



**KWESST MICRO SYSTEMS INC.**

**AMENDED AND RESTATED MANAGEMENT'S  
DISCUSSION AND ANALYSIS**

Quarter ended December 31, 2020

(Expressed in Canadian Dollars)

**AMENDED AND RESTATED AS OF APRIL 15, 2021**

**KWESST MICRO SYSTEMS INC.**  
**AMENDED AND RESTATED MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**QUARTER ENDED DECEMBER 31, 2020**

---

**NOTICE TO READER**

Following the Company's independent auditors' review of its condensed consolidated interim financial statements for the quarter ended December 31, 2020, the Company has made the following changes:

- 1) The correction of \$159,124 overstatement of Accounts Payable and Accrued Liabilities, Deficit and Business Development costs for the annual payment related to the acquisition of GhostStep electronic decoy in June 2020 because it was previously accounted for in the fair value of the purchase consideration of GhostStep Technology.
- 2) The correction of \$60,000 overstatement of Contributed Surplus and understatement of Share Capital of \$60,000 for the exercise of warrants on December 31, 2020 which settled on same day, and the understatement of total outstanding common shares by 250,000 shares for the exercise of these warrants;
- 3) The reclassification of \$85,188 from Advertising and Promotion costs to Business Development costs and Consulting fees of \$30,480 and \$54,708, respectively; and
- 4) A change in presentation within Operating Expenses in which the Marketing and Investor Relations costs are now combined with Advertising and Promotion due to similarities in nature of expenses.

As a result of the above adjustments, the Company's reported Net Loss and Comprehensive Loss was reduced from \$1,607,983 to \$1,448,859. There was no change to the reported net loss per share (basic and diluted). Please refer to Note 21 of the Amended and Restated Condensed Consolidated Interim Financial Statements for the quarter ended December 31, 2020 and 2019 for additional information.

In connection with the filing of the above amended and restated interim financials, the Company is also filing (i) amended and restated management discussion and analysis in compliance with the requirements of National Instrument 51-102 *Continuous Disclosure Obligations*, and (ii) CEO and CFO certifications in compliance with National Instrument 51-109 *Certification of Disclosure in Issuers' Annual and Interim Filings*.

**KWESST MICRO SYSTEMS INC.**  
**AMENDED AND RESTATED MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**QUARTER ENDED DECEMBER 31, 2020**

---

All references in this amended and restated management's discussion and analysis (the "MD&A") to "KWESST", "we", "us", "our", and the "Company" refer to KWESST Micro Systems Inc. and its subsidiary as at December 31, 2020.

This MD&A is intended to provide readers with the information that management believes is required to gain an understanding of the current results of KWESST and to assess the Company's future prospects. Accordingly, certain sections of this MD&A contain forward-looking statements that are based on current plans and expectations. These forward-looking statements are affected by risks and uncertainties that are discussed in this MD&A and that could have a material impact on future prospects (see Forward-Looking Statements below). Readers are cautioned that actual events and results will vary.

The MD&A was approved by the Board of Directors on April 15, 2021 and should be in conjunction with the unaudited amended and restated consolidated interim financial statements for the three months ended December 31, 2020 ("Q1 Fiscal 2021") and the annual audited consolidated financial statements and related notes for the period ended September 30, 2020 ("Fiscal 2020"). The financial information presented in this MD&A is derived from these unaudited amended and restated consolidated interim financial statements prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB").

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](http://www.sedar.com).

## **NON-IFRS MEASURES**

---

This MD&A makes reference to certain non-IFRS measures such as "EBITDA" and "Adjusted EBITDA". These non-IFRS measures are not recognized, defined or standardized measures under IFRS. Our definitions for these non-IFRS measures will likely differ from that used by other companies and therefore comparability may be limited.

EBITDA and Adjusted EBITDA should not be considered a substitute for or in isolation form measures prepared in accordance with IFRS. These non-IFRS measures should be read in conjunction with the unaudited consolidated interim financial statements and the related notes thereto as at and for the three months ended December 31, 2020 (herein referred as Q1 Fiscal 2021 FS). Readers should not place undue reliance on non-IFRS measures and should instead view them in conjunction with the most comparable IFRS financial measures. See the reconciliations to these IFRS measures in the "Reconciliation of Non-IFRS Measures" section of this MD&A.

## **GOING CONCERN**

---

As an early-stage company, KWESST has incurred significant losses and negative operating cash flows from inception that have primarily been funded from financing activities. KWESST's Q1 2021 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. While KWESST had \$1.4 million of working capital at December 31, 2020 and subsequently raised additional capital via exercised options and warrants as well as additional borrowings, the Company is in the process of raising additional capital to fund its business growth strategies over the next 12 months (see Overview – Subsequent Events section of this MD&A). Refer to Note 2(a) of the Q1 2021 FS.

**KWESST MICRO SYSTEMS INC.**  
**AMENDED AND RESTATED MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**QUARTER ENDED DECEMBER 31, 2020**

---

**FORWARD-LOOKING STATEMENTS**

---

Except for statements of historical fact relating to the Company, certain information contained herein constitutes forward-looking information under Canadian securities legislation. Forward-looking statements include, but are not limited to, statements with respect to the Company's proposed acquisitions and strategy, development potential and timetable of the Company's products; the Company's ability to raise required funds; conclusions of economic evaluation; the timing and amount of estimated future products and development; costs of research and development; capital expenditures; success of production activities; currency exchange rates; government regulations; and environmental risks. Generally, forward-looking statements can be identified by the use of forward-looking terminology such as "plans", "expects" or "does not expect", "is expected", "budget", "scheduled", "estimates", "forecasts", "intends", "anticipates" or "does not anticipate", or "believes", or variations of such words and phrases or statements that certain actions, events or results "may", "could", "would", "might" or "will be taken", "occur" or "be achieved".

