KWESST MICRO SYSTEMS INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Three and nine months ended June 30, 2022

(Expressed in Canadian Dollars)

All references in this management's discussion and analysis (the "MD&A") to "KWESST", "we", "us", "our", and the "Company" refer to KWESST Micro Systems Inc. and its subsidiaries as at June 30, 2022. This MD&A has been prepared with an effective date of August 11, 2022.

This MD&A should be read in conjunction with our unaudited condensed consolidated interim financial statements for the three and nine months ended June 30, 2022 ("Q3 Fiscal 2022 FS") and the annual audited consolidated financial statements and related notes for the year ended September 30, 2021 ("Fiscal 2021 FS"). The financial information presented in this MD&A is derived from these unaudited condensed consolidated interim financial statements prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"). This MD&A contains forward-looking statements involves risk, uncertainties and assumptions, including statements regarding anticipated developments in future financial periods and our future plans and objectives. There can be no assurance that such information will prove to be accurate, and readers are cautioned not to place undue reliance on such forward-looking statements. See "Forward-Looking Statements".

All references to $ or dollar amounts in this MD&A are to Canadian currency unless otherwise indicated.

Additional information, including press releases, relating to KWESST is available for view on SEDAR at www.sedar.com.

NON-IFRS MEASURES

In this MD&A, we have presented earnings before interest, taxes, depreciation and amortization ("EBITDA") and EBITDA that has been adjusted for the removal of stock-based compensation, foreign exchange loss (gain) and any one-time, irregular and nonrecurring items ("Adjusted EBITDA") to provide readers with a supplemental measure of our operating performance and thus highlight trends in our core business that may not otherwise be apparent when relying solely on IFRS financial measures. Management also uses non-IFRS measures, in addition to IFRS financial measures, to understand and compare operating results across accounting periods, for financial and operational decision making, for planning and forecasting purposes, and to evaluate our financial performance. We believe that these non-IFRS financial measures enable us to identify underlying trends in our business that could otherwise be hidden by the effect of certain expenses that we exclude in the calculations of the non-IFRS financial measures.

Accordingly, we believe that these non-IFRS financial measures reflect our ongoing business in a manner that allows for meaningful comparisons and analysis in the business and provides useful information to investors and securities analysts, and other interested parties in understanding and evaluating our operating results, enhancing their overall understanding of our past performance and future prospects.

We caution readers that these non-IFRS financial measures do not replace the presentation of our IFRS financial results and should only be used as a supplement to, not as a substitute for, our financial results presented in accordance with IFRS. There are limitations in the use of non-IFRS measures because they do not include all the expenses that must be included under IFRS as well as they involve the exercise of judgment concerning exclusions of items from the comparable non-IFRS financial measure. Furthermore, other peers may use other non-IFRS measures to evaluate their performance, or may calculate non-IFRS measures differently, all of which could reduce the usefulness of our non-IFRS financial measures as tools for comparison.

GOING CONCERN

As an early-stage company, we have incurred significant losses and negative operating cash flows from inception that have primarily been funded from financing activities. KWESST's Q3 Fiscal 2022 FS have been prepared on the "going concern" basis which presumes that KWESST will be able to realize its assets and discharge its liabilities in the normal course of business for the foreseeable future. Refer to Note 2(a) of the Q3 Fiscal 2022 FS.

TRADEMARKS

We own or have rights to various trademarks, service marks and trade names that we use in connection with the operation of our business. This MD&A also contains additional trademarks, trade names and service marks belonging to other companies. Solely for convenience, trademarks, trade names and service marks referred to in this MD&A may appear without the ®, ™ or SM symbols, but such references are not intended to indicate, in any way, that we will not assert, to the fullest extent under applicable law, our rights or the right of the applicable licensor to these trademarks, trade names and service marks. We do not intend our use or display of other parties' trademarks, trade names or service marks to imply, and such use or display should not be construed to imply, a relationship with, or endorsement or sponsorship of us by, these other parties.

FORWARD-LOOKING STATEMENTS

Certain statements in this document constitute "forward-looking statements". Such forward-looking statements include, but are not limited to, information with respect to our objectives and our strategies to achieve these objectives, as well as statements with respect to our beliefs, plans, expectations, anticipations, estimates and intentions. These forward-looking statements may be identified by the use of terms and phrases such as "may", "would", "should", "could", "expect", "intend", "estimate", "anticipate", "plan", "foresee", "believe", or "continue", the negative of these terms and similar terminology, including references to assumptions, although not all forward-looking statements contain these terms and phrases. Forward-looking statements are provided for the purposes of assisting the reader in understanding us, our business, operations, prospects and risks at a point in time in the context of historical and possible future developments and therefore the reader is cautioned that such information may not be appropriate for other purposes.

Forward-looking statements relating to us include, among other things, statements relating to:

- our expectations regarding our business, financial condition and results of operations;
- the future state of the legislative and regulatory regimes, both domestic and foreign, in which we conduct business and may conduct business in the future;
- our expansion into domestic and international markets;
- our ability to attract customers and clients;
- our marketing and business plans and short-term objectives;
- our ability to obtain and retain the licences and personnel we require to undertake our business;
- our strategic relationships with third parties;
- our anticipated trends and challenges in the markets in which we operate;
- governance of us as a public company; and
- expectations regarding future developments of products and our ability to bring these products to market.

Forward-looking statements are based upon a number of assumptions and are subject to a number of risks and uncertainties, many of which are beyond our control, which could cause actual results to differ materially from those that are disclosed in or implied by such forward-looking statements. These risks and uncertainties include, but are not limited to, the following risk factors, some of which are discussed in greater detail under the section "*Risk Factors*" in our Annual Information Form dated June 24, 2022 (the "AIF").

