



KWESST MICRO SYSTEMS INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Three and nine months ended June 30, 2021

(Expressed in Canadian Dollars)

**KWESST MICRO SYSTEMS INC.
MANAGEMENT'S DISCUSSION AND ANALYSIS
THREE AND NINE MONTHS ENDED JUNE 30, 2021**

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, 2021.

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 August 24, 2021 and should be read in conjunction with the unaudited condensed consolidated interim financial statements for the three and nine months ended June 30, 2021 (herein referred as "2021 Interim FS") 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 2021 Interim FS prepared in accordance with IAS 34, Interim Financial Reporting, 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.

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 from 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 and nine months ended June 30, 2021. 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 2021 Interim 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 2021 Interim FS).

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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 Amended Annual Information Form dated April 15, 2021 (herein referred as "AIF"). 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.

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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 and on the OTCQB® Venture Market ("OTCQB®"), a US trading platform that is operated by the OTC Markets Group in New York, under the symbol KWEMF.

KWESST's Core Business and Strategy

KWESST develops and commercializes next-generation tactical systems that meet the requirements of security forces and personal defense for overmatch capability against adversaries. Key market segments and solutions addressed by KWESST technologies are: (i) breakthrough technology in non-lethal systems with broad application, including law enforcement and personal defence, (ii) modernized digitization of tactical forces for shared situational awareness and targeting, and (iii) counter-measures against threats such as drones, lasers and electronic detection. KWESST's primary markets are the U.S. and other NATO and NATO partner countries.

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

Business Highlights for the fiscal quarter ended June 30, 2021

The following is a summary of the key business highlights for KWESST for the fiscal quarter ended June 30, 2021.

Business and product development

Low-Energy Cartridge System ("LEC System")

On April 29, 2021, KWESST expanded and diversified its business with the acquisition of the Low Energy Cartridge technology system ("LEC System") from DEFSEC (see Acquisition section of this MD&A). Based on management's knowledge, the LEC System is the world's first cartridge based non-lethal firing system with universal applications. We have made significant progress towards building demonstration samples. On July 9, 2021, KWESST completed its first public live demonstration of the LEC System to a group of investors in the Whistler, British Columbia area.

Further in July 2021, we announced that Brandon Tatum agreed to act as advisor and an advocate of KWESST's LEC System for law enforcement and personal defense in the United States. Mr. Tatum is a former Tucson Police Officer. Today, he runs the YouTube channel called "The Officer Tatum" with over 1.6 million subscribers and is a frequent guest on TV shows such as The Ingraham Angle and Justice with Judge Jeanine on Fox News Channel. He has a regular following of more than three million people across various social media platforms, providing KWESST with an excellent opportunity to increase market awareness of its LEC System in the United States. The number of subscribers and followers was provided by Mr. Tatum.

TASCS IFM

Under contract to a key U.S. military customer, in April 2021, we successfully conducted U.S. military exercises of TASCS IFM mortar system for the 81mm mortar. These exercises provided KWESST with further insight for enhancing the performance of its TASCS IFM mortar system in advance of the second round of U.S. military

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exercises. At the customer's request, these additional U.S. military exercises have since been rescheduled from July 2021 to October 2021. Accordingly, we now expect to complete this contract during the first quarter of FY 2022.

Subject to continued success at the U.S. military exercises in October 2021, we expect to win follow-on orders for the U.S. military customer. During the quarter, we also began engaging in discussions regarding this product with the Canadian Department of National Defence and expect to do demonstrations in early October.

GreyGhost®

In April 2021, KWESST entered into an amended and restated licensing agreement with AerialX to gain exclusive rights to manufacture, operate, and use its drone for the C-UAS (Counter Unmanned Aerial Systems) market, specifically for the United States Department of Defense and Canada's Department of National Defence for a period of two years (the "Exclusivity") from the date upon which AerialX will meet certain technical milestones (see 2021 Interim FS – Note 20 for further details on financial terms).

The amended and restated licensing agreement also resulted in the postponement of minimum annual royalty payments to KWESST until the first anniversary of certain technological milestones being met. Accordingly, the minimum annual payments will be as follows:

- 1st anniversary: \$150,000
- 2nd anniversary: \$200,000
- 3rd anniversary: \$300,000
- 4th anniversary: \$400,000
- 5th anniversary: \$500,000

At June 30, 2021, the minimum royalties provision was not triggered.

In accordance with the original royalty agreement dated November 18, 2019, in the first quarter of Fiscal 2020 KWESST made a payment of \$150,000 as an advance for future royalty payments (the "Advance"). This Advance was recorded as a non-current deposit in the audited consolidated statements of financial position at December 31, 2019 and September 30, 2020. In accordance with IFRS, during the quarter management performed a recoverability review of all KWESST's financial assets, including this Advance. Management made the recoverability assessment on the Advance based on anticipated future sales of the licensed technology. While KWESST continues to work with AerialX on this project, management has concluded the timing and volume of future sales of the licensed drone was uncertain at this stage given AerialX has not yet met the technological milestones. Accordingly, KWESST took a full charge to net loss for the Advance in Q3 Fiscal 2021.

Phantom™

In April 2021, KWESST was awarded its first U.S. patent (No. 10,969,467) for its Phantom™ electronic decoy, specifically for the programmable multi-waveform RF generator for use as battlefield decoy. In conjunction with the patent award, KWESST's Phantom™ was selected in defence and innovation programs for evaluation, including a U.S. Special Operations Command ("USSOCOM") program. This evaluation took place in June 2021 at the USSOCOM Technical Experimental event held in Indiana, where we successfully demonstrated the initial Phantom™ prototype, fully integrated with ATAK (as defined below).

