



Consolidated Financial Statements of

DEFSEC TECHNOLOGIES INC.
(Formerly KWESST MICRO SYSTEMS INC.)

Years ended September 30, 2025, 2024 and 2023.
(Expressed in Canadian Dollars)

DEFSEC TECHNOLOGIES INC.
(formerly KWESST Micro Systems Inc.)

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of DEFSEC Technologies Inc.

Opinion on the Consolidated Financial Statements

We have audited the accompanying consolidated statements of financial position of DEFSEC Technologies Inc. (the "Company") (formally Kwesst Micro Systems Inc.) as of September 30, 2025 and 2024, and the related consolidated statements of net loss and comprehensive loss, changes in shareholders' equity (deficit), and cash flows for each of the years in the two year period ended September 30, 2025, and the related notes (collectively referred to as the "consolidated financial statements").

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Company as of September 30, 2025 and 2024, and the results of its consolidated operations and its consolidated cash flows for each of the years in the two year period ended September 30, 2025, in conformity with IFRS® Accounting Standards as issued by the International Accounting Standards Board.

We have also audited the effects of the adjustments to retrospectively apply the 2025 reverse stock split as described in note 1(b) and the effect of the stock split as described in Note 15, 16 and 17 to the 2023 consolidated financial statements. In our opinion, such adjustments are appropriate and have been properly applied. We were not engaged to audit, review, or apply any procedures to the 2023 consolidated financial statements of the Company other than with respect to the adjustments above and, accordingly, we do not express an opinion or any other form of assurance on the 2023 consolidated financial statements taken as a whole.

Material Uncertainty Related to Going Concern

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 2(a) to the consolidated financial statements, the Company has suffered a net loss and negative operating cash flows and has an accumulated deficit which raises substantial doubt about its ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 2(a). The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Basis for Opinion

These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's consolidated financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits, we are required to obtain an understanding of internal control over financial reporting, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.

Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ MNP LLP

Chartered Professional Accountants;
Licensed Public Accountants

We have served as the Company's auditor since 2024.

Ottawa, Canada
December 29, 2025

MNP LLP

Suite 800, 1600 Carling Avenue, Ottawa ON, K1Z 1G3

T: 613.691.4200 F: 613.726.9009

DEFSEC TECHNOLOGIES INC.
(formerly KWESST Micro Systems Inc.)
Consolidated Statements of Financial Position
At September 30, 2025 and 2024
(Expressed in Canadian dollars)

	Notes	September 30, 2025	September 30, 2024
ASSETS			
Cash and cash equivalents		\$ 6,686,429	\$ 256,828
Restricted short-term investment	12	47,500	30,000
Trade and other receivables	4	1,494,152	567,875
Inventories	5	519,609	533,163
Prepaid expenses and other		163,562	179,051
Deferred costs	27	34,773	275,438
Current assets		8,946,025	1,842,355
Property and equipment	6	279,132	311,712
Right-of-use assets	7	1,165,181	230,124
Deposit		46,132	28,806
Intangible assets	8	2,390,030	3,174,832
Deferred costs		94,976	29,319
Non-current assets		3,975,451	3,774,793
Total Assets		\$ 12,921,476	\$ 5,617,148
LIABILITIES AND SHAREHOLDERS' EQUITY			
Liabilities			
Accounts payable and accrued liabilities	9	\$ 2,310,662	\$ 1,660,637
Accrued royalties liability	10	200,000	200,000
Lease obligations	13	188,907	147,078
Contract liabilities	14	7,671	120,571
Warrant liabilities	15	210,965	847,295
Current liabilities		2,918,205	2,975,581
Accrued royalties liability	10	1,087,009	1,118,135
Lease obligations	13	1,114,543	155,145
Non-current liabilities		2,201,552	1,273,280
Total Liabilities		5,119,757	4,248,861
Shareholders' Equity			
Share capital	16	47,003,991	37,822,725
Warrants	16	7,764,412	1,084,687
Contributed surplus	16	5,398,445	5,152,753
Accumulated other comprehensive loss		(85,077)	(38,520)
Accumulated deficit		(52,280,052)	(42,653,358)
Total Shareholders' Equity		7,801,719	1,368,287
Total Liabilities and Shareholders' Equity		\$ 12,921,476	\$ 5,617,148

See Note 2(a) Going Concern and Note 25 Commitments and contingencies.
See accompanying notes to the consolidated financial statements.

On behalf of the Board of Directors:

(signed) James Yersh, Director

(signed) David Luxton, Director

DEFSEC TECHNOLOGIES INC.**(formerly KWESST Micro Systems Inc.)**

Consolidated Statements of Net Loss and Comprehensive Loss

Years ended September 30, 2025, 2024 and 2023

(Expressed in Canadian dollars)