Forward-looking statements are based on the opinions and estimates of management as of the date such statements are made. Estimates regarding the anticipated timing, amount and cost of production activities are based on previous industry experience and regional political and economic stability. Capital and operating cost estimates are based on significant research of the Company, recent estimates of development costs and other factors that are set out herein. Forward-looking statements are subject to known and unknown risks, uncertainties and other factors that may cause the actual results, level of activity, performance or achievements of the Company to be materially different from those expressed or implied by such forward-looking statements, including but not limited to risks related to:

- our expectations regarding our business, financial condition, and results of operations;
- the impact of the ongoing COVID-19 pandemic, including the duration, severity, scope of the outbreak and measures taken by governments and businesses to contain the pandemic;
- our anticipated cash needs over the next 12 months;
- our ability to protect, maintain, and enforce our intellectual property ("IP") rights;
- our future growth plans, including expansion in international markets;
- the acceptance by our customers and the marketplace of our technologies and system solutions;
- our ability to attract new customers and develop and maintain existing customers;
- our ability to deliver on our marketing and business plans and short-term objectives;
- our ability to attract and retain personnel as well as to obtain required licenses;
- the unexpected events and delays during research and development;
- our ability to generate the anticipated investment returns from acquisitions;
- 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 ability to raise timely external financing on acceptable terms, when required, to fund our business growth;
- our ability to govern effectively and efficiently as a new public company; and
- anticipated trends and challenges in our business and the markets in which we operate.

These risks are described in further detail in the section entitled "Risks Factors" in our most recently filed Annual Information Form. Although the forward-looking statements contained in this MD&A are based upon assumptions management believes to be reasonable, these risks, uncertainties, assumptions and other factors could cause our actual results, performance, achievements and experience to differ materially from our expectations, future results, performances or achievements expressed or implied by the forward-looking statements. In light of these risks, uncertainties and assumptions, readers should not place undue reliance on forward-looking statements.

**KWESST MICRO SYSTEMS INC.**  
**AMENDED AND RESTATED MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**QUARTER ENDED DECEMBER 31, 2020**

---

## **OVERVIEW**

---

### ***Corporate Information***

KWESST is domiciled in Canada and was incorporated under the Business Corporations Act (British Columbia) on November 28, 2017. Its registered office is located at 550 Burrard St., Suite 2900, Vancouver, British Columbia, V6C 0A3, with its corporate office located at 155 Terence Matthews Crescent, Unit #1, Ottawa, Ontario, Canada, K2M 2A8.

KWESST's common stock is listed on the TSX-Venture Exchange ("TSX-V") under the stock symbol of KWE. On February 3, 2021, KWESST announced that its common shares have been approved for listing on the OTCQB® Venture Market ("OTCQB®"), a US trading platform that is operated by the OTC Markets Group in New York. On February 4, 2021, KWESST commenced trading on the OTCQB® under the symbol KWEMF.

### ***KWESST's Core Business and Strategy***

KWESST's mission is to be a leader in advancing the modern networked capability of soldiers and responders, including the networked *Soldier Systems* mission of NATO and its allies, with niche application that make a critical difference to safety and effective.

KWESST develops and markets proprietary technology for applications in the military and homeland security market. KWESST's core technology has multiple applications based on Micro Integrated Systems and Software Technology ("MISST"), a proprietary integration of miniaturized sensors, optics, ballistics and software that provides an advancement in affordable smart systems and mission capability. Current applications and offerings enable: (i) real-time networked situational awareness for soldiers and their weapons systems; (ii) smart management of ordinance systems; (iii) solutions for countering drone attacks and countermeasures against weaponized lasers.

The Company's primary markets are the U.S. and other NATO and NATO partner countries, many of whom have increased their military budgets.

While KWESST is an early-stage company, during Fiscal 2020 we achieved revenue growth of 126% annualized over the prior year and continued to generate revenues in the first quarter of Fiscal 2021, in part due to significant progress in gaining acceptance from a major U.S. military customer for its TASCs IFM system (Tactical Awareness and Situational Control System - Integrated Fires Modules). Following successful trials in Virginia held in September 2020 and in California in November 2020 for KWESST's TASCs IFM system on the 81mm mortar platform, the customer awarded a follow-on order of US\$800,000 or approximately \$1.1 million to expand the use of our TASCs IFM system in military exercises at two battalions. This is generally a precursor to wider adoption and formal customer acceptance.

For more details on KWESST products and markets, refer to the amended Annual Information Form dated April 15, 2021. This document and other information about KWESST are available on SEDAR under the Company's profile at [www.sedar.com](http://www.sedar.com).

