



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

Three and six months ended March 31, 2022, and 2021  
(Unaudited – Expressed in Canadian dollars)

**KWESST MICRO SYSTEMS INC.**

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**KWESST MICRO SYSTEMS INC.**  
**Condensed Consolidated Interim Statements of Financial Position**  
**At March 31, 2022 and September 30, 2021**  
*(Unaudited)*

<i>In Canadian dollars</i>	<b>Notes</b>	<b>March 31, 2022</b>	September 30, 2021
<b>ASSETS</b>			
Cash		\$ 1,517,162	\$ 2,688,105
Restricted short-term investment		30,000	30,000
Trade and other receivables	5	115,875	699,251
Inventories	6	449,592	90,299
Prepaid expenses		300,508	548,042
Deferred share offering costs		83,966	-
<b>Current assets</b>		<b>2,497,103</b>	4,055,697
Property and equipment		905,043	903,649
Right-of-use assets		237,172	266,214
Deposit		22,456	21,367
Intangible assets	7	3,990,886	3,470,919
<b>Non-current assets</b>		<b>5,155,557</b>	4,662,149
<b>Total Assets</b>		<b>\$ 7,652,660</b>	\$ 8,717,846
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
<b>Liabilities</b>			
Accounts payable and accrued liabilities	8 and 9	\$ 1,279,148	\$ 1,127,202
Corporate taxes payable		3,609	-
Lease obligations		65,791	32,288
Borrowings	10	83,076	-
Contract liabilities	11	157,901	-
<b>Current liabilities</b>		<b>1,589,525</b>	1,159,490
Accrued royalties liability		1,182,583	1,105,756
Lease obligations		241,907	275,621
Borrowings	10	1,577,873	53,251
<b>Non-current liabilities</b>		<b>3,002,363</b>	1,434,628
<b>Total Liabilities</b>		<b>4,591,888</b>	2,594,118
<b>Shareholders' Equity</b>			
Share capital	12(a)	18,336,409	17,215,068
Contingent shares	4 and 20(b)	83,319	-
Warrants	12(b)	1,919,253	1,848,389
Contributed surplus	12(c)	3,637,720	2,458,211
Accumulated other comprehensive income (loss)		6,048	(8,991)
Accumulated deficit		(20,921,977)	(15,388,949)
<b>Total Shareholders' Equity</b>		<b>3,060,772</b>	6,123,728
<b>Total Liabilities and Shareholders' Equity</b>		<b>\$ 7,652,660</b>	\$ 8,717,846

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

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

On behalf of the Board of Directors:

*(signed) John McCoach, Director*

*(signed) David Luxton, Director*

**KWESST MICRO SYSTEMS INC.**

**Condensed Consolidated Interim Statements of Net Loss and Comprehensive Loss**

**Three and six months ended March 31, 2022 and 2021**

*(Unaudited)*

<i>In Canadian dollars</i>	<b>Notes</b>	<b>Three Months Ended March 31, 2022</b>	Three Months Ended March 31, 2021	<b>Six Months Ended March 31, 2022</b>	Six Months Ended March 31, 2021
<b>Revenue</b>	14	\$ 166,251	\$ 447,684	\$ 183,716	\$ 594,033
Cost of sales		(142,012)	(331,472)	(167,491)	(403,036)
<b>Gross profit</b>		<b>24,239</b>	116,212	<b>16,225</b>	190,997
<b>Operating expenses</b>	2(f)				
General and administrative		1,033,017	1,132,730	2,088,157	1,672,363
Selling and marketing		733,364	778,523	2,079,755	1,313,384
Research and development, net		465,344	464,842	1,259,756	970,089
<b>Total operating expenses</b>		<b>2,231,725</b>	2,376,095	<b>5,427,668</b>	3,955,836
<b>Operating loss</b>		<b>(2,207,486)</b>	(2,259,883)	<b>(5,411,443)</b>	(3,764,839)
<b>Other expenses</b>					
Net finance costs	15	(72,479)	(15,129)	(120,121)	(33,077)
Foreign exchange loss		(9,044)	(1,776)	(299)	(5,164)
Loss on disposals		(1,165)	-	(1,165)	-
<b>Total other expenses</b>		<b>(82,688)</b>	(16,905)	<b>(121,585)</b>	(38,241)
<b>Net loss</b>		<b>\$ (2,290,174)</b>	\$ (2,276,788)	<b>\$ (5,533,028)</b>	\$ (3,803,080)
<b>Other comprehensive income:</b>					
<i>Items that are or may be reclassified subsequently to profit or loss:</i>					
Foreign currency translation differences		11,653	-	15,039	-
<b>Total comprehensive loss</b>		<b>\$ (2,278,521)</b>	\$ (2,276,788)	<b>\$ (5,517,989)</b>	\$ (3,803,080)
<b>Net loss per share</b>					
Basic and diluted		<b>\$ (0.05)</b>	\$ (0.05)	<b>\$ (0.11)</b>	\$ (0.09)
<b>Weighted average number of shares outstanding</b>					
Basic and diluted	13	<b>49,868,065</b>	42,141,523	<b>49,440,449</b>	41,813,109