	Notes	September 30, 2025	September 30, 2024	September 30, 2023
Revenue	18	\$ 4,942,626	\$ 1,504,328	\$ 1,234,450
Cost of sales		(3,204,578)	(1,017,826)	(1,425,828)
Gross profit (loss)		1,738,048	486,502	(191,378)
Operating expenses				
General and administrative	19	5,225,997	4,836,815	6,165,297
Selling and marketing	19	2,037,088	1,525,228	2,892,679
Research and development, net	19	2,367,995	2,354,160	1,529,572
Share-based compensation		113,692	291,761	373,554
Depreciation and amortization		1,073,727	1,277,911	952,508
Total operating expenses		10,818,499	10,285,875	11,913,610
Operating loss		(9,080,451)	(9,799,373)	(12,104,988)
Other income (expenses)				
Share issuance costs	16(a)	(1,807,686)	(541,566)	(1,985,074)
Net finance costs	20	(173,375)	(196,323)	(668,034)
Foreign exchange gain (loss)		114,347	59,191	(98,275)
Impairment of right-of-use assets		(88,596)	—	—
Gain/loss on disposals		6,809	(7,256)	(291,181)
Change in fair value of warrant liabilities	15	1,402,258	3,047,568	5,841,192
Total other income (expenses), net		(546,243)	2,361,614	2,798,628
Loss before income taxes		(9,626,694)	(7,437,759)	(9,306,360)
Income tax recovery				
Deferred tax recovery	21	—	—	—
Net loss		\$ (9,626,694)	\$ (7,437,759)	\$ (9,306,360)
Other comprehensive income (loss):				
<i>Items that are or may be reclassified subsequently to profit or loss</i>				
Foreign currency translation differences		(46,557)	1,143	61,755
Total comprehensive loss		\$ (9,673,251)	\$ (7,436,616)	\$ (9,244,605)
Net loss per share				
Basic and diluted	17	\$ (15.78)	\$ (188.86)	\$ (478.85)
Weighted average number of shares outstanding				
Basic and diluted	17	610,169	39,382	19,435

See accompanying notes to the consolidated financial statements.

DEFSEC TECHNOLOGIES INC.
(formerly KWESST Micro Systems Inc.)

Consolidated Statements of Changes in Shareholders' Equity

Years ended September 30, 2025, 2024 and 2023

(Expressed in Canadian dollars)

	Notes	Number of Common Shares ⁽¹⁾	Share capital	Warrants	Contributed surplus	Translation reserve	Deficit	Total Shareholders' Equity
Balance, September 30, 2022		3,682	\$ 19,496,640	\$ 1,959,796	\$ 3,551,330	\$ (101,418)	\$(25,909,239)	\$ (1,002,891)
Shares issued for public offering	16(a)	22,706	16,725,436	—	—	—	—	16,725,436
Share offering costs	16(a)	—	(3,671,791)	393,911	125,086	—	—	(3,152,794)
Shares issued for debt	16(a)	267	233,485	—	—	—	—	233,485
Options exercised	16(c)	5	5,836	—	(1,789)	—	—	4,047
Warrants exercised	16(b)	17	60,000	(60,000)	—	—	—	—
Warrants expired	16(b)	—	—	(1,251,050)	1,251,050	—	—	—
Share-based compensation	16(c)	—	—	—	373,554	—	—	373,554
Shares for vested RSUs and PSUs	16(c)	67	529,504	—	(529,504)	—	—	—
Vested RSUs and PSUs repurchased		—	—	—	(612)	—	—	(612)
Other comprehensive loss		—	—	—	—	61,755	—	61,755
Net loss		—	—	—	—	—	(9,306,360)	(9,306,360)
Balance, September 30, 2023		26,744	\$ 33,379,110	\$ 1,042,657	\$ 4,769,115	\$ (39,663)	\$(35,215,599)	\$ 3,935,620
Shares issued for public offering	16(a)	39,761	3,608,154	133,907	—	—	—	3,742,061
Share offering costs	16(a)	—	(1,033,393)	—	—	—	—	(1,033,393)
Warrants exercised	16(b)	8,473	1,771,239	—	—	—	—	1,771,239
Shares issued for debt	16(a)	222	97,615	—	—	—	—	97,615
Warrants expired	16(b)	—	—	(91,877)	91,877	—	—	—
Share-based compensation	16(c)	—	—	—	291,761	—	—	291,761
Other comprehensive loss		—	—	—	—	1,143	—	1,143
Net loss		—	—	—	—	—	(7,437,759)	(7,437,759)
Balance, September 30, 2024		75,200	\$ 37,822,725	\$ 1,084,687	\$ 5,152,753	\$ (38,520)	\$(42,653,358)	\$ 1,368,287
Shares issued for public offering	16(a)	676,894	3,271,209	—	—	—	—	3,271,209
Shares issued for private placement	16(a)	50,248	371,154	—	—	—	—	371,154
Warrants issued for private placement	16(a)	—	—	5,724,586	—	—	—	5,724,586
Warrants issued for public offering	16(a)	—	—	3,651,131	—	—	—	3,651,131
Pre-funded warrants issued for public offering	16(b)	—	—	3,710,729	—	—	—	3,710,729
Pre-funded warrants issued for private placement	16(a)	—	—	1,249,522	—	—	—	1,249,522
Share issuance costs	16(a)	—	(795,253)	(2,442,700)	—	—	—	(3,237,953)
Shares issued for debt	16(a)	5,669	100,000	—	—	—	—	100,000
Pre-funded warrants exercised	16(b)	571,643	5,606,428	(4,813,793)	—	—	—	792,635
Warrants exercised	16(b)	16,667	627,728	(267,750)	—	—	—	359,978
Warrants expired	16(b)	—	—	(132,000)	132,000	—	—	—
Share-based compensation	16(c)	—	—	—	113,692	—	—	113,692
Other comprehensive loss		—	—	—	—	(46,557)	—	(46,557)
Net loss		—	—	—	—	—	(9,626,694)	(9,626,694)
Balance, September 30, 2025		1,396,321	\$ 47,003,991	\$ 7,764,412	\$ 5,398,445	\$ (85,077)	\$(52,280,052)	\$ 7,801,719

(1) See Notes 1(b) and (c)

See accompanying notes to the consolidated financial statements.