ATAK

As disclosed in Q2 Fiscal 2021, we launched an ATAK Centre of Excellence to facilitate customer requirements for integration into ATAK (Android Tactical Assault Kit), a pre-eminent battlefield management system used by more than a dozen U.S. government agencies and many NATO allies and partner nations.

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We are currently in active discussions with major parties for ATAK integration services, which we anticipate will lead to sales contracts in Fiscal 2022.

Financing

On April 29, 2021, KWESST closed an over-subscribed brokered private placement for aggregate gross proceeds of more than \$4.4 million (herein referred as "2021 Financing"), providing the Company with near-term liquidity and capital to expand and accelerate its business growth strategies. See Liquidity and Capital Resources section of this MD&A for further details on the 2021 Financing and use of funds to June 30, 2021.

Further, during the quarter KWESST received notification from Innovation Solutions Canada ("ISC") that it qualified for up to \$1.5 million in project funding in support of the further development and productization of its TACSC IFM system, Phantom™ electronic decoy system, and counter-drone system. This non-dilutive funding is subject to various conditions, including securing end-user sponsorship from the Canadian Department of National Defence or other agencies. In August 2021, KWESST announced it has successfully secured the required sponsorship for two of the three projects, with the sponsorship for the third one expected in the near term.

Organizational

With the significant business expansion (LEC acquisition in April 2021 and creation of the ATAK Centre of Excellence in March 2021), we have augmented KWESST's leadership team with the appointment of Rick Bowes as Vice President, Operations for Digitization and Tactical Products. Mr. Bowes held various senior roles with defence contractors and had a distinguished career as a senior officer in the Canadian Army, retiring in 2003 as a Lieutenant Colonel. Further, KWESST's part-time CFO (Steven Archambault) agreed to join the Company on a full-time basis effective April 1st.

Additionally, in July 2021 we hired Blaine Groves to lead the ongoing productization effort of the LEC System starting in early September 2021. Mr. Groves spent over 17 years in senior positions at Colt Canada including most recently R&D Manager and Product Support Engineering. Colt Canada is the Canadian division of the American firearms manufacturer.

COVID-19 Impact to Operations

While the COVID-19 pandemic has caused material changes to the global economic, political, and consumer landscape, there have not been any significant interruptions to our business activities during the latest quarter. We continue to operate at full capacity with no shutdown. Further, the COVID-19 pandemic has not hindered KWESST's ability to meet key performance milestones under its contract with a US military customer for the TASCs IFM. That said, persistent government-imposed international travel restrictions and lock downs have significantly curtailed business development activities to promote and conduct sales demonstrations of KWESST's product offerings in overseas markets. While KWESST is encouraged by the global roll-out of government-approved vaccines, a prolonged government-imposed international travel restriction and/or lock down may impede our ability to accelerate our overseas market development plans in the near-term. One notable exception is the U.K., where Europe's premier defence tradeshow, DESI, held in September each year, has been reinstated for 2021 after a long COVID hiatus.

To reduce the above risk, KWESST continues to leverage its US-based business development team to prioritize and pursue U.S. military contract opportunities. Further, the recent launch of the ATAK Centre of Excellence enables remote delivery of ATAK integration services to anywhere in the world, providing another source of expected revenue in the near term.

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Outlook

Our near-term priorities are, but not limited to:

- Commercialize the initial phase of the LEC system for the personal defence and law enforcement markets, including a soft launch in Q1 of Fiscal 2022 with selected end-user groups and market influencers, followed by a hard launch at the SHOT Show in Las Vegas, January 18-21, 2022;
- Finalize upgrades for the TASCs IFM system on the 81mm mortar for additional customer trials and demonstrations scheduled for October 2021;
- Close on pending ATAK integration service sales opportunities, including with major defence contractors, before the end of calendar 2021;
- Complete the development of KWESST's first generation of the Phantom™ electronic decoy following positive feedback from the USSCOM demonstration held in June 2021 for follow-on demonstrations and initial sales opportunities;
- Accelerate enhancement and productization of the GreyGhost micro-drone missile system, to address both the C-UAS and the emerging counter loitering munitions (C-LM) markets;
- Complete the announced funding contract negotiation with Innovative Solutions Canada; and
- Upgrade the Company's digital marketing tools including video creations of KWESST's product offerings.

ACQUISITIONS

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

LEC System

On April 29, 2021, KWESST completed the acquisition of LEC System with DEFSEC, a proprietary non-lethal cartridge-based firing system. This asset acquisition includes all IP rights for the LEC System.

The LEC System 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 are 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, RV, camping, hiking); and
- iv) High-action gaming.

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

At closing, KWESST issued 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 in a binding letter of agreement) subject to 25% annual vesting from the closing date. The Warrants will expire on April 29, 2026. Further, KWESST will pay a 7%

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royalty on annual sales of the LEC System, subject to annual minimum royalty payments starting on the 2nd anniversary of the closing date. Based on estimated fair value measurement, management determined the total purchase consideration for this asset acquisition was \$2.8 million. Refer to Note 4(a) of the 2021 Interim FS for more fulsome disclosure, including the minimum annual royalty payment commitment.