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

**KWESST MICRO SYSTEMS INC.**

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

**Six months ended March 31, 2022, and 2021**

*(Unaudited)*

*In Canadian dollars*

	Notes	Share capital	Contingent shares	Warrants	Contributed surplus	Translation reserve	Deficit	Total Shareholders' Equity
Balance, September 30, 2020		\$ 9,374,563	\$ -	\$ 277,170	\$ 306,708	\$ -	\$ (6,102,058)	\$ 3,856,383
Shares issued to settle debt		63,949	-	-	-	-	-	63,949
Stock options exercised		616,104	-	-	(166,897)	-	-	449,207
Warrants exercised		220,220	-	(102,991)	-	-	-	117,229
Share-based compensation	12(c)	-	-	-	878,458	-	-	878,458
Net loss	12	-	-	-	-	-	(3,803,080)	(3,803,080)
<b>Balance, March 31, 2021</b>		<b>\$ 10,274,836</b>	<b>\$ -</b>	<b>\$ 174,179</b>	<b>\$ 1,018,269</b>	<b>\$ -</b>	<b>\$ (9,905,138)</b>	<b>\$ 1,562,146</b>
Balance, September 30, 2021		17,215,068	-	1,848,389	2,458,211	(8,991)	(15,388,949)	6,123,728
Shares issued to settle debt		19,000	-	-	-	-	-	19,000
Shares and warrants issued on acquisition	4	377,503	83,319	132,000	-	-	-	592,822
Warrants exercised		237,136	-	(61,136)	-	-	-	176,000
Share-based compensation	12(c)	-	-	-	1,350,461	-	-	1,350,461
Shares for vested RSUs and PSUs		148,137	-	-	(148,137)	-	-	-
Vested RSUs and PSUs repurchased for withholding taxes		-	-	-	(22,815)	-	-	(22,815)
Shares issued for unsecured loans	10	365,888	-	-	-	-	-	365,888
Share offering costs		(26,323)	-	-	-	-	-	(26,323)
Other comprehensive income		-	-	-	-	15,039	-	15,039
Net loss		-	-	-	-	-	(5,533,028)	(5,533,028)
<b>Balance, March 31, 2022</b>		<b>\$ 18,336,409</b>	<b>\$ 83,319</b>	<b>\$ 1,919,253</b>	<b>\$ 3,637,720</b>	<b>\$ 6,048</b>	<b>\$ (20,921,977)</b>	<b>\$ 3,060,772</b>

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

**KWESST MICRO SYSTEMS INC.**  
**Condensed Consolidated Interim Statements of Cash Flows**  
**Six months ended March 31, 2022, and 2021**  
*(Unaudited)*

