

KWESST MICRO SYSTEMS INC.
(formerly Foremost Ventures Corp.)

CONDENSED INTERIM FINANCIAL STATEMENTS
(Expressed in Canadian Dollars)
(Unaudited – prepared by management)

THREE AND SIX MONTHS ENDED AUGUST 31, 2020 AND 2019

These unaudited condensed interim financial statements of KWESST Micro Systems Inc. for the three and six months ended August 31, 2020 and 2019 have been prepared by management and approved by the Board of Directors on October 30, 2020. These unaudited condensed interim financial statements have not been reviewed by the Company's external auditors.

KWESST MICRO SYSTEMS INC.
(FORMERLY FOREMOST VENTURES CORP.)
CONDENSED INTERIM STATEMENTS OF FINANCIAL POSITION
AS AT
(Expressed in Canadian Dollars)
(Unaudited – prepared by management)

	August 31, 2020	February 29, 2020
	(unaudited)	(audited)
ASSETS		
Current		
Cash	\$ 81,157	\$ 146,974
Deferred transaction costs (Note 6)	<u>85,891</u>	<u>-</u>
	<u>\$ 167,048</u>	<u>\$ 146,974</u>
LIABILITIES		
Accrued liabilities	<u>51,825</u>	<u>17,795</u>
	<u>51,825</u>	<u>17,795</u>
SHAREHOLDERS' EQUITY		
Share capital (Note 4)	245,472	225,872
Reserve (Note 4)	40,704	40,704
Deficit	<u>(170,953)</u>	<u>(137,397)</u>
	<u>115,223</u>	<u>129,179</u>
	<u>\$ 167,048</u>	<u>\$ 146,974</u>
Subsequent Event (Note 6)		

The accompanying notes are an integral part of these condensed interim financial statements.

FOREMOST VENTURES CORP.
CONDENSED INTERIM STATEMENTS OF LOSS AND COMPREHENSIVE LOSS
(Expressed in Canadian Dollars)
(Unaudited – prepared by management)

	Three Months Ended August 31, 2020	Three Months Ended August 31, 2019	Six Months Ended August 31, 2020	Six Months Ended August 31, 2019
EXPENSES				
Professional fees (Note 10)	\$ 10,996	\$ 7,599	\$ 18,595	\$ 7,599
Transfer agent and filing fees	11,391	2,031	13,422	4,825
Administration	<u>\$ 1,495</u>	<u>\$ 44</u>	<u>\$ 1,539</u>	<u>\$ 165</u>
Loss and comprehensive loss for the period	<u>\$ (23,882)</u>	<u>\$ (9,674)</u>	<u>\$ (33,556)</u>	<u>\$ (12,589)</u>
Basic and diluted loss per common share	<u>\$ (0.01)</u>	<u>\$ (0.00)</u>	<u>\$ (0.01)</u>	<u>\$ (0.00)</u>
Weighted average number of common shares outstanding	<u>4,196,000</u>	<u>4,000,000</u>	<u>4,094,804</u>	<u>4,000,000</u>

The accompanying notes are an integral part of these condensed interim financial statements.

FOREMOST VENTURES CORP.

CONDENSED INTERIM STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(Expressed in Canadian Dollar)

(Unaudited – prepared by management)

	<u>Share capital</u>		Deficit	Reserve	Total shareholders' equity
	Common shares	Amount			
Balance, February 28, 2019	4,000,000	\$ 225,872	\$ (83,624)	\$ 40,704	\$ 182,952
Net loss for the period	-	-	(12,589)	-	(12,589)
Balance, August 31, 2019	4,000,000	236,372	(96,213)	40,704	170,363
Balance, February 29, 2020	4,000,000	\$ 225,872	\$ (137,397)	\$ 40,704	\$ 129,179
Common shares issued for cash	196,000	19,600	-	-	19,600
Net loss for the period	-	-	(33,556)	-	(33,556)
Balance, August 31, 2020	4,196,000	\$ 245,472	\$ (170,953)	\$ 40,704	\$ 115,223

The accompanying notes are an integral part of these condensed interim financial statements.

See Note 4.

