



Unaudited Condensed Consolidated Interim Financial Statements of

KWESST MICRO SYSTEMS INC.

Three and six months ended March 31, 2025 and 2024
(Expressed in Canadian dollars)

KWESST MICRO SYSTEMS INC.

Table of contents for the three and six months ended March 31, 2025 and 2024

	Page
FINANCIAL STATEMENTS	
Unaudited Condensed Consolidated Interim Statements of Financial Position	3
Unaudited Condensed Consolidated Interim Statements of Net Loss and Comprehensive Loss	4
Unaudited Condensed Consolidated Interim Statements of Changes in Shareholders' Equity	5
Unaudited Condensed Consolidated Interim Statements of Cash Flows	6
Notes to the Unaudited Condensed Consolidated Interim Financial Statements	7-29

KWESST MICRO SYSTEMS INC.
Unaudited Condensed Consolidated Interim Statements of Financial Position
At March 31, 2025 and September 30, 2024

<i>In Canadian dollars</i>	Notes	March 31, 2025	September 30, 2024
ASSETS			
Cash and cash equivalents		\$ 4,408,844	\$ 256,828
Restricted short-term investment		30,000	30,000
Trade and other receivables	4	1,081,864	567,875
Inventories	5	581,197	533,163
Prepaid expenses and deposits		333,125	179,051
Deferred costs		16,354	275,438
Current assets		6,451,384	1,842,355
Property and equipment		248,738	311,712
Right-of-use assets		62,923	230,124
Deposit		30,276	28,806
Intangible assets	6	2,725,138	3,174,832
Deferred costs		69,030	29,319
Non-current assets		3,136,105	3,774,793
Total Assets		\$ 9,587,489	\$ 5,617,148
LIABILITIES AND SHAREHOLDERS' EQUITY			
Liabilities			
Accounts payable and accrued liabilities	7 and 8	\$ 1,122,180	\$ 1,660,637
Accrued royalties liability		-	200,000
Lease obligations		140,972	147,078
Contract liabilities	9	122,612	120,571
Warrant liabilities	10 and 11(b)	177,327	847,295
Current liabilities		1,563,091	2,975,581
Accrued royalties liability		1,202,961	1,118,135
Lease obligations		38,492	155,145
Non-current liabilities		1,241,453	1,273,280
Total Liabilities		2,804,544	4,248,861
Shareholders' Equity			
Share capital	11(a)	43,197,908	37,822,725
Warrants	11(b)	5,926,182	1,084,687
Contributed surplus	11(c)	5,362,150	5,152,753
Accumulated other comprehensive loss		(133,415)	(38,520)
Accumulated deficit		(47,569,880)	(42,653,358)
Total Shareholders' Equity		6,782,945	1,368,287
Total Liabilities and Shareholders' Equity		\$ 9,587,489	\$ 5,617,148

See Note 2(a) Going concern and Note 17 Commitments and contingencies.
See accompanying notes to the unaudited condensed consolidated interim financial statements.

KWESST MICRO SYSTEMS INC.
Unaudited Condensed Consolidated Interim Statements of Net Loss and Comprehensive Loss
Three and six months ended March 31, 2025 and 2024

		Three Months Ended March 31, 2025	Three Months Ended March 31, 2024	Six Months Ended March 31, 2025	Six Months Ended March 31, 2024
<i>In Canadian dollars</i>	Notes				
			(Reclassification Note 2(g))		(Reclassification Note 2(g))
Revenue	13	\$ 1,264,162	\$ 485,864	\$ 2,151,820	\$ 614,932
Cost of sales		(950,141)	(243,681)	(1,433,277)	(426,554)
Gross margin		314,021	242,183	718,543	188,378
Operating expenses					
General and administrative		1,102,261	1,682,698	2,613,705	2,684,994
Selling and marketing		334,114	418,027	1,016,661	900,968
Research and development		299,916	705,640	972,491	1,289,928
Share-based compensation		26,342	60,982	77,397	124,471
Depreciation and amortization		285,929	319,654	600,420	641,075
Total operating expenses		2,048,562	3,187,001	5,280,674	5,641,436
Operating loss		(1,734,541)	(2,944,818)	(4,562,131)	(5,453,058)
Other income (expenses)					
Share issuance costs	11(a)	-	-	(1,807,686)	-
Net finance costs	14	(31,361)	(61,658)	(93,420)	(74,855)
Foreign exchange gain (loss)		77,823	(805)	191,106	90,905
Impairment of right-of-use assets		6,809	-	(81,787)	-
Change in fair value of warrant liabilities	10	221,763	(532,922)	1,437,396	1,497,832
Total other income (expenses), net		275,034	(595,385)	(354,391)	1,513,882
Net loss		\$ (1,459,507)	\$ (3,540,203)	\$ (4,916,522)	\$ (3,939,176)
Other comprehensive income (loss):					
<i>Items that are or may be reclassified subsequently to profit or loss:</i>					
Foreign currency translation differences		1,381	(34,497)	(94,895)	(3,203)
Total comprehensive loss		\$ (1,458,126)	\$ (3,574,700)	\$ (5,011,417)	\$ (3,942,379)
Net loss per share					
Basic and diluted	1(b)(c) and 12	\$ (6.16)	\$ (127.66)	\$ (16.11)	\$ (144.63)
Weighted average number of shares outstanding					
Basic and diluted	1(b)(c) and 12	237,039	27,732	305,190	27,236

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

KWESST MICRO SYSTEMS INC.
Unaudited Condensed Consolidated Interim Statements of Changes in Shareholders' Equity
Six months ended March 31, 2025 and 2024
In Canadian dollars

		Number of			Contributed	Translation		Total
	Notes	Shares ⁽¹⁾	Share capital	Warrants	surplus	reserve	Deficit	Shareholders' Equity
Balance, September 30, 2023		26,969	\$ 33,379,110	\$ 1,042,657	\$ 4,769,115	\$ (39,663)	\$ (35,215,599)	\$ 3,935,620
Warrants exercised	11(b)	1,837	594,667	-	-	-	-	594,667
Warrants expired	11(b)	-	-	(1,012)	1,012	-	-	-
Share-based compensation	11(c)	-	-	-	124,471	-	-	124,471
Other comprehensive loss		-	-	-	-	(3,203)	-	(3,203)
Net loss		-	-	-	-	-	(3,939,176)	(3,939,176)
Balance, March 31, 2024		28,806	\$ 33,973,777	\$ 1,041,645	\$ 4,894,598	\$ (42,866)	\$ (39,154,775)	\$ 712,379
Balance, September 30, 2024		75,199	\$ 37,822,725	\$ 1,084,687	\$ 5,152,753	\$ (38,520)	\$ (42,653,358)	\$ 1,368,287
Shares issued for public offering	11(a)	3,810	100,310	-	-	-	-	100,310
Shares issued for private placement	11(a)	50,248	371,154	-	-	-	-	371,154
Warrants issued for private placement	11(a)	-	-	2,394,955	-	-	-	2,394,955
Pre-funded warrants issued for public offering	11(a)	-	-	3,489,393	-	-	-	3,489,393
Pre-funded warrants issued for private placement	11(a)	-	-	4,579,154	-	-	-	4,579,154
Share offering costs	11(a)	-	(164,199)	(1,671,762)	-	-	-	(1,835,961)
Shares issued for debt	11(a)	5,669	100,000	-	-	-	-	100,000
Pre-funded warrants exercised	11(b)	378,771	4,339,668	(3,550,495)	-	-	-	789,173
Warrants exercised	11(b)	16,667	628,250	(267,750)	-	-	-	360,500
Warrants expired	11(b)	-	-	(132,000)	132,000	-	-	-
Share-based compensation	11(c)	-	-	-	77,397	-	-	77,397
Other comprehensive loss		-	-	-	-	(94,895)	-	(94,895)
Net loss		-	-	-	-	-	(4,916,522)	(4,916,522)
Balance, March 31, 2025		530,364	\$ 43,197,908	\$ 5,926,182	\$ 5,362,150	\$ (133,415)	\$ (47,569,880)	\$ 6,782,945