- limited operating history;
- failure to realize growth strategy;
- failure to complete transactions or realize anticipated benefits;
- reliance on key personnel;
- regulatory compliance;
- competition;

- changes in laws, regulations and guidelines;
- demand for our products;
- current global inflationary pressure;
- availability of components and materials due to global supply chain challenges;
- pricing for products;
- ability to supply sufficient product;
- expansion to other jurisdictions;
- damage to our reputation;
- operating risk and insurance coverage;
- negative operating cash flow;
- management of growth;
- product liability;
- product recalls;
- environmental regulations and risks;
- ownership and protection of intellectual property;
- constraints on marketing products;
- reliance on management;
- fraudulent or illegal activity by our employees, contractors and consultants;
- breaches of security at our facilities or in respect of electronic documents and data storage and risks related to breaches of applicable privacy laws;
- government regulations with regards to COVID-19, employee health and safety regulations;
- the duration and impact of COVID-19, and including variants of COVID-19, on our operations;
- regulatory or agency proceedings, investigations and audits;
- additional capital requirements to support our operations and growth plans, leading to further dilution to shareholders;
- conflicts of interest;
- litigation;
- risks related to United States' and other international activities;
- risks related to security clearances and risks relating to the ownership of KWESST common shares ("Common Shares") such as potential volatility of share price; and
- no assurance of active market for Common Shares.

Although the forward-looking statements contained herein are based upon what we believe are reasonable assumptions, investors are cautioned against placing undue reliance on this information since actual results may vary from the forward-looking statements. Certain assumptions were made in preparing the forward-looking statements concerning availability of capital resources, business performance, market conditions and customer demand.

BUSINESS OVERVIEW

Corporate Information

We are an early commercial-stage technology company focused on the development and commercialization of next-generation technologies that deliver a tactical advantage for military, public safety agencies, and personal defense markets. Our core mission is to protect and save lives.

We focus on three niche market segments as follows:

For more details on KWESST products and markets, refer to our AIF. This document and other information about KWESST are available on SEDAR under the Company's profile at www.sedar.com.

Major Highlights

The following is a summary of the major highlights that occurred during the nine months ended June 30, 2022 ("YTD Fiscal 2022").

- On October 13, 2021, we announced that we are accelerating the readiness of deployable and man-wearable Battlefield Laser Detection System ("BLDS") for first deliveries available by end of Q1 Fiscal 2022, following military interest from a number of NATO land and Special Operation Forces at the signature European defense show, DESI, which took place in London, UK, on September 13 to 18, 2021. While no deliveries took place to date, we continue to be actively engaged with an overseas NATO country for the potential purchase of four vehicle-mounted versions of the BLDS for Special Forces light patrol vehicles during Q4 Fiscal 2022 for delivery in Q1 Fiscal 2023.

- On November 12, 2021, we announced that General Dynamics Land Systems ("GDLS") has selected KWESST's Phantom electronic battlefield decoy as part of its ongoing efforts to develop a next generation multi-million domain mobile capability at the tactical level. If GLDS wins the contract with their United States military customer, we have estimated the potential value for this contract to KWESST could be more than USD $40 million, depending on the number of Phantom units per military vehicle and final pricing based on volume. The United States military customer is expected to announce the winner of the tender for 400-500 next generation military vehicles in calendar 2023. Accordingly, there is no assurance that we will be awarded this contract or if we are, what the value of such contract will be to KWESST.

- On November 15, 2021, we conducted live fire demonstrations of our initial non-lethal cartridge-based single shot device for investors near Toronto, Ontario, including an opportunity for these investors to use the devices. Further, on January 14, 2022, we announced the unveiling of our non-lethal cartridge-based products under the brand PARA OPS at the 2022 SHOT Show® in Las Vegas held on January 18 to 21, 2022.

- On November 23, 2021, in connection with an updated capital markets strategy, we submitted our initial application to list on The Nasdaq Stock Market ("Nasdaq"). We believe that, if successful, a Nasdaq listing can broaden investor awareness for KWESST's common shares, with a view to supporting shareholder value.

- On December 2, 2021, we announced that we have engaged the New York-based public relations firm AMW Public Relations to lead our public relations, brand strategy, and media communication initiatives.

- On December 8, 2021, our United States military customer accepted the delivery of the final milestone of the US $0.8 million relating to the integration of our TASCS IFM with the 81 mortar system. Final payment was received in January 2022. While we expect follow-on customer orders for this solution during Fiscal 2023, there is no assurance we will receive such orders.

- On December 14 and 16, 2021, we announced that we signed a Master Services Agreement with General Dynamics Mission Systems – Canada ("GDMS") to support the development of digitization solutions for future Canadian land C4ISR programs. At the time of entering this agreement, we estimated the contract's value to KWESST to be up to $1.0 million over 12 months. We delivered on the first Statement of Work ("SOW") during Q3 Fiscal 2022 and expect to sign a follow-on SOW during Q4 Fiscal 2022 and another SOW in Q2 Fiscal 2023. We now estimate the total contract value to KWESST to be approximately $0.7 million.

- On December 15, 2021, we completed the non-cash acquisition of Police Ordnance Company Inc. – see below "Acquisition" for further details. On January 10, 2022, we announced that Police Ordnance Company Inc. received orders from law enforcement agencies for approximately $0.4 million in ARWEN products, all have since been delivered as of the date of this MD&A. However, as most of the shipments related to open customer orders at the acquisition date, these were not recorded as revenue during the quarter but rather as a reduction of intangible assets in accordance with IFRS.