FOREMOST VENTURES CORP.
CONDENSED INTERIM STATEMENTS OF CASH FLOWS
SIX MONTHS ENDED AUGUST 31,
(Expressed in Canadian Dollars)
(Unaudited – prepared by management)

	2020	2019
CASH FLOWS USED IN OPERATING ACTIVITIES		
Loss for the period	\$ (33,556)	\$ (12,589)
Change in non-cash working capital item:		
Receivables	-	(22,500)
Accounts payable	-	(5,460)
Accrued liabilities	34,030	(5,098)
Net cash used in operating activities	<u>474</u>	<u>(45,647)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Deferred transaction costs	<u>(85,891)</u>	-
Net cash from financing activities	<u>-</u>	<u>-</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds on issuance of share capital	<u>19,600</u>	-
Net cash from financing activities	<u>19,600</u>	<u>-</u>
Change in cash during the period	(65,817)	(45,647)
Cash, beginning of period	<u>146,974</u>	<u>201,010</u>
Cash, end of period	<u>\$ 81,157</u>	<u>\$ 155,363</u>

There were no non-cash transactions during the six months ended August 31, 2020 and 2019.

The accompanying notes are an integral part of these condensed interim financial statements.

KWESST MICRO SYSTEMS INC.
(FORMERLY FOREMOST VENTURES CORP.)
NOTES TO THE CONDENSED INTERIM FINANCIAL STATEMENTS
SIX MONTHS ENDED AUGUST 31, 2020 AND 2019
(Expressed in Canadian Dollars)
(Unaudited – prepared by management)

1. NATURE AND CONTINUANCE OF OPERATIONS

KWESST Micro Systems Inc. (formerly Foremost Ventures Corp., referred to as “Foremost” herein) (the “Company”) is a company domiciled in Canada. The Company was incorporated on November 28, 2017 under the laws of the Province of British Columbia. The address of the Company’s registered and head office is Suite 1510, 789 West Pender Street, Vancouver, B.C., V6C 1H2.

On June 15, 2018, the Company completed its initial public offering (“IPO”) and its common shares were listed on the TSX-Venture Exchange (“TSX-V”) as a Capital Pool Company (“CPC”) as defined in Policy 2.4 of the TSX-V Corporate Finance Manual. The Company’s principal business is the identification and evaluation of companies, assets or businesses with a view to completing a Qualifying Transaction (“QT”). Such a transaction will be subject to shareholder and regulatory approval.

On March 2, 2020, Foremost entered into a letter of intent (“LOI”) with KWESST Inc. (“KWESST”), a private corporation existing under the laws of Ontario with respect to a QT. On April 30, 2020, KWESST and Foremost entered into an amalgamation agreement (the “Amalgamation Agreement”). The Amalgamation is an arm’s length transaction and, if completed, will constitute a QT for Foremost pursuant to the policies of the TSX-V.

On September 17, 2020, Foremost completed the Amalgamation and its QT – see Note 6.

2. BASIS OF PRESENTATION

Statement of Compliance

These unaudited condensed interim financial statements, including comparatives, have been prepared in accordance with International Accounting Standard 34 “Interim Financial Reporting” (“IAS 34”) using accounting policies consistent with the International Financial Reporting Standards (“IFRS”) issued by the International Accounting Standards Board (“IASB”) and Interpretations of the IFRS Interpretations Committee.

These unaudited condensed interim financial statements do not include all of the information required of a full annual financial report and is intended to provide users with an update in relation to events and transactions that are significant to an understanding of the changes in financial position and performance of the Company since the end of the last annual reporting period. It is therefore recommended that this financial report be read in conjunction with the audited annual financial statements of the Company for the year ended February 28, 2020.

Approval of the financial statements

The unaudited condensed interim consolidated financial statements of the Company for the six months ended August 31, 2020 were reviewed by the Audit Committee and approved and authorized for issue by the Board of Directors on October 30, 2020.

Basis of preparation

The financial statements of the Company comply with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”) and interpretations of the International Financial Reporting Interpretations Committee (“IFRIC”).

KWESST MICRO SYSTEMS INC.
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2. BASIS OF PRESENTATION (continued)

Presentation and functional currency

The functional currency of the Company, is the Canadian dollar, which is also the presentation currency of the financial statements.

