a "Pre-funded Warrant"), with each Common Share and Pre-funded Warrant being bundled with one common share purchase warrant of the Company (each a "Common Warrant"). Each Pre-Funded Warrant entitles the holder to acquire one Common Share at an exercise price of US$0.01 per Common Share, and each Common Warrant is immediately exercisable and entitles the holder to acquire one Common Share at an exercise price of US$26.60 (CAD$35.00) per Common Share for a period of 60 months following the closing of the July 2023 Offering. Although the Common Shares and Pre-funded Warrants are each bundled with a Common Warrant, each security is issued separately.

<u>Brokers' Compensation and Share Offering Costs</u>

ThinkEquity acted as sole placement agent for the Offering. As compensation for services rendered, the Company paid to ThinkEquity a cash fee of $475,013.14 representing 8.5% of the aggregate gross proceeds of the Offering and issued 12,363 warrants to purchase a number of Common Shares (the "Placement Agent Warrants"), representing 5% of the Common Shares and Pre-Funded Warrants sold in the Offering. The Placement Agent Warrants will be exercisable, in whole or in part, immediately upon issuance and will expire 60 months after the closing date of the Offering at an initial exercise price of US$26.60 (CAD$35.00) per Common Share.

<u>2022 Activities</u>

Private Placement

On July 14, 2022, we closed a non-brokered private placement, resulting in the issuance of 2,285 units of KWESST ("July 2022 Units"), at a price of $150.50 per July 2022 Unit (the "Issue Price"), for aggregate gross proceeds of $344,000 (the "July 2022 Offering").

Each July 2022 Unit is comprised of one common share and seventy one-half common share purchase warrant (the "July 2022 Warrants"). Accordingly, we issued 80,000 Warrants exercisable at $2.85 each for a period of 24 months from the closing date. Each Warrant converts into 0.01428571 common shares or 70 warrants for one common share. There was no finder fee paid in this private placement.

Certain of our directors and officers (the "Insiders") purchased 581 Units for a total consideration of $87,500. The issuance of Units to the Insiders constitutes a related party transaction but is exempt from the formal valuation and minority approval requirements of Multilateral Instrument 61-101 - Protection of Minority Security Holders in Special Transactions ("MI 61-101") as KWESST's securities are not listed on any stock exchange identified in Section 5.5(b) of MI 61-101 and neither the fair market value of the units issued to the Insiders, nor the fair market value of the entire private placement, exceeds 25% of our market capitalization.

The securities were issued in accordance with applicable prospectus exemptions under Canadian securities laws.

Police Ordnance Acquisition

As disclosed in Note 4(a), we issued 396 common shares to the selling shareholders in December 2021 at the closing of the acquisition and an additional 87 common shares in April 2022 following the achievement of the financial milestone as defined in the share purchase agreement.

Debt for Equity Settlement

(Expressed in Canadian dollars, except share amounts)

During the year ended September 30, 2022, we settled $19,000 of legal fees for 143 common shares.

b) Warrants

The following reflects the warrant activities:

	September 30, 2024		September 30, 2023		September 30, 2022	
	Number of warrants	**Weighted average exercise price**	Number of warrants	Weighted average exercise price	Number of warrants	Weighted average exercise price
Outstanding, beginning of year	**1,550,787**	**$ 24.90**	1,341,716	$ 7.75	1,390,164	$ 7.38
Issued	**609,405**	**$ 3.20**	658,786	$ 52.90	100,000	$ 5.72
Exercised	**(178,135)**	**$ 0.02**	(25,000)	$ 5.00	(133,000)	$ 2.56
Expired	**(822,000)**	**$ 2.10**	(424,715)	$ 18.60	(15,448)	$ 5.63
Outstanding, end of year	**1,160,057**	**$ 32.30**	1,550,787	$ 24.90	1,341,716	$ 7.75
Exercisable, end of year	**1,147,559**	**$ 32.60**	1,538,286	$ 25.00	1,279,215	$ 8.15

The following table provides additional information on the total outstanding warrants at September 30, 2024:

(Expressed in Canadian dollars, except share amounts)