DEFSEC TECHNOLOGIES INC.
(formerly KWESST Micro Systems Inc.)
Consolidated Statements of Cash Flows
Years ended September 30, 2025, 2024 and 2023
(Expressed in Canadian dollars)

	Notes	September 30, 2025	September 30, 2024	September 30, 2023
OPERATING ACTIVITIES				
Net loss		\$ (9,626,694)	\$ (7,437,759)	\$ (9,306,360)
<i>Items not affecting cash:</i>				
Depreciation and amortization	6,7,8	1,081,590	1,277,911	952,508
Share-based compensation	16(c)	113,692	291,761	373,554
Change in fair value of warrant liabilities (including related foreign exchange gain)	15	(1,325,549)	(3,047,568)	(5,786,593)
Net finance costs	20	173,375	196,323	668,034
Impairment of intangible assets	8	—	—	1,169,440
Impairment of ROU asset	7	72,868	—	—
Loss on disposals		—	7,256	291,181
Gain on debt settlement	7	(500)	—	—
Unrealized foreign exchange loss	7	29,637	—	—
Changes in non-cash working capital items	23	(358,246)	(343,671)	(2,310,266)
Interest received (paid)		74,896	(4,997)	(130,127)
Add back items not affecting operating activities:				
Share issuance costs		1,807,686	—	—
Cash used in operating activities		(7,957,245)	(9,060,744)	(14,078,629)
INVESTING ACTIVITIES				
Additions of property and equipment	6	(140,620)	(101,330)	(176,949)
Investments in intangible assets	8	(26,675)	(9,823)	(1,123,186)
Purchase of restricted short-term investment	12	(17,500)	—	—
Deposit for advanced royalties	10	—	—	(148,410)
Recognition of open orders from acquisition	8	4,387	—	7,811
Cash flows used in investing activities		(180,408)	(111,153)	(1,440,734)
FINANCING ACTIVITIES				
Proceeds from U.S. IPO and Canadian Offering, net	16(a)	—	—	16,346,768
Proceeds from the issuance of common shares and warrants	15, 16(a)	18,718,524	4,965,680	7,357,012
Payments of share offering costs	16(a)	(4,346,838)	(747,926)	(542,591)
Payments of lease obligations	13	(172,153)	(197,651)	(75,487)
Proceeds from exercise of warrants	16(b)	402,837	1,613	—
Repayment of borrowings		—	—	(2,333,315)
Proceeds from exercise of stock options		—	—	4,052
Repurchase of vested RSUs and PSUs		—	—	(612)
Cash flows provided by financing activities		14,602,370	4,021,716	20,755,827
Net change in cash during the year		6,464,717	(5,150,181)	5,236,464
Cash and cash equivalents, beginning of year		256,828	5,407,009	170,545
Effect of exchange rates on cash		(35,116)	—	—
Cash and cash equivalents, end of year		\$ 6,686,429	\$ 256,828	\$ 5,407,009
Cash and cash equivalents consist of the following:				
Cash held in banks		\$ 6,686,429	\$ 256,828	\$ 4,407,009
Short-term guaranteed investment certificates		—	—	1,000,000
Cash and cash equivalents, end of year		\$ 6,686,429	\$ 256,828	\$ 5,407,009

See accompanying notes to the consolidated financial statements

1. Corporate information

(a) Corporate information

KWESST Micro Systems Inc. (the “Company”, “KWESST”) was incorporated on November 28, 2017, under the laws of the Province of British Columbia. The registered office is located at 550 Burrard Street, Suite 2900, Vancouver, British Columbia, Canada, and the corporate office is located at Unit 300, 80 Hines Rd., Ottawa, Ontario, Canada. The Company has representative offices in the following foreign locations: Washington DC (United States), London (United Kingdom), and Abu Dhabi (United Arab Emirates).

On June 30, 2025, the Company changed its name to “DEFSEC Technologies Inc.” (“DEFSEC”).

The Company develops and commercializes next-generation technology solutions that deliver a tactical advantage for military, public safety agencies and personal defense markets. The Company’s core mission is to protect and save lives.

DEFSEC’s common stock is listed on the TSX-Venture Exchange (“TSX-V”) under the stock symbol of DFSC, on the Nasdaq Capital Market (“Nasdaq”) under the stock symbol of DFSC and on the Frankfurt Stock Exchange under the stock symbol of 62U2. Additionally, warrants issued in the United States are also listed on the Nasdaq under the stock symbol of DFSCW. Effective May 1, 2023, the warrants issued in Canada are listed on the TSX-V under the stock symbol of DFSC.WT.U.

(b) 2025 Reverse Stock Split (applied retrospectively)

On April 23, 2025, on Nasdaq and on April 24, 2025, on the TSX-V, DEFSEC 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 DEFSEC in exchange for twenty-one outstanding common shares of DEFSEC. 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 and warrants were proportionately adjusted to reflect the 2025 Reverse Split. All information respecting outstanding common shares, including net loss per share, in the current and comparative periods presented herein give effect to the 2025 Reverse Split.

(c) 2024 Reverse Stock Split (applied retrospectively)

In October 2024, DEFSEC effected a ten for one (10-for-1) reverse stock split of its common stock on October 23, 2024 (the “2024 Reverse Split”). Accordingly, all shareholders of record at the opening of business on October 23, 2024, received one issued and outstanding common shares of DEFSEC in exchange for ten outstanding common shares of DEFSEC. 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 and warrants were proportionately adjusted to reflect the 2024 Reverse Split. All information respecting outstanding common shares, including net loss per share, in the current and comparative periods presented herein give effect to the 2024 Reverse Split.