This asset acquisition was a related party transaction because DEFSEC is a private company owned by David Luxton, KWESST's Executive Chairman. Mr. Luxton recused himself from the Board deliberations and approval of this transaction. While this asset acquisition did not require the formal valuation and minority shareholder approval under Multilateral Instrument 61-101, *Protection of Minority Security Holders in Special Transactions*, we nevertheless obtained written approval from over 51% disinterested shareholders as well as from the TSX-V prior to closing.

RESULTS OF OPERATIONS

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

	Quarter ended June 30,		Change	Nine months ended June 30,		Change
	2021	2020		2021	2020	
Revenue	\$ 521,724	\$ 600,474	-13%	\$ 1,115,757	\$ 653,174	71%
Cost of sales	315,273	143,536	120%	718,309	159,527	350%
Gross profit	206,451	456,938	-55%	397,448	493,647	-19%
<i>Gross margin %</i>	<i>39.6%</i>	<i>76.1%</i>		<i>35.6%</i>	<i>75.6%</i>	
Operating expenses	2,797,871	1,047,622	167%	6,753,707	2,424,030	179%
Operating loss	(2,591,420)	(590,684)	339%	(6,356,259)	(1,930,383)	229%
Fair value adjustments on derivatives	-	(89,489)	-100%	-	(64,948)	-100%
Gain on government grant	-	-		3,514	-	
Net finance costs	(27,780)	(81,546)	-66%	(64,371)	(158,687)	-59%
Foreign exchange loss	(9,025)	(14,549)	-38%	(14,189)	(9,727)	46%
Net loss	\$ (2,628,225)	\$ (776,268)	239%	\$ (6,431,305)	\$ (2,163,745)	197%
Adjusted EBITDA ⁽¹⁾	\$ (2,057,558)	\$ (411,463)	400%	\$ (4,868,894)	\$ (1,671,710)	191%
Earnings (loss) per share - basic and diluted	\$ (0.06)	\$ (0.03)	124%	\$ (0.15)	\$ (0.10)	51%
Weighted average common shares - basic	46,016,645	30,393,359		43,126,552	21,860,441	

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

For the quarter ended June 30, 2021 (herein referred to as Q3 Fiscal 2021), KWESST incurred a net loss of \$2.6 million or \$0.06 loss per basic share, compared to net loss of \$0.8 million or \$0.03 loss per basic share for the same period in Fiscal 2020. For the nine months ended June 30, 2021 (herein referred to as "YTD Fiscal 2021"), KWESST incurred a net loss of \$6.4 million or \$0.15 per share, compared to net loss of \$2.2 million or \$0.10 loss per basic share for the same period in Fiscal 2020.

While KWESST experienced significant revenue growth for YTD Fiscal 2021, it also made significant investments throughout the organization over the last twelve months to position KWESST for success which resulted in incurring operating expenses greater than KWESST's earned gross profit for both periods. See below Operating Expenses ("OPEX") for further details on the increase in OPEX.

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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 measures. We believe the securities analysts, investors, and other interested parties frequently use non-IFRS measures in evaluating the 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.

	Quarter ended June 30,		Nine months ended June 30,	
	2021	2020	2021	2020
Net loss as reported under IFRS	\$ (2,628,225)	\$ (776,268)	\$ (6,431,305)	\$ (2,163,745)
Net finance costs	27,780	81,546	64,371	158,687
Depreciation and amortization	13,439	53,925	88,484	112,711
EBITDA loss	(2,587,006)	(640,797)	(6,278,450)	(1,892,347)
<i>Other adjustments:</i>				
Stock-based compensation	520,423	125,296	1,398,881	145,962
Fair value adjustments on derivatives	-	89,489	-	64,948
Gain on government grant	-	-	(3,514)	-
Foreign exchange loss	9,025	14,549	14,189	9,727
Adjusted EBITDA loss	\$ (2,057,558)	\$ (411,463)	\$ (4,868,894)	\$ (1,671,710)

For Q3 and YTD Fiscal 2021, KWESST's Adjusted EBITDA loss was \$2.1 million and \$4.9 million, an increase of \$1.6 million and \$3.2 million, respectively, over the comparable periods. Share-based compensation accounted for most of the adjustments to EBITDA. The significant increase in both periods in Fiscal 2021 compared to the same periods in Fiscal 2020 is mainly due to granting a higher volume of options at a higher fair value per option for recruiting and retaining directors, executives and key business consultants. The total outstanding options was 3.7 million at June 30, 2021, compared to 1.2 million at June 30, 2020. Refer to Note 14 of the 2021 Interim FS for further details on stock option activities. There were no stock options granted prior to Q1 Fiscal 2020.

Revenue and Gross Profit

	Quarter ended June 30,			Nine months ended June 30,		
	2021	2020	Change	2021	2020	Change
TASCS system	\$ 497,792	\$ 596,439	\$ (98,647)	\$ 1,080,933	\$ 631,719	\$ 449,214
Other	23,932	4,035	19,897	34,824	21,455	13,369
Total revenue	\$ 521,724	\$ 600,474	\$ (78,750)	\$ 1,115,757	\$ 653,174	\$ 462,583
Gross profit	\$ 206,451	\$ 456,938	\$ (250,487)	\$ 397,448	\$ 493,647	\$ (96,199)
<i>Gross margin</i>	<i>39.6%</i>	<i>76.1%</i>		<i>35.6%</i>	<i>75.6%</i>	

For Q3 Fiscal 2021, total revenue decreased by \$0.1 million over the comparable period mainly due to fulfilling two TASCS system contracts last year; offset partially by KWESST's first ATAK order during the current quarter.