- At the 2022 SHOT Show held in Las Vegas from January 18th to 21st 2022, we showcased our initial PARA OPS single shot device. Since this event, we have continued to make further improvements to this device based on positive feedback from the SHOT Show. As of the date of this MD&A, we have finalized the design of the single shot device and are in the process of producing small quantities for market testing prior to commercial launch by end of Fiscal 2022. We are also in the process of optimizing the design of our multi-shot device for market testing in September 2022 and commercial launch soon after. Our initial sales focus will be law enforcements (see below *Government Regulations Update*).

- On February 11, 2022, we filed U.S. patent application No. 17/669,420 claiming priority to a provisional patent serial 63/148,163 by the USPO for our PARA OPS system.

- On March 11, 2022, we closed a non-secured and non-convertible loan financing with a syndicate of 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"). Our directors and officers participated in the amount of $74,000. See *Liquidity and Capital Resources* section of this MD&A for further information.

- On March 29, 2022, KWESST's common stock commenced trading on the Frankfurt Stock Exchange under the symbol "62U". We believe this listing will provide us with the opportunity to further increase our investor base globally, improve our stock liquidity, and promote KWESST to the European financial markets.

- On April 22, 2022, we issued 61,264 common shares to the selling shareholders of Police Ordnance as a result of achieving the performance milestone as defined in the share purchase agreement.

- On April 25, 2022, we announced that we engaged RedChip Companies ("RedChip") to lead our investor relations efforts in the United States in advance of our pending Nasdaq listing. Headquartered in Orlando, Florida, RedChip provides investor relations, financial media, and research for microcap and small-cap stocks.

The following is a summary of the major highlights that occurred since Q3 Fiscal 2022:

- On July 6, 2022, we entered into a three-year contract with Counter-Crisis Technology Inc. ("CC-T") to design, develop, and implement a significant component of a national Ground Search and Rescue Incident Command System for Public Safety Canada, with the Ontario Provincial Police ("OPP") as technical advisory stakeholder for this project. The total contract value is approximately $0.7 million, net of in-kind contributions of $76,000, over three years of services commencing in late July 2022.

- On July 14, 2022, we closed a non-brokered private placement, resulting in the issuance of 1,600,000 units of KWESST, at a price of $0.215 per July 2022 Unit, for aggregate gross proceeds of $0.34 million. Certain of our directors and officers participated in the amount of $87,500. See *Liquidity and Capital Resources* section of this MD&A for further information.

Government Regulations Update

<u>Non-lethal</u>

United States

In February 2022, we retained the services of Orchid Advisors to assist us with the classification and ATF compliance for our PARA OPS devices. Orchid Advisors is a Federal Firearms License ("FFL") compliance solutions firm headquartered in Hartford, Connecticut.

Based on Orchid Advisor's interpretation of the ATF rules and regulations, we have self-classified the .67 caliber version of the PARA OPS devices as a "destructive device," providing us with the ability to go to market much sooner than waiting for ATF classification ruling. Under the ATF rules, a manufacturer must determine whether the device is a firearm and therefore be subject to ATF regulation, and if it is a firearm whether it is subject to National Firearms Act of 1934 ("NFA") regulations.

To be considered a regulated firearm in the United States, the device must be: (i) a weapon that (ii) will or is designed to expel a projectile (iii) by the action of an explosive. Although primers in ammunition cartridges are exempt from control under the explosives regulations as administered by ATF, they are still considered an "explosive" for the purposes of the firearm definition. Because we use primers in the ammunition cartridges for our PARA OPS devices, we have decided to self-classify our PARA OPS devices as a form of firearm in the United States pending any different eventual classification by the ATF.

As the PARA OPS product line is identified as a firearm in the United States, it must be determined whether an additional level of control is imposed by the NFA. Under NFA regulations, there are only two possible types of NFA firearm that PARA OPS could be defined as: (1) a "any other weapon" ("AOW") or (2) a "destructive device". Sale of either of these to consumers is permissible but requires a lengthy approval process conducted by the ATF (the background check process on the consumer); whereas sale to law enforcement agencies, military bodies, or government agencies is a more expedient approval process (usually less than 7 days). Further, the AOW classification requires only a $5 transfer tax to consumers whereas a destructive device classification results in a $200 transfer tax to consumers (such tax being borne by the consumer). While our PARA OPS is non-lethal (the velocity of our projectile is well below lethal threshold), we have determined that the current version of our PARA OPS devices are "destructive devices" because the measurement of the bore of our device is currently in excess of the one-half inch in diameter, the maximum size for AOW.

As a result, initial sales of our PARA OPS devices in the United States are expected to come primarily from law enforcement agencies until we reduce the bore of our device to less than one-half inch in diameter for the consumer market. We expect to partner with a FFL manufacturer for the production of our PARA OPS products in the United States during Q4 Fiscal 2022. We are currently developing a new version of PARA OPS device to meet the AOW firearm classification in order to reduce the tax burden on a consumer purchasing the PARA OPS devices. We expect to commercially launch this AOW version before the end of calendar 2022. The distribution of our PARA OPS in the United States will be done directly with FFL distributors/firearm dealers for civilian sales. Today, all 50 states of the United States allow civilians to own a firearm subject to the firearm laws of the state (which vary by state). We expect the sales of our PARA OPS devices will position us well for significant recurring revenues through the sale of subsequent ammunition over the next 12 months.

For the non-lethal ARWEN products, in Canada we maintain a Firearm Business License issued by the Chief Firearms Office of the Ontario Ministry of the Solicitor General and a Factory License and Manufacturing – Certificate issued by the Natural Reserves Canada (renewed on July 29, 2022). Further, we are also registered under the Controlled Goods Program in Canada. In the United States, we maintain a Federal Explosives License/Permit for the manufacturing of explosives and a Federal Firearms License for manufacturer and sale of destructive devices, both issued by the ATF in the United States. All sales of our ARWEN launchers are made directly to law enforcement agencies.

Rest of the World

As our current focus is commercializing PARA OPS in the United States, we have not begun analyzing the related government regulations for the rest of the world.