<i>In Canadian dollars</i>	<b>Notes</b>	<b>Six months ended March 31, 2022</b>	<b>Six months ended March 31, 2021</b>
<b>OPERATING ACTIVITIES</b>			
Net loss		\$ (5,533,028)	\$ (3,803,080)
<i>Items not affecting cash:</i>			
Depreciation and amortization		145,186	75,045
Impairment of intangible assets		-	55,376
Share-based compensation	12(c)	1,350,461	878,458
Net finance costs		120,121	31,541
Loss on disposals		1,165	-
Changes in non-cash working capital items	17	1,051,854	(312,134)
Interest paid		(16,085)	(19,095)
<b>Cash used in operating activities</b>		<b>(2,880,326)</b>	<b>(3,093,889)</b>
<b>INVESTING ACTIVITIES</b>			
Additions of property and equipment		(118,703)	(31,250)
Investments in intangible assets	7	(441,074)	-
Recognition of open orders from acquisition	7	64,233	-
Cash acquired on acquisition	4	162,547	-
Purchase of restricted short-term investment		-	(30,000)
<b>Cash flows used in investing activities</b>		<b>(332,997)</b>	<b>(61,250)</b>
<b>FINANCING ACTIVITIES</b>			
Proceeds from borrowings	10	2,000,000	326,000
Payments of deferred financing fees		(74,055)	-
Payments of share offering costs		(26,323)	-
Repayments to related party loans		-	(31,252)
Repayments of lease obligations		(10,427)	(32,037)
Proceeds from exercise of warrants		176,000	117,229
Proceeds from exercise of stock options		-	449,207
Repurchase of vested RSUs and PSUs for withholding taxes		(22,815)	-
<b>Cash flows provided by financing activities</b>		<b>2,042,380</b>	<b>829,147</b>
<b>Net change in cash during the period</b>		<b>(1,170,943)</b>	<b>(2,325,992)</b>
<b>Cash, beginning of period</b>		<b>2,688,105</b>	<b>3,073,760</b>
<b>Cash, end of period</b>		<b>\$ 1,517,162</b>	<b>\$ 747,768</b>

*See Note 17 Supplemental cash flow information.*

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

# KWESST MICRO SYSTEMS INC.

Notes to Unaudited Condensed Consolidated Interim Financial Statements  
Three and six months ended March 31, 2022, and 2021  
(Expressed in Canadian dollars, except share amounts)

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## 1. 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 technologies that deliver a tactical advantage for military and security forces, and personal defense. Key market segments and solutions addressed by our proprietary technologies are: (i) public safety systems with broad application, including law enforcement and personal defense, (ii) modernized digitization of tactical forces for shared situational awareness and targeted information, and (iii) counter-measures against threats such as drones, lasers and electronic detection.

KWESST’s common stock is listed on the TSX-Venture Exchange (“TSX-V”) under the stock symbol of KWE and on the OTCQB® Venture Market under the stock symbol of KWEMF and on the Frankfurt Stock Exchange under the stock symbol of 62U.

## 2. Basis of preparation

### (a) *Going concern*

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

As an early-stage company, we have not yet reached commercial production 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 incurred \$5.5 million net loss and negative operating cash flows of \$2.9 million for the six months ended March 31, 2022 (2021 - \$3.8 million net loss and \$3.1 million negative operating cash flows).

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 and the ability to raise additional debt or equity financing, as required. There are various risks and uncertainties affecting our future financial position and its performance including, but not limited to:

- The market acceptance and rate of commercialization 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 COVID-19 pandemic.

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.

# KWESST MICRO SYSTEMS INC.

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

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

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

These unaudited condensed consolidated interim financial statements were authorized for issue by our Board of Directors on May 27, 2022.

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

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

Control is achieved where 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 March 31, 2022, we have the following wholly-owned subsidiaries:

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

Subsequent to March 31, 2022, we have incorporated the following new wholly-owned subsidiaries:

- KWESST Public Safety Systems Canada Inc.;
- KWESST Public Safety Systems U.S. Inc.; and
- KWESST U.S. Holdings Inc.

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

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



# KWESST MICRO SYSTEMS INC.

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## *(e) Basis of measurement*

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

## *(f) Comparative figures*

For the year ended September 30, 2021, we changed the presentation of its expenses in the consolidated statements of net loss and comprehensive loss from by nature to by function. We made this change in presentation to provide more relevant financial information to facilitate peer benchmarking, particularly with peers in the United States. As a result, our operating expenses for the three and six months ended March 31, 2022 and 2021 are now presented as follows: general and administration (“G&A”), selling and marketing (“S&M”), and net research and development (“R&D”).

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

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

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

## Judgments

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

- Note 4 – *acquisition of Police Ordnance*: whether the purchase price allocation applied to the consideration transferred and assumptions used as inputs in determining the fair value of net assets acquired is reasonable.
- Note 10 – *unsecured loans*: whether the estimated market discount rate used to estimate the fair value of the unsecured loans is reasonable.