### ***COVID-19 Impact to Operations***

While the COVID-19 pandemic has caused material changes to the global economic, political, and consumer landscape, we have been able to adapt quickly and remain focused on delivering on our key milestones during Fiscal 2020, including successful trials of our TASCs IFM and the completion of the QT. To date, we have been able to operate at full capacity with no shutdown. That being said, KWESST is not immune by the impact of a prolonged COVID-19, including lockdowns, as it may impede our ability to do international travel for certain field trials, deployments, testing, data gathering, business development and sales activities due to government-

**KWESST MICRO SYSTEMS INC.**  
**AMENDED AND RESTATED MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**QUARTER ENDED DECEMBER 31, 2020**

---

imposed travel restrictions and the health risks that traveling during a time of significant uncertainty and risk would entail. Consequently, this may adversely affect our revenue and cash flows outlook for Fiscal 2021. To reduce this business risk, we have opened a U.S. office in January 2021 to accelerate our pursuit for U.S. military opportunities.

***Subsequent Events***

In addition to the Board approval of the LEC Technology acquisition (see Acquisitions section of this MD&A), the Company had the following material events since December 31, 2020:

***Amended and Restated Licensing Agreement***

On April 5, 2021, KWESST entered into an amended and restated licensing agreement with AerialX to gain exclusive rights to the Licensed Technology for the United States Department of Defense and Canada's Department of National Defence from the date upon which AerialX will meet certain technical milestones. In consideration for the exclusivity, upon signing the agreement, KWESST will issue 100,000 common shares to AerialX. KWESST also agreed to issue an additional 100,000 common shares upon AerialX achieving the technical milestones.

KWESST will continue to have non-exclusive worldwide license.

In addition to the above share consideration, KWESST also agreed to issue up to 300,000 common shares subject to achieving the following financial milestones:

# of Common Shares	Milestones
75,000	\$3 million in sales
100,000	\$9 million in sales
125,000	\$18 million in sales

The amended and restated licensing agreement will expire on April 30, 2026.

The above is in addition to the current 8% royalty on annual sales subject to the following minimum annual royalties as per previous licensing agreement:

Year <sup>(1)</sup>	Minimum Annual Royalties
Year 1	\$150,000
Year 2	\$200,000
Year 3	\$300,000
Year 4	\$400,000
Year 5	\$500,000

(1) From the Prototype Date (2<sup>nd</sup> milestone above)

KWESST has already prepaid \$150,000 as advanced royalties to be applied against future royalty payments.

***Financing***

On April 6, 2021, KWESST has entered into an agreement with PI Financial Corp., as lead agent and sole bookrunner (the "Lead Agent"), on its own behalf and, if applicable, on behalf of a syndicate of agents (together with the Lead Agent, the "Agents") in connection with a best efforts, private placement of up to 2,000,000 units of the Company (the "Units") at a price of \$1.25 per Unit (the "Offering Price") for gross proceeds of up

**KWESST MICRO SYSTEMS INC.**  
**AMENDED AND RESTATED MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**QUARTER ENDED DECEMBER 31, 2020**

---

to \$2,500,000 (the "Offering"). On April 9, 2021, KWESST announced the Offering was upsized up to a total of 3,200,000 Units for total gross proceeds of \$4,000,000.

Each Unit will be comprised of one common share of KWESST (a "Common Share") and one Common Share purchase warrant ("Warrant"). Each Warrant will be exercisable to acquire one Common Share (a "Warrant Share") at a price of \$1.75 per Warrant Share for a period of 24 months from the closing of the Offering. If at any time after four (4) months and one (1) day following the Closing Date, the trading price of the Shares on the TSX Venture Exchange is equal to or exceeds \$3 for a period of 10 consecutive trading days, as evidenced by the price at the close of market, the Company will be entitled to notify the holders of Warrants of its intention to force the exercise of the Warrants. Upon receipt of such notice, the holders of Warrants will have 30 days to exercise the Warrants, failing which the Warrants will automatically expire.

KWESST will pay the Agents a commission of 7% of the gross proceeds of the Offering (3.5% for Units issued to subscribers on the Presidential list). Additionally, KWESST will issue compensation options of 7% of the total Units (excluding subscribers on the Presidential list). Each option may be exercised at \$1.25 to purchase one Unit and will expire in two years.

The use of proceeds will be primarily to: (i) finance working capital; (ii) close the previously announced LEC technology acquisition; (iii) begin the commercialization of this LEC product; (iv) accelerate productization of the GreyGhost micro-drone missile; (v) ramp up the Company's ATAK Centre of Excellence (refer to the Company's announcement on March 30, 2021); and (vi) accelerate productization of the Phantom electronic decoy.

#### *Organizational*

On January 15, 2021, KWESST announced that Canadian General (Retired) Rick Hillier will lead its new International Advisory Council, which will provide guidance to KWESST on its strategic build-out on a global scale. General Hillier served as Canada's Chief of Defence Staff ("CDS") CDS from February 4, 2005, to July 1, 2008.

On February 24, 2021, Ms. Elisabeth Preston joined the Company as a member of the board of directors and Corporate Secretary. Ms. Preston is the Chief Legal Counsel for a top tier international defence company with widespread global operations.

On April 12, 2021, KWESST announced the appointment of Mr. Rick Bowes as Chief Operating Officer. Mr. Bowes held various senior roles with defence contractors such as General Dynamics Canada, DRS Technologies Canada (now Leonardo DRS), ATCO Frontec and ADGA Group Inc., and he had a distinguished career as a senior officer in the Canadian Army, retiring in 2003 as a Lieutenant Colonel.

#### **Outlook**

With the \$1.1 million U.S. military contract awarded in December 2020, we are on track to meet key milestones including current live-fire exercises at a U.S. military base in April 2021. We have already begun collecting on this contract for services rendered.