COVID-19 Update

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 persistence of COVID-19: disruptions to business operations resulting from quarantine of employees, customers, manufacturers and other third-party service providers in areas affected by the outbreak; disruptions to business operations resulting from travel restrictions, including travel to industry tradeshows; and uncertainty around the duration of the virus' impact.

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

ACQUISITION

To accelerate our growth plans and respond to market opportunities, we made the following acquisition during Fiscal 2022.

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 our non-lethal public safety business.

The fair value of the purchase consideration was $592,822, which comprised of: (i) 277,576 Common Shares, (ii) 200,000 Common Share purchase warrants exercisable at a price of $1.72 per share and expiring on December 15, 2024; and (ii) 61,264 Common Shares contingent on fulfilment of a financial milestone which was achieved in April 2022. At this time the purchase price allocation remains preliminary as certain inventory and intangible asset valuation assessments are ongoing. We expect to finalize the allocation in Q4 2022 (refer to Note 4 of the Q3 Fiscal 2022 FS for further financial information). While this acquisition is expected to be accretive annually based on historical results, we do not expect it will have a material impact to our overall consolidated results of operations, financial condition, and/or cash flows over the next twelve months.

RESULTS OF OPERATIONS

The following selected financial data has been extracted from Q3 Fiscal 2022 FS.

	Three months ended June 30,		Change	Nine months ended June 30,		Change
(Unaudited)	**2022**	2021(1)	**%**	**2022**	2021(1)	**%**
Revenue	**$ 282,432**	$ 521,724	-46%	**$ 466,148**	$ 1,115,757	-58%
Cost of sales	**(238,350)**	(315,273)	-24%	**(405,841)**	(718,309)	-44%
Gross profit	**44,082**	206,451	-79%	**60,307**	397,448	-85%
Gross margin %	***15.6%***	*39.6%*		***12.9%***	*35.6%*	
Operating Expenses						
General and administrative	**1,322,730**	1,236,988	7%	**3,410,887**	2,909,349	17%
Selling and marketing	**851,705**	882,261	-3%	**2,931,460**	2,195,647	34%
R&D	**350,689**	678,622	-48%	**1,610,445**	1,648,711	-2%
Total operating expenses	**2,525,124**	2,797,871	-10%	**7,952,792**	6,753,707	18%
Operating loss	**(2,481,042)**	(2,591,420)	-4%	**(7,892,485)**	(6,356,259)	24%
Other expenses						
Gain on acquisition	**41,869**	-	N/A	**41,869**	-	N/A
Net finance costs	**(184,177)**	(27,780)	563%	**(304,298)**	(60,857)	400%
Foreign exchange gain (loss)	**22,901**	(9,025)	-354%	**22,602**	(14,189)	-259%
Loss on disposals	**-**	-	N/A	**(1,165)**	-	N/A
Net loss	**$ (2,600,449)**	**$ (2,628,225)**	**-1%**	**$ (8,133,477)**	**$ (6,431,305)**	**26%**
EBITDA loss	**$ (2,336,150)**	**$ (2,587,006)**	**-10%**	**$ (7,603,871)**	**$ (6,281,964)**	**21%**
Adjusted EBITDA loss(2)	**$ (1,532,263)**	**$ (2,057,558)**	**-26%**	**$ (5,291,673)**	**$ (4,868,894)**	**9%**
Loss per share - basic and diluted	**$ (0.05)**	**$ (0.06)**	**-12%**	**$ (0.16)**	**$ (0.15)**	**8%**
Weighted average common shares - basic	**51,988,774**	46,016,645	**13%**	**50,288,043**	43,126,552	**17%**

(1) See Note 2(f) of the Q3 Fiscal 2022 FS.

(2) EBITDA and Adjusted EBITDA are non-IFRS measures. See ''Non-IFRS Measures''.

In the following table, we have reconciled EBITDA and Adjusted EBITDA to the most comparable IFRS financial measure.

	Three months ended June 30,		Nine months ended June 30,	
(Unaudited)	**2022**	2021	**2022**	2021
Net loss as reported under IFRS	**$ (2,600,449)**	$ (2,628,225)	**$ (8,133,477)**	$ (6,431,305)
Net finance costs	**184,177**	27,780	**304,298**	60,857
Depreciation and amortization	**80,122**	13,439	**225,308**	88,484
EBITDA loss	**(2,336,150)**	(2,587,006)	**(7,603,871)**	(6,281,964)
Other adjustments:				
Stock-based compensation	**524,931**	520,423	**1,875,392**	1,398,881
Professional fees relating to U.S. financing	**343,726**	-	**500,112**	-
Gain on acquisition	**(41,869)**	-	**(41,869)**	-
Foreign exchange loss (gain)	**(22,901)**	9,025	**(22,602)**	14,189
Loss on disposals	**-**	-	**1,165**	-
Adjusted EBITDA loss	**$ (1,532,263)**	$ (2,057,558)	**$ (5,291,673)**	$ (4,868,894)

For Q3 and YTD Fiscal 2022, KWESST's net loss was $2.6 million and $8.1 million, respectively. While the results Q3 Fiscal 2022 remained relatively consistent with the comparable prior period, the YTD Fiscal 2022 net loss increased by $1.7 million over the comparable prior period, primarily due to lower revenue and higher operating expenses driven by higher headcount and related share-based awards, and increased sales and marketing efforts. Additionally, we incurred higher professional fees relating to our Nasdaq listing application and the prospectus and related Registration Statement with respect to an initial public offering, coupled with financing efforts in the United States (see below).