KWESST MICRO SYSTEMS INC.
Unaudited Condensed Consolidated Interim Statements of Cash Flows
Six months ended March 31, 2025 and 2024

<i>In Canadian dollars</i>	Notes	Six months ended March 31, 2025	Six months ended March 31, 2024
OPERATING ACTIVITIES			
Net loss		\$ (4,916,522)	\$ (3,939,176)
<i>Items not affecting cash:</i>			
Depreciation and amortization		600,420	641,075
Share-based compensation	11(c)	77,397	124,471
Change in fair value of warrant liabilities (including related foreign exchange gain)	10	(1,359,187)	(1,539,317)
Net finance costs	14	93,420	74,855
Changes in non-cash working capital items	16	(1,188,324)	(368,103)
Impairment of ROU asset		82,954	-
Payments of share issuance costs		1,807,686	-
Gain on debt settlement		(500)	-
Changes in non-current deferred costs		(39,711)	-
Interest received (paid)		(9,564)	27,086
Cash flows used in operating activities		(4,851,931)	(4,979,109)
INVESTING ACTIVITIES			
Additions of property and equipment		(32,035)	(64,370)
Investments in intangible assets	6	(26,675)	(5,037)
Cash flows used in investing activities		(58,710)	(69,407)
FINANCING ACTIVITIES			
Proceeds from U.S. Public Offering-November 2024	11(a)	4,871,033	-
Proceeds from Private Placement-November 2024	11(a)	3,421,635	-
Proceeds from Private Placement-February 2025	11(a)	3,655,758	-
Repayments of lease obligations		(67,554)	(74,437)
Payments of share issuance costs	11(a)	(3,188,310)	-
Payments of deferred financing fees		-	(20,844)
Proceeds from exercise of warrants		370,095	522
Cash flows provided by financing activities		9,062,657	(94,759)
Net change in cash and cash equivalents during the period		4,152,016	(5,143,275)
Cash and cash equivalents, beginning of period		256,828	5,407,009
Cash and cash equivalents, end of period		\$ 4,408,844	\$ 263,734
Cash and cash equivalents consist of the following:			
Cash held in banks		\$ 4,378,844	\$ 263,734
Short-term guaranteed investment certificates		30,000	-
Cash and cash equivalents		\$ 4,408,844	\$ 263,734

See Note 16 Supplemental cash flow information.
See accompanying notes to the unaudited condensed consolidated interim financial statements.

KWESST MICRO SYSTEMS INC.

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

Three and six months ended March 31, 2025 and 2024

(Expressed in Canadian dollars, except share amounts)

1. Corporate information

a) Corporate information

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

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

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

b) 2024 Reverse Stock Split

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

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

c) 2025 Reverse Stock Split (applied retrospectively)

On April 23, 2025, on Nasdaq and on April 24, 2025, on the TSX-V, KWESST effected a twenty-one for one (21-for-1) reverse stock split of its common stock (the “2025 Reverse Split”). Accordingly, all shareholders of record at the opening of business on April 23, 2025, received one issued and outstanding common share of KWESST in exchange for twenty-one outstanding common shares of KWESST. No fractional shares were issued in connection with the 2025 Reverse Split. All fractional shares created by the 2025 Reverse Split were rounded to the nearest whole number of common shares, with any fractional interest representing 0.5 or more common shares entitling holders thereof to receive one whole common share.

Effective on the date of the 2025 Reverse Split, the exercise price and number of common shares issuable upon the exercise of outstanding stock options were proportionately adjusted to reflect the 2025 Reverse Split. All information respecting outstanding common shares and other securities of KWESST, including net loss per share, in the current and comparative periods presented herein give effect to the 2025 Reverse Split.

KWESST MICRO SYSTEMS INC.

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

Three and six months ended March 31, 2025 and 2024

(Expressed in Canadian dollars, except share amounts)

2. Basis of preparation

(a) Going concern

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

As an early-stage company, we have not yet reached significant revenue levels for most of our products and have incurred significant losses and negative operating cash flows from inception that have primarily been funded from financing activities. We have incurred a \$4.9 million net loss and negative operating cash flows of \$4.9 million for the six months ended March 31, 2025 (2024 – \$3.9 million net loss and negative operating cash flows of \$5.0 million). At March 31, 2025, we had \$4.9 million in working capital (September 30, 2024 – negative \$1.1 million) and \$47.6 million in accumulated deficit (September 30, 2024 – \$42.7 million).

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

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

Our strategy to mitigate these material risks and uncertainties is to execute on a timely basis a business plan aimed at continued focus on revenue growth, product development and innovation, improving overall gross margin, managing operating expenses and working capital requirements, and securing additional capital, as needed.

Failure to implement our business plan could have a material adverse effect on our financial condition and/or financial performance. There is no assurance that we will be able to raise additional capital should it be required in the future. Accordingly, there are material risks and uncertainties that may cast substantial doubt about our ability to continue as a going concern.

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

(b) Statement of compliance

These unaudited condensed consolidated interim financial statements have been prepared in accordance with IAS 34, Interim Financial Reporting, ("IAS 34") as issued by the International Accounting Standards Board ("IASB") and the interpretations of the IFRS Interpretations Committee. They do not include all the information required for a complete set of financial statements prepared in accordance with IFRS® Accounting Standards ("IFRS") and should be read in conjunction with our annual audited Consolidated Financial Statements for the year ended September 30, 2024 ("Annual Financial Statements"). However, selected explanatory notes are included to explain events and transactions that are material to an understanding of the changes in our financial position and performance since the last annual audited Consolidated Financial Statements as at and for the year ended September 30, 2024.

KWESST MICRO SYSTEMS INC.

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

Three and six months ended March 31, 2025 and 2024

(Expressed in Canadian dollars, except share amounts)

These unaudited condensed consolidated interim financial statements were authorized for issue by the Board of Directors on May 15, 2025.

(c) Basis of consolidation

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

Control is achieved where we have the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities, are exposed to, or have rights to, variable returns from our involvement with the entity and have the ability to affect those returns through its power over the entity. Subsidiaries are fully consolidated from the date on which control is transferred to us until the date on which control ceases. Profit or loss of subsidiaries acquired during the year are recognized from the date of acquisition or effective date of disposal as applicable. All intercompany transactions and balances have been eliminated.

At March 31, 2025, we have the following wholly owned subsidiaries:

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

(d) Functional and presentation currency

These unaudited condensed consolidated interim financial statements are presented in Canadian dollars ("CAD"), our functional currency and presentation currency.

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

(e) Basis of measurement

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

(f) Use of estimates and judgments

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

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

KWESST MICRO SYSTEMS INC.

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

Three and six months ended March 31, 2025 and 2024

(Expressed in Canadian dollars, except share amounts)

Judgments

Information about judgments made in applying accounting policies that have the most material effects on the amounts recognized in these unaudited condensed consolidated interim financial statements are the same as disclosed in Note 2(f) of the Annual Financial Statements for the year ended September 30, 2024.

Estimates

Information about assumptions and estimation uncertainties at March 31, 2025, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities in the next financial year are the same as those disclosed in Note 2(f) of the Annual Financial Statements for the year ended September 30, 2024.

(g) Reclassification

Certain comparative figures on the unaudited condensed interim statements of net loss and comprehensive loss have been reclassified to conform to the current period presentation. These reclassifications have no effect on net loss or shareholders' equity as previously reported. An adjustment has been made to reduce the general and administrative, selling and marketing and research and development to break out the share-based compensation and depreciation and amortization. General and administrative expenses were reduced by \$361,791 and \$692,495 for the three and six month periods ended March 31, 2024, respectively. Selling and marketing expenses were reduced by nil and \$13,654 for the three and six month periods ended March 31, 2024, respectively. Research and development expenses were reduced by \$18,845 and \$59,397 for the three and six month periods ended March 31, 2024, respectively. Share-based compensation expense was increased by \$60,982 and \$124,471 for the three and six month periods ended March 31, 2024. Depreciation and amortization expense was increased by \$319,654 and \$641,075 for the three and six month periods ended March 31, 2024.