## Estimates

Information about assumptions and estimation uncertainties at March 31, 2022 that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities in the next financial year are the same as disclosed in Note 2(g) of the consolidated financial statements for the year ended September 30, 2021.

## COVID-19 Uncertainties

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

# KWESST MICRO SYSTEMS INC.

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

### 3. Significant accounting policies

During the three and six months ended March 31, 2022, the accounting policies in these condensed consolidated interim financial statements are the same as those applied in our consolidated financial statements as at and for the year ended September 30, 2021.

### 4. Acquisition

#### *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 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.

#### *Consideration Transferred:*

The purchase consideration comprised of the following:

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

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

We will issue 61,264 common shares to the sellers subject to fulfillment of a financial milestone in Fiscal 2022 as defined in the share purchase agreement (see Note 20(a)).

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 \$1.72, underlying stock price of \$1.36, 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.

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

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

## KWESST MICRO SYSTEMS INC.

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### *Net Assets Acquired:*

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

<b>Total purchase consideration at fair value</b>	<b>\$</b>	<b>592,822</b>
<i>Police Ordnance's net assets:</i>		
Cash		162,547
Trade and other receivables		83,775
Inventories		348,234
Intangible assets		139,805
Accounts payable and accrued liabilities		82,963
Corporate tax liability		32,338
Borrowings		26,238
<b>Net assets at fair value</b>	<b>\$</b>	<b>592,822</b>

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

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

The results of operations of Police Ordnance are included in these unaudited condensed consolidated interim statements of net loss and comprehensive loss from December 16, 2021. If the acquisition had occurred on October 1, 2021, management estimates that Police Ordnance would have contributed approximately \$128,600 and \$282,300 of revenue and approximately \$47,300 and \$59,100 of net loss to KWESST's operating results for the three and six months ended March 31, 2022, respectively. In determining these amounts, management has assumed that the fair value adjustments that arose on the date of the acquisition would have been the same if the acquisition had occurred on October 1, 2021.

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

## 5. Trade and other receivables

The following table presents trade and other receivables for KWESST:

	<b>March 31, 2022</b>	September 30, 2021
Trade receivables	<b>\$ 31,186</b>	\$ -
Unbilled revenue	-	308,728
Sales tax recoverable	<b>84,689</b>	183,761
Investment tax credits refundable	-	206,762
<b>Total</b>	<b>\$ 115,875</b>	\$ 699,251

There was no impairment of trade and other receivables during the three and six months ended March 31, 2022 (2021 – \$nil).

## KWESST MICRO SYSTEMS INC.

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The following table presents changes in unbilled receivables:

	March 31, 2022	September 30, 2021
Balance, beginning of period	\$ 308,728	\$ -
Revenue in excess of billings, net of amounts transferred to trade receivables	-	308,728
Transferred to trade receivables	(308,728)	-
<b>Balance, end of period</b>	<b>\$ -</b>	<b>\$ 308,728</b>
Current	\$ -	\$ 308,728
Non-current	\$ -	\$ -

### 6. Inventories

The following table presents a breakdown of inventories:

	March 31, 2022	September 30, 2021
Finished goods	\$ 127,658	\$ -
Work-in-progress	43,999	-
Raw materials	277,935	90,299
<b>Total</b>	<b>\$ 449,592</b>	<b>\$ 90,299</b>

There was no impairment of inventories during the three and six months ended March 31, 2022 (2021 - \$nil).

### 7. Intangible assets

The following table presents intangible assets for KWESST:

Cost	Phantom™		PARA OPS™		Patent	ARWEN™	Total
	System	System <sup>(1)</sup>					
Balance at September 30, 2021	\$ 564,700	\$ 2,906,219	\$ -	\$ -	\$ -	\$ -	\$ 3,470,919
Additions	173,909	241,703	28,783	-	-	-	444,395
Acquisition (Note 4)	-	-	-	139,805	-	-	139,805
Recognition of open orders <sup>(2)</sup>	-	-	-	(64,233)	-	-	(64,233)
<b>Balance at March 31, 2022</b>	<b>\$ 738,609</b>	<b>\$ 3,147,922</b>	<b>\$ 28,783</b>	<b>\$ 75,572</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 3,990,886</b>

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

(2) This represents the open customer orders at the time of the acquisition measured at fair value, which were subsequently delivered to customers during the period.