Most of the adjustments to EBITDA relate to non-cash share-based compensation and professional fees incurred in an effort to raise at least US$7.0 million of capital via a brokered private placement in the United States, which we did not close due to very challenging global equity market conditions where the S&P 500 index and Nasdaq index declined by approximately 20.6% and 29.5%, respectively from January 1, 2022, to June 30, 2022. To preserve our remaining liquidity for near-term working capital, certain professional firms involved in this financing have agreed to defer the timing of payment until we complete an initial public offering on Nasdaq, which remains subject to SEC's acceptance of our Form F-1 Registration Statement and Nasdaq's approval of our listing on its exchange. The increase in share-based compensation in Q3 Fiscal 2022 compared to the same comparable prior period was primarily driven by 678,204 RSUs and 1,200,000 PSUs granted to officers and consultants near and at the end of Q2 Fiscal 2022, net of 400,000 PSUs forfeited during the current quarter due to not achieving one of the performance milestones as established by the independent directors of our Board. This also contributed to the increase in the YTD Fiscal 2022 share-based compensation compared to the same period in Fiscal 2021, coupled with an increase in expense for the stock units issued to key business consultants in Q4 Fiscal 2021 and Q1 Fiscal 2022 earned over 12 months.

Revenue and Gross Profit

	Three months ended June 30,		Change	Nine months ended June 30,		Change
(Unaudited)	**2022**	2021	%	**2022**	2021	%
Digitization	**$ 157,900**	$ 497,792	-68%	**$ 314,515**	$ 1,080,933	-71%
ARWEN™	**100,684**	-	N/A	**111,176**	-	N/A
Training and services	**23,495**	-	N/A	**39,169**	-	N/A
Other	**353**	23,932	-99%	**1,288**	34,824	-96%
Total revenue	**$ 282,432**	$ 521,724	-46%	**$ 466,148**	$ 1,115,757	-58%
Gross profit	**$ 44,082**	$ 206,451		**$ 60,307**	$ 397,448	
Gross margin	***15.6%***	*39.6%*		***12.9%***	*35.6%*	

Total revenue declined by 46% and 58% during Q3 Fiscal 2022 and YTD Fiscal 2022, respectively, compared to same periods in Fiscal 2021. Revenue for Digitization product line declined by 68% and 71% for Q3 Fiscal 2022 and YTD Fiscal 2022, respectively, primarily due to the timing of expected contracts and a smaller contract awarded by General Dynamic Mission Systems Canada in Q1 Fiscal 2022, compared to the US$0.8 million contract awarded by a US military customer in the same quarter in Fiscal 2021 delivered throughout Fiscal 2021. The new ARWEN product line is as a result of the Police Ordnance Acquisition made in late Q1 Fiscal 2022. The Q3 Fiscal 2022 and YTD Fiscal 2022 ARWEN revenue excludes $0.2 million and $0.3 million, respectively for deliveries of ARWEN products for open customer orders at the closing of the Police Ordnance Acquisition which were recognized as a reduction of intangible assets.

We expect revenue to ramp up over the next few quarters with new anticipated military contracts, coupled with the pending commercial launch of our PARA OPS, with low-rate initial production ("LRIP") shipments of the PARA OPS products expected to commence in September 2022. We anticipate transitioning from LRIP to full production with strategic U.S. manufacturing and distribution partners in Q1 Fiscal 2023.

Gross margin was lower for the three and nine months ended June 30, 2022, compared to the same prior periods, primarily due to negative gross margin earned on training and services on TASCS IFM and on ARWEN products provided to military and law enforcement agencies during Q3 Fiscal 2022 to drive business development for future sales opportunities, which resulted in additional ARWEN orders during the quarter for shipment in Q4 Fiscal 2022. Excluding the impact of this negative margin on training and services, our gross margin would have been 33.53% and 26.99% for Q2 Fiscal 2022 and YTD Fiscal 2022, respectively. Our gross profit will continue to fluctuate from quarter-to-quarter with the anticipated new product mix and sales volume.

Operating Expenses (OPEX)

	Three months ended June 30,		Change	Nine months ended June 30,		Change
(Unaudited)	**2022**	2021 (1)	**%**	**2022**	2021 (1)	**%**
General and administrative ("G&A")	**$ 1,322,730**	$ 1,236,988	7%	**$ 3,410,887**	$ 2,909,349	17%
Selling and marketing ("S&M")	**851,705**	882,261	-3%	**2,931,460**	2,195,647	34%
Research and development ("R&D")	**350,689**	678,622	-48%	**1,610,445**	1,648,711	-2%
Total operating expenses	**$ 2,525,124**	$ 2,797,871	-10%	**$ 7,952,792**	$ 6,753,707	18%

(1) See Note 2(f) of the Q3 Fiscal 2022 FS.

Total OPEX decreased by 10% or $0.3 million for the current quarter over the comparable prior period driven by a 48% reduction in R&D spend due to allocating some of our engineers to revenue-related activities and other projects in which we capitalized development costs (included in intangible assets). This was partially offset by a 7% increase in G&A driven primarily by higher professional fees relating to our US financing effort during Q3 Fiscal 2022 (see above Adjusted EBITDA). This was partially offset by no licensing expense incurred in the current quarter, compared to $0.3 million in Q3 Fiscal 2021 in connection with our amended licensing agreement with AerialX.

Total OPEX increased by 18% or $1.2 million for YTD Fiscal 2022 over the comparable prior period, including $0.5 million of additional share-based compensation or 7.1 percentage points of the total increase. Excluding share-based compensation (non-cash item), total OPEX was $6.1 million for YTD Fiscal 2022 compared to $5.4 million for YTD Fiscal 2021. The increase was driven by the following factors:

- G&A increased by 17% or $0.5 million, primarily due augmenting the senior management team with two full-time executives and recruiting independent directors and other staff, which led to an increase in total personnel costs including $0.1 million of additional share-based compensation over YTD Fiscal 2021. Additionally, as noted above for the Q3 Fiscal 2022 increase in G&A, we incurred higher professional fees which was partially offset by no licensing expense with AerialX in the current quarter compared to Q3 Fiscal 2021.