3. Material accounting policies

During the six months ended March 31, 2025, the accounting policies in these unaudited condensed consolidated interim financial statements are the same as those applied in the Annual Financial Statements.

4. Trade and other receivables

The following table presents trade and other receivables for KWESST:

	March 31, 2025	September 30, 2024
Trade receivables	\$ 997,553	\$ 455,049
Unbilled revenue	150	42,248
Sales tax recoverable	84,161	70,578
Total	\$ 1,081,864	\$ 567,875

There was an impairment of trade and other receivables during the three and six months ended March 31, 2025, of \$8,096 and \$8,096, respectively (2024 – nil and nil).

KWESST MICRO SYSTEMS INC.

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

Three and six months ended March 31, 2025 and 2024

(Expressed in Canadian dollars, except share amounts)

The following table presents changes in unbilled receivables:

	March 31, 2025	September 30, 2024
Balance, beginning of period	\$ 42,248	\$ 5,211
Revenue billed during the period	(42,248)	(5,211)
Revenue in excess of billings, net of amounts transferred to trade receivables	150	42,248
Balance, end of period	\$ 150	\$ 42,248
Current	\$ 150	\$ 42,248
Non-current	\$ -	\$ -

5. Inventories

The following table presents a breakdown of inventories:

	March 31, 2025	September 30, 2024
Finished goods	\$ 50,538	\$ 55,754
Work-in-progress	49,416	59,519
Raw materials	481,243	417,890
Total	\$ 581,197	\$ 533,163

There was no impairment of inventories during the three and six months ended March 31, 2025 (2024 – nil).

At March 31, 2025, a total of \$0.1 million (2024 – \$0.1 million) of inventory was included in profit or loss as an expense as part of cost of sales.

6. Intangible assets

The following table shows a breakdown of our intangible assets:

	KWE PSSC		POC		POC		POC		
Cost	PARA OPS™ System	PARA OPS™ Patent	ARWEN™ Tradename	Customer Relationships	Purchase Orders	ARWEN™ 40mm Patent			Total
Balance at September 30, 2024	\$ 3,074,677	\$ 40,295	\$ 19,432	\$ 36,041	\$ 4,387	\$ -			\$ 3,174,832
Additions	-	-	-	-	-	26,675			26,675
Amortization	(460,343)	(6,903)	(4,400)	(2,500)	-	(2,223)			(476,369)
Balance at March 31, 2025	\$ 2,614,334	\$ 33,392	\$ 15,032	\$ 33,541	\$ 4,387	\$ 24,452			\$ 2,725,138

At March 31, 2025, management concluded there was no indication of impairment on the intangible assets.

KWESST MICRO SYSTEMS INC.

Notes to the Unaudited Condensed Consolidated Interim Financial Statements
Three and six months ended March 31, 2025 and 2024
(Expressed in Canadian dollars, except share amounts)

7. Accounts payable and accrued liabilities

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

	March 31, 2025	September 30, 2024
Trade payable	\$ 383,123	\$ 881,835
Accrued liabilities	465,498	610,558
Warranty Reserve	13,900	-
Salary and vacation payable	259,659	168,244
Total	\$ 1,122,180	\$ 1,660,637

8. Related party transactions

At March 31, 2025, there was \$96,651 (September 30, 2024 – \$471,465) outstanding in accounts payable and accrued liabilities due to officers and directors for accrued wages and vacation, consulting fees, directors' fees and expense reimbursements.

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

9. Contract liabilities

The following table presents the changes in contract liabilities:

	March 31, 2025	September 30, 2024
Balance, beginning of period	\$ 120,571	\$ 120,970
Amounts invoiced and revenue deferred	43,113	108,573
Recognition of deferred revenue included in the balance at the beginning of period	(41,072)	(108,972)
Balance, end of period	\$ 122,612	\$ 120,571

10. Warrant liabilities

The following table shows a breakdown and balance of warrant liabilities for the six months ended March 31, 2025:

	U.S. IPO and Canadian Offering		Private Placement		Debt Settlement	Direct Offering Aug'24	Public Offering Nov'24	
	2022 Warrants	Over-allotment Warrants	2023 Warrants	Pre-Funded Warrants	Warrants	Warrants	Pre-Funded Warrants	Total
Balance, beginning of period	\$ 65,765	\$ 7,644	\$ 60,373	\$ 31,338	\$ 1,145	\$ 681,030	\$ -	\$ 847,295
Initial recognition	-	-	-	-	-	-	4,770,722	4,770,722
Exercised	-	-	-	-	-	-	(779,578)	(779,578)
(Gain) Loss on revaluation of financial instruments	39,479	(8,148)	(62,124)	(27,746)	744	(664,689)	(714,912)	(1,437,396)
Exchange (gain) loss on revaluation	3,293	504	3,968	89	-	44,662	25,693	78,209
Extinguish Warrant Liability/Transfer to equity	-	-	-	-	-	-	(3,301,925)	(3,301,925)
Balance, end of period	\$ 108,537	\$ -	\$ 2,217	\$ 3,681	\$ 1,889	\$ 61,003	\$ -	\$ 177,327
Number of outstanding securities as at March 31, 2025	3,226,392	-	1,542,194	151,734	56,141	4,715,000	-	9,691,461

KWESST MICRO SYSTEMS INC.

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

Three and six months ended March 31, 2025 and 2024

(Expressed in Canadian dollars, except share amounts)

The following table shows a breakdown and balance of warrant liabilities for the year ended September 30, 2024:

	U.S. IPO and Canadian Offering			Private Placement		Debt Settlement	Public Offering	Direct Offering	
	2022 Warrants	Over-allotment Pre-Funded Warrants	Over-allotment Warrants	2023 Warrants	Pre-Funded Warrants	Warrants	Pre-Funded Warrants	Warrants	Total
Balance, beginning of period	\$ 1,042,538	\$ 414,334	\$ 121,173	\$ 798,573	\$ 1,940,914	\$ 18,141	\$ -	\$ -	\$ 4,335,673
Initial recognition	-	-	-	-	-	-	708,054	647,039	1,355,093
Exercised	-	(119,257)	-	-	(829,720)	-	(820,649)	-	(1,769,626)
(Gain) Loss on revaluation of financial instruments	(973,396)	(295,186)	(113,022)	(728,282)	(1,069,466)	(16,996)	104,227	44,553	(3,047,568)
Exchange (gain) loss on revaluation	(3,377)	109	(507)	(9,918)	(10,390)	-	8,368	(10,562)	(26,277)
Balance, end of period	\$ 65,765	\$ -	\$ 7,644	\$ 60,373	\$ 31,338	\$ 1,145	\$ -	\$ 681,030	\$ 847,295
Number of outstanding securities as at September 30, 2024	3,226,392	-	375,000	1,542,194	151,734	56,141	-	4,715,000	10,066,461

U.S. Public Offering (April 2024)

On April 9, 2024, we closed an underwritten U.S. public offering for gross proceeds of \$1.4 million (US\$1 million) (see Note 11(a)). In this offering, 803,500 pre-funded warrants with an exercise price of US\$0.21 per common share for US\$0.649 per pre-funded warrant were issued.

Refer to Note 11(a) for further information on the offering and to Note 1 (b) and (c) for further information on the share consolidations.

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

Warrant liabilities

All 803,500 warrants were subsequently exercised at a weighted average exercise price of US\$0.001 per warrant and we recognized a loss of \$104,227 in fair value of warrant liabilities during the year ended September 30, 2024, which was reported in the consolidated statements of net loss and comprehensive loss.