Further, on February 19, 2021, the TSX Venture Exchange (TSX-V) approved the LEC Technology acquisition (see next section) and consented KWESST to close the transaction. We expect to close this acquisition concurrently with the \$4.0 million brokered private placement (see above).

**KWESST MICRO SYSTEMS INC.**  
**AMENDED AND RESTATED MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**QUARTER ENDED DECEMBER 31, 2020**

---

## **ACQUISITIONS**

---

To accelerate our growth plans and respond to market opportunities, we have made the following technology acquisition.

### **LEC Technology**

On June 6, 2020, we entered into a binding letter of agreement with DEFSEC to acquire the proprietary non-lethal munitions technology system referred to as Low Energy Cartridge technology ("LEC Technology") from DEFSEC. The acquisition includes all IP rights for the LEC Technology.

In January 2021, KWESST's Board of Directors approved this transaction, subject to TSX Venture Exchange (TSX-V) approval. As previously noted, the TSX-V has consented of this technology acquisition in February 2021.

The LEC Technology is a proprietary non-lethal cartridge-based ordnance system to address four market segments that currently use a variety of dated "non-lethal" or "less-lethal" products, each having a vast global market. The four market segments as follows:

- i) Public order (riots and control of dangerous subjects);
- ii) Military and law enforcement training (realistic force-on-force training);
- iii) Personal defence (home, car, boat, RB, camping, hiking); and
- iv) High-action gaming.

With recent events of riots / widespread protests in the U.S. leading to fatalities, we believe this LEC Technology will position us well to address this potentially large market demand for non-lethal weapons.

The purchase consideration for the LEC Technology is 1 million common shares of KWESST and 500,000 share purchase warrants of KWESST at \$0.70 each, as previously agreed on June 6, 2020. The warrants are subject to vesting with 25% on the first anniversary of the closing of the LEC Technology acquisition and 25% on each of the subsequent three anniversaries. Additionally, at closing of the acquisition, KWESST will pay \$150,000 as an advance on future royalties. Under the technology purchase agreement, KWESST will pay 7% royalty on annual sales of the LEC Technology, net of taxes, duties, customs brokerage fees, shipping and handling costs, customer credits, discounts and returns, up to a maximum of \$10 million ("Maximum Royalties"). Starting on the second anniversary of the LEC closing date, for each year until the Maximum Royalties have been paid, KWESST agreed to pay the following annual minimum royalty payments:

- a) 2<sup>nd</sup> anniversary: \$150,000;
- b) 3<sup>rd</sup> anniversary: \$150,000;
- c) 4<sup>th</sup> anniversary: \$200,000;
- d) 5<sup>th</sup> anniversary: \$200,000;
- e) 6<sup>th</sup> anniversary: \$250,000;
- f) 7<sup>th</sup> anniversary: \$250,000;
- g) 8<sup>th</sup> anniversary: \$300,000;
- h) 9<sup>th</sup> anniversary: \$300,000;
- i) 10<sup>th</sup> anniversary: \$350,000; and
- j) 11<sup>th</sup> anniversary: \$350,000

This acquisition constitutes as a related party transaction because DEFSEC is a private company owned by David Luxton, our Executive Chairman. Mr. Luxton recused himself from the Board deliberations and approval of this acquisition.



**KWESST MICRO SYSTEMS INC.**  
**AMENDED AND RESTATED MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**QUARTER ENDED DECEMBER 31, 2020**

**RESULTS OF OPERATIONS**

The following selected financial data has been extracted from Q1 Fiscal 2021 FS.

	Three months ended December 31,	
	2020	2019
<b>Revenue</b>	\$ 146,349	\$ 3,741
Cost of sales	71,564	7,887
<b>Gross profit</b>	<b>74,785</b>	(4,146)
<i>Gross margin %</i>	<i>51.1%</i>	<i>NM</i>
Operating expenses	1,502,311	713,972
<b>Operating loss</b>	<b>(1,427,526)</b>	(718,118)
Foreign exchange loss	(3,385)	(41,617)
Gain on derivatives	-	113,178
Net finance costs	(17,948)	(52,231)
<b>Net loss</b>	<b>\$ (1,448,859)</b>	<b>\$ (698,788)</b>
<b>Adjusted EBITDA<sup>(1)</sup></b>	<b>\$ (1,192,607)</b>	<b>\$ (693,633)</b>
<b>Earnings (loss) per share - basic and diluted</b>	<b>\$ (0.04)</b>	<b>\$ (0.03)</b>
<b>Weighted average common shares - basic</b>	<b>41,392,149</b>	20,767,543

(1) Adjusted EBITDA is a non-IFRS measure. See "Non-IFRS Measures". See below for "Reconciliation of Non-IFRS Measure".

NM – not meaningful

**Reconciliation of Non-IFRS Measure**

KWESST has presented EBITDA and Adjusted EBITDA in this MD&A to provide readers with a supplemental measure of our operating performance and thus highlight trends in its core business that may not otherwise be apparent when relying solely on IFRS financial measure. We believe the securities analysts, investors, and other interest parties frequently use non-IFRS measures in evaluating company's performance. Management also uses non-IFRS measures in order to facilitate operating performance comparisons from period to period, prepare annual operating budgets and assess our ability to meet our capital expenditure and working capital requirements.