- S&M increased by 34% or $0.7 million; however, excluding share-based compensation S&M increased by $0.4 million. This increase was primarily due to attending various investor conferences in the United States and engaging strategic advisors during Fiscal 2022. This included The Officer Tatum LLC who joined us in July 2021 as our strategic advisor and advocate for our PARA OPS product line for law enforcement and personal defense in the United States; the engagement of STRYK Group in September 2021 to assist us with the commercialization of our PARA OPS product line up to January 2022; the engagement of AMW Public Relations in November 2021 to lead our United States public relations, brand strategy and media communications initiatives; and the engagement of Orchid Advisors to assist us with ATF compliance for our PARA OPS product line. Additionally, our S&M personnel costs increased as result of the Police Ordinance Acquisition. Partially offsetting this increase in S&M, we reduced our spend in external investor relations and social media promotions.

Net Finance Costs

Total finance costs for Q3 Fiscal 2022 and YTD Fiscal 2022 were $0.2 million and $0.3 million respectively, a 563% and 400% increase over the comparable prior periods primarily due to the accretion and interest costs relating to the Unsecured Loans (see *Business Overview* section of this MD&A) and the accretion cost of the discounted royalties payable to DEFSEC Corporation for the PARA OPS technology acquisition.

SUMMARY OF QUARTERLY RESULTS

The following tables summarize selected results for the eight most recent completed quarters to June 30, 2022 (unaudited).

($ in thousands, except per share)	September 2021 (Q4 FY21)	December 2021 (Q1 FY22)	March 2022 (Q2 FY22)	June 2022 (Q3 FY22)
Revenue	$ 160	$ 17	$ 166	$ 282
Cost of sales	$ 80	$ 25	$ 142	$ 238
Gross profit	$ 80	$ (8)	$ 24	$ 44
Gross margin %	50.0%	-45.9%	14.6%	15.6%
Operating expenses	$ 2,925	$ 3,196	$ 2,231	$ 2,525
Operating loss	$ (2,845)	$ (3,204)	$ (2,207)	$ (2,481)
Other income (expenses)	$ (38)	$ (39)	$ (83)	$ (119)
Net loss	**$ 2,883**	**$ 3,243**	**$ 2,290**	**$ 2,600**
Net finance costs	$ 19	$ 48	$ 72	$ 184
Depreciation and amortization	$ 53	$ 72	$ 73	$ 81
EBITDA loss	**$ 2,811**	**$ 3,123**	**$ 2,145**	**$ 2,336**
Other adjustments:				
Stock-based compensation	$ 998	$ 928	$ 423	$ 525
Professional fees relating to U.S. financing	$ -	$ 112	$ 44	$ 344
Gain on acquisition	$ -	$ -	$ -	$ (42)
Foreign exchange loss (gain)	$ (19)	$ (9)	$ 9	$ (24)
Loss on disposal	$ 1	$ -	$ 1	$ -
Adjusted EBITDA loss	**$ 1,831**	**$ 2,092**	**$ 1,668**	**$ 1,532**
Loss per share - basic and diluted	**$ (0.06)**	**$ (0.07)**	**$ (0.05)**	**$ (0.05)**
Weighted average common shares - basic	47,745,525	49,022,129	49,868,065	51,988,774

($ in thousands, except per share)	September 2020 (Q4 FY20)	December 2020 (Q1 FY21)	March 2021 (Q2 FY21)	June 2021 (Q3 FY21)
Revenue	$ 213	$ 146	$ 448	$ 522
Cost of sales	$ 95	$ 72	$ 332	$ 315
Gross profit	$ 118	$ 74	$ 116	$ 207
Gross margin %	55.1%	55.1%	26.0%	39.6%
Operating expenses	$ 2,392	$ 1,580	$ 2,376	$ 2,798
Operating loss	$ (2,274)	$ (1,506)	$ (2,260)	$ (2,591)
Other income (expenses)	$ 248	$ (21)	$ (17)	$ (37)
Net loss	**$ 2,026**	**$ 1,527**	**$ 2,277**	**$ 2,628**
Net finance costs	$ (45)	$ 18	$ 15	$ 28
Depreciation and amortization	$ 15	$ 39	$ 35	$ 13
EBITDA loss	**$ 2,056**	**$ 1,470**	**$ 2,227**	**$ 2,587**
Other adjustments:				
Non-cash M&A costs	$ 1,515	$ -	$ -	$ -
Stock-based compensation	$ 137	$ 274	$ 605	$ 555
Fair value adjustments on derivatives	$ (178)	$ -	$ -	$ -
Foreign exchange loss (gain)	$ 9	$ 3	$ (5)	$ 15
Adjusted EBITDA loss	**$ 573**	**$ 1,193**	**$ 1,627**	**$ 2,017**
Loss per share - basic and diluted	**$ (0.07)**	**$ (0.04)**	**$ (0.05)**	**$ (0.06)**
Weighted average common shares - basic	33,024,736	41,392,149	42,141,523	46,016,645

Note: due to preparing the table in thousands, there may be rounding differences.

Quarterly Results Trend Analysis

There is no material change to our quarterly results trend from our disclosure in our annual MD&A dated November 23, 2021, except that we expect further volatility with our quarterly revenue during Fiscal 2022 due to the Police Ordnance Acquisition, pending commercial launch of PARA OPS products, and anticipated new military contracts. Additionally, excluding non-cash share-based compensation, we have significantly reduced OPEX in the last two quarters by reducing discretionary spending to conserve liquidity for activities generating revenue or near commercialization (including PARA OPS). Subject to closing on additional capital, we expect this trend to reverse in future quarters with the commercial launch of PARA OPS in the United States.