2. Basis of preparation

(a) Going concern

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

As an early-stage company, it has not yet reached significant revenue levels for most of its products and services and have incurred significant losses and negative operating cash flows from inception that have primarily been funded from financing activities. The Company has incurred a \$9.6 million net loss and negative operating cash flows of approximately \$8.0 million for the year ended September 30, 2025 (2024 - \$7.4 million net loss and negative operating cash flows of \$9.1 million, 2023 - \$9.3 million net loss and negative operating cash flows of \$14.1 million). At September 30, 2025, the Company had positive working capital of \$6.0 million (2024 - negative working capital of \$1.1 million, 2023 - positive working capital of \$0.5 million) and a deficit of \$52.3 million (September 30, 2024 - \$42.7 million, September 30, 2023 - \$35.2 million).

The Company's ability to continue as a going concern and realize its assets and discharge its 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 the Company's product offerings;
- The Company's ability to grow its digitization services business;
- Ability to successfully execute the Company's 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
- Risks related to United States tariffs, including potential supply chain disruptions, required operational adjustments, increased costs and potential logistical disruptions.

The Company's strategy to mitigate these material risks and uncertainties is to execute a business plan, in a timely manner, aimed at continued focus on revenue growth, product development and innovation, improving overall gross profit, managing operating expenses and working capital requirements, and securing additional capital, as needed.

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

These consolidated 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 consolidated financial statements have been prepared in accordance with IFRS[®] Accounting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") and interpretations of the IFRS Interpretations Committee ("IFRIC").

The consolidated financial statements were authorized for issue by the Board of Directors effective on December 29, 2025.

(c) Basis of consolidation

These consolidated financial statements incorporate the financial statements of DEFSEC and the entities it controls.

Control is achieved where we have the power to govern the financial and operating policies of an entity to obtain benefits from its activities, are exposed to, or have rights to, variable returns from the Company's 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 September 30, 2025, the Company has the following wholly-owned subsidiaries:

Entity	Location	Functional Currency	Equity%
KWESST Inc.	Ottawa, Canada	CAD	100%
2720178 Ontario Inc.	Ottawa, Canada	CAD	100%
Police Ordnance Company Inc.	Ottawa, Canada	CAD	100%
KWESST U.S. Holdings Inc.	Delaware, United States	USD	100%
KWESST Defense Systems U.S. Inc	North Carolina, United States	USD	100%
KWESST Public Safety Systems U.S. Inc.	North Carolina, United States	USD	100%
KWESST Public Safety Systems Canada Inc.	Ottawa, Canada	CAD	100%

(d) Functional and presentation currency

The consolidated financial statements are presented in Canadian dollars ("CAD"), which is the functional and presentation currency.

While each of the Company's subsidiaries has its own functional currency, the functional currency of the parent company, DEFSEC, is CAD as this is the currency of the primary economic environment in which the Company operates. Most of the revenues, cost of revenues and operating expenses from significant subsidiaries are denominated in CAD. The Company's Canadian wholly owned subsidiaries are measured using CAD as the functional currency and its U.S. owned subsidiaries are measured using the United States dollar ("USD") as their functional currency.

(e) Basis of measurement

The consolidated financial statements have been prepared on the 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 consolidated 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.

Judgments

Information about judgments made in applying accounting policies that have the most significant effects on the amounts recognized in these consolidated financial statements is included in the following notes:

- **Impairment:** The Company is required to make a judgment regarding whether indicators of impairment exist at each reporting date by evaluating conditions specific to the organization that may lead to the impairment of assets. The assessment of impairment or impairment reversal indicators is based on management's judgement of whether there are internal and external factors indicating impairment. Such factors including: market decline, adverse changes in technology, legal environment, or economic conditions, and evidence of obsolescence.

Estimates

Information about assumptions and estimation uncertainties at September 30, 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 is included in the following notes:

- **Note 5 – *Inventories*:** assumptions used in evaluating inventory obsolescence.
- **Note 15 – *Warrant liabilities*:** whether the valuation assumptions used in the Black Scholes calculations for the warrant liabilities are reasonable, including DEFSEC's stock volatility, and expected life are reasonable in light of its limited operating history.
- **Note 16(c) - *Share-based compensation*:** whether the determination of DEFSEC's stock volatility, forfeiture rate, and expected life are reasonable in light of its limited operating history, all significant inputs in the valuation model to fair value options granted; and
- **Note 18 – *Revenue*:** key assumptions underlying the recognition of revenue based on percentage of completion, including remaining hours and costs to complete.
- **Note 7 and 13 – *Right-of-use assets and lease liabilities*:** To determine the value of the initial recognition of right-of-use assets and lease obligations, management is required to exercise judgment in several areas, such as determining the appropriate discount rate, whether it is reasonably certain that an extension or termination option will be exercised, whether variable payments are in substance fixed, and whether a right-of-use asset is impaired. The Company enters into leases with third-party landlords and as a consequence the rate implicit in the relevant lease is not readily determinable. Therefore, the Company uses its incremental borrowing rate as the discount rate for determining its lease liabilities at the lease commencement date. The incremental borrowing rate is the rate of interest that the Company would have to pay to borrow over similar terms which requires estimations when no observable rates are available. Changes in these estimates and assumptions could affect the identification and determination of the value of lease liabilities and right-of-use assets at initial recognition. These items could potentially result in changes to amounts reported in the consolidated statements of loss and statements of financial position in a given period.