U.S. Registered Direct Offering (August 2024)

On August 13, 2024, we closed a direct offering for the purchase and sale of 22,452 common shares at a purchase price of \$56.70 (US\$42.00) per common share for gross proceeds of \$1.3 million (US\$0.9 million) (see Note 11(a)). In a concurrent private placement, we issued 4,715,000 unregistered warrants to purchase common shares at an exercise price of \$72.03 (US\$52.50) per common share. This was a unit offering consisting of a share and a warrant. The fair value of the warrants attached to the units are valued based on the Black-Scholes model and the difference between the proceeds raised and the value assigned to the warrants is the residual fair value of the shares.

Refer to Note 11(a) for further information on the offering and to Note 1 (b) and (c) for further information on the share consolidations.

Under IFRS, the above securities are classified as financial liabilities (referred herein as “warrant liabilities”) because the exercise price is denominated in U.S. dollars, which is different from our functional currency (Canadian dollars). Accordingly, the ultimate proceeds in Canadian dollars from the potential exercise of the above securities are not known at inception. These financial liabilities are classified and measured at FVTPL

KWESST MICRO SYSTEMS INC.

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

Three and six months ended March 31, 2025 and 2024

(Expressed in Canadian dollars, except share amounts)

(see Note 3(c) of the Annual Financial Statements). Gains on revaluation of the warrant liabilities are presented in other income (expenses) on the unaudited condensed consolidated interim statements of net loss and comprehensive loss.

Warrant liabilities

At March 31, 2025, we remeasured the fair value of these warrants using the following assumptions:

	2024 Warrants
	(1)
Number of warrants	4,715,000
Exercise price per warrant (in USD)	\$ 0.25
Nasdaq closing price (in USD)	\$ 0.27
Black Scholes fair value (in USD)	\$ 0.009
Volatility	100%
Risk free rate	2.76%
Exchange rate (USD/CAD)	\$ 1.4376
Fair value per warrant (CAD)	\$ 0.013

(1) Fair value is based on the Black Scholes model on March 31, 2025, for the warrants.

We recognized a gain of \$203,349 and \$664,689 (2024 – nil and nil) in fair value of warrant liabilities during the three and six months ended March 31, 2025, respectively, which was reported in the unaudited condensed consolidated interim statements of net loss and comprehensive loss.

U.S. Public Offering (November 2024)

On November 1, 2024, the Company announced the closing of a public offering of 3,810 common shares and 3,809,000 pre-funded warrants (“PFW”) at a public offering price of \$26.25 (US\$18.90) per common share and \$1.25 (US\$0.90) per pre-funded warrant. The gross proceeds from the offering were \$4.9 million (US\$3.5 million). The fair value of the pre-funded warrants on initial recognition was \$1.249, which is the purchase price less the per warrant exercise price of \$0.001.

Refer to Note 11(a) for further information on the offering and to Note 1 (b) and (c) for further information on the share consolidations.

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

Warrant liabilities

639,000 pre-funded warrants were subsequently exercised at a weighted average exercise price of US\$0.021 per common share. On November 12, 2024, we converted the remaining 3,170,000 pre-funded warrants to CAD denomination which led to the transfer of pre-funded warrants to equity and extinguishing the related warrant liability. On November 12, 2024, we recognized a gain of \$693,328 in the change in fair value of warrant liabilities, before reclassifying the pre-funded warrants to equity, which was reported in the unaudited condensed consolidated interim statements of net loss and comprehensive loss.

KWESST MICRO SYSTEMS INC.

Notes to the Unaudited Condensed Consolidated Interim Financial Statements
Three and six months ended March 31, 2025 and 2024
(Expressed in Canadian dollars, except share amounts)

11. Share Capital and Contributed Surplus

As disclosed in Note 1(b) and (c), the 2024 Reverse Split and 2025 Reverse Split have been applied retrospectively herein.

a) Share capital

Authorized

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

Issued Common Shares

The following is a summary of changes in outstanding common shares since September 30, 2024:

	Number	Amount
Balance at September 30, 2024	75,199	\$ 37,822,725
Issued for U.S. Public Offering	3,810	100,310
Issued for U.S. Private Placement	50,248	371,154
Issued for debt settlements	5,669	100,000
Issued for warrant exercise	395,438	4,967,918
Less: share issuance costs for the period	-	(164,199)
Balance at March 31, 2025	530,364	\$ 43,197,908

Debt Settlement (January 2024)

On January 10, 2024, we issued 222 common shares in a settlement of debt in an amount of approximately \$97,615. The debt resulted from a tail obligation relating to services rendered by a third-party consultant which the Company has elected to pay in common shares. The common shares issued pursuant to the debt settlement (signed October 31, 2023) were subject to a four-month hold period pursuant to applicable securities legislation and the policies of the TSX Venture Exchange.

U.S. Public Offering (April 2024)

On April 9, 2024, we closed a brokered U.S. public offering, resulting in the issuance of 3,500 common shares of KWESST, for aggregate gross proceeds of \$1.4M (US\$1.0M) (the "April 2024 Public Offering").

As a part of the April 2024 Public Offering, the Company issued 3,500 common shares and 803,500 pre-funded warrants with an exercise price of \$0.21 per share at a public offering price of \$184.80 (US\$136.50) per common share and \$0.881 (US\$0.649) per pre-funded warrant, less the underwriting discount.

Brokers' Compensation and Share Issuance Costs

ThinkEquity acted as sole book-running manager for the April 2024 Public Offering. As compensation for services rendered, the placement agent fees represent \$0.4875 per unit (being an aggregate of \$101,838 (US\$75,002) or 7.5% of the public offering price of the securities). In addition, the Company issued 76,925 warrants to purchase a number of common shares (the "Placement Agent Warrants"), representing 5% of the common shares and pre-funded warrants sold in the April 2024 Public Offering. The Placement Agent Warrants will be exercisable, in whole or in part, immediately upon issuance and will expire 60 months after the closing of the April 2024 Public Offering at an initial exercise price of \$231.63 (US\$170.63) per common share. The

KWESST MICRO SYSTEMS INC.

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

Three and six months ended March 31, 2025 and 2024

(Expressed in Canadian dollars, except share amounts)

share issuance costs related to the April 2024 Public Offering that was recognized in the consolidated statements of net loss and comprehensive loss was \$339,324 and recognized in equity was \$269,400.

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

		Initial Recognition
Number of Warrants		76,925
Nasdaq closing price (in USD)	\$	0.75
Exercise price per warrant (in USD)	\$	0.89
Black Scholes fair value (in USD)	\$	0.42
Volatility		66%
Divident yield		Nil
Risk-free interest rate		3.86%
Expected life (in years)		5.00
Exchange rate (USD/CAD)	\$	1.3578
Fair value per warrant (CAD)	\$	0.57

U.S. Public Offering (June 2024)

On June 14, 2024, we closed a brokered U.S. public offering, resulting in the issuance of 13,810 common shares of KWESST for aggregate gross proceeds of approximately \$2.3M (US\$1.7M) (the “June 2024 Public Offering”).

As a part of the June 2024 Public Offering, the Company issued 13,810 common shares at a public offering price of \$168.00 (US\$121.80) per share, less the placement agent fees.

Brokers’ Compensation and Share Issuance Costs

ThinkEquity acted as sole book-running manager for the June 2024 Public Offering. As compensation for services rendered, the placement agent fees represent \$0.435 per common share (being an aggregate of \$173,469 (US\$126,150) or 7.5% of the public offering price of the securities). In addition, the Company issued to the placement agent 145,000 common share purchase warrants with an exercise price of \$210.00 (US\$152.25) per common share, exercisable, in whole or in part, immediately upon issuance and will expire 60 months after the closing of the June 2024 Public Offering. All of the share issuance costs related to the June 2024 Public Offering were recognized in equity.

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

KWESST MICRO SYSTEMS INC.