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Due to the rescheduling of the U.S. military exercises from July 2021 to October 2021, we anticipate minimal revenue to be recognized for the TASCs system during Q4 Fiscal 2021. We are in active discussions with a few potential clients for ATAK integration services, which may result in additional ATAK system revenue in the near term.

For YTD Fiscal 2021, total revenue increased by 71% to \$1.1 million compared to the same period in Fiscal 2020 mainly due to winning a US\$0.8 million U.S. military contract in late in Q1 Fiscal 2021 for KWESST's TASCs IFM mortar system. Revenue for this contract is being recognized on a percentage of completion basis, based on projected total hours. We expect to fully deliver under this contract during Q1 of Fiscal 2022.

The gross margin was 39.6% and 35.6% for Q3 and YTD Fiscal 2021, respectively, compared to 76.1% and 75.6%, respectively, for the same prior periods. Comparison to prior year gross margins is not meaningful due to KWESST's product lines being pre-commercialization stage, except for ATAK system. Further, margins will vary based on the size and complexity of the customer contracts, coupled with the varying level of non-recurring engineering involved for each contract.

Operating Expenses (OPEX)

	Quarter ended June 30,			Nine months ended June 30,		
	2021	2020	Change %	2021	2020	Change %
Advertising and promotion	602,708	78,651	666%	1,427,035	102,666	1290%
Stock-based compensation	520,423	125,296	315%	1,398,881	145,962	858%
Personnel costs	554,134	327,067	69%	1,202,607	846,664	42%
Professional fees	110,791	62,885	76%	506,254	183,178	176%
Business development	200,011	127,451	57%	424,371	212,996	99%
R&D consulting and material costs, net	173,107	26,805	546%	423,892	207,773	104%
Consulting fees	160,396	99,022	62%	416,720	328,135	27%
Royalty and license costs	287,000	-	NM	287,000	-	NM
General and administrative expenses	86,569	29,454	194%	167,089	37,838	342%
Travel and conferences	14,588	25,998	-44%	138,958	138,742	0%
Insurance	44,982	9,161	391%	104,617	25,458	311%
Transfer agent and TSX-V fees	28,455	-	NM	90,168	-	NM
Depreciation and amortization	13,439	53,925	-75%	88,484	112,711	-21%
Impairment of intangible assets	-	-	NM	55,376	-	NM
Merger and acquisition costs	1,268	81,907	-98%	22,255	81,907	-73%
Total operating expenses	\$ 2,797,871	\$ 1,047,622	167%	\$ 6,753,707	\$ 2,424,030	179%

NM – not meaningful

Total OPEX increased by 167% or \$1.8 million for the current quarter over the comparable prior period. The increase was driven primarily by:

- \$0.5 million in advertising and promotion to promote and increase awareness of KWESST and its new product offerings to position the company for success;
- \$0.4 million in share-based compensation due to KWESST granting significant stock options over the last 12 months to recruit and retain directors, key employees and consultants;
- \$0.3 million in royalty and license costs due to the fair value recognition of the 100,000 common shares of KWESST issued to AerialX as consideration for the Exclusivity under the amended and restated license agreement and the charge on the Advance as previously noted above (see Business Highlights For the Quarter Ended June 30, 2021 in the Overview section of this MD&A);

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- \$0.2 million in personnel costs due to an increase in headcount from seven at June 30, 2020 to fifteen at June 30, 2021; partially offset by payroll costs allocated to WIP inventories; and
- \$0.1 million in R&D mainly due to ramping up product development with investments allocated to Phantom™, Laser Defense systems, and GreyGhost (see *Use of Proceeds from Financings* in the Liquidity and Capital Resources section of this MD&A).

Total OPEX increased by 179% or \$4.3 million for YTD Fiscal 2021 over the comparable prior period. The increase was driven by the same reasons as noted above for Q3 Fiscal 2021 in addition to:

- \$0.3 million in professional fees driven by the increase in regulatory compliance costs as a result of going public, coupled with additional legal fees for proposed financing transactions as well as assistance with KWESST's Long-Term Incentive Plan and annual general meeting documents;
- \$0.2 million in business development costs due to entering into a consulting agreement with SageGuild LLC to promote and facilitate the sale of KWESST's product offerings in the United States, coupled with the addition of a sales consultant to focus on the Canadian military market (effective January 2021 SageGuild LLC is a related party – see Related Party Transactions section of this MD&A);
- \$0.1 million increase in consulting fees mainly driven by external engineering consulting for the development of the LEC System;
- \$0.1 million in general and administrative costs mainly due to increase spend for new office location as well as an increase in software licensing fees and telecommunication costs due to an increase in headcount; and
- \$0.1 million in transfer agent and TSX-V fees as a result of being a public company.

Gain on Derivatives

In Q1 Fiscal 2019, KWESST issued \$0.6 million of convertible notes and as a result it accounted for the conversion feature as a derivative liability at fair value at closing. This derivative liability is remeasured quarterly with the change in fair value reported in earnings.

Accordingly, KWESST recognized a fair value loss on derivative liability of \$89 thousand for Q3 Fiscal 2020 and a fair value loss of \$65 thousand for YTD Fiscal 2020. The non-cash loss incurred was due to conversion feature becoming "in-the-money" following a capital raise priced higher than the conversion rate for the convertible notes.