3. Material accounting policies

(a) Revenue recognition

Revenue is recognized upon transfer of control of products or services to customers at an amount that reflects the transaction price the Company expects to receive in exchange for the products or services. The Company's contracts with customers may include the delivery of multiple products and services, which are generally capable of being distinct and accounted for as separate performance obligations. The accounting for a contract or contracts with a customer that contain multiple performance obligations requires us to allocate the contract or contracts transaction price to the identified distinct performance obligations based on the stand-alone selling price of each performance obligation. When the fair value cannot be determined based on when it was sold separately, the Company determines a value that most reasonably reflects the selling price that might be achieved in a stand-alone transaction by using either a market assessment, expected cost plus a margin or a residual approach.

Revenue from contracts with customers is recognized, for each performance obligation, either over a period of time or at a point in time, depending on which method reflects the transfer of control of the goods or services underlying the particular obligation to the customer. Contracts based on task oriented, time and materials are measured based on agreed-upon hourly rates, direct labor hours expended, and material costs incurred and billed and recognized on a monthly basis. For product sales, revenue is recognized when the Company transfers control of the product to the customer. Control of the product transfers when the customer takes delivery of the product.

For performance obligations satisfied over time, the Company recognizes revenue over time using an input method, based on costs incurred to date relative to total estimated costs at completion, to measure progress toward satisfying such performance obligation (for non-recurring engineering services, the input method is based on hours). Under this method, costs that do not contribute to the performance of DEFSEC in transferring control of goods or services to the customer are excluded from the measurement of progress toward satisfying the performance obligation. In certain other situations, the Company might recognize revenue at a point in time, when the criteria to recognize revenue over time are not met. In any event, when the total anticipated costs exceed the total anticipated revenues on a contract, such a loss is recognized in its entirety in the period it becomes known.

The Company may enter into contractual arrangements with a customer to deliver services on one project with respect to more than one performance obligation, such as non-recurring engineering, procurement, and training. When entering into such arrangements, the Company allocates the transaction price by reference to the stand-alone selling price of each performance obligation. Accordingly, when such arrangements exist on the same project, the value of each performance obligation is based on its stand-alone price and recognized according to the respective revenue recognition methods described above. When the fair value cannot be determined based on when it was sold separately, the Company determines a value that most reasonably reflects the selling price that might be achieved in a stand-alone transaction. The Company determines a value that most reasonably reflects the selling price that might be achieved in a stand-alone transaction by using either a market assessment, expected cost plus a margin or a residual approach.

For non-recurring engineering services rendered over a contract period the revenue is recognized using the percentage of completion method; whereas for training services the revenue is recognized after the training is delivered (i.e. point in time).

The Company accounts for a contract modification, which consists of a change in the scope or price (or both) of a contract, as a separate contract when the remaining goods or services to be delivered after the modification are distinct from those delivered prior to the modification and the price of the contract increases by an amount of consideration to a price which reflects DEFSEC's stand-alone selling price of the additional promised goods or services. When the contract modification is not accounted for as a separate contract, the Company recognize an adjustment to revenue on a cumulative catch-up basis at the date of contract modification.

The timing of revenue recognition often differs from performance payment schedules, resulting in revenue that has been earned but not billed. These amounts are included in unbilled receivables. Amounts billed in accordance with customer contracts, but not yet earned, are recorded and presented as part of contract liabilities.

When a contract includes a significant financing component, the value of such component is excluded from the transaction price and is recognized separately as finance income or expense, as applicable.

(b) Financial instruments

The Company recognizes a financial asset or a financial liability when it becomes a party to the contractual provisions of the instrument.

Trade and other receivables without a significant financing component are initially measured at the transaction price. All other financial assets and financial liabilities are initially recognized at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at fair value through profit or loss ("FVTPL")) are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at fair value through profit or loss are recognized immediately in profit or loss.

Financial assets

All financial assets are recognized and de-recognized on trade date.

Financial assets are recognized at fair value and subsequently classified and measured at:

- a) Amortized cost.
- b) Fair value through other comprehensive income ("FVOCI"); or
- c) Fair value through profit or loss ("FVTPL").

The Company determines the classification of the Company's financial assets on the basis of both the business model for managing the financial assets and the contractual cash flow characteristics of the financial asset. Financial assets are not reclassified subsequent to their initial recognition unless the Company changes its business model for managing financial assets.

A financial asset is measured at amortized cost if it is held within a business model whose objective is to hold assets to collect contractual cash flows, and its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest of the principal amount outstanding. Financial assets classified at amortized cost are measured using the effective interest method. At September 30, 2025, the Company classified the following as amortized cost:

- Cash and cash equivalents
- Restricted short-term investment
- Trade and other receivables (excluding sales tax recoverable)
- Lease deposit (non-current other asset)

All financial assets not classified and measured at amortized cost or FVOCI are measured at FVTPL. At September 30, 2025, the Company did not have financial assets classified as FVOCI or FVTPL.

Expected credit losses

The Company measure a loss allowance based on the lifetime expected credit losses. The Company has applied the simplified method approach to recognize the lifetime expected credit losses that are estimated based on factors such as the Company's past experience of collecting payments, the number of delayed payments in the portfolio past the average credit period, observable changes in national or local economic conditions that correlate with default on receivables, financial difficulty of the borrower, and it becoming probable that the borrower will enter bankruptcy or financial re-organization.

Financial assets are written off when there is no reasonable expectation of recovery.

Financial liabilities

Financial liabilities are recognized at fair value and subsequently classified and measured at amortized cost or fair value through profit or loss ("FVTPL").

The Company determines the classification of the Company's financial liabilities at initial recognition. The Company has classified the following as amortized cost:

- Accounts payable and accrued liabilities
- Accrued royalties liability

The warrant liabilities are classified as FVTPL.

Financial liabilities at amortized cost are measured using the effective interest rate method.