FINANCIAL CONDITION, LIQUIDITY, AND CAPITAL RESOURCES

Financial Condition

The following table summarizes our financial position:

(Unaudited)		**June 30, 2022**		September 30, 2021
Assets				
Current	**$**	**1,139,586**	$	4,055,697
Non-current		**5,382,825**		4,662,149
Total assets	**$**	**6,522,411**	$	8,717,846
Liabilities				
Current	**$**	**4,234,017**	$	1,159,490
Non-current		**1,297,386**		1,434,628
Total liabilities		**5,531,403**		2,594,118
Net assets	**$**	**991,008**	$	6,123,728
Working capital (1)	**$**	**(3,094,431)**	$	2,896,207

(1) Working capital is calculated as current assets less current liabilities.

Our working capital was negative $3.1 million at June 30, 2022, a decrease of $6.0 million from September 30, 2021. This decrease was mainly driven by our net operating loss for YTD Fiscal 2022, which was partially offset by the net proceeds from the Unsecured Loans and net assets assumed from the Police Ordnance Acquisition.

Total assets decreased by $2.2 million from September 30, 2021, mainly due to $2.9 million decrease in currents assets driven by the $2.5 million net use of cash to fund our operating activities, partially offset by the net current assets assumed in the Police Ordnance Acquisition. Additionally, the total decrease was partially offset by an increase of $0.7 million in non-current assets, largely due to the increase in intangible assets from capitalized development costs for our Phantom and PARA OPS systems, coupled with the acquired intangible assets from Police Ordnance.

Total liabilities increased by $2.9 million from September 30, 2021, mainly due to the Unsecured Loans financing in March 2022 (see below) and an increase in accounts payable and accrued liabilities due to deferred payments with certain vendors (mainly professional firms).

Liquidity and Capital Resources

Overview

Our primary sources of capital to date have been from security offerings, exercise of stock options and warrants, and, to a lesser extent, pre-commercial revenue. As at June 30, 2022, our cash position was $0.2 million, a decrease of $2.5 million since September 30, 2021 primarily due to incurring a net operating loss for YTD Fiscal 2022, offset primarily by an increase in cash from the net proceeds of the Unsecured Loans financing in March 2022 and exercise of warrants.

While we are confident we will be awarded additional customer contracts in Fiscal 2022, we expect additional capital will be required to initially fund these potential contracts, our commercialization efforts in the United States for the launch of the PARA OPS system, R&D activities and our working capital requirements over the next twelve months. Potential sources of capital may include additional equity and/or debt financings, Canadian ITCs for SR&ED activities, and other government funding such as Innovation Solutions Canada. Based on management's current estimates, the minimum additional funding required to fund operations at their current level of business activities, including contractual obligations, for at least the next 12 months is approximately $10 million, excluding any potential new customer contracts or cost reduction measures which could be implemented. While we continue to be in active discussions with investors, there can be no assurance that we will be able to obtain the capital sufficient to meet any or all of our needs. In our view, the availability of capital will be affected by, among other things, capital market conditions, the success of our PARA OPS system commercialization efforts, timing for winning new customer contracts, potential acquisitions, and other relevant considerations. In the event we raise additional funds by issuing equity securities, our existing shareholders will likely experience dilution, and any additional incurrence of indebtedness would result in increased debt service obligations and could require us to agree to operational and financial covenants that could further restrict our operations. Any failure to raise additional funds on terms favorable to us or at all may require us to significantly change or curtail our current or planned operations in order to conserve cash until such time, if ever, that sufficient proceeds from operations are generated, and could result in us not being in a position to advance our commercialization strategy or take advantage of business opportunities.

Cash Flows

Our approach to managing liquidity is to ensure, to the extent possible, that we always have sufficient liquidity to meet our liabilities as they come due. We regularly perform cash flow forecasts to ensure that we have sufficient cash to meet our operational needs while maintaining sufficient liquidity. At this time, we do not use any derivative financial instruments to hedge our currency risk.

The following table summarizes our consolidated statements of cash flows for the respective periods:

	Nine months ended June 30,	
(Unaudited)	**2022**	2021
Total cash provided by (used in):		
Operating activities	**$ (3,947,752)**	$ (4,718,229)
Investing activities	**(614,028)**	(299,909)
Financing acitivities	**2,063,262**	4,376,504
Net cash outflows	**$ (2,498,518)**	$ (641,634)
Cash, beginning of period	**2,688,105**	3,073,760
Cash, end of period	**$ 189,587**	$ 2,432,126

Cash used by operating activities

As previously noted, we have funded our operating activities primarily from additional equity and debt financing for both periods in Fiscal 2022 and 2021. For the nine months ended June 30, 2022, total cash flow used in operating activities decreased by 16% compared to the same period in Fiscal 2021 primarily due to deferring payments with certain vendors (primarily professional firms) to conserve cash for near-term working capital. However, we expect this to reverse for the next quarter as we honor our payment commitments with these vendors coupled with an increase in cash outflows for the launch of PARA OPS in the United States and additional inventories across all three business lines.

Cash used by investing activities

Cash flow used in investing activities increased in YTD Fiscal 2022 compared to YTD Fiscal 2021 mainly due to $0.8 million in capitalized development costs and $0.2 million in additions to capital assets, partially offset by net cash acquired from the Police Ordnance Acquisition.

Cash provided by financing activities

The $2.3 million decrease in cash provided by financing activities in YTD Fiscal 2022 over YTD Fiscal 2021 was primarily driven by lower capital raised. In YTD Fiscal 2021, we raised net proceeds of $4.0 million from equity issuance in a brokered private placement; whereas, for YTD Fiscal 2022 we raised net proceeds of $2.0 million from Unsecured Loans (see below). We also benefited from higher volume of exercised stock options, offset partially by repayment of related party loans, during YTD Fiscal 2021.