These convertible notes were all converted to KWESST common shares in Q4 of Fiscal 2020 as a result of KWESST going public and accordingly there is no further outstanding derivative liability since September 30, 2020.

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Net Finance Costs

The following table shows the breakdown of net finance costs:

	Quarter ended June 30,			Nine months ended June 30,		
	2021	2020	%	2021	2020	%
Interest expense from:						
Lease obligations	\$ (2,891)	\$ 15,734	-118%	\$ 25,916	\$ 40,257	-36%
Accretion cost - accrued royalties liability	25,567	-		25,567	-	
Related party loans	628	2,513	-75%	4,581	13,312	-66%
Unsecured loan	2,817	-		4,527	-	
CEBA term loan	1,221	-		3,228	-	
2019 convertible notes	-	9,683	-100%	-	48,911	-100%
2020 convertible notes	-	63,553	-100%	-	63,553	-100%
Other	1,042	7,590	-86%	3,784	10,418	-64%
Total interest expense	28,384	99,073	-71%	67,603	176,451	-62%
Interest income	(604)	-		(3,232)	(237)	1264%
Gain on termination of lease obligation	-	(17,527)	-100%	-	(17,527)	-100%
Net finance costs	\$ 27,780	\$ 81,546	-66%	\$ 64,371	\$ 158,687	-59%

Total net finance costs for Q3 Fiscal 2021 and YTD Fiscal 2021 declined by 66% and 59% compared to the same periods in Fiscal 2020. This reduction is primarily due to the conversion of all convertible notes to KWESST common shares in Q4 Fiscal 2020 in addition to lower financing costs relating to the current office lease entered in March 2020 including an immaterial adjustment for the accrued interest during the current quarter. The reduction in both periods was partially offset by the accretion costs relating to CEBA term loan and the accrued royalties liability in respect to the future minimum royalty payments due to DEFSEC for the LEC System acquisition. Accrued royalties liability was initially recorded at fair value and subsequently measured at amortized cost.

For Q3 Fiscal 2020 and YTD Fiscal 2020, KWESST also recognized a gain on termination for the former office lease obligation. We vacated the former office space due to breach of contract by the landlord.

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Key Balance Sheet Items

The following table summarizes KWESST's financial position:

	June 30, 2021	September 30, 2020 (adjusted)
Assets		
Current	\$ 3,874,249	\$ 3,996,514
Non-current	3,841,690	1,316,263
Total assets	\$ 7,715,939	\$ 5,312,777
Liabilities		
Current	\$ 1,028,049	\$ 1,120,004
Non-current	1,310,145	307,909
Total liabilities	\$ 2,338,194	\$ 1,427,913
Net assets	\$ 5,377,745	\$ 3,884,864

Changes since September 30, 2020:

Current assets decreased by \$0.1 million mainly due to \$4.7 million cash used in operating activities, offset partially by gross proceeds of \$4.4 million from the 2021 Financing (see Liquidity and Capital Resources section of this MD&A).

Non-current assets increased by \$2.5 million mainly due to an increase in intangible assets relating to the LEC System acquisition.

Current liabilities decreased by \$0.1 million mainly due to \$0.2 million repayment of related party loans, offset partially by an increase in trade payables and accrued liabilities.

Non-current liabilities increased by \$1.0 million mainly due to the accrued royalties liability relating to the estimated fair value of the future annual minimum annual royalty payable to DEFSEC for the LEC System acquisition.

As a result, KWESST's net assets increased by \$1.5 million to \$5.4 million at June 30, 2021.

During the quarter, we have adjusted the lease assets and related obligations at September 30, 2020 to correct the application of IFRS 16, *Leases*. Refer to Note 8 of the 2021 Interim FS for further details. The following table summarizes the outstanding balances:

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	June 30, 2021	September 30, 2020 (adjusted)
Right-of-use assets	\$ 280,735	\$ 327,576
Lease obligations:		
Current	31,494	44,128
Non-current	291,859	307,909
Lease obligations	\$ 323,353	\$ 352,037

The right-of-use assets excludes the security deposit to be returned at the end of the lease. The security deposit of \$29 thousand was initially recorded at fair value of \$18 thousand and reported under non-current assets. At June 30, 2021, the carrying value was \$21 thousand.

SUMMARY OF QUARTERLY RESULTS

The following tables summarize selected results for the eight most recently completed quarters to June 30, 2021.