De-recognition of financial liabilities

DEFSEC de-recognizes financial liabilities when its obligations are discharged, cancelled or they expire.

(c) Cash and cash equivalents

Cash and cash equivalents include cash investments in interest-bearing accounts and term deposits which can readily be redeemed for cash without penalty or are issued for terms of three months or less from date of acquisition.

(d) Inventories

DEFSEC's inventories may consist of raw materials, work-in-progress ("WIP") and finished goods. Inventories are measured at the lower of cost and net realizable value, with cost being determined using the weighted average cost method. The cost of WIP and finished goods includes the cost of raw materials, direct labour, and overhead. Net realizable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses. At each reporting period, management estimates the provision for obsolete and slow-moving inventory which may be reversed in subsequent periods, should the value subsequently be recovered.

(e) Property and equipment

Property and equipment are measured at cost less accumulated depreciation and accumulated impairment losses. Cost comprises the fair value of consideration given to acquire or construct an asset and includes the direct charges associated with bringing the asset to the location and condition necessary for putting it into use along with the future cost of dismantling and removing the asset. These assets are depreciated over their estimated useful lives using the straight-line method as this most closely reflects the expected pattern of consumption of

the future economic benefits. Depreciation methods, useful lives and residual values are reviewed at each financial year end and adjusted prospectively, if appropriate.

The following table provides a summary of estimated useful lives for property and equipment:

	Rate
Computer equipment	3 years
Computer software	3 years
Office furniture and equipment	5 years
Low-rate initial production equipment ("LRIP")	5 years
R&D equipment	5 years
Sales demo equipment	2 years
Leasehold improvements	Shorter of useful life or remaining term of lease

At the end of each reporting period, the Company reviews the carrying amounts of its property and equipment to determine whether there is any indication of impairment. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). The recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For the purpose of impairment testing, assets that cannot be tested individually are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash flows of other assets or groups of assets (the "cash-generating unit, or CGU"). If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. An impairment loss is recognized immediately in profit or loss. Where an impairment loss subsequently reverses, the carrying amount of the CGU is increased to the revised estimate of its recoverable amount, so long as the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognized for the CGU in prior years.

Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

(f) Leases

At inception of a contract, the Company assesses whether a contract is, or contains, a lease based on whether the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

The Company recognizes a right-of-use asset and a lease liability at the lease commencement date. The lease obligation is measured at the present value of the lease payments that are not paid at the commencement date of the lease, discounted using its incremental borrowing rate at the inception of the lease. The right-of-use asset is initially measured based on the initial amount of the lease liability adjusted for any lease payments made at or before the commencement date, plus any initial direct costs incurred and an estimate of costs to dismantle and remove the underlying asset or to restore the underlying asset or the site on which it is located, less any lease incentives received. The assets are depreciated to the earlier of the end of the useful life of the right-of-use asset or the lease term using the straight-line method as this most closely reflects the expected pattern of consumption of the future economic benefits. The lease term includes periods covered by an option to extend if it is reasonably certain to exercise that option. In addition, the right-of-use asset is periodically reduced by impairment losses, if any, and adjusted for certain remeasurements of the lease liability.

The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted using the interest rate implicit in the lease or, if that rate cannot be readily determined, the Company's incremental borrowing rate. Variable lease payments that do not depend on an index or rate are not included in the measurement of the lease liability.

The lease liability is measured at amortized cost using the effective interest method. It is remeasured when there is a change in future lease payments arising from a change in an index or rate, if there is a change in estimate of the amount expected to be payable under a residual value guarantee, or if the assessment of whether a purchase, extension, or termination option will be exercised. When the lease liability is remeasured in this way, a corresponding adjustment is made to the carrying value of the right-of-use asset or, is recorded in profit or loss if the carrying amount of the right-of-use asset has been reduced to zero.

The Company has elected to apply the practical expedient not to recognize right-of-use assets and lease liabilities for short-term leases that have a lease term of 12 months or less and leases of low-value assets. The lease payments associated with these leases are recognized as an expense on a straight-line basis over the lease term.

(g) Intangible assets

(i) Research and development (“R&D”) costs

Expenditure on research activities, undertaken with the prospect of gaining new scientific or technical knowledge and understanding, is recognized in profit or loss when incurred.

Development expenditure is capitalized only if development costs can be measured reliably, the product or process is technically and commercially feasible, future economic benefits are probable, and the Company has the intention and sufficient resources to complete the development and to use or sell the asset. The expenditure capitalized in respect of development activities includes the cost of materials, direct labor and overhead costs that are directly attributable to preparing the asset for its intended use, and capitalized borrowing costs. Other development expenditures are recognized in profit or loss when incurred.

(ii) Subsequent expenditure

Subsequent expenditure is capitalized only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditures, including expenditure on internally generated goodwill and brands, is recognized in profit or loss as incurred.

(iii) Acquired intangible assets

Acquired intangible assets consist of open customer orders, tradenames, customer relationships, patents, and technology assets acquired either through an asset purchase or a business combination transaction. These intangible assets are recorded at their fair value at the acquisition date.

After initial recognition, intangible assets are measured at cost less any accumulated amortization and impairment losses. Open customer orders are reduced when the Company has delivered under the customer contract, with an offset to accounts receivable (i.e. there is no revenue recognized for acquired open customer orders). Intangible assets with finite useful lives are amortized on a straight-line basis over their estimated useful lives. Amortization begins when the related acquired technology is ready for use. The Company anticipates the estimated useful life for the current technology assets to be between five to ten years once ready for use.