The balance at March 31, 2022 for Phantom™ and PARA OPS™ represents the acquired technology asset (i.e. intellectual properties), coupled with additional capitalized development costs. As both product lines have not yet reached commercialization, no amortization charge was recorded for the three and six months ended March 31, 2022 (2021 - \$nil). The patent relates to the PARA OPS™ system. Management anticipates the estimated useful life to be five years for both technology assets subsequent to then expected commercialization date and the estimated useful life of the patent will be determined subsequent to the approval of the patent.

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For the six months ended March 31, 2022, management concluded there was no impairment on the intangible assets (2021 - \$55,376).

### 8. Accounts payable and accrued liabilities

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

	March 31, 2022	September 30, 2021
Trade payable	\$ 761,115	\$ 620,041
Accrued liabilities	343,273	384,239
Salary and vacation payable	174,760	122,922
<b>Total</b>	<b>\$ 1,279,148</b>	<b>\$ 1,127,202</b>

### 9. Related party transactions

In November 2019, KWESST hired SageGuild LLC to assist us in promoting our product offerings in the United States. In January 2021, the Acting CEO and sole shareholder of SageGuild LLC agreed to serve as director of KWESST U.S. Inc. and as a result SageGuild LLC became a related party to KWESST. The total cash and share-based remuneration amounted to \$82,772 and \$169,477 for the three and six months ended March 31, 2022, respectively (three months and six months ended March 31, 2021: \$115,528). Except for the cash consideration recorded at the exchange amount, the share-based compensation was recorded at fair value.

At March 31, 2022, \$36,171 (September 30, 2021 - \$23,187) was owed to directors and officers for business expense reimbursements, which was included in accounts payable and accrued liabilities and paid subsequently. Additionally, \$74,000 of borrowings were owed to directors and officers at March 31, 2022 for their participation in the Unsecured Loans financing (see Note 10).

### 10. Borrowings

There were no changes to KWESST's RBC Credit Facility since September 30, 2021, which consists of a \$30,000 corporate credit card program collateralized by the short-term investment.

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

	CEBA Term Loan	Unsecured Loans	Total
Balance, September 30, 2021	\$ 53,251	\$ -	\$ 53,251
Assumed from acquisition (Note 4)	26,238	-	26,238
Issuance at fair value	-	1,634,112	1,634,112
Deferred financing fees	-	(74,055)	(74,055)
Net borrowings	79,489	1,560,057	1,639,546
Accrued interest and accretion expense	3,587	28,089	31,676
Interest paid	-	(10,273)	(10,273)
<b>Balance, March 31, 2022</b>	<b>\$ 83,076</b>	<b>\$ 1,577,873</b>	<b>\$ 1,660,949</b>
Current	\$ 83,076	\$ -	\$ 83,076
Non-current	-	1,577,873	1,577,873
<b>Total</b>	<b>\$ 83,076</b>	<b>\$ 1,577,873</b>	<b>\$ 1,660,949</b>

On March 11, 2022, we closed a non-secured loan financing with various lenders in an aggregate amount of \$1.8 million and an additional \$0.2 million on March 15, 2022, for a total of \$2.0 million (the "Unsecured Loans").

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Certain directors and officers participated in this financing for an aggregate amount of \$74,000. The Unsecured 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 Unsecured 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 Unsecured Loans, we issued an aggregate of 1,000,000 bonus common shares to the lenders. These common shares were issued pursuant to prospectus exemptions of applicable securities laws and therefore subject to a four-month plus one day trading restriction.

As a result of issuing common shares and debt for a total combined cash consideration of \$2 million, we allocated the gross proceeds to these two financial instruments based on their relative fair value. To measure the fair value of the Unsecured Loans, we used the income approach and estimated a market discount rate of 22% to discount the future cash flows of the Unsecured Loans resulting in an estimated fair value of \$1.63 million. Accordingly, we allocated \$1.63 million of the \$2 million to Unsecured Loans and \$0.37 million to share capital for the bonus common shares issued (see Note 12(a)).