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

Three and six months ended March 31, 2025 and 2024

(Expressed in Canadian dollars, except share amounts)

		Initial Recognition
Number of Warrants		145,000
Nasdaq closing price (in USD)	\$	0.58
Exercise price per warrant (in USD)	\$	0.73
Black Scholes fair value (in USD)	\$	0.31
Volatility		66%
Divident yield		Nil
Risk-free interest rate		3.86%
Expected life (in years)		5.00
Exchange rate (USD/CAD)	\$	1.3751
Fair value per warrant (CAD)	\$	0.42

U.S. Registered Direct Offering (August 2024)

On August 13, 2024, we closed a registered direct offering for the purchase and sale of 22,452 common shares at a purchase price of \$57.54 (US\$44.00) per common share for gross proceeds of \$1.4M (US\$0.9M) (the “August 2024 Offering”). In a concurrent private placement, the Company issued 4,715,000 unregistered warrants to purchase common shares at an exercise price of \$72.03 (US\$52.50) per common share that are immediately exercisable upon issuance and will expire five years following the date of issuance.

Brokers’ Compensation and Share Issuance Costs

H.C. Wainwright & Co. (“Wainwright”) acted as the exclusive placement agent for the August 2024 Offering. As compensation for services rendered, the placement agent fees were US\$70,725 or 7.5% of the public offering price of the securities. In connection with the closing of the August 2024 Offering, we issued Wainwright or its designees warrants to purchase up to an aggregate of 353,625 common shares at an exercise price of \$72.03 (US\$52.50) per common share, the warrants are exercisable upon issuance and have an expiry date of August 9, 2029. The shares offered as Brokers’ Compensation related to the August 2024 Offering were recognized in equity.

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

KWESST MICRO SYSTEMS INC.

Notes to the Unaudited Condensed Consolidated Interim Financial Statements
Three and six months ended March 31, 2025 and 2024
(Expressed in Canadian dollars, except share amounts)

	Initial Recognition
Number of Warrants	353,625
Nasdaq closing price (in USD)	\$ 0.14
Exercise price per warrant (in USD)	\$ 0.25
Black Scholes fair value (in USD)	\$ 0.06
Volatility	91%
Divident yield	Nil
Risk-free interest rate	3.12%
Expected life (in years)	2.50
Exchange rate (USD/CAD)	\$ 1.3751
Fair value per warrant (CAD)	\$ 0.08

U.S. Public Offering (November 2024)

On November 1, 2024, the Company announced the closing of a public offering of 3,810 common shares and 3,809,000 pre-funded warrants at a public offering price of \$26.25 (US\$18.90) per common share and \$1.25 (US\$0.90) per pre-funded warrant (the “November 2024 Offering”). The gross proceeds from the offering were approximately \$4.9 million (US\$3.5 million), before deducting placement agent fees of \$1.974 (US\$1.4175) per common share and \$0.094 (US\$0.0675) per pre-funded warrant (being an aggregate of \$365,726 (US\$262,508) or 7.5% of the public offering price of the securities). In addition, the Company issued to the placement agent as compensation for its services 194,450 common share purchase warrants with an exercise price of \$32.907 (US\$23.625) per common share.

On November 12, 2024, we amended the pre-funded warrants whereas the exercise price of the warrants, along with all the other settlement amounts, were amended to be denominated in CAD currency, which is consistent with the Company’s functional and presentation currency. As a result, we reclassified the remaining unexercised pre-funded warrants as equity instruments under IAS 32. This resulted in a transfer of \$3,301,925 from warrant liabilities to equity warrants. The amendments effectively remove the cashless exercise option and ensure settlement in CAD, thereby meeting the criteria for equity classification. We also applied IFRIC 19 to appropriately derecognize the liabilities and recognize the equity effective November 12, 2024.

Accounting Treatment

Refer to Note 10 for the accounting of the warrants issued in the November 2024 Offering accounted for as warrant liabilities up to November 11, 2024.

The remaining 3,170,000 pre-funded warrants were subsequently exercised at a weighted average exercise price of \$0.021 per common share, for proceeds of \$3,170, during the six months ended March 31, 2025.

Brokers’ Compensation and Share Issuance Costs

In connection with the August 2024 Offering, Wainwright was also granted a tail obligation resulting in earning 7.5% on any equity financing raised from investors introduced to the Company as part of the offering. The November 1, 2024, financing fell entirely within the scope of the tail obligation and resulted in a payment of \$362,618 (US\$260,661), representing 7.5% of the \$4.9 million (US\$3.5 million) gross proceeds to Wainwright upon closing of the transaction.

ThinkEquity acted as the sole placement agent for the November 2024 Offering. As compensation for services rendered, the placement agent fees were \$365,725 (US\$262,508) or 7.5% of the public offering price of the securities). In addition, the Company issued to the placement agent as compensation for its services 194,450

KWESST MICRO SYSTEMS INC.

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

Three and six months ended March 31, 2025 and 2024

(Expressed in Canadian dollars, except share amounts)

common share purchase warrants with an exercise price of \$32.907 (US\$23.625) per common share. The warrants are exercisable upon issuance and have an expiry date of November 1, 2029. The shares offered as Brokers' Compensation related to the November 2024 Offering were recognized in equity.

The fair value of the broker compensation warrants at the closing of the November 2024 Offering was \$187,468, calculated using the Black Scholes model.

The share issuance costs related to the November 2024 Offering that were recognized in the unaudited condensed consolidated statements of net loss and comprehensive loss was \$1,807,686 and recognized in equity were \$227,557, inclusive of the broker compensation warrants.

	Initial Recognition
Number of Warrants	194,450
Nasdaq closing price (in USD)	\$ 0.93
Exercise price per warrant (in USD)	\$ 1.13
Black Scholes fair value (in USD)	\$ 0.69
Volatility	103%
Divident yield	Nil
Risk-free interest rate	2.92%
Expected life (in years)	5.00
Exchange rate (USD/CAD)	\$ 1.3932
Fair value per warrant (CAD)	\$ 0.96

Debt Settlement (November 2024)

On November 11, 2024, we issued 5,669 common shares at a deemed price per common share of \$17.64 per share, representing a 20% discount on the closing price of the Shares on the TSX Venture Exchange on the last trading day prior to the news release, for settlement of business expenses incurred while representing the Company in an aggregate amount of \$100,000 owed to a company controlled by Mr. David Luxton, Chairman of the Company.

Private Placement (November 2024)

On November 12, 2024, we closed a brokered private placement offering to an institutional accredited investor for aggregate gross proceeds of approximately \$3.4 million (approximately US\$2.5 million) (the "November 2024 PP").

As a part of the November 2024 PP, the Company issued 4,145,200 pre-funded warrants to acquire common shares of the Company on a basis of twenty-one warrants to one common share, with no par value at a price of \$0.824 (US\$0.592) per pre-funded warrant, inclusive of the exercise price of \$0.021 per common share. Each pre-funded warrant was bundled with one common share purchase warrant ("November 2024 Common Warrant") of the Company. Each November 2024 Common Warrant was immediately exercisable on the basis of twenty-one warrants to one common share at an exercise price of \$21.63 (US\$15.54) per common share for a period of 60 months following the closing of the November 2024 PP. Although the pre-funded warrants are each bundled with a November 2024 Common Warrant, each security is issued separately. Since the instruments were bundled, the Company uses the bifurcation method to determine the fair value of each security. The Black Scholes model was used to determine the fair value of the underlying November 2024 Common Warrant and the remainder of the purchase price was allocated to the pre-funded warrant, resulting in a fair value of the November 2024 Common Warrants of \$0.765 and a fair value of \$0.06 for the pre-funded warrants.

KWESST MICRO SYSTEMS INC.