	Number outstanding	Conversion ratio to Common Shares		Book value	Expiry Date
Classified as Equity					
LEC's Warrants:					
Exercise price of $7.00	50,000	70 for 1	$	425,000	April 29, 2026
Acquisition of Police Ordnance (Note 4):					
Exercise price of $17.20	20,000	70 for 1	$	132,000	December 15, 2024
December 2022 U.S. Underwriter Warrants					
Exercise price of US$51.625	13,495	1 for 1	$	189,592	December 6, 2024
July 2023 U.S. Underwriter Warrants					
Exercise price of US$26.60	12,363	1 for 1	$	204,187	December 6, 2024
April 2024 U.S. Underwriter Warrants					
Exercise price of US$8.125	7,692	1 for 1	$	43,869	April 9, 2029
June 2024 U.S. Underwriter Warrants					
Exercise price of US$7.25	14,500	1 for 1	$	61,213	June 14, 2029
August 2024 U.S. Underwriter Warrants					
Exercise price of US$2.50	35,362	1 for 1	$	28,826	August 9, 2029
	153,412		$	1,084,687	
Classified as liability					
December 2022 Public Offerings:					
Exercise price of US$50.00	322,639	1 for 1	$	65,765	December 9, 2027
December 2022 Option Warrants					
Exercise price of US$51.625	37,500	1 for 1	$	7,644	December 9, 2024
December 2022 Debt Settlement					
Exercise price of US$50.00	5,614	1 for 1	$	1,145	December 9, 2027
July 2023 Public Offerings:					
Exercise price of US$26.60	154,219	1 for 1	$	60,373	July 21, 2028
July 2023 Pre-Funded Warrants					
Exercise price of US$0.01	15,173	1 for 1	$	31,338	No expiry
August 2024 Public Offering					
Exercise price of US$2.50	471,500	1 for 1	$	681,030	August 9, 2029
	1,006,645			847,295	
Total outstanding warrants	**1,160,057**		**$**	**1,931,982**	

The weighted average fair value for the warrants issued during the year ended September 30, 2024, was determined by the Black Scholes option pricing model using the following key inputs:

(Expressed in Canadian dollars, except share amounts)

		August 2024 Warrants
Exercise Price (in USD)	$	2.50
Stock price (in USD)	$	1.43
Black Scholes fair value (in USD)	$	1.00
Volatility		103%
Dividend Yield		Nil
Risk-free interest rate		3.03%
Expected life		5
Exchange rate (USD/CAD)		1.3499
Weighted average fair value per warrant (CAD)	**$**	**1.35**

The weighted average fair value for the warrants issued during the year ended September 30, 2023, was determined by the Black Scholes option pricing model using the following key inputs:

		2023 Warrants		2022 Warrants
Exercise Price (in USD)	$	26.60	$	50.00
Stock price (in USD)	$	20.80	$	41.30
Volatility		67%		75%
Dividend Yield		Nil		Nil
Risk-free interest rate		4.44%		4.20%
Expected life		2.5		2.5
Weighted average fair value per warrant	**$**	**9.90**	**$**	**14.30**

The fair value for the warrants issued during the year ended September 30, 2022, was determined by the Black Scholes option pricing model using the following key inputs:

		Acquisition of POC		July 2022 Warrants
Exercise Price	$	17.20	$	2.850
1/700 of stock price	$	13.60	$	2.150
Volatility		84.7%		90.5%
Dividend Yield		Nil		Nil
Risk-free interest rate		1.04%		3.12%
Expected life		3		2
Weighted average fair value per warrant	**$**	**6.60**	**$**	**0.90**

c) Contributed Surplus

Contributed surplus consists of issued broker compensation options at fair value, the cumulative amortized fair value of share-based compensation grants since inception, less amounts transferred to share capital for exercises. If outstanding options expire or are forfeited, there is no reversal of contributed surplus.

Broker Compensation Options

(Expressed in Canadian dollars, except share amounts)

In the Canadian Offering, we issued 5,084 Canadian Compensation Options. Each Canadian Compensation Option is exercisable to acquire one Unit, as defined in Note 16(a), at a price equal to $56.29 (US$41.30) for a period of two years (expiring on December 9, 2024). Based on the structure of the Compensation Option, management estimated its fair value using the Monte Carlo method (Level 2). We used the following key inputs in the Monte Carlo model (100,000 simulations):

		Initial Recognition
Number of securities		5,084
Exercise price - compensation option (in USD)	$	41.30
1-Year CAD/USD Forward Exchange Rate	$	1.3560
Exercise price - compensation warrant (in USD)	$	50.00
2-Year CAD/USD Forward Exchange Rate	$	1.3483
Share price (in CAD)	$	42.00
Expected life - compensation option		1.00
Expected life - compensation warrant		2.50
Dividend	$	-
Volatility - compensation option		90%
Volatility - compensation warrant		75%
Risk free rate - compensation option		4.38%
Risk free rate - compensation warrant		3.15%
Fair value per compensation option (CAD)	**$**	**24.60**

We have recorded $125,086 of Canadian Compensation Options in contributed surplus, with an equal offset to share offering costs (a non-cash transaction).