Capital Management

Our objective in managing our capital is to safeguard KWESST’s ability to continue as a going concern and to sustain future development of the business. KWESST 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 its growth strategy. The 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. We are not subject to any externally imposed capital requirements or restrictions.

KWESST’s capital is composed of the following:

(Unaudited)	**June 30, 2022**	September 30, 2021
Debt:		
Lease obligations	**$ 291,860**	$ 307,909
Borrowings	**1,752,865**	53,251
Equity:		
Share capital	**19,165,734**	17,215,068
Warrants	**1,902,055**	1,848,389
Contributed surplus	**3,473,768**	2,458,211
Accumulated other comprehensive loss	**(28,123)**	(8,991)
Accumulated deficit	**(23,606,494)**	(15,388,949)
Total capital	**$ 2,951,665**	$ 6,484,888

At June 30, 2022, our contractual obligations and commitments were as follows:

Payment due:	**Total**	**Within 1 Year**	**1 to 3 years**	**3 to 5 years**
Minimum royalty commitments	**$ 2,500,000**	$ 150,000	$ 350,000	$ 2,000,000
Borrowings	**2,090,000**	2,090,000	-	-
Accounts payable and accrued liabilities	**2,263,702**	2,263,702	-	-
Lease obligations	**351,000**	93,600	187,200	70,200
Other commitments	**12,886**	12,886	-	-
Short-term rental obligations	**10,574**	10,574	-	-
Total contractual obligations	**$ 7,228,162**	**$ 4,620,762**	**$ 537,200**	**$ 2,070,200**

Equity Issuances

We issued a total of 3,221,476 common shares during YTD Fiscal 2022 primarily due to 1,330,000 exercise of warrants, 1,000,000 bonus common shares related to the Unsecured Loans (see below), 542,636 conversion of stock units, and 338,840 common shares for the Police Ordnance Acquisition (see *Acquisition* section of this MD&A).

In July 2022, we closed a non-brokered private placement of $344,000, resulting in the issuance of 1,600,000 units of KWESST ("July 2022 Units"), at a price of $0.215 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 one-half common share purchase warrant (the "Warrants"). Each Warrant entitles its holder to acquire one additional common share of KWESST at a price of $0.285 for a period of 24 months from the closing date. Accordingly, we issued 800,000 Warrants under the July 2022 Offering. There was no finder fee paid in this private placement. The proceeds from the July 2022 Offering will be used to fund our working capital requirements. All securities issued in connection with the July 2022 Offering are subject to a statutory hold period in Canada expiring four (4) months and one (1) day from the closing of the Offering. We have received final acceptance by the TSX Venture Exchange.

In connection with the July 2022 Offering, certain of our directors and officers (the "Insiders") purchased 406,975 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.

Debt Offerings

Since September 30, 2021, we conducted the following debt offering:

On March 11, 2022, we closed a non-secured and non-convertible loan financing with various lenders in an aggregate amount of $1.8 million, which was upsized to $2.0 million on March 15, 2022. 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 us 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 million common shares to the lenders as a bonus. 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. The use of proceeds was for working capital purposes.

OFF-BALANCE SHEET ARRANGEMENTS

We have no off-balance sheet arrangements that have or are reasonably likely to have, a current or future effect on our results of operations, financial condition, revenues or expenses, liquidity, capital expenditures or capital resources.

RELATED PARTY TRANSACTIONS

Refer to Note 9 of Q3 Fiscal 2022 FS for disclosure about KWESST's related party transactions conducted in the normal course of business.

FINANCIAL INSTRUMENTS AND OTHER INSTRUMENTS

We recognize financial assets and liabilities when we become party to the contractual provisions of the instrument. On initial recognition, financial assets and liabilities are measured at fair value plus transaction costs directly attributable to the financial assets and liabilities, except for financial assets or liabilities at fair value through profit and loss, whereby the transactions costs are expensed as incurred.

Refer to Note 16 of the Q3 Fiscal 2022 FS for further disclosure on KWESST's financial instruments.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Refer to Note 2(g) of the Fiscal 2021 audited consolidated financial statements and Note 2(g) of the Q3 Fiscal 2022 FS for a discussion of the accounting policies and estimates that are critical to the understanding of our business operations and the results of our operations.

OUTSTANDING SHARE INFORMATION

As at June 30, 2022, KWESST's authorized capital consists of an unlimited number of common shares with no stated par value. There were 53,787,107 outstanding and issued common shares as at August 11, 2022.

DISCLOSURE CONTROLS AND PROCEDURES AND INTERNAL CONTROLS OVER FINANCIAL REPORTING

Disclosure controls and procedures ("DC&P") are intended to provide reasonable assurance that material information is gathered and reported to senior management to permit timely decisions regarding public disclosure. Internal controls over financial reporting ("ICFR") are intended to provide reasonable assurance regarding the reliability of financial reporting and the preparation of consolidated financial statements for external purposes in accordance with IFRS accounting principles.

TSX Venture-listed companies are not required to provide representations in their annual and interim filings relating to the establishment and maintenance of DC&P and ICFR, as defined in Multinational Instrument MI 52-109. In particular, the CEO and CFO certifying officers do not make any representations relating to the establishment and maintenance of (a) controls and other procedures designed to provide reasonable assurance that information required to be disclosed by the issuer in its annual filings, interim filings or other reports filed or submitted under securities legislation is recorded, processed, summarized and reported within the time periods specified in securities legislation, and (b) processes to provide reasonable assurance regarding the reliability of financial reporting and the preparation of consolidated financial statements for external purposes in accordance with the issuer's GAAP.