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

Three and six months ended March 31, 2025 and 2024

(Expressed in Canadian dollars, except share amounts)

	Initial Recognition
Number of Warrants	4,145,200
Nasdaq closing price (in CAD)	\$ 1.00
Exercise price per warrant	\$ 1.03
Black Scholes fair value	\$ 0.765
Volatility	103%
Divident yield	Nil
Risk-free interest rate	2.92%
Expected life (in years)	5.00
Fair value per warrant (CAD)	\$ 0.765

The 4,145,000 pre-funded warrants and 350,000 November 2024 Common Warrants were subsequently exercised at a weighted average exercise price of \$0.08, for proceeds of \$364,645, during the six months ended March 31, 2025.

Brokers' Compensation and Share Issuance Costs

In connection with the August 2024 Offering, Wainwright was also granted a tail obligation resulting in earning 7.5% on any equity financing raised from investors introduced to the Company as part of the offering. The November 12, 2024, financing fell entirely within the scope of the tail obligation and resulted in a payment of \$259,534 (US\$184,047), representing 7.5% of the \$3.4 million (US\$2.5 million) gross proceeds to Wainwright upon closing of the transaction.

ThinkEquity acted as sole placement agent for the Offering. As compensation for services rendered, the Company (i) paid to ThinkEquity, at the closing of the November 2024 PP, a cash fee equal of \$274,027 (US\$196,400), representing 8.0% of the aggregate gross proceeds of the November 2024 PP; and (ii) issued to ThinkEquity or its designees 207,260 warrants ("Placement Agent Warrants") to purchase common shares on the basis of twenty-one warrants to one common share, equal to 5% of the pre-funded warrants sold in the November 2024 PP. The Placement Agent Warrants are immediately exercisable, and entitle the holder to acquire one common share at an exercise price of \$1.03 (US\$0.74) per common share for a period of 60 months following the closing of the November 2024 PP.

The fair value of the broker compensation warrants at the closing of the November 2024 PP was \$158,554, calculated using the Black Scholes model.

The share issuance costs related to the November 2024 PP that were recognized in equity were \$681,185, inclusive of the broker compensation warrants.

KWESST MICRO SYSTEMS INC.

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

Three and six months ended March 31, 2025 and 2024

(Expressed in Canadian dollars, except share amounts)

	Initial Recognition
Number of Warrants	207,260
Nasdaq closing price (in CAD)	\$ 1.00
Exercise price per warrant	\$ 1.03
Black Scholes fair value	\$ 0.765
Volatility	103%
Divident yield	Nil
Risk-free interest rate	2.92%
Expected life (in years)	5.00
Fair value per warrant (CAD)	\$ 0.765

Private Placement (February 2025)

On February 21 and February 25, 2025, we closed the first and second tranche, respectively, of a brokered private placement offering for aggregate gross proceeds of approximately \$3.7 million (the “February 2025 PP”).

As part of the February 2025 PP, the Company issued 50,248 common shares and 2,884,179 pre-funded warrants to acquire one common share of the Company. The common shares and pre-funded warrants had a no par value per share at a price of \$19.488 per common share and \$0.928 per pre-funded warrant, inclusive of the exercise price of \$0.021 per common share. Each common share and pre-funded warrant was bundled with one common share purchase warrant (“February 2025 Common Warrant”) of the Company. Each February 2025 Common Warrant is immediately exercisable and entitles the holder to acquire one common share for every 21 February 2025 Common Warrant exercised at an exercise price of \$24.36 per common share for a period of 60 months following the closing of the February 2025 PP. Although the common shares and pre-funded warrants are each bundled with a February 2025 Common Warrant, each security is issued separately. Since the instruments were bundled, the Company uses the bifurcation method to determine the fair value of each security. The Black Scholes model was used to determine the fair value of the underlying February 2025 Common Warrant and the remainder of the purchase price was allocated to the common share or pre-funded warrant, resulting in a fair value of the first tranche of the February 2025 Common Warrants of \$0.58 and \$0.55 and a fair value of \$7.308 for the common shares and \$0.348 for the pre-funded warrants.

February 21 Tranche	Initial Recognition
Number of Warrants	3,787,879
Nasdaq closing price (in CAD)	\$ 0.80
Exercise price per warrant	\$ 1.16
Black Scholes fair value	\$ 0.58
Volatility	104%
Divident yield	Nil
Risk-free interest rate	2.76%
Expected life (in years)	5.00
Fair value per warrant (CAD)	\$ 0.58

KWESST MICRO SYSTEMS INC.

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

Three and six months ended March 31, 2025 and 2024

(Expressed in Canadian dollars, except share amounts)

February 25 Tranche	Initial Recognition
Number of Warrants	151,515
Nasdaq closing price (in CAD)	\$ 0.77
Exercise price per warrant	\$ 1.16
Black Scholes fair value	\$ 0.55
Volatility	104%
Divident yield	Nil
Risk-free interest rate	2.65%
Expected life (in years)	5.00
Fair value per warrant (CAD)	\$ 0.55

Brokers' Compensation and Share Issuance Costs

In connection with the August 2024 Offering, Wainwright was also granted a tail obligation resulting in earning 7.5% on any equity financing raised from investors introduced to the Company as part of the offering. The February 2025 PP fell mostly within the scope of the tail obligation and resulted in a payment of \$244,128, representing 7.5% of the gross proceeds, within the scope of the tail obligation, to Wainwright upon closing of the transaction.

ThinkEquity acted as sole placement agent for the Offering. As compensation for services rendered, the Company (i) paid to ThinkEquity, at the closing of the February 2025 PP, a cash fee equal to \$279,338, representing 7.5% of the aggregate gross proceeds of the February 2025 PP; and (ii) issued to ThinkEquity or its designees 196,970 warrants ("February 2025 Placement Agent Warrants") equal to 105% of the common shares and 5% of the pre-funded warrants sold in the February 2025 PP. The February 2025 Placement Agent Warrants are immediately exercisable, and entitle the holder to acquire one common share for every 21 February 2025 Placement Agent Warrants exercised at an exercise price of \$24.36 per common share for a period of 60 months following the closing of the February 2025 PP.

The fair value of the broker compensation warrants at the closing of the February 2025 PP was \$114,046, calculated using the Black Scholes model.

The share issuance costs related to the February 2025 PP that were recognized in equity were \$927,219, inclusive of the broker compensation warrants.

February 21 Tranche	Initial Recognition
Number of Warrants	189,394
Nasdaq closing price (in CAD)	\$ 0.80
Exercise price per warrant	\$ 1.16
Black Scholes fair value	\$ 0.58
Volatility	104%
Divident yield	Nil
Risk-free interest rate	2.76%
Expected life (in years)	5.00
Fair value per warrant (CAD)	\$ 0.58

KWESST MICRO SYSTEMS INC.

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

Three and six months ended March 31, 2025 and 2024

(Expressed in Canadian dollars, except share amounts)

February 25 Tranche	Initial Recognition
Number of Warrants	7,576
Nasdaq closing price (in CAD)	\$ 0.77
Exercise price per warrant	\$ 1.16
Black Scholes fair value	\$ 0.55
Volatility	104%
Divident yield	Nil
Risk-free interest rate	2.65%
Expected life (in years)	5.00
Fair value per warrant (CAD)	\$ 0.55

b) Warrants

The following is a summary of changes in outstanding warrants since September 30, 2024:

	Number of warrants	Weighted average exercise price
Outstanding at September 30, 2024	11,600,598	\$ 3.23
Issued (Note 11(a))	19,521,653	0.49
Exercised ⁽¹⁾	(8,304,200)	0.04
Expired	(575,000)	5.01
Outstanding at March 31, 2025	22,243,051	\$ 4.00
Exercisable at March 31, 2025	22,243,051	\$ 4.00

The table below outlines the ratio upon which the above warrants are converted into common shares.

(1) The Pre-Funded Warrants exercised in Fiscal 2025 had a strike price of \$0.001.

In the six months ended March 31, 2025, there were 7,954,200 pre-funded warrants and 350,000 November 2024 Common Warrants exercised, resulting in an increase to share capital of \$4,700,168, a decrease to warrants of \$3,818,245 and a decrease to warrant liabilities of \$667,634 with the difference being recorded in the change in fair value of the warrant liabilities that was recognized in the unaudited condensed consolidated statements of net loss and comprehensive loss.