<i>(\$ in thousands, except per share)</i>	Q3 FY2019	Q4 FY2019	Q1 FY2020	Q2 FY2020	Q3 FY2020	Q4 FY2020	Q1 FY2021	Q2 FY2021	Q3 FY2021
	(adjusted) ⁽¹⁾	(adjusted) ⁽¹⁾	(adjusted) ^{(1),(2)}		(adjusted) ⁽³⁾	(adjusted) ⁽³⁾	(adjusted) ⁽⁴⁾		
Revenue	\$ 147	\$ 349	\$ 4	\$ 49	\$ 600	\$ 213	\$ 146	\$ 448	\$ 522
Cost of sales	\$ 5	\$ 62	\$ 8	\$ 8	\$ 144	\$ 95	\$ 72	\$ 332	\$ 315
Gross profit	\$ 142	\$ 287	\$ (4)	\$ 41	\$ 456	\$ 118	\$ 74	\$ 116	\$ 207
Gross margin %	96.6%	82.2%	-100.0%	83.7%	76.0%	55.4%	50.7%	25.9%	39.7%
Operating expenses	\$ 235	\$ 217	\$ 799	\$ 577	\$ 1,048	\$ 2,481	\$ 1,580	\$ 2,376	\$ 2,798
Operating loss	\$ (93)	\$ 70	\$ (803)	\$ (536)	\$ (592)	\$ (2,363)	\$ (1,506)	\$ (2,260)	\$ (2,591)
Other income (expenses)	\$ (70)	\$ (64)	\$ 60	\$ (108)	\$ (186)	\$ 248	\$ (21)	\$ (17)	\$ (37)
Net income (loss)	\$ (163)	\$ 6	\$ (743)	\$ (644)	\$ (778)	\$ (2,115)	\$ (1,527)	\$ (2,277)	\$ (2,628)
Adjusted EBITDA (loss)	\$ (36)	\$ 105	\$ (779)	\$ (482)	\$ (360)	\$ (733)	\$ (1,114)	\$ (1,620)	\$ (2,034)
Earnings (loss) per share - basic and diluted	\$ (0.01)	\$ 0.00	\$ (0.04)	\$ (0.02)	\$ (0.03)	\$ (0.06)	\$ (0.04)	\$ (0.05)	\$ (0.06)
Weighted average common shares - basic	17,200	18,090	20,768	28,695	30,393	33,025	41,392	42,142	46,017

- (1) Other income (expenses) was adjusted due to cut-off errors in recording the quarterly foreign exchange loss, resulting in reallocating \$32 thousand to Q3 FY2019 and \$9 thousand to Q4 FY2019 with an offset to Q1 FY2020. As a result, the net loss for these periods were also adjusted accordingly. This resulted in no change to the total foreign exchange loss as reported in the audited consolidated financial statements for the year ended December 31, 2019.
- (2) Operating expenses were adjusted due to cut-off error in recording the reversal of an accrual for consulting fees, resulting in reallocating the reversal of \$85 thousand to Q2 FY2019 from Q1 FY2020. As a result, the net loss for these periods were also adjusted accordingly. This resulted in no change to the total consulting fees as reported in the audited consolidated financial statements for the year ended December 31, 2019.
- (3) Operating expenses, Other income (expenses), and Net income (loss) were adjusted to correct for the application of IFRS 16, *Leases*, for the office lease agreement entered in March 2020. This resulted in a favorable adjustment to net income (loss) of \$10 thousand and \$18 thousand for Q3 FY2020 and Q4FY2020, respectively, for total favorable adjustment of \$28k to Fiscal 2020.
- (4) Operating expenses were adjusted to increase it by \$78 thousand for additional share-based compensation expense relating to a partially cancelled option grant.

Quarterly Results Trend Analysis

KWESST's historical quarterly operating results have been volatile because it is an early-stage company in the pre-commercialization phase. 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,

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KWESST 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 Fiscals 2020 and 2021.

The general trend of increased quarterly operating expenses reflects the investments being made to grow KWESST's business, coupled with significant investments in promoting the Company's profile and its product offerings. More recently, with the LEC System acquisition, we made further investments to accelerate the timing for launching this product line by January 2022.

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.

LIQUIDITY AND CAPITAL RESOURCES

KWESST has financed its operations to date through the issuance of common shares and to a lesser extent revenue. To fund KWESST's business growth strategies, we may need to raise additional capital from time to time. On April 29, 2021, KWESST raised gross proceeds of \$4.4 million in equity - see 2021 Financing below for further details.

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 \$2.4 million at June 30, 2021, from \$3.1 million at September 30, 2020, primarily due to the net operating loss incurred during YTD Fiscal 2021 offset partially by additional new capital.

Our principal cash requirements are for working capital and product development investments. KWESST's working capital as at June 30, 2021 was approximately \$2.8 million, in line with September 30, 2020.

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

	Three months ended June 30,			Nine months ended June 30,		
	2021	2020	%	2021	2020	%
Cash inflows (outflows) by activity:						
Operating activities	\$ (1,624,340)	\$ (94,615)	1617%	\$ (4,718,229)	\$ (1,659,940)	184%
Investing activities	(238,659)	(295,603)	-19%	(299,909)	(515,418)	-42%
Financing activities	3,547,357	1,165,014	204%	4,376,504	3,447,316	27%
Net cash inflows (outflows)	\$ 1,684,358	\$ 774,796	117%	\$ (641,634)	\$ 1,271,958	-150%

Cash used by operating activities

With the additional capital raised during the last 12 months, we continued to invest significantly across the organization and product development. As an early-stage company with various products in the pipeline (pre-commercialization phase), KWESST's revenue remains low and insufficient to cover the increase in overhead costs, professional fees, advertising and promotion costs, and R&D costs. As a result, cash flow used in operating activities was \$1.6 million and \$4.7 million for Q3 Fiscal 2021 and YTD Fiscal 2021, respectively, compared to \$0.1 million and \$1.7 million for the comparable prior periods, respectively.

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Cash used by investing activities

Cash flow used in investing activities declined by 19% and 42% for Q3 Fiscal 2021 and YTD Fiscal 2021, respectively, mainly due to investments in capitalized developments projects and the cash consideration for the acquisition of the Phantom™ system from SageGuild LLC in the comparable prior periods.