Significant accounting judgments and estimates

The preparation of these financial statements using accounting policies consistent with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities, and the reported amounts of revenues and expenses. The preparation of these financial statements also requires management to exercise judgment in the process of applying the accounting policies.

The preparation of financial statements in accordance with IFRS requires the Company to make judgements apart from those involving estimates, in applying accounting policies. Management has determined that the only significant judgement applying to the financial statements for the year ended February 28, 2020 is the Company's ability to continue as a going concern.

3. SIGNIFICANT ACCOUNTING POLICIES

Recent accounting pronouncements

Certain new accounting standards, amendments to standards and interpretations have been issued, effective for annual periods beginning on or after August 31, 2020. These standards have been assessed to not have a significant impact on the Company's financial statements.

4. SHARE CAPITAL

Authorized

Unlimited common shares without par value

Issued

On June 15, 2018, the Company completed its IPO and issued 2,000,000 common shares for gross proceeds of \$200,000. The Company incurred costs of \$43,500, paid a finder's fee of \$20,000 and issued 200,000 agent warrants, entitling the holder to acquire one common share per warrant for \$0.10 for a period of two years. The Company has estimated the fair value of the agent warrants to be \$10,628 based on the Black-Scholes Option Pricing Model. The assumptions used for the Black-Scholes valuation of the agent warrants were as follows: a risk-free interest rate of 2.29%, an expected life of two years, a dividend rate of 0%, forfeiture rate of 0%, and an annualized volatility of 100%.

During the period ended May 31, 2020, the Company issued 196,000 common shares at a price of \$0.10 for gross proceeds of \$19,600.

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4. SHARE CAPITAL (continued)

Escrow shares

Pursuant to an escrow agreement dated May 2, 2018, 2,000,000 common shares issued are held in escrow. Under the escrow agreement, 10% of the escrowed shares will be released from escrow on the date of the final TSX-V bulletin (the “Initial Release”) upon completion of a QT and an additional 15% will be released every six months following the initial release over a period of thirty six months.

Reserve

The reserve records items recognized as share-based compensation expense and other share-based payments until such time that the stock options or warrants are exercised, at which time the corresponding amount will be transferred to share capital. Any fair value attributed to the warrants is recorded in the reserve. If the warrants expire unexercised, the value attributed to the warrants is transferred to deficit.

Stock options

The Company has a rolling stock option plan (the “Plan”) that authorizes the board of directors to grant incentive stock options to directors, officers, consultants and employees, whereby a maximum of 10% of the issued common shares are reserved for issuance under the plan. Under the Plan, the exercise price of each option may not be less than the market price of the Company’s shares at the date of grant. Options granted under the Plan will have a term not to exceed five years and be subject to vesting provisions as determined by the board of directors of the Company.

The following table summarizes the Company’s stock option activity:

	Number of Options	Weighted Average Exercise Price
Outstanding and exercisable, February 28, 2019, February 29, 2020 and August 31, 2020	400,000	\$ 0.10

Warrants

The following table summarizes the Company’s warrant activity:

	Number of Warrants	Weighted Average Exercise Price
Outstanding, February 28, 2019 and February 29, 2020	200,000	\$ 0.10
Expired	(4,000)	0.10
Exercised	<u>(196,000)</u>	0.10
Outstanding, August 31, 2020	Nil	\$ 0.10

On June 15, 2020, the Company had 4,000 warrants exercisable at \$0.10 per warrant that expired.

5. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

a) Classification of financial instruments

As at August 31, 2019, the Company's financial instruments are comprised of cash and accrued liabilities. The fair value of these financial instruments approximates their carrying value due to its short-term maturity. Fair values of financial instruments are classified in a fair value hierarchy based on the inputs used to determine fair values. The levels of the fair value hierarchy are as follows:

Level 1 – quoted prices (unadjusted) in active markets for identical assets or liabilities;

Level 2 – inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and

Level 3 – inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The Company's financial instruments are measured using level 1 inputs.

b) Financial risk management

The Company's risk exposures and the impact on the Company's financial instruments are summarized below:

Credit risk

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. Financial instruments that potentially subject the Company to credit risk consist primarily of cash. The Company limits its exposure to credit risk by placing its cash with a high credit quality financial institution in Canada. The Company believes it has no significant credit risk.