In the six months ended March 31, 2025, there were 575,000 warrants that expired resulting in \$132,000 being recorded to contributed surplus.

KWESST MICRO SYSTEMS INC.

Notes to the Unaudited Condensed Consolidated Interim Financial Statements
Three and six months ended March 31, 2025 and 2024
(Expressed in Canadian dollars, except share amounts)

The following table provides additional information on the total outstanding warrants at March 31, 2025:

	Number of warrants outstanding	Conversion ratio to Common Shares	Underlying Securities	Book value	Expiry date
Classified as equity					
<i>LEC's Warrants:</i>					
Exercise price of CAD\$0.70	500,000	14,700 for 1	34 \$	425,000	April 29, 2026
<i>December 2022 U.S. Underwriter Warrants</i>					
Exercise price of US\$5.1625	134,950	210 for 1	643 \$	189,592	December 9, 2027
<i>July 2023 U.S. Underwriter Warrants</i>					
Exercise price of US\$2.66	123,637	210 for 1	589 \$	204,187	July 21, 2028
<i>April 2024 U.S. Underwriter Warrants</i>					
Exercise price of US\$0.8125	76,925	210 for 1	366 \$	43,869	April 9, 2029
<i>June 2024 U.S. Underwriter Warrants</i>					
Exercise price of US\$0.725	145,000	210 for 1	690 \$	61,213	June 14, 2029
<i>August 2024 U.S. Underwriter Warrants</i>					
Exercise price of US\$0.25	353,625	210 for 1	1,684 \$	28,826	August 9, 2029
<i>November 2024 U.S. Underwriter Warrants</i>					
Exercise price of US\$1.125	194,450	21 for 1	9,260 \$	187,468	November 1, 2029
<i>November 2024 Private Placement Warrants</i>					
Exercise price of CAD\$1.03	3,795,200	21 for 1	180,724 \$	2,903,470	November 12, 2029
<i>November 2024 PP Underwriter Warrants</i>					
Exercise price of CAD\$1.03	207,260	21 for 1	9,870 \$	158,554	November 12, 2029
<i>February 21, 2025 Private Placement Warrants</i>					
Exercise price of CAD\$1.16	3,787,879	21 for 1	180,375 \$	2,196,970	February 21, 2030
<i>February 21, 2025 Pre-Funded Warrants</i>					
Exercise price of CAD\$0.001	2,884,179	21 for 1	137,342 \$	1,000,810	No expiry
<i>February 21, 2025 PP Underwriter Warrants</i>					
Exercise price of CAD\$1.16	189,394	21 for 1	9,019 \$	109,849	February 21, 2030
<i>February 25, 2025 Private Placement Warrants</i>					
Exercise price of CAD\$1.16	151,515	21 for 1	7,215 \$	83,939	February 25, 2030
<i>February 25, 2025 PP Underwriter Warrants</i>					
Exercise price of CAD\$1.16	7,576	21 for 1	361 \$	4,197	February 25, 2030
<i>Costs related to the Nov 2024 Public Offering Warrants</i>			\$ (187,468)		
<i>Costs related to the Nov 2024 Private Placement Warrants and PFWs</i>			\$ (681,185)		
<i>Costs related to the Feb 2025 Private Placement Warrants and PFWs</i>			\$ (803,109)		
	12,551,590		538,172 \$	5,926,182	
Classified as liability					
<i>December 2022 Public Offerings:</i>					
Exercise price of US\$5.00	3,226,392	210 for 1	15,364 \$	108,537	December 9, 2027
<i>December 2022 Debt Settlement</i>					
Exercise price of US\$5.00	56,141	210 for 1	267 \$	1,889	December 9, 2027
<i>July 2023 Public Offerings:</i>					
Exercise price of US\$2.66	1,542,194	210 for 1	7,344 \$	2,217	July 21, 2028
<i>July 2023 Pre-Funded Warrants</i>					
Exercise price of US\$0.001	151,734	210 for 1	723 \$	3,681	No expiry
<i>August 2024 Public Offering</i>					
Exercise price of US\$0.25	4,715,000	210 for 1	22,452 \$	61,003	August 9, 2029
	9,691,461		46,150	177,327	
Total outstanding warrants	22,243,051		584,322 \$	6,103,509	

KWESST MICRO SYSTEMS INC.

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

Three and six months ended March 31, 2025 and 2024

(Expressed in Canadian dollars, except share amounts)

c) Contributed Surplus

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

Share-based compensation

On August 26, 2024, KWESST shareholders approved the renewal of the Long-Term Incentive Plan (the “LTIP”). The number of RSUs, PSUs, deferred share units (“DSUs”), and stock appreciation rights (“SARs”) (collectively “Share Units”) authorized for issuance pursuant to the LTIP is 1,939 Share Units. Accordingly, we have 882 Share Units available for future grants.

We did not grant any stock options, RSUs, PSUs, and SARs, pursuant to our LTIP during the six months ended March 31, 2025. Accordingly, we had 1,057 outstanding stock options at March 31, 2025, we have 51,979 stock option units available for future grants.

	Number of options	Weighted average exercise price
Outstanding at September 30, 2024	1,229	\$ 554.40
Cancelled	(172)	\$ 664.41
Outstanding at March 31, 2025	1,057	\$ 554.95
Options exercisable at March 31, 2025	816	\$ 560.69

For the three and six months ended March 31, 2025, we recorded share-based compensation of \$26,342 and \$77,397 (2024 – \$60,981 and \$124,471).

12. Loss per share

As disclosed in Note 1(b) and (c), the 2024 Reverse Split and 2025 Reverse Split has been applied retrospectively herein.

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

	Three months ended March 31, 2025	Three months ended March 31, 2024	Six months ended March 31, 2025	Six months ended March 31, 2024
Issued common shares, beginning of period	144,391	26,747	75,199	26,747
Effect of shares issued from:				
November 2024 U.S. Public Offering (Note 11(a))	-	-	3,140	-
February 2025 U.S. Private Placement (Note 11(a))	20,441	-	10,333	-
Debt settlements	-	198	4,361	98
Exercise of warrants	72,207	787	212,157	391
Weighted average number of dilutive common shares	237,039	27,732	305,190	27,236

KWESST MICRO SYSTEMS INC.

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

Three and six months ended March 31, 2025 and 2024

(Expressed in Canadian dollars, except share amounts)

At March 31, 2025 and 2024, all dilutive securities, being warrants, pre-funded warrants and stock options, were anti-dilutive because we incurred a net loss for the above periods.

13. Revenue

a) Revenue streams

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

b) Disaggregation of revenue from contracts with customers

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

	Three months ended March 31, 2025	Three months ended March 31, 2024	Six months ended March 31, 2025	Six months ended March 31, 2024
Major products / service lines				
Digitization	\$ 1,066,786	\$ 280,717	\$ 1,785,769	\$ 373,486
Non-Lethal	197,376	204,972	365,124	240,484
Other	-	175	927	962
	\$ 1,264,162	\$ 485,864	\$ 2,151,820	\$ 614,932
Primary geographical markets				
Canada	\$ 1,207,168	\$ 412,776	\$ 2,056,456	\$ 541,844
United States	56,994	73,088	95,364	73,088
	\$ 1,264,162	\$ 485,864	\$ 2,151,820	\$ 614,932
Timing of revenue recognition				
Products and services transferred over time	\$ 1,066,786	\$ 280,717	\$ 1,785,769	\$ 373,486
Products transferred at a point in time	197,376	205,147	366,051	241,446
	\$ 1,264,162	\$ 485,864	\$ 2,151,820	\$ 614,932

Revenue allocated to remaining performance obligations represents contracted revenue that has not yet been recognized (“contracted not yet recognized”) and includes unearned revenue and amounts that will be invoiced and recognized as revenue in future periods. At March 31, 2025, KWESST’s contracted not yet recognized revenue was \$109,181 (2024 – \$302,617), of which 100% of this amount is expected to be recognized over the next 12 months.