Share-based compensation

On August 26, 2024, KWESST shareholders approved the renewal of the Long-Term Incentive Plan (the "LTIP"). The number of RSUs, PSUs, DSUs, and SARs (collectively "Share Units") authorized for issuance pursuant to the LTIP is 40,727 Share Units. Accordingly, we have 14,915 Share Units available for future grants.

Further, the disinterested shareholders (shareholders that are not directors, officers, or other insiders of the Company) of KWESST approved to revise the exercise price of 50,981 stock options to $36.00, the closing price of KWESST common shares on the TSX-V on March 31, 2023. In accordance with IFRS 2, this resulted in an immediate fair value increase of $77,001 included in share-based compensation, with an offset to contributed surplus.

For the year ended September 30, 2024, we recorded share-based compensation of $291,761 (2023 - $373,554, 2022 - $1,960,072).

(i) Stock Options

The following is summary of changes in outstanding stock options for the respective periods:

(Expressed in Canadian dollars, except share amounts)

	Number of options		Weighted average exercise price
Outstanding at September 30, 2021	5,953	$	959.00
Granted	950	$	695.90
Cancelled	(1,192)	$	1,317.60
Outstanding at September 30, 2022	5,711	$	838.70
Granted	34,000	$	25.90
Exercised	(112)	$	36.00
Cancelled	(607)	$	706.50
Outstanding at September 30, 2023	38,992	$	28.00
Cancelled	(13,181)	$	31.10
Outstanding at September 30, 2024	**25,811**	**$**	**26.44**
Options exercisable at September 30, 2024	**14,061**	**$**	**27.23**

At September 30, 2024, the weighted average remaining vesting period was 0.87 years (2023 - 1.87 years, 2022 - 0.88 years).

For the options granted during the year ended September 30, 2024, the per share weighted-average fair value of stock options was $nil (2023 – $14.20, 2022 – $382.10), using the Black-Scholes option model with the following weighted-average assumptions:

	2024	2023	2022
Stock price	$1.75 to $24.50	$25.50 to $40.00	$147.00 to $1,267.00
Exercise price	Nil	$25.50 to $40.00	$147.00 to $1,267.00
Volatility	Nil	96.37%	90.48%
Dividend yield	Nil	Nil	Nil
Risk-free interest rate	Nil	4.65%	2.04%
Expected life (years)	Nil	2.93	2.91
Weighted-average fair value per option	**Nil**	**$ 14.20**	**$ 382.06**

The following table summarizes information about stock options outstanding at September 30, 2024:

	Exercise price	Number outstanding	Weighted average remaining contractual life		Weighted average outstanding strike price	Exercisable	Remaining exercisable contractual life		Weighted average exercisable strike price
$	25.50	23,500	2.88	$	25.50	11,750	2.88	$	25.50
$	36.00	2,311	2.55	$	36.00	2,311	2.55	$	36.00
		25,811	**2.85**	**$**	**26.44**	**14,061**	**2.83**	**$**	**27.23**

Amendment to stock option grants

For the years ended September 30, 2024 and 2023, we had no amended stock option grants.

(Expressed in Canadian dollars, except share amounts)

(ii) Share Units

The following table shows the changes in Share Units:

	RSUs	PSUs	SARs	Total
Outstanding at September 30, 2021	1,628	285	214	2,127
Granted	1,072	1,794	51	2,917
Vested and converted to common shares	(568)	(266)	-	(834)
Vested and repurchased for withholding taxes	(14)	(24)	-	(38)
Expired / cancelled	-	(1,771)	-	(1,771)
Outstanding at September 30, 2022	**2,118**	**18**	**265**	**2,401**
Granted	-	-	-	-
Vested and converted to common shares	(2,010)	(18)	-	(2,028)
Vested and repurchased for withholding taxes	-	-	-	-
Expired / cancelled	-	-	-	-
Outstanding at September 30, 2023	**108**	**-**	**265**	**373**
Granted	-	-	-	-
Vested and converted to common shares	-	-	-	-
Vested and repurchased for withholding taxes	-	-	-	-
Expired / cancelled	(108)	-	(265)	(373)
Outstanding at September 30, 2024	**-**	**-**	**-**	**-**

RSUs:

Each RSU entitles the holder to receive one common share in the future, based on continued service during the applicable period.

During the year ended September 30, 2024, we did not grant any RSUs (2023 - nil, 2022 – 1,072), with a weighted-average grant date fair value of $nil per unit (2023 - $nil, 2022 - $435). There were no outstanding RSUs at September 30, 2024 (2023 - weighted average vesting period was 0.1 years, 2022 - weighted average vesting period was 0.18 years).

PSUs:

Each PSU entitles the holder to receive one common share in the future, based on the achievement of established performance criteria and continued service during the applicable performance period.