Liquidity risk

Liquidity risk is the risk that the Company cannot meet its financial liabilities as they become due. As at August 31, 2019, the Company had a cash balance of \$155,363 to settle future liabilities and as such, is not exposed to significant liquidity risk.

Market risk

Market risk is the risk of loss that may arise from changes in market factors such as interest rates, foreign exchange rates, and commodity and equity prices.

(a) Interest rate risk

Interest rate risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in the market interest rates. The Company's cash is held in an account with a major Canadian financial institution. The funds may be withdrawn at any time without penalty.

(b) Foreign currency risk

The Company does not have assets or liabilities in a foreign currency and therefore is not exposed to foreign currency risk.

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5. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (continued)

(c) Price risk

The Company is exposed to price risk with respect to equity prices. Equity price risk is defined as the potentially adverse impact on the Company's ability to obtain equity financing due to movements in individual equity prices or general movements in the level of the stock market. The Company closely monitors individual equity movements and the stock market to determine the appropriate course of action to be taken by the Company.

c) Capital risk management

The Company manages its capital to ensure that it will be able to continue as a going concern while maximizing the return to stakeholders through a suitable debt and equity balance appropriate for an entity of the Company's size and status. The Company's overall strategy remains unchanged from last year.

The capital structure of the Company consists of equity attributable to common shareholders. The availability of new capital will depend on many factors including positive stock market conditions, and the experience of management. The Company is not subject to any external covenants on its capital.

Cash from proceeds of share issuance are restricted pursuant to section 8.4 of TSX-V policy 2.4 (the "Policy") as follows:

- (a) Until the completion of the QT, no more than the lesser of 30% of the gross proceeds from the sale of securities issued by the Company and \$210,000 may be used for purposes other than as provided in section 8.3.
- (b) Until the completion of the QT, no proceeds from the sale of securities of the Company may be used to acquire or lease a vehicle.
- (c) The restrictions in this Policy on expenditures and the use of proceeds continue to apply until completion of the QT.
- (d) If the Company completes a QT before spending the entire proceeds on identifying and evaluating properties or businesses, the Company may use the remaining funds to finance or partly finance the acquisition of, or participation in the significant assets.

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6. SUBSEQUENT EVENT

On September 17, 2020, Foremost completed its QT with KWESST. Prior to the completion of the QT, Foremost effected a consolidation of its outstanding common shares on the basis of one post-consolidation common share for every 4.67 pre-consolidation common shares. The QT was done by way of a three-cornered amalgamation (the "Amalgamation") pursuant to which, among other things, (i) KWESST Inc. amalgamated with a wholly-owned subsidiary of Foremost, incorporated for the purposes of the Amalgamation, pursuant to the provisions of the Business Corporations Act (Ontario), (ii) Foremost changed its name to KWESST Micro Systems Inc., and (iii) all of the outstanding common shares of KWESST Inc. (the "KWESST Shares") were cancelled and, in consideration therefor, the holders thereof received post-consolidation common shares of KWESST Micro Systems Inc. on the basis of one KWESST Micro System Inc. share for each KWESST Share. On September 22, 2020, the KWESST Micro System Inc. shares began trading on the TSX-V under the stock symbol KWE.

As part of the QT, the subscription receipts issued by KWESST on July 9, 2020 pursuant to a brokered private placement (the "KWESST Subscription Receipts"), were automatically converted, into shares of KWESST. The private placement which was completed through PI Financial Corp. as agent, consisted of 4,409,553 KWESST Subscription Receipts issued at \$0.70 per subscription receipt for gross proceeds of about \$3.1 million.

Immediately following the QT, there were 41,266,821 shares of KWESST outstanding, of which 40,367,678 were held by the former shareholders of KWESST (representing approximately 97.8% of the outstanding shares of the Company) and 899,143 were held by the shareholders of Foremost prior to the QT.

During the three and six months period ended August 31, 2020, the Company incurred transaction costs of \$33,940 and \$85,891, respectively. These costs were deferred and reported as "Deferred transaction costs" under current assets in the statements of financial position as at August 31, 2020.