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

**KWESST MICRO SYSTEMS INC.**  
**AMENDED AND RESTATED MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**QUARTER ENDED DECEMBER 31, 2020**

	Three months ended December 31,	
	2020	2019
<b>Net loss as reported under IFRS</b>	<b>\$ (1,448,859)</b>	<b>\$ (698,788)</b>
Net finance costs	17,948	52,231
Income tax expense	-	-
Depreciation	38,734	24,485
<b>EBITDA</b>	<b>(1,392,177)</b>	<b>(622,072)</b>
<i>Other adjustments:</i>		
Share-based compensation	196,185	-
Gain on derivatives	-	(113,178)
Foreign exchange loss	3,385	41,617
<b>Adjusted EBITDA (loss)</b>	<b>\$ (1,192,607)</b>	<b>\$ (693,633)</b>

**Revenue and Gross Profit**

	Quarter ended December 31,		Change - %
	2020	2019	
TASCS systems	\$ 138,934	\$ -	-
Other	7,415	3,741	98%
<b>Total revenue</b>	<b>\$ 146,349</b>	<b>\$ 3,741</b>	<b>NM</b>
Gross profit	\$ 74,785	\$ (4,146)	
<i>Gross margin</i>	<i>51%</i>	<i>NM</i>	

NM – not meaningful

For the current quarter, the TASCS systems revenue was generated from one U.S. military customer. In the comparable prior period, KWESST had no TASCS systems sales. Due to KWESST's early-stage, its revenue will be volatile from quarter to quarter and it is anticipated that its revenue will continue to be concentrated with a limited number of customers over the next 12 months.

**KWESST MICRO SYSTEMS INC.**  
**AMENDED AND RESTATED MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**QUARTER ENDED DECEMBER 31, 2020**

**Operating Expenses (OPEX)**

	Quarter ended December 31,		Change - %
	2020	2019	
Advertising and promotion	370,239	13,147	NM
Personnel costs	317,503	336,457	-6%
Stock-based compensation	196,185	-	NM
R&D consulting and material costs, net	156,293	143,762	9%
Consulting fees	118,835	59,400	100%
Professional fees	106,573	96,640	10%
Business development	102,473	-	NM
Depreciation and amortization	38,734	24,485	58%
General and administrative expenses	38,197	(3,752)	NM
M&A costs	10,614	-	NM
Travel and conferences	21,975	36,022	-39%
Insurance	24,690	7,811	216%
<b>Total operating expenses</b>	<b>\$ 1,502,311</b>	<b>\$ 713,972</b>	<b>110%</b>

NM – not meaningful

Overall, our OPEX increased by 110% or \$788,339 for the current quarter over the comparable prior period. The increase in the quarter ended December 31, 2020 was driven primarily by:

- \$357,092 in advertising and promotion to promote and increase market awareness on KWESST and its new product offerings, and management anticipates further investment in the near-term particularly as the Company plans to accelerate its go-to-market initiatives by end of Fiscal 2021 for certain of its product offerings, namely: Phantom, GreyGhost, and LEC in addition to ramping up its ATAK Centre of Excellence;
- \$196,185 in non-cash share-based compensation as a result of granting options to key employees, directors and consultants in the second half of Fiscal 2020 (no stock option was granted in the quarter ended December 31 2019 or outstanding at December 31, 2019);
- \$102,473 in business development due to engaging SageGuild LLC for sales and marketing in the US region;
- \$59,435 in consulting fees due to outsourcing certain internal positions including controller and corporate secretary roles, coupled with the hire of a government relations and strategic consulting firm to assist with positioning KWESST to win Canadian military contracts; and
- \$41,949 in general and administrative expenses mainly due to increase in IT and office supplies with the new office location in the second half of Fiscal 2020, coupled with negative adjustment of \$10,961 for reversal of over-accrued expenses in the quarter ended December 31, 2019.

**KWESST MICRO SYSTEMS INC.**  
**AMENDED AND RESTATED MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**QUARTER ENDED DECEMBER 31, 2020**

The following table further breaks down our OPEX by function for the quarter ended December 31<sup>st</sup>:

	Three months ended December 31, 2020				Three months ended December 31, 2019			
	R&D	Sales & Marketing	Corporate	Total	R&D	Sales & Marketing	Corporate	Total
Advertising and promotion	-	-	370,239	370,239	-	-	13,147	13,147
Personnel costs	235,003	-	82,500	317,503	304,114	-	32,343	336,457
Stock-based compensation	20,292	-	175,893	196,185	-	-	-	-
R&D consulting and material costs, net	156,293	-	-	156,293	143,762	-	-	143,762
Consulting fees	-	-	118,835	118,835	-	-	59,400	59,400
Professional fees	-	-	106,573	106,573	-	-	96,640	96,640
Business development	-	102,473	-	102,473	-	-	-	-
Depreciation and amortization	34,861	-	3,873	38,734	22,036	-	2,449	24,485
G&A expenses	-	-	38,197	38,197	-	-	(3,752)	(3,752)
M&A costs	10,614	-	-	10,614	-	-	-	-
Travel and conferences	-	21,975	-	21,975	-	36,022	-	36,022
Insurance	-	-	24,690	24,690	-	-	7,811	7,811
<b>Total OPEX</b>	<b>\$457,063</b>	<b>\$124,448</b>	<b>\$ 920,800</b>	<b>\$ 1,502,311</b>	<b>\$ 469,912</b>	<b>\$ 36,022</b>	<b>\$ 208,038</b>	<b>\$ 713,972</b>

### *Research & Development ("R&D")*

For the current quarter, KWESST recognized an additional \$24,141 of investment tax credits relating to SR&ED activities in Fiscal 2020 (netted with R&D consulting and material costs). Excluding this amount, R&D marginally increased over the comparable prior period.