During the year ended September 30, 2024, we did not grant any PSUs (2023 - nil, 2022 – 1,794), with a weighted-average grant date fair value of $nil per unit (2023 - $nil, 2022 - $1,267). There were no outstanding PSUs at September 30, 2024 (2023 - fully vested, 2022 - fully vested).

SARs:

Each SAR entitles the holder to receive cash or common share at our discretion in the future, based on continued service during the applicable period. The amount of the cash payment or the value of common shares is determined based on the increase of the share price of KWESST between the grant date and the exercise date. Because we intend to always settle in common shares, we account for SARs as equity-settled awards.

During the year ended September 30, 2024, we did not grant any SARs (2023 - nil, 2022 - 51) at an exercise price of $nil (2023 - $nil, 2022 - $1,267). There were no outstanding SARs at September 30, 2024.

(iii) Share-based Compensation

(Expressed in Canadian dollars, except share amounts)

For the year ended September 30, 2024, we recorded share-based compensation of $291,761 (2023 - $373,554, 2022 - $1,960,072).

The following table presents a breakdown of total share-based compensation expense by function:

	Year ended September 30, 2024	Year ended September 30, 2023	Year ended September 30, 2022
General and administrative	**$ 189,692**	$ 246,436	$ 1,104,858
Selling and marketing	**-**	53,800	552,627
Research and development, net	**102,069**	73,318	302,587
Total share-based compensation	**$ 291,761**	$ 373,554	$ 1,960,072

17. Loss per share

As disclosed in Note 1(b), and Note 1(c), the Reverse Splits have been applied retrospectively herein.

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

	Year ended Setpember 30, 2024	Year ended Setpember 30, 2023	Year ended Setpember 30, 2022
Issued common shares, beginning of year	561,678	77,322	69,951
Effect of shares issued from:			
Debt settlements	3,369	4,475	13
April 2024 U.S. Public Offering (Note 16(a))	34,942	-	-
June 2024 U.S. Public Offering (Note 16(a))	85,573	-	-
August 2024 U.S. Public Offering (Note 16(a))	61,836	-	-
December 2022 U.S. IPO and Canadian Offering (Note 16(a))	-	260,763	-
Over-allotment Pre-Funded Warrants (Note 15)	-	16,083	-
July 2023 Private Placement (Note 16(a))	-	29,998	-
July 2023 Pre-Funded Warrants (Note 15)	-	18,101	-
Conversion of stock units	-	1,181	370
Exercise of options	-	267	-
Exercise of warrants	79,737	33	1,059
Issuance of bonus shares	-	-	826
Private placements	-	-	457
Acquisition of Police Ordnance (Note 4)	-	-	314
Conversion of contingent shares	-	-	38
Weighted average number of basic common shares	**827,135**	**408,223**	**73,028**
Dilutive securities:			
Stock options	-	-	-
Warrants	-	-	-
Weighted average number of dilutive common shares	**827,135**	**408,223**	**73,028**

(Expressed in Canadian dollars, except share amounts)

At September 30, 2024, 2023 and 2022, all dilutive securities were anti-dilutive because we incurred a net loss for the years.

18. Revenue

a) Revenue streams

KWESST generates revenue from the sale of products to its customers.

b) Disaggregation of revenue from contracts with customers

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

	Year ended September 30, 2024	Year ended September 30, 2023	Year ended September 30, 2022
Major products / service lines			
Digitization	**$ 1,034,257**	$ 819,604	$ 354,620
Less-Lethal	**465,082**	411,758	330,658
Training and services	**1,028**	-	34,590
Other	**3,961**	3,088	1,651
	$ 1,504,328	$ 1,234,450	$ 721,519
Primary geographical markets			
United States	**$ 155,103**	$ 42,780	$ 389,210
Canada	**1,349,225**	743,200	332,309
Europe	**-**	448,470	-
	$ 1,504,328	$ 1,234,450	$ 721,519
Timing of revenue recognition			
Products and services transferred over time	**$ 1,035,285**	$ 819,604	$ 389,210
Products transferred at a point in time	**469,043**	414,846	332,309
	$ 1,504,328	$ 1,234,450	$ 721,519

Revenue allocated to remaining performance obligations represents contracted revenue that has not yet been recognized ("contracted not yet recognized") and includes unearned revenue and amounts that will be invoiced and recognized as revenue in future periods. At September 30, 2024, our contracted not yet recognized revenue was $261,815 (2023 - $496,199, 2022 - $625,177), of which 100% of this amount is expected to be recognized over the next 12 months.

For the year ended September 30, 2024, two customers accounted for 36% and 20% (2023 - two customers accounted for 23% and 18%, 2022 - one customer accounted for 41%) of revenue.