The total offering costs were \$0.09 million, \$0.07 million of which was allocated to deferred financing fees and \$0.02 million 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 Unsecured Loans as a financing cost and the share offering costs were recognized as a reduction to common shares.

As the Unsecured Loans mature in April 2023, we presented these as non-current borrowings in the consolidated financial position.

## 11. Contract liabilities

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

		<b>Contract liabilities</b>
Balance, September 30, 2021	\$	-
Additions		<b>300,340</b>
Revenue recognized		<b>(142,439)</b>
<b>Balance, March 31, 2022</b>	<b>\$</b>	<b>157,901</b>

## 12. Share capital and Contributed Surplus

### a) Share capital

#### *Authorized*

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

#### *Issued Common Shares*

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

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	Number	Amount
Balance at September 30, 2021	48,965,631	\$ 17,215,068
Issued for acquisition (Note 4)	277,576	\$ 377,503
Issued for debt settlements	10,000	\$ 19,000
Issued for exercise of warrants	1,130,000	\$ 237,136
Issued for conversion of stock units	101,136	\$ 148,137
Issued for bonus shares relating to borrowings (Note 10)	1,000,000	\$ 365,888
Less: share offering costs for the period		\$ (26,323)
<b>Balance at March 31, 2022</b>	<b>51,484,343</b>	<b>\$ 18,336,409</b>

## b) Warrants

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

	Number of warrants	Weighted average exercise price
Outstanding at September 30, 2021	13,901,640	\$ 0.74
Issued (Note 4)	200,000	\$ 1.72
Exercised	(1,130,000)	\$ 0.27
Outstanding at March 31, 2022	12,971,640	\$ 0.79
Exercisable at March 31, 2022	12,221,640	\$ 0.88

The following table provides additional information on the total outstanding warrants at March 31, 2022:

	Number outstanding	Fair value <sup>(1)</sup>	Expiry Date
<i>Founders' warrants:</i>			
Exercise price of \$0.20	5,720,000	\$ 1,049	January 1, 2024
Exercise price of \$0.20	1,900,000	\$ 18,865	June 14, 2024
<i>GhostStep's warrants:</i>			
Exercise price of \$0.50	250,000	\$ 60,000	January 15, 2023
<i>April 2021 equity financing:</i>			
Exercise price of \$1.75	3,274,657	\$ 785,918	April 29, 2023
Exercise price of \$1.75	40,000	\$ 9,600	August 25, 2023
<i>LEC's warrants:</i>			
Exercise price of \$0.70	500,000	\$ 425,000	April 29, 2026
<i>September 2021 equity financing:</i>			
Exercise price of \$2.35	750,000	\$ 390,000	September 16, 2023
<i>Broker warrants:</i>			
Exercise price of \$0.45	84,622	\$ 17,162	May 8, 2022
Exercise price of \$0.70	69,862	\$ 14,259	July 9, 2022
Exercise price of \$1.75	137,499	\$ 33,000	April 29, 2023
Exercise price of \$2.00	45,000	\$ 32,400	September 16, 2023
<i>Acquisition of Police Ordnance (Note 4):</i>			
Exercise price of \$1.72	200,000	\$ 132,000	December 15, 2024
	<b>12,971,640</b>	<b>\$ 1,919,253</b>	

(1) Fair value is calculated based on the grant date fair value and number outstanding at March 31, 2022 and therefore it does not represent the fair value at March 31, 2022.

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The fair value for the warrants issued during the six months ended March 31, 2022, was determined using the Black-Scholes option model and key inputs:

	<b>Acquisition of POC</b>
<b>Exercise Price</b>	<b>\$ 1.72</b>
Stock price	\$ 1.36
Volatility	84.7%
Dividend Yield	Nil
Risk-free interest rate	1.04%
Expected life	3
<b>Weighted average fair value per warrant</b>	<b>\$ 0.66</b>

### e) Contributed Surplus

#### *Share-based compensation*

For the three and six months ended March 31, 2022, KWESST recorded stock-based compensation expenses of \$422,931 (2021: \$604,773) and \$1,350,461 (2021: \$878,458), respectively.