### *Sales & Marketing*

KWESST began investing in sales and marketing in the second quarter of Fiscal 2020.

For the current quarter, sales and marketing costs includes consulting fees paid to SageGuild LLC to assist us in promoting our TASCs systems in the United States. SageGuild is a U.S. private company with extensive experience in U.S. military contracts and sold its GreyGhost® Technology to KWESST in the second quarter of Fiscal 2020. Starting from end of January 2021, SageGuild is a related party as a result of its CEO, Mr. Jeffrey Dunn, serving as sole director of KWESST U.S. Inc.

The lower travel and conferences spending in the first quarter of Fiscal 2021 compared to same period last fiscal year is due to the COVID-19 pandemic.

### *Corporate*

Corporate expenses increased by \$712,762 or 343% for the quarter ended December 31, 2020, compared to same period in 2019. We have significantly invested in positioning KWESST to be a successful public company, which led to higher advertising & promotion costs, personnel costs, consulting fees, and professional fees.

To preserve cash and to motivate and retain directors, employees and consultants, KWESST implemented a stock option plan during the first quarter of Fiscal 2020. For the quarter ended December 31, 2020, KWESST incurred a non-cash compensation charge of \$175,893, which also contributed to the increase in total Corporate expenses. Refer to Note 13 of Q1 Fiscal 2021 for further information.

### *Gain on Derivatives*

During the quarter ended December 31, 2019, KWESST recognized a gain on derivatives of \$113,178 as a result of certain convertible debt converted to common shares.

**KWESST MICRO SYSTEMS INC.**  
**AMENDED AND RESTATED MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**QUARTER ENDED DECEMBER 31, 2020**

---

**Net Finance Costs**

Total finance costs for the quarter ended December 31, 2020 were \$17,948, a 66% reduction over the comparable prior period. This reduction is primarily due to the conversion of all convertible notes to KWESST common shares upon the closing of the Qualifying Transaction which occurred in September 2020.

**Net Loss and Adjusted EBITDA Loss**

For the quarter ended December 31, 2020, KWESST incurred a net loss of \$1,448,859 or \$0.04 loss per basic share, compared to net loss of \$698,788 or \$0.03 loss per basic share for the same period in 2019.

These results include foreign exchange loss, non-cash and non-recurring items and accordingly we have also presented Adjusted EBITDA loss in this MD&A in order to help readers better understand our operating results. For the quarter ended December 31, 2020, Adjusted EBITDA loss was \$1,192,607 compared to Adjusted EBITDA loss of \$693,633 for the same period in 2019.

**Key Balance Sheet Items**

---

The following table summarizes our financial position:

	December 31, 2020	September 30, 2020
<b>Assets</b>		
Current	\$ 2,773,498	\$ 3,994,888
Non-current	1,803,416	1,512,123
<b>Total assets</b>	<b>\$ 4,576,914</b>	<b>\$ 5,507,011</b>
<b>Liabilities</b>		
Current	\$ 1,223,571	\$ 1,154,234
Non-current	489,539	496,394
<b>Total liabilities</b>	<b>\$ 1,713,110</b>	<b>\$ 1,650,628</b>
<b>Net book value</b>	<b>\$ 2,863,804</b>	<b>\$ 3,856,383</b>

*Changes since September 30, 2020:*

Current assets decreased by \$1.2 million due mainly to working capital used to fund its operations (see Liquidity and Capital Resources section of this MD&A).

Non-current assets increased by \$0.3 million mainly due to capitalization of development costs in which the Company expects to recover from the U.S. military contract awarded in December 2020.

There were no significant changes to total liabilities since September 30, 2020.

**KWESST MICRO SYSTEMS INC.**  
**AMENDED AND RESTATED MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**QUARTER ENDED DECEMBER 31, 2020**

The following table shows a summary of the rights-of-use assets and related obligations as reported in the Q1 Fiscal 2021 FS:

	December 31, 2020	September 30, 2020
<b>Right-of-use assets</b>	<b>\$ 495,479</b>	<b>\$ 520,440</b>
Lease obligations:		
Current	87,325	78,358
Non-current	489,539	496,394
<b>Lease obligations</b>	<b>\$ 576,864</b>	<b>\$ 574,752</b>

The right-of-use assets excludes the lease deposit to be returned at the end of the lease. The deposit of \$38,212 was initially recorded at fair value and reported as other under non-current assets. At December 31, 2020, the carrying value was \$23,048.

**SUMMARY OF QUARTERLY RESULTS**

The following tables summarize selected results for the eight most recently completed quarters to December 31, 2020.