Cash provided by financing activities

Cash provided by financing activities increased by 204% and 27% for Q3 Fiscal 2021 and YTD Fiscal 2021, respectively mainly because of higher equity raises in private placements (see below 2021 Financing) and proceeds from exercised options and warrants; partially offset by repayments of related party loans and lease obligations.

2021 Financing

On April 29, 2021, KWESST closed its previously announced over-subscribed brokered private placement, resulting in the issuance of 3,536,057 units ("Units") of KWESST, at a price of \$1.25 per Unit (the "Issue Price"), for aggregate gross proceeds of \$4.4 million (the "Offering"). Subsequent to June 30, 2021, the Lead Agent (PI Financial Corp.) discovered it had erroneously omitted one subscription for 40,000 units or \$50,000 from the Offering. Following TSX-V approval on an exception basis, KWESST accepted this additional subscription in August 2021.

Accordingly, the net proceeds from this Offering were as follows:

Gross proceeds	\$ 4,470,071
Less:	
Broker's cash commission	(288,405)
Legal fees and other expenses	(172,443)
Net proceeds	\$ 4,009,223

Under the Offering, KWESST sold a total of 3,576,057 units at a price of \$1.25 per Unit. Each Unit is comprised of one common share of the Company (a "Common Share") and one Common Share purchase warrant ("Warrant"). Each Warrant is 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 \$3.00 for a period of 10 consecutive trading days, as evidenced by the price at the close of market, KWESST shall 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 shall have 30 days to exercise the Warrants, failing which the Warrants will automatically expire.

The Offering was completed by PI Financial Corp. as lead agent and sole bookrunner and other dealers (the "Agents"). As consideration for the services provided by the Agents in connection with the Offering, the Agents received: (a) a cash commission of \$288,405; and (b) 230,734 compensation options (the "Compensation Options"). Each Compensation Option is exercisable to acquire one unit of the Company (a "Compensation Option Unit") at a price equal to \$1.25 for a period of two years after the closing of the Offering. Each Compensation Option Unit is comprised of one Common Share and one Common Share purchase warrant (a "Compensation Option Warrant"). Each Compensation Option Warrant is exercisable to acquire one Common Share (a "Compensation Option Warrant Share") at a price of \$1.75 per Compensation Option Warrant Share for a period of 24 months from the closing of the Offering.

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Directors and officers of KWESST (the "Insiders") purchased 72,000 Units for a total consideration of \$90,000. 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 the Company's market capitalization. KWESST did not file a material change report with respect to the participation of the Insiders at least 21 days prior to the closing of the Offering as the insiders' participations were not determined at that time.

All securities issued in connection with the Offering are subject to a statutory hold period in Canada expiring four (4) months and one (1) day from the closing of the Offering (August 30, 2021). Additionally, all the directors and officers have agreed to enter into a lock-up agreement for this same period, imposing restriction from selling, disposing, transferring, or pledging their current holdings in KWESST.

This Offering was also approved by the TSX-V.

Use of Proceeds from Financings

The following table shows the net proceeds funds from the 2021 Financing plus the remaining working capital on April 29, 2021 available to fund future working capital, product development, repayment loans and other investments:

Available Funds	
Working capital on April 29, 2021	\$ 235,345
Net proceeds from 2021 Financing	4,009,223
	\$ 4,244,568

The following table provides an approximate breakdown of the funds spent by KWESST from the proceeds raised in September 2020 plus the working capital available at that time as disclosed in KWESST's Filing Statement dated August 28, 2020, coupled with the above available funds from the 2021 Financing including remaining working capital at April 29, 2021:

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Use of Proceeds ⁽¹⁾	2020 Financing			2021 Financing		
	Expected Allocation of Net Proceeds ⁽²⁾	Estimated and Unaudited Actual Use of Funds from September 1, 2020 to Apr 28, 2021	Proceeds Unspent as at April 28, 2021	Expected Allocation of Net Proceeds	Estimated and Unaudited Actual Use of Funds from April 29, 2021 to June 30 2021	Proceeds Unspent as at June 30, 2021
Products development: ⁽³⁾						
TASCS NORs (formerly TASCS Sniper)	\$ 150,000	\$ 15,210	\$ 134,790	\$ -	\$ -	\$ -
TASCS IFM ⁽⁴⁾	150,000	628,177	(478,177)	400,000	244,445	155,555
KWESST LWS and LD	575,000	74,874	500,126	200,000	3,986	196,014
Shot Counter	120,000	-	120,000	-	-	-
Phantom	150,000	134,935	15,065	500,000	125,739	374,261
GreyGhost	250,000	91,284	158,716	200,000	9,840	190,160
ATAK	-	-	-	500,000	62,754	437,246
LEC	-	-	-	500,000	68,848	431,152
Total products development	1,395,000	944,480	450,520	2,300,000	515,612	1,784,388
Other specific allocations:						
Costs related to complete the Qualifying Transaction ("QT")	150,000	145,560	4,440	-	-	-
Broker commissions and fees relating to QT	189,520	189,520	-	-	-	-
Repayment of CEO and employee loans	114,049	31,252	82,797	191,600	191,600	-
Repayment of unsecured borrowings	-	-	-	310,527	310,527	-
Marketing costs	345,000	832,852	(487,852)	-	-	-
Prepaid royalties to DEFSEC ⁽⁵⁾	150,000	-	150,000	150,000	150,000	-
Total allocated proceeds	2,343,569	2,143,664	199,905	2,952,127	1,167,739	1,784,388
Unallocated proceeds for working capital	1,746,237	1,710,797	35,440	1,057,096	-	1,057,096
Transferred to 2021 Financing for working capital	-	235,345	(235,345)	235,345	230,629	4,716
Total use of proceeds	\$ 4,089,806	\$ 4,089,806	\$ -	\$ 4,244,568	\$ 1,398,368	\$ 2,846,200

(1) Excludes non-cash transactions settled in KWESST common shares.