#### (i) Stock Options

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

	<b>Number of options</b>	<b>Weighted average exercise price</b>
Outstanding at September 30, 2021	4,167,516	\$ 1.37
Granted	365,000	1.64
Forfeited	(65,157)	1.08
<b>Outstanding at March 31, 2022</b>	<b>4,467,359</b>	<b>\$ 1.39</b>
<b>Options exercisable at March 31, 2022</b>	<b>3,027,234</b>	<b>\$ 1.33</b>

At March 31, 2022, there were 715,597 stock options available for grant under KWESST's LTIP.

For the options granted during the six months ended March 31, 2022, the per share weighted-average fair value of stock options was \$0.89 using the Black-Scholes option model with the following weighted-average assumptions:

Stock price	\$1.24 to \$1.81
Exercise price	\$1.24 to \$1.81
Volatility	85.21%
Dividend yield	Nil
Risk-free interest rate	1.15%
Expected life (years)	3.00
<b>Weighted-average fair value per option</b>	<b>\$ 0.89</b>



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### Amended Stock option grants

There were no amended stock option grants during the six months ended March 31, 2022.

During the six months ended March 31, 2021, the Board approved the acceleration of vesting for 275,000 options and the cancellation of 250,000 options. This resulted in an additional share-based compensation charge of \$61,736.

### (ii) Share Units

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

	RSUs	PSUs	SARs	Total
Outstanding at September 30, 2021	1,139,072	200,000	150,000	1,489,072
Granted	750,784	1,256,000	36,000	2,042,784
Vested and converted to common shares	(88,536)	(12,600)	-	(101,136)
Vested and repurchased for withholding taxes	(5,846)	(17,400)	-	(23,246)
Forfeited	-	(20,000)	-	(20,000)
<b>Outstanding at March 31, 2022</b>	<b>1,795,474</b>	<b>1,406,000</b>	<b>186,000</b>	<b>3,387,474</b>

At March 31, 2022, there were 705,193 Share Units available for grant under KWESST's LTIP.

### 13. Earnings (loss) per share

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

	Three months ended March 31, 2022	Three months ended March 31, 2021	Six months ended March 31, 2022	Six months ended March 31, 2021
Issued common shares, beginning of period	49,508,997	41,942,258	48,965,631	41,266,176
<i>Weighted average effect of shares issued from:</i>				
Acquisition of Police Ordnance (Note 4)	-	-	161,664	-
Exercise of options	-	138,023	-	324,763
Exercise of warrants	95,276	61,242	170,742	168,302
Debt settlements	-	-	8,626	53,868
Conversion of stock units	70,459	-	38,181	-
Issuance of bonus shares (Note 10)	193,333	-	95,605	-
<b>Weighted average number of basic common shares</b>	<b>49,868,065</b>	<b>42,141,523</b>	<b>49,440,449</b>	<b>41,813,109</b>
<i>Dilutive securities:</i>				
Stock options	-	-	-	-
Warrants	-	-	-	-
<b>Weighted average number of dilutive common shares</b>	<b>49,868,065</b>	<b>42,141,523</b>	<b>49,440,449</b>	<b>41,813,109</b>

At March 31, 2022 and 2021, all dilutive securities were anti-dilutive because of KWESST's net loss for the above periods.

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### 14. Revenue

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

	Three months ended March 31, 2022	Three months ended March 31, 2021	Six months ended March 31, 2022	Six months ended March 31, 2021
<b>Major products / service lines</b>				
Digitization and counter-threat systems	\$ 139,975	\$ 444,208	\$ 156,615	\$ 583,141
Public safety product sales	10,492	-	10,492	-
Training and services	15,674	-	15,674	-
Other	110	3,476	935	10,892
	<b>\$ 166,251</b>	<b>\$ 447,684</b>	<b>\$ 183,716</b>	<b>\$ 594,033</b>
<b>Primary geographical markets</b>				
United States	\$ 4,411	\$ 444,208	\$ 21,051	\$ 583,141
Canada	161,840	3,476	162,665	10,892
	<b>\$ 166,251</b>	<b>\$ 447,684</b>	<b>\$ 183,716</b>	<b>\$ 594,033</b>
<b>Timing of revenue recognition</b>				
Products and services transferred over time	\$ 155,649	\$ 444,208	\$ 172,289	\$ 583,141
Products transferred at a point in time	10,602	3,476	11,427	10,892
	<b>\$ 166,251</b>	<b>\$ 447,684</b>	<b>\$ 183,716</b>	<b>\$ 594,033</b>

At March 31, 2022, our total contracted not yet recognized revenue was \$157,901 (2021 - \$588,000), which we expect to deliver by June 30, 2022.