For the three months ended March 31, 2025, three customers accounted for 68.95%, 9.27% and 6.99% (2024 – three customers accounted for 35.53%, 25.98%, and 13.22%) of revenue. For the six months ended March 31, 2025, three customers accounted for 64.76%, 9.96% and 8.27% (2024 – three customers accounted for 31.19%, 20.53%, and 20.45%) of revenue.

KWESST MICRO SYSTEMS INC.

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

Three and six months ended March 31, 2025 and 2024

(Expressed in Canadian dollars, except share amounts)

14. Net finance costs

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

	Three months ended March 31, 2025	Three months ended March 31, 2024	Six months ended March 31, 2025	Six months ended March 31, 2024
Finance costs from:				
Accretion cost - accrued royalties liability	\$ 39,309	\$ 45,483	\$ 84,826	\$ 89,931
Lease obligations	9,052	18,326	23,093	37,861
Other	2,148	341	6,453	694
Total financing costs	50,509	64,150	114,372	128,486
Interest income	(19,148)	(2,492)	(21,452)	(53,631)
Gain on debt settlement	-	-	500	-
Net finance costs	\$ 31,361	\$ 61,658	\$ 93,420	\$ 74,855

15. Financial instruments

For the three and six months ended March 31, 2025, there were no material changes to our financial risks as disclosed in Note 23 of the Annual Financial Statements, except for the following:

Foreign currency risk

For the three and six months ended March 31, 2025, we raised gross proceeds of \$4.9 million (US\$3.5 million) in the November 2024 Offering (see Note 11(a)), including the issuance of warrants with an exercise price denominated in U.S. dollars in the November U.S. Public Offering (see Note 10). Warrants exercised in the first quarter of fiscal 2025 resulted in proceeds of \$0.8 million (US\$0.6 million). On November 12, 2024, the warrants were subsequently converted to CAD denomination and extinguished from liabilities as they were transferred to equity. We also raised gross proceeds of \$3.4 million (US\$2.5 million) in the November 2024 PP (see Note 11(a)), including the issuance of warrants with an exercise price denominated in CAD dollars in the November Private Placement (see Note 11(a)). Although the financing was denominated in CAD, the terms of the deal allowed for the proceeds to be sent to the Company in U.S. dollars for convenience. We also raised gross proceeds of \$3.7 million in the February 2025 PP (see Note 11(a)), including the issuance of warrants with an exercise price denominated in CAD dollars in the February Private Placement (see Note 11(a)). Although the financing was denominated in CAD, the terms of the deal allowed for the proceeds to be sent to the Company in U.S. dollars for convenience. Also, certain of our revenues were denominated in U.S. dollars and we also procure certain raw materials denominated in U.S. dollars for product development. Accordingly, we are exposed to the U.S. dollar currency. Where a natural hedge cannot be achieved, a significant change in the U.S. dollar currency could have a significant effect on our financial performance, financial position and cash flows. Currently, we do not use derivative instruments to hedge the U.S. dollar exposure. Throughout the year we maintained the majority of our cash assets in U.S. dollars and converted to CAD as needed as we primarily received funds from financing in U.S. dollars.

At March 31, 2025, we had the following net U.S. dollar exposure:

	Total USD
Net assets in U.S. subsidiary	\$ -
US denominated from other:	
Assets	\$ 2,899,196
Liabilities	(358,542)
Net US dollar exposure	\$ 2,540,654
Impact to profit or loss if 5% movement in the US dollar	\$ 127,033

KWESST MICRO SYSTEMS INC.

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

Three and six months ended March 31, 2025 and 2024

(Expressed in Canadian dollars, except share amounts)

During the three and six months ended March 31, 2025, we recorded a foreign exchange gain of \$77,823 and \$191,106, respectively (2024 – loss of \$805 and gain of \$90,905).

Liquidity risk

At March 31, 2025, our contractual obligations were as follows:

Payment due:	Total	Within 1 Year	1 to 3 years	3 to 5 years	5 years and beyond
Minimum royalty commitments	\$ 2,000,000	\$ -	\$ 450,000	\$ 550,000	\$ 1,000,000
Accounts payable and accrued liabilities	1,122,180	1,122,180	-	-	-
Lease obligations	205,589	163,881	41,708	-	-
Total contractual obligations	\$ 3,327,769	\$ 1,286,061	\$ 491,708	\$ 550,000	\$ 1,000,000

At March 31, 2025, we had \$4.4 million in cash and \$4.9 million in working capital (current assets less current liabilities) (September 30, 2024 - \$0.3 million in cash and negative \$1.1 million in working capital).

16. Supplemental cash flow information

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

	Six months ended March 31, 2025	Six months ended March 31, 2024
Trade and other receivables	\$ (513,989)	\$ (261,971)
Inventories	(48,034)	(70,451)
Prepaid expenses and deposits	(154,074)	(118,178)
Deferred costs	(10,077)	-
Accounts payable and accrued liabilities	(464,191)	107,564
Contract liabilities	2,041	(25,067)
	\$ (1,188,324)	\$ (368,103)

The following is a summary of non-cash items that were excluded from the Unaudited Condensed Consolidated Statements of Cash Flows for the six months ended March 31, 2025:

- 119,047 shares issued for debt settlement of business expenses incurred while representing the Company in an aggregate amount of \$100,000 owed to a company controlled by Mr. David Luxton, Chairman of the Company;
- \$187,468 non-cash share issuance costs as part of the net proceeds settlement at the closing of the November 1, 2024 U.S. Public Offering (see Note 11(a));
- \$221,088 non-cash share issuance costs as part of the net proceeds settlement at the closing of the November 12, 2024 Private Placement (see Note 11(a));
- \$114,046 non-cash share issuance costs as part of the net proceeds settlement at the closing of the February 2025 Private Placement (see Note 11(a)); and
- Expiry of 200,000 warrants in connection with the acquisition of Police Ordnance Company (see Note 4 of the Annual Financial Statements) expired December 15, 2024.

The following is a summary of non-cash items that were excluded from the Unaudited Condensed Consolidated Statements of Cash Flows for the six months ended March 31, 2024:

KWESST MICRO SYSTEMS INC.

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

Three and six months ended March 31, 2025 and 2024

(Expressed in Canadian dollars, except share amounts)

- 46,706 shares issued for debt settlement. The debt resulted in a tail obligation relating to services rendered by a third-party consultant; and
- 385,716 warrants exercised in connection with the July 2023 Private Placement.

17. Commitments and contingencies

There were no commitments and contingencies at March 31, 2025 other than the royalty payment disclosed in Note 15.

18. Segmented information

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

At March 31, 2025, we no longer have the right-of-use asset (2024 – \$64,782) and equipment (\$56,187) (2024 – \$nil) in the United States while all other property and equipment are located in Canada.

19. Key management compensation

Key management personnel are those persons having the authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly. The key management personnel of the Company are the members of the Company's executive management team and Board of Directors.

Key management compensation for the three and six months ended March 31, 2025 and 2024 were as follows:

	Three months ended March 31, 2025	Three months ended March 31, 2024	Six months ended March 31, 2025	Six months ended March 31, 2024
Short-term key management compensation	\$ 217,083	\$ 166,250	\$ 929,583	\$ 274,167
Share-based payments	21,370	30,396	49,963	59,103
Directors' fees	122,500	152,500	375,000	285,000
	\$ 360,953	\$ 349,146	\$ 1,354,546	\$ 618,270

20. Subsequent Events

Exercise of warrants

Subsequent to March 31, 2025, all 2,884,179 pre-funded warrants from the February 2025 Private Placement were exercised at their exercise price of \$0.021 per common share. These exercises resulted in the issuance of 137,342 common shares of the Company. After these exercises, there are 151,764 total remaining outstanding pre-funded warrants of the Company.