19. Expenses by nature

The following table presents a breakdown of expenses by nature for the following periods:

(Expressed in Canadian dollars, except share amounts)

	Year ended September 30, 2024	Year ended September 30, 2023	Year ended September 30, 2022
Employee benefits	$ 4,670,646	$ 3,011,923	$ 4,883,062
Advertising and promotion	60,823	19,090	1,352,750
Consulting fees	1,294,949	2,743,272	1,315,917
Professional fees	967,938	940,667	1,028,240
Travel and conferences	385,759	804,481	518,140
R&D consulting and material costs, net	774,261	556,013	420,378
Depreciation and amortization	1,277,911	952,508	326,491
Impairment of intangible assets	-	1,174,354	-
Impairment of inventory	113,283	-	-
Other expenses	434,682	691,566	266,822
Insurance	690,014	716,931	236,150
Transfer agent and listing fees	151,854	120,690	94,885
Royalty and license costs	-	305,918	-
Total expenses	10,822,120	12,037,413	10,442,835
Allocation to cost of sales:			
Employee benefits	(536,245)	(123,803)	(166,706)
Total operating expenses	$ 10,285,875	$ 11,913,610	$ 10,276,129

20. Depreciation and Amortization

The following table presents total depreciation and amortization expense of property and equipment, intangible assets, and right-of-use assets by function:

	2024	2023	2022
General and administrative	$ 1,242,748	$ 833,029	$ 123,960
Selling and marketing	13,655	77,804	129,265
Research and development	21,508	41,675	73,266
Total depreciation and amortization	**$ 1,277,911**	**$ 952,508**	**$ 326,491**

21. Net finance costs

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

(Expressed in Canadian dollars, except share amounts)

	Year ended September 30, 2024	Year ended September 30, 2023	Year ended September 30, 2022
Interest expense from:			
Unsecured loan	**$ -**	$ 503,251	$ 321,313
Accretion cost - accrued royalties liability	**180,965**	170,373	159,451
Lease obligations	**70,351**	37,786	30,112
CEBA term loan	**-**	8,281	-
Other	**694**	3,857	1,114
Total interest expense	**252,010**	723,548	511,990
Interest income	**(55,687)**	(55,514)	(5,988)
Net finance costs	**$ 196,323**	$ 668,034	$ 506,002

22. Income taxes

a) Income tax recovery

Income tax recovery is made up of the following components:

	Year end ended September 30, 2024	Year ended September 30, 2023	Year ended September 30, 2022
Current income tax recovery (expense):	**-**	-	-
Deferred income tax (recovery) expense:	**-**	-	(49,442)
	$ -	$ -	$ (49,442)

b) Reconciliation of effective income tax rate

Our effective income tax rate differs from the statutory rate of 26.5% that would be obtained by applying the combined Canadian basic federal and provincial income tax rate to loss before income taxes. These differences result from the following:

	Year ended September 30, 2024	Year ended September 30, 2023	Year ended September 30, 2022
Loss before income taxes	**$ (7,437,759)**	(9,306,360)	(10,569,732)
Expected statutory tax rate	**26.5%**	26.5%	26.5%
Expected tax recovery resulting from loss	**(1,971,006)**	(2,466,185)	(2,800,979)
Increase (reduction) in income taxes resulting from:			
Non-deductible expenses	**130,295**	149,270	563,842
Foreign operations subject to different tax rates	**(21)**	1,447	5,329
Fair value of warrant liabilities	**(814,569)**	(1,547,916)	-
Unrecognized temporary differences	**2,655,301**	3,863,384	2,182,366
	$ -	$ -	$ (49,442)

(Expressed in Canadian dollars, except share amounts)

KWESST claims research and development deductions for tax purposes based on management's interpretation of the applicable legislation in the Income Tax Act of Canada. These claims are subject to audit by the Canada Revenue Agency ("CRA") and any adjustments that results could affect ITCs recorded in the consolidated financial statements. The following table shows the breakdown of R&D expenses, net of ITCs:

	Year ended September 30, 2024	Year ended September 30, 2023	Year ended September 30, 2022
R&D expenses	**$ 2,477,736**	$ 1,644,565	$ 2,064,493
Less:			
Investment tax credits	**-**	-	-
R&D expenses, net	**$ 2,477,736**	$ 1,644,565	$ 2,064,493

c) Deferred tax balances

The following tables deferred tax assets (liabilities) have been recognized in the consolidated financial statements:

	Balance at September 30, 2023	**Arising on a business combination**	**Recognized in profit or loss**	**Balance at September 30, 2024**
Deferred tax assets (liabilities):				
Net operating loss carryforwards	16,869	-	(3,271)	**13,598**
Intangibles and development costs	(16,869)	-	3,271	**(13,598)**
	$ -	$ -	$ -	**$ -**

	Balance at September 30, 2022	**Arising on a business combination**	**Recognized in profit or loss**	**Balance at September 30, 2023**
Deferred tax assets (liabilities):				
Net operating loss carryforwards	26,459	-	(9,590)	**16,869**
Impairment provision	(26,459)	-	9,590	**(16,869)**
	$ -	$ -	$ -	**$ -**

	Balance at September 30, 2021	**Arising on a business combination**	**Recognized in profit or loss**	**Balance at September 30, 2022**
Deferred tax assets (liabilities):				
Net operating loss carryforwards	-	-	26,459	**26,459**
Impairment provision	-	(49,442)	22,983	**(26,459)**
	$ -	$ (49,442)	$ 49,442	**$ -**

d) Unrecognized net deferred tax assets

(Expressed in Canadian dollars, except share amounts)

Deferred taxes reflect the impact of loss carryforwards and of temporary differences between amounts of assets and liabilities for financial reporting purposes and such amounts as measured by enacted tax laws. However, KWESST has not recorded net deferred tax assets at September 30, 2024 and 2023 on the following deductible temporary differences, due to the uncertainty involved in determining whether these deferred tax assets will be realized upon expiration due to KWESST's limited history and cumulative operating losses since its inception.

The following is a summary of KWESST's unrecognized deductible temporary differences:

	Balance at September 30, 2024	Balance at September 30, 2023	Balance at September 30, 2022
Net operating loss carryforwards	42,737,987	30,178,141	$ 18,589,894
Share issuance costs	5,072,949	5,275,081	1,298,783
Intangibles and development costs	171,182	1,356,922	608,705
Scientific research and development expenditures	1,583,058	1,583,058	1,583,058
Other	1,496,897	1,467,509	46,300
	$ 51,062,073	$ 39,860,711	$ 22,126,740

e) Available net operating losses

At September 30, 2024, KWESST has the following net operating losses in Canada available to reduce future year's taxable income which expire as follows:

Year of Expiry	**Amount**
2036	**$ 508,324**
2037	**747,861**
2038	**1,174,797**
2039	**1,732,039**
2040	**338,504**
2041	**5,518,336**
2042 and thereafter	**32,718,126**
	$ 42,737,987

f) Available research and development investment tax credits

The Company has the following research and development investment tax credits available to reduce future years' income taxes payable which expire as follows:

Year of Expiry	**Amount**
2038	**$ 13,361**
2039	**6,742**
2040	**-**
2041	**328,480**
2042 and thereafter	**-**
	$ 348,583

23. Financial instruments

Fair value of financial instruments

The fair values of our cash, restricted short-term investment, trade and other receivables (excluding sales tax recoverable), accounts payable and accrued liabilities, and deposit (included in non-current other assets), approximate carrying value because of the short-term nature of these instruments.

Under IFRS, the levels of fair value hierarchy are as follows:

Level 1: Unadjusted quoted prices in active markets for identical assets or liabilities;
Level 2: Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and
Level 3: inputs for the asset or liability that are not observable market data (unobservable inputs).

The lease deposit, accrued royalties liability, warrant liabilities and borrowings were recorded at fair value at initial recognition. The fair value measurement for these was Level 2. Subsequently, these were measured at amortized cost and accreted to their nominal value over their respective terms, except warrant liabilities that are measured at fair value. Except for warrant liabilities, the carrying values approximate the fair values. At September 30, 2024, the fair value for accrued royalties liability determined using a discount rate of 24% (2023 - 24%, 2022 - 24%) would be $1,014,212 (2023 - $928,776, 2022 - $869,219, 2021 – $1,105,756).

Financial risk management

We are exposed to a number of financial risks arising through the normal course of business as well as through its financial instruments. Our overall business strategies, tolerance of risk and general risk management philosophy are determined by our Board of Directors in accordance with prevailing economic and operating conditions.

(a) Interest rate risk

Interest rate risk is the risk that the fair value of cash flows of a financial instrument will fluctuate because of changes in market interest rates. At September 30, 2024, our loans were all repaid and therefore not subject to interest rate risk. At September 30, 2023, our loans were all repaid and therefore not subject to interest rate risk. At September 30, 2022, our borrowings were all subject to fixed interest rates and therefore these were not subject to interest rate risk.

(b) Foreign currency risk

Foreign currency risk is the risk that the future cash flows or fair value of our financial instruments that are denominated in a currency that is not our functional currency will fluctuate due to a change in foreign exchange rates.