For the three and six months ended March 31, 2022, one customer accounted for 84.19% and 85.25% of the total revenue (2021 – one customer accounted for 100% and 96.60% for the three and six months ended March 31, 2021), respectively.

### 15. Net finance costs

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

	Three months ended March 31, 2022	Three months ended March 31, 2021	Six months ended March 31, 2022	Six months ended March 31, 2021
Interest expense from:				
Accretion cost - accrued royalties liability	\$ 35,322	\$ -	\$ 73,506	\$ -
Borrowings	28,089	-	28,089	-
Lease obligations	8,396	13,912	16,028	28,807
Other	1,334	5,053	4,959	8,106
Total interest expense	73,141	18,965	122,582	36,913
Interest income	(662)	(3,836)	(2,461)	(3,836)
<b>Net finance costs</b>	<b>\$ 72,479</b>	<b>\$ 15,129</b>	<b>\$ 120,121</b>	<b>\$ 33,077</b>

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## 16. Financial instruments

### *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 the directors in accordance with prevailing economic and operating conditions.

For the three and six months ended March 31, 2022, there were no material changes to KWESST's financial risks as disclosed in Note 22 of the audited consolidated financial statements for the year ended September 30, 2021.

At March 31, 2022, our contractual obligations were as follows:

<b>Payment due:</b>	<b>Total</b>	<b>Within 1 Year</b>	<b>1 to 3 years</b>	<b>3 to 5 years</b>
Minimum royalty commitments	\$ 2,500,000	\$ -	\$ 150,000	\$ 2,350,000
Borrowings	2,090,000	30,000	2,060,000	-
Accounts payable and accrued liabilities	1,279,148	1,279,148	-	-
Lease obligations	374,400	93,600	187,200	93,600
Short-term rental obligations	17,944	17,944	-	-
Other commitments	12,496	12,496	-	-
<b>Total contractual obligations</b>	<b>\$ 6,273,988</b>	<b>\$ 1,433,188</b>	<b>\$ 2,397,200</b>	<b>\$ 2,443,600</b>

At March 31, 2022, we had \$907,578 (September 30, 2021 - \$2,896,207) in working capital (current assets less current liabilities).

## 17. Supplemental cash flow information

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

	<b>Six months ended March 31, 2022</b>	<b>Six months ended March 31, 2021</b>
Trade and other receivables	\$ 667,151	\$ (129,572)
Inventories	(11,059)	(476,297)
Prepaid expenses	247,534	(141,113)
Accounts payable and accrued liabilities	19,056	391,604
Contract liabilities	157,901	43,244
Corporate taxes payable	(28,729)	-
	<b>\$ 1,051,854</b>	<b>\$ (312,134)</b>

The following is a summary of non-cash items that were excluded from the Statements of Cash Flows for the six months ended March 31, 2022:

- \$19,000 debt settlement via common shares;
- \$61,136 fair value of warrants exercised and transferred to share capital from warrants; and
- \$125,000 for 250,000 warrants exercised in connection with the GhostStep™ acquisition in June 2020.

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

## **KWESST MICRO SYSTEMS INC.**

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- \$63,949 debt settlement via common shares;
- \$125,000 for 250,000 warrants exercised in connection with the GhostStep™ acquisition in June 2020; and
- \$102,991 fair value of warrants and \$166,897 fair value of options exercised and transferred to share capital from contributed surplus.

### **18. Commitments and contingencies**

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

### **19. Segmented information**

Our Executive Chairman has been identified as the chief operating decision maker. The Executive Chairman evaluates our performance 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.

At March 31, 2022, and 2021, all of KWESST's property and equipment are located in Canada, including the right-of-use assets.

### **20. Subsequent events**

#### a) Contingent Shares

In April 2022, we issued 61,264 common shares to the selling shareholders as a result of achieving the performance milestone as defined in the share purchase agreement relating to the Police Ordinance Acquisition (see Note 4).