Management has estimated the useful lives of tradename and customer relationships of five and ten years, respectively.

(iv) Amortization

Amortization is a systematic allocation of the amortizable amount of an intangible asset of its useful life. The amortizable amount is the cost of the asset less its estimated residual value. The Company recognizes amortization in profit or loss over the estimated useful lives of the intangible assets from the date they are available for use. Amortization is performed on a straight-line basis.

Internally generated intangible assets are not amortized as long as they are not available for use. The Company reviews the estimated useful life of its assets at least at each financial year-end and whenever there is an indication that the expected pattern of economic benefits has changed.

(v) Impairment

At the end of each reporting period, the Company reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Any impairment losses are recognized in the consolidated statements of net loss and comprehensive loss in those expense categories consistent with the function of the impaired asset.

An assessment is made at each reporting date as to whether there is any indication that previously recognized impairment losses may no longer exist or may have decreased. If such indication exists, the Company estimates the asset's recoverable amount. The recoverable amount is the higher of the fair value less transaction costs and its value in-use. A previously recognized impairment loss is reversed only if there has been a change in the assumptions used to determine the asset's recoverable amount since the last impairment loss was recognized. The reversal is limited so that the carrying amount of the asset does not exceed its recoverable amount, nor exceed the carrying amount that would have been determined, net of amortization, had no impairment loss been recognized for the asset in prior years. Such reversal is recognized in the consolidated statements of net loss and comprehensive loss.

(h) Provisions

A provision is recognized if, as a result of a past event, there is a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risk specific to the liability. The accretion of the discount is recognized as a finance cost.

(i) Income taxes

Income tax expense comprises of current income tax expense and deferred income tax expense. Current and deferred income taxes are recognized as an expense and included in profit or loss for the period, except to the extent that the tax arises from a transaction which is recognized in other comprehensive income or directly in shareholder's equity.

Current income tax

Current tax expense is the amount of income taxes payable (recoverable) in respect of the taxable income (tax loss) for a period. Current liabilities (assets) for the current and prior periods are measured at the amount expected to be paid to (recovered from) the taxation authorities, using the tax rates that have been enacted or substantively enacted by the end of the reporting period.

Deferred income tax

Deferred tax assets and liabilities are recognized for the temporary differences between transactions and carrying amounts of assets and liabilities that have been included in the consolidated financial statements and the amounts used for taxation purposes. Deferred income taxes are provided for using the liability method. Under the liability method, deferred income taxes are recognized for all significant temporary differences between the tax and financial statement bases of assets and liabilities and for certain carry-forward items. Deferred income tax assets are recognized only to the extent that it is probable that the deferred income tax assets will be realized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent it is no longer probable that the related tax benefit will be realized.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the year when the asset is realized or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the reporting period. Deferred income tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of the enactment or substantive enactment. Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority, and the Company intends to settle the Company's current tax assets and liabilities on a net basis.

Investment tax credits

Investment tax credits relating to scientific research and experimental development expenditures are recorded in the fiscal period the qualifying expenditures are incurred based on management's interpretation of applicable legislation in the Income Tax Act of Canada. Credits are recorded provided there is reasonable assurance that the tax credit will be realized. Credits claimed are subject to review by the Canada Revenue Agency.

Credits claimed in connection with R&D activities are accounted for using the cost reduction method. Under this method, assistance and credits relating to current expenditures, which are primarily salaries and related benefits, are included in the determination of profit or loss as a reduction of the R&D expenses.

(j) Related party transactions

Parties are considered to be related if one party has the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial and operating decisions. Parties are also considered to be related if they are subject to common control or common significant influence. Related parties may be individuals or corporate entities. A transaction is considered to be a related party transaction when there is a transfer of resources or obligations between related parties. Related party transactions are in the normal course of business and have commercial substance.

(k) Share-based compensation

The Company has a Long-Term Incentive Plan ("LTIP") to grant stock options, restricted share units ("RSUs"), performance stock units ("PSUs"), deferred stock units ("DSUs"), and stock appreciation rights ("SARs") to directors, employees, and consultants. The Company measures share-based compensation at fair value for all share-based awards granted under the LTIP.

Equity-settled service award

The grant date fair value of equity-settled share-based awards is recognized as an expense on a straight-line basis over the requisite service period, with a corresponding increase in equity, over the vesting period of the awards. For stock options, the grant date fair value is determined using the Black-Scholes option model. For share units, the grant date fair value is based on DEFSEC's closing stock price. Each tranche of an award is considered a separate award with its own vesting period and grant date fair value. The amount recognized as an expense is adjusted for estimated forfeitures.

Equity-settled performance award

The accounting for equity-settled performance award is the same as above, except compensation expense is subject to periodic adjustment based on the achievement of establishment performance criteria.

(l) Equity

Share capital represents the amount received for shares that have been issued less transaction costs directly attributable to the issuance of common shares net of any related income tax benefits.

Valuation of equity instruments

The Company has adopted a residual method with respect to the measurement of common shares and warrants issued as units. Warrants attached to units are valued based on the fair value of the warrants using the Black Scholes option pricing model and the share price at the time of financing, and the difference between the proceeds raised and the value assigned to the warrants is the residual fair value of the shares. The proceeds from the issue of the units are allocated between share capital and warrants. In situations when the warrants are categorized as FVTPL the value associated with the warrants is presented as a liability. If and when the warrants are exercised, the applicable amounts of warrants or liability are transferred to share capital. Any consideration paid on the exercise of the warrants is credited to share capital.