For the years ended September 30, 2024, 2023 and 2022, 10% (2023 - 3%, 2022 - 54%) of the Company’s revenue was denominated in U.S. dollar driven by contracts with U.S. prime contractors in the defense sector. We also procure certain raw materials denominated in U.S. dollar for product development. Accordingly, we are exposed to the U.S. dollar currency. Where a natural hedge cannot be achieved, a significant change in the U.S. dollar currency could have a significant effect on our financial performance, financial position, and cash flows. Currently, we do not use derivative instruments to hedge its U.S. dollar exposure. Throughout the year we maintained the majority of our cash assets in USD and converted to CAD as needed as we primarily raise our funds in USD.

At September 30, 2024, we had the following net U.S. dollar exposure:

(Expressed in Canadian dollars, except share amounts)

		Total USD
Net assets in U.S. subsidiary	$	-
US denominated:		
Assets	$	156,286
Liabilities		(324,094)
Net US dollar exposure	**$**	**(167,808)**
Impact to profit or loss if 5% movement in the US dollar	**$**	**(8,390)**

During the year ended September 30, 2024, we recorded foreign exchange gain of $59,903 (2023 - foreign exchange loss of $98,275, 2022 - foreign exchange gain of $28,780).

(c) Credit risk

Credit risk is the risk of financial loss to KWESST if a counterparty to a financial instrument fails to meet its contractual obligations. Our credit risk exposure is limited to cash, and trade and other receivables. Refer to Note 5 for the breakdown of our trade and other receivables. We enter into contracts with either large, financially sound global general contractors or law enforcement agencies, which mitigates the credit risk. At September 30, 2024, our trade receivable was $455,049 (2023 - $68,530, 2022 - $114,877), of which $27,779 was overdue by more than 60 days from law enforcement agencies.

(d) Liquidity risk

Liquidity risk is the risk that we will be unable to meet our financial obligations as they become due. Our objective is to ensure that we have sufficient cash to meet our near-term obligations when they become due, under both normal and stressed condition, without incurring unacceptable losses or risking reputational damage to KWESST. A key risk in managing liquidity is the degree of uncertainty in our cash flows due to our early stage in operations and the need for additional capital to fund our business strategies (see Note 2(a)).

At September 30, 2024, our contractual obligations were as follows:

Payment due:	**Total**	**Within 1 Year**	**1 to 3 years**	**3 to 5 years**	**5 years and beyond**
Minimum royalty commitments	**$ 2,200,000**	$ 200,000	$ 450,000	$ 550,000	$ 1,000,000
Accounts payable and accrued liabilities	**1,660,637**	1,660,637	-	-	-
Lease obligations	**361,272**	206,827	154,445	-	-
Total contractual obligations	**$ 4,221,909**	**$ 2,067,464**	**$ 604,445**	**$ 550,000**	**$ 1,000,000**

At September 30, 2024, we had $256,828 in cash and $1,133,226 in negative working capital (current assets less current liabilities). Refer to Note 27 for financing activities subsequent to September 30, 2024.

24. Supplemental cash flow information

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

(Expressed in Canadian dollars, except share amounts)

	Year ended September 30, 2024	Year ended September 30, 2023	Year ended September 30, 2022
Trade and other receivables	**$ (267,606)**	$ (128,387)	$ 631,801
Inventories	**9,225**	(148,850)	49,446
Prepaid expenses and other	**383,357**	(440,242)	425,876
Deferred costs	**(35,596)**	-	-
Accounts payable and accrued liabilities	**(257,257)**	(1,666,486)	2,515,289
Contract liabilities	**(399)**	73,699	17,410
Warrant liabilities	**(25,395)**	-	-
Accrued royalties liability	**(150,000)**	-	-
	$ (343,671)	$ (2,310,266)	$ 3,639,822

The following is a summary of non-cash items that were excluded from the Statements of Cash Flows for the year ended September 30, 2024:

- 4,670 shares issued for debt settlement of $97,615. The debt resulted in a tail obligation relating to services rendered by a third-party consultant;
- $44,868 non-cash share offering costs as part of the net proceeds settlement at the closing of the April 2024 US Public Offering (see Note 16(a));
- $61,213 non-cash share offering costs as part of the net proceeds settlement at the closing of the June 2024 US Public Offering (see Note 16(a));
- $28,631 non-cash share offering costs as part of the net proceeds settlement at the closing of the August 2024 US Registered Direct Offering (see Note 16(a)); and
- 178,131 warrants exercised throughout Fiscal 2024 in connection with past financings (see Note 15).