	Q2 FY2020	Q3 FY2020	Q4 FY2020	Q1 FY2021
Revenue	\$ 48,959	\$ 600,473	\$ 212,485	\$ 146,349
Cost of sales	\$ 8,104	\$ 143,536	\$ 95,473	\$ 71,564
Gross profit	\$ 40,855	\$ 456,937	\$ 117,012	\$ 74,785
Gross margin %	83.4%	76.1%	55.1%	51.1%
Operating expenses	\$ 577,436	\$ 1,072,075	\$ 2,473,119	\$ 1,502,311
Operating loss	\$ (536,581)	\$ (615,138)	\$ (2,356,107)	\$ (1,427,526)
Other income (expenses)	\$ (107,953)	\$ (109,475)	\$ 159,995	\$ (21,333)
<b>Net loss</b>	<b>\$ (644,534)</b>	<b>\$ (724,613)</b>	<b>\$ (2,196,112)</b>	<b>\$ (1,448,859)</b>
<b>Adjusted EBITDA (loss)</b>	<b>\$ (483,765)</b>	<b>\$ (447,189)</b>	<b>\$ (644,735)</b>	<b>\$ (1,192,607)</b>
<b>Earnings (loss) per share - basic and diluted</b>	<b>\$ (0.02)</b>	<b>\$ (0.02)</b>	<b>\$ (0.07)</b>	<b>\$ (0.04)</b>
Weighted average common shares - basic	28,715,236	30,743,298	33,024,736	41,392,149

**KWESST MICRO SYSTEMS INC.**  
**AMENDED AND RESTATED MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**QUARTER ENDED DECEMBER 31, 2020**

	Q2 FY2019	Q3 FY2019	Q4 FY2019	Q1 FY2020
Revenue	\$ 10,178	\$ 146,697	\$ 348,530	\$ 3,741
Cost of sales	\$ 9,669	\$ 5,125	\$ 62,420	\$ 7,887
Gross profit	\$ 509	\$ 141,572	\$ 286,110	\$ (4,146)
Gross margin %	5.0%	96.5%	82.1%	-110.7%
Operating expenses <sup>(1)</sup>	\$ 272,138	\$ 234,898	\$ 217,367	\$ 713,972
Operating loss <sup>(1)</sup>	\$ (271,629)	\$ (93,326)	\$ 68,743	\$ (718,118)
Other income (expenses) <sup>(1)</sup>	\$ (59,698)	\$ (38,468)	\$ (54,114)	\$ 19,330
<b>Net income (loss) <sup>(1)</sup></b>	<b>\$ (331,327)</b>	<b>\$ (131,794)</b>	<b>\$ 14,629</b>	<b>\$ (698,788)</b>
<b>Adjusted EBITDA (loss) <sup>(1)</sup></b>	<b>\$ (245,743)</b>	<b>\$ (67,440)</b>	<b>\$ 94,629</b>	<b>\$ (693,633)</b>
<b>Earnings (loss) per share - basic and diluted <sup>(1)</sup></b>	<b>\$ (0.03)</b>	<b>\$ (0.01)</b>	<b>\$ 0.00</b>	<b>\$ (0.03)</b>
Weighted average common shares - basic	9,750,600	17,200,200	18,090,310	20,767,543

(1) Restated due to cut-off errors between quarters; however, this resulted in no change to the total for 2019 as reported in the audited consolidated financial statements except for rounding differences.

### Quarterly Results Trend Analysis

KWESST's historical quarterly operating results have been volatile because it is an early-stage company. Since KWESST's incorporation in late 2017, we have devoted significant energy to developing our proprietary TASCs system, our signature app and snap-on weapon adaptor that enables real-time streaming of situational awareness data of any kind from any source, including drones, direct to smart devices and operational assets, for a common operating picture and networked engagement. During 2018 and 2019, we also invested significant time in doing demonstrations of our early prototypes to U.S. customers which led to entering into two teaming agreements with AeroVironment Inc. and ManTech International Corporation. These agreements led to more meaningful revenues in the second half of 2019 and the last two quarters of Fiscal 2020.

The general trend of increased quarterly operating expenses reflects the investments being made to grow our business (an increase headcount and facility costs). In the last two quarters of Fiscal 2020, operating costs increased primarily as a result of higher professional fees incurred for patents and trademarks, share-based compensation, investor relations costs and going public related costs.

Over the next 12 months, management expects continued volatility in KWESST's quarterly revenue, operating results, and cash flows for the foreseeable future as KWESST continues to invest in promoting KWESST and its product offerings, product development and bringing products to market during Fiscal 2021.

### LIQUIDITY AND CAPITAL RESOURCES

We have financed our operations to date through the issuance of common shares. To fund KWESST business growth, we may need to raise additional capital through various means including the issuance of equity and/or debt during Fiscal 2021 (see Overview – Subsequent Events section of this MD&A).

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 do so by continuously monitoring cash flow and actual operating expenses.

KWESST's cash position decreased to \$1.7 million at December 31, 2020, from \$3.1 million at September 30, 2020, primarily due to the net operating loss incurred during Q1 Fiscal 2021.

**KWESST MICRO SYSTEMS INC.**  
**AMENDED AND RESTATED MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**QUARTER ENDED DECEMBER 31, 2020**

Our principal cash requirements are for working capital and R&D investments. KWESST's working capital as at December 31, 2020 was approximately \$1.6 million, a reduction of \$1.3 million since September 30, 2020.

The following table provides a summary of cash inflows and outflows by activity:

	Quarter ended December 31, 2020	Quarter ended December 31, 2019
<b><i>Cash inflow (outflow) by activity:</i></b>		
Operating activities	\$ (1,229,875)	\$ (759,321)
Investing activities	(329,316)	(160,691)
Financing activities	186,795	938,234
<b>Net cash inflows</b>	<b>\$ (1,372,397)</b>	<b>\$ 18,222</b>

***Cash used by operating activities***

As an early-stage company, we continued to invest significantly across the Company's organization. Despite the revenue growth over the prior year, it was not sufficient to cover our overhead costs, professional fees, advertising and promotion costs, and R&D costs. Accordingly, this resulted in negative operating cash flows of \$1.3 million for Q1 Fiscal 2021, compared to negative \$0.8 million for Q1 Fiscal 2020.