Broker warrants

The Company uses the fair value method based on the Black-Scholes pricing model to determine the fair value of the warrants issued to brokers and records a debit to share issuance costs with a corresponding credit to warrants. Warrants within equity are included in the warrants outstanding.

(m) Foreign currency

Foreign currency transactions

The financial statements of DEFSEC and its Canadian wholly owned subsidiaries are measured using CAD as the functional currency. Transactions in currencies other than in CAD are translated at the exchange rates prevailing at the dates of the transactions. At the end of each reporting period, monetary items denominated in foreign currencies are translated to the functional currency at the rates prevailing at that date. Exchange differences on monetary items are recognized in profit or loss in the period in which they arise. Non-monetary items carried at fair value that are denominated in foreign currencies are translated to the functional currency at the rates prevailing at the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the rates at the date of the transaction and are not subsequently retranslated.

Foreign operations

The financial statements of DEFSEC's U.S. owned subsidiaries are measured using the United States dollar ("USD") as its functional currency. Assets and liabilities have been translated into USD using exchange rates prevailing at the end of each reporting period. Income and expense items are translated at the average exchange rates for the period, unless exchange rates fluctuate significantly during that period, in which cases the exchange rates at the dates of the transactions are used. Exchange differences arising, if any, are recognized in other comprehensive income and accumulated in shareholders' equity.

(n) Earnings (loss) per share

Basic earnings (loss) per share is computed using net earnings (loss) over the weighted average number of common shares outstanding during the period. The Company uses the treasury stock method to compute the dilutive effect of options, warrants, and similar instruments. Under this method, the dilutive effect on earnings per share is calculated presuming the exercise of outstanding options, warrants, and similar instruments. It

assumes that the proceeds of such exercise would be used to repurchase common shares at the average market price during the period.

However, the calculation of diluted loss per share excludes the effects of various conversions and exercises of options and warrants that would be anti-dilutive.

(o) Change in presentation and comparative figures

During the year ended September 30, 2025, the Company changed the presentation of operating expenses in the statement of profit or loss to break out share-based compensation and depreciation and amortization as separate line items. This change in presentation has been applied retrospectively. Comparative figures for the prior period have been restated to reflect the new presentation. Amounts previously included within General and Administrative, Selling and Marketing, and Research and Development, net have been adjusted to exclude share-based compensation and depreciation and amortization, which are now presented separately. The total operating expenses and profit or loss remain unchanged; only the classification of expenses has been modified. Note 19 has also been updated accordingly to reflect this change.

The following is a reconciliation of the change to the fiscal 2024 results:

	Previously Disclosed	Adjustment	Revised Disclosure
General and administrative	\$ 6,269,257	\$ (1,432,442)	\$ 4,836,815
Selling and marketing	1,538,882	(13,654)	1,525,228
Research and development, net	2,477,736	(123,576)	2,354,160
Share-based compensation	–	291,761	291,761
Depreciation and amortization	–	1,277,911	1,277,911
Total operating expenses	\$ 10,285,875	\$ –	\$ 10,285,875

The following is a reconciliation of the change to the fiscal 2023 results:

	Previously Disclosed	Adjustment	Revised Disclosure
General and administrative	\$ 7,244,762	\$ (1,079,465)	\$ 6,165,297
Selling and marketing	3,024,283	(131,604)	2,892,679
Research and development, net	1,644,565	(114,993)	1,529,572
Share-based compensation	–	373,554	373,554
Depreciation and amortization	–	952,508	952,508
Total operating expenses	\$ 11,913,610	\$ –	\$ 11,913,610

(p) Changes to standards and interpretations

IFRS 18 Presentation and Disclosure in Financial Statements

The IASB issued IFRS 18 Presentation and Disclosure in Financial Statements on April 9, 2024, to replace IAS 1 Presentation of Financial Statements and is effective for annual periods beginning on or after January 1, 2027. IFRS 18 introduces a defined structure for the presentation of the statement of income, including required totals and subtotals, as well as aggregating and disaggregating principles to categorize financial information. The standard also requires all Management-defined performance measures to be disclosed in the notes to the financial statements. The Company is currently assessing the impact of this new standard.

4. Trade and other receivables

The following table presents a breakdown of trade and other receivables:

	September 30, 2025	September 30, 2024
Trade receivables	\$ 1,352,216	\$ 455,049
Unbilled revenue	–	42,248
Sales tax recoverable	141,936	70,578
Total	\$ 1,494,152	\$ 567,875

There was no impairment of trade and other receivables during the year ended September 30, 2025 (2024 - \$nil).

The following table presents changes in unbilled receivables:

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

5. Inventories

The following table presents a breakdown of inventories:

	September 30, 2025	September 30, 2024
Finished goods	\$ 34,463	\$ 55,754
Work-in-progress	29,414	417,890
Raw materials	455,732	59,519
Total	\$ 519,609	\$ 533,163

In Fiscal 2025, a total of \$313,050 (2024 - \$139,813) of inventories was included in profit or loss as an expense as part of cost of sales.

During the year ended September 30, 2025, the Company identified inventory items that were obsolete, no longer in use, or otherwise non-viable for production purposes valued at \$151,316 (2024 - \$113,283, 2023 - \$nil) which were specifically considered impaired and subsequently written off to reflect their reduced value.

DEFSEC TECHNOLOGIES INC.
(formerly KWESST Micro Systems Inc.)
Notes to Consolidated Financial Statements
Years ended September 30, 2025, 2024 and 2023.
(Expressed in Canadian dollars)

6. Property and equipment

The following is a summary of changes in property and equipment:

Cost	Computer equipment	Computer software	Office furniture and equipment	LRIP equipment ⁽¹