The following is a summary of non-cash items that were excluded from the Statements of Cash Flows for the year ended September 30, 2023:

- $2,924,880 non-cash share offering costs and $453,102 accounts payables as part of the net proceeds settlement at the closing of the U.S. IPO and Canadian Offering;
- 25,000 warrants exercised in connection with the GhostStep™ acquisition in June 2020; and
- $529,504 of shares issued for vested RSUs and PSUs.

The following is a summary of non-cash items that were excluded from the consolidated statements of cash flows for the year ended September 30, 2022:

- $83,319 fair value of 87 contingent shares settled via common shares (see Note 4(a));
- $19,000 debt settlement via common shares;
- $61,173 fair value of warrants exercised and transferred to share capital from warrants; and
- $125,000 for 25,000 warrants exercised in connection with the GhostStep™ acquisition in June 2020.

25. Segmented information

Our Executive Chairman has been identified as the chief operating decision maker. Our Executive Chairman evaluates the performance of KWESST and allocates resources based on the information provided by our internal management system at a consolidated level. We have determined that we have only one operating segment.

(Expressed in Canadian dollars, except share amounts)

At September 30, 2024, we had one right-of-use asset ($49,563) (2023 - $79,867, 2022 - $nil), some inventory ($153,087) (2023 - $78,039, 2022 - $nil), and equipment ($76,222) (2023 - $71,906, 2022 - $70,557) in the United States while all other property and equipment are located in Canada.

26. Capital management

Our objective in managing our capital is to safeguard our ability to continue as a going concern and to sustain future development of the business. Our senior management is responsible for managing the capital through regular review of financial information to ensure sufficient resources are available to meet operating requirements and investments to support our growth strategy. Our Board of Directors is responsible for overseeing this process. From time to time, we could issue new common shares or debt to maintain or adjust our capital structure (see Note 27). KWESST is not subject to any externally imposed capital requirements.

KWESST's capital is composed of the following:

	September 30, 2024	September 30, 2023
Debt:		
Lease obligations	**$ 302,223**	$ 429,523
Equity:		
Share capital	**37,822,725**	33,379,110
Warrants	**1,084,687**	1,042,657
Contributed surplus	**5,152,753**	4,769,115
Accumulated other comprehensive loss	**(38,520)**	(39,663)
Accumulated deficit	**(42,653,358)**	(35,215,599)
Total capital	**$ 1,670,510**	$ 4,365,143

27. Subsequent Events

On October 21, 2024, the Company received approval of the TSX Venture Exchange (the "TSX-V") for the consolidation of the Company's issued and outstanding common shares on the basis of ten (10) pre-consolidation Shares for each one (1) post-consolidation Share (the "Consolidation"). The Shares began trading on the TSX-V and Nasdaq Capital Market (the "Nasdaq", and together with the TSX-V, the "Exchanges") on a consolidated basis on October 23, 2024.

On November 1, 2024, the Company announced the closing of a public offering of 3,889,000 pre-funded warrants ("PFW") at a public offering price of $1.25 (US$0.90) per Common Share. The gross proceeds from the offering were approximately $4.9 million (US$3.5 million), before deducting placement agent fees of $0.094 (US$0.0675) per Common Share (being an aggregate of $365,726 (US$262,508) or 7.5% of the public offering price of the securities) and estimated offering expenses were approximately $417,960 (US$300,000). In addition, the Company issued to the placement agent as compensation for its services 194,450 common share purchase warrants with an exercise price of $1.567 (US$1.125) per share.

On November 11, 2024, the Company issued a total of 119,047 common shares at a deemed price per common share of $0.84 per share, representing a 20% discount on the closing price of the Shares on the TSXV for settlement for reimbursement of business expenses incurred while representing the Company in an aggregate amount of $100,000 owed to a company controlled by Mr. David Luxton, Executive Chairman of the Company.

On November 12, 2024, the Company announced the closing of a brokered private placement offering to an institutional accredited investor for aggregate gross proceeds of approximately $3.4 million (approximately

US$2.5 million). As a part of the Offering, the Company issued 4,145,200 pre-funded warrants to acquire one common share of the Company, no par value per share at a price of $0.824 (US$0.592) per pre-funded warrant, inclusive of the exercise price of $0.001 per Common Share. Although the financing was denominated in CAD, the terms of the deal allowed for the proceeds to be sent to the Company in USD for convenience. Each Pre-funded Warrant was bundled with one common share purchase warrant of the Company. Each Common Warrant is immediately exercisable and entitles the holder to acquire one Common Share at an exercise price of $1.03 (US $0.74) per Common Share for a period of 5 years following the closing of the Offering.

In December 2024, the LEC royalty payment due April 2025, in the amount of $200,000 was paid early to DEFSEC in exchange for a $25,000 reduction resulting in a net payment of $175,000.