(2) As disclosed in KWESST's Filing Statement dated August 28, 2020.

(3) Includes concept & design, initial prototype, market testing, and pre-production including a few demo units. Costs includes internal labor costs, outsourced engineering costs, and materials (no overhead allocation).

(4) Net of customer funding of \$0.7 million up to June 30, 2021. The total spending includes capitalized expenditures as WIP inventory for the U.S. military contract.

(5) In connection with the LEC System acquisition.

As noted in the above table, we allocated more funds to the TASCS IFM product line as a result of winning an additional contract with a U.S. military customer following the trials/testing held in September and November 2020. These trials provided KWESST with constructive feedback for further enhancements to the TASCS IFM mortar system in advance of the extensive U.S. military exercises now scheduled for October 2021. We also reallocated some of the funds to Marketing to further promote and increase awareness of KWESST and its product offerings. As noted in the above table, at April 28, 2021 there were \$235,345 remaining proceeds from the 2020 Financing, which we have allocated to the 2021 Financing table as part of the unallocated working capital.

While management intends to spend the remaining available funds as shown under the 2021 Financing in the above table; there may be circumstances where, for sound business reasons, a reallocation of funds may be advisable.

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Contractual Commitments and Obligations

KWESST'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 DEFSEC for the LEC System acquisition (see Acquisition section of this MD&A).

At June 30, 2021, KWESST's 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	\$ 2,350,000
Accounts payable and accrued liabilities	996,555	996,555	-	-
Lease obligations	413,400	62,400	187,200	163,800
Borrowings	60,000	-	60,000	-
Total contractual obligations	\$ 3,969,955	\$ 1,058,955	\$ 397,200	\$ 2,513,800

The above table does not include the contingent minimum annual royalty payments (total of \$1.55 million over five years) that will be due to AerialX for its licensed technology (see Note 20 of 2021 Interim FS) as this is triggered only upon meeting certain technical milestones, which have not been met as of the date of this MD&A.

Going forward, management anticipates the cash burn rate will be approximately \$1.25 million per quarter or \$5.0 million per annum for the near-term, including investments in LEC Systems and other product lines.

Depending on the timing and size of new sales contracts and project funding from Innovation Solutions Canada, KWESST may need to moderate its spend rate and/or raise additional capital to meet all of the above contractual commitments and obligations as well as to fund its business growth over the next 12 months. There is no assurance that KWESST will be able to raise capital at reasonable terms, if any, and may result in further dilution to current shareholders.

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 11 of 2021 Interim FS for disclosure about KWESST's related party transactions conducted in the normal course of business. In summary, the related party transactions that occurred during YTD Fiscal 2021 were:

- \$2.8 million purchase consideration (100% share deal) for the acquisition of the LEC System from DEFSEC, a private company owned by David Luxton, KWESST's Executive Chairman;
- \$0.2 million in compensation (cash and share-based) to SageGuild for providing U.S. business development services from January 2021 to June 30, 2021 (became a related party only in January 2021 as a result of SageGuild's CEO serving as director and acting CEO for KWESST U.S. subsidiary); and
- \$0.2 million repayment of CEO and employee loans, including accrued interest (no amount outstanding at June 30, 2021).

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At June 30, 2021, 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 18 of the 2021 Interim FS for 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 June 30, 2021, KWESST's authorized capital consists of an unlimited number of common shares with no stated par value.

The following table shows the changes in KWESST's common shares and dilutive securities from June 30, 2021, to August 24, 2021, along with total proceeds if all dilutive securities were exercised:

	June 30, 2021	Exercised	Granted	Issued	Converted	August 24, 2021	Proceeds if Exercised	Average price
Common shares	47,274,607	-	-	297,565	7,453	47,579,625		
Founders' warrants	8,500,000	-	-	-	-	8,500,000	\$ 1,700,000	\$ 0.20
Broker warrants	161,151	-	-	-	-	161,151	\$ 91,650	\$ 0.57
Warrants	4,536,057	(5,340)	-	40,000	-	4,570,717	\$ 6,857,092	\$ 1.50
Stock options	3,672,053	(252,225)	405,000	-	-	3,824,828	\$ 4,727,046	\$ 1.24
Restricted stock units (RSUs)	36,525	-	810,000	-	(7,453)	839,072		
Performance stock units (PSUs)	-	-	200,000	-	-	200,000		
Stock appreciation rights (SARs) ⁽¹⁾	-	-	-	30,434	-	30,434		
Agents' compensation options:								
Common shares	230,734	-	-	-	-	230,734	\$ 288,418	\$ 1.25
Warrants	230,734	-	-	-	-	230,734	\$ 403,785	\$ 1.75
Total dilutive securities	64,641,861	(257,565)	1,415,000	367,999	-	66,167,295	\$ 14,067,991	

(1) Represents the approximate number of shares to be issued based on 150,000 SARs and August 13, 2021 closing stock price, assuming fully vested.

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-

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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.