***Cash used by investing activities***

During the quarter ended December 31, 2020, KWESST continued to invest in development projects in which recoverability is anticipated from the \$1.1 million U.S. military contract awarded in December 2020. This contributed mainly to the negative investing activities for the quarter. In the comparable prior period, KWESST made a \$150,000 advanced royalty payment to AerialX.

***Cash provided by financing activities***

During the quarter ended December 31, 2020, we raised \$195,957 through exercised of stock options. In the comparable prior period, KWESST raised approximately \$1.0 million through issuance of common shares in a non-brokered private placement.

***Contractual Commitments and Obligations***

The Company's remaining operating lease commitments are for office premises, which will expire in March 2026. Further, KWESST has committed to minimum annual royalty payments to AerialX for its licensed drone (see Note 18 of Q1 Fiscal 2021 FS) and upon closing the LEC Technology acquisition it will be subject to further minimum annual royalty payments starting from the 2<sup>nd</sup> anniversary from closing date (see Acquisition section of this MD&A).



**KWESST MICRO SYSTEMS INC.**  
**AMENDED AND RESTATED MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**QUARTER ENDED DECEMBER 31, 2020**

At December 31, 2020, KWESST's contractual obligations and commitments 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	\$ 1,550,000	\$ 150,000	\$ 500,000	\$ 900,000
Lease obligations	751,992	127,830	254,805	369,357
Accounts payable and accrued liabilities	884,105	884,105	-	-
Borrowings	60,000	-	60,000	-
Total with third parties	3,246,097	1,161,935	814,805	1,269,357
Related party loans	199,094	199,094	-	-
Total contractual obligations	\$ 3,445,191	\$ 1,361,029	\$ 814,805	\$ 1,269,357

The above table does not include the minimum annual royalty payments that will be due to DEFSEC once the asset acquisition is closed. Upon closing and in accordance with the purchase agreement, KWESST will make an advanced royalty payment of \$150,000 to DEFSEC.

Further, since December 31, 2020, we have increased our borrowings by \$306,000 as a result of entering into an unsecured demand loan agreement with a private fund managed by a KWESST's shareholder for general corporate purposes. This unsecured loan agreement is due the earlier of a change of control (as defined in the agreement) and May 25, 2021 and bears interest at a rate of 0.5% per month.

Management has estimated the Company's normalized monthly cash burn rate to be approximately \$260,000 or \$3.1 million per annum; however, more recently the monthly burn rate has been above this level primarily due to an increased investment in advertising and promotion to raise market awareness on the Company's profile and its product offerings. The Company anticipates this trend will continue into the next quarter.

As a result of the available working capital at December 31, 2020, subsequent capital raise (see below Outstanding Share Information) and the anticipated collection from the \$1.1 million follow-on sales order awarded in December 2020, management believes the Company has significant capital to finance its working capital requirements for the near term. Additionally, as previously noted, KWESST launched a \$4 million brokered private placement to raise additional capital to meet all the contractual commitments and obligations and to accelerate its go-to-market initiatives for KWESST's product offerings. There is no assurance that KWESST will close this brokered private placement.

#### **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 10 of Q1 Fiscal 2021 FS for comprehensive disclosure about KWESST's related party transactions conducted in the normal course of business. In summary, the related party transactions that occurred during the quarter ended December 31, 2020 were:

- \$11,252 repayment of employee loan, including \$68 of accrued interest;
- \$10,000 partial repayment of CEO loan and accrued interest of \$2,002, leaving \$199,094 outstanding December 31, 2020; and

**KWESST MICRO SYSTEMS INC.**  
**AMENDED AND RESTATED MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**QUARTER ENDED DECEMBER 31, 2020**

---

- \$35,615 compensation (cash and share-based) to a consulting firm for providing capital markets advisory services (a significant shareholder of KWESST).

The above transactions were market based. At December 31, 2020, there were no outstanding amount in accounts payable and accrued liabilities due to officers and directors of KWESST.

#### **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 Q1 Fiscal 2021 FS for comprehensive disclosure on KWESST's financial instruments.

#### **CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

---

Refer to Note 2(f) of the Fiscal 2020 audited consolidated financial statements 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**

---

At December 31, 2020, KWESST's authorized capital consists of an unlimited number of common shares with no stated par value.

The following table shows the changes in common shares, options, and warrants since December 31, 2020 to the date of this MD&A:

	<b>December 31, 2020</b>	<b>Exercised</b>	<b>Granted</b>	<b>Other</b>	<b>Issued</b>	<b>April 15, 2021</b>
Common shares	<b>41,942,258</b>	-	-	(270)	585,399	<b>42,527,387</b>
Warrants	<b>9,335,050</b>	(173,899)	-		-	<b>9,161,151</b>
Stock options	<b>2,484,358</b>	(411,500)	1,152,500		-	<b>3,225,358</b>
Total securities	<b>53,761,666</b>	(585,399)	1,152,500	(270)	585,399	<b>54,913,896</b>

The common share issuances relate to exercised warrants and stock options. Since December 31, 2020, KWESST raised \$357,900 from exercised stock options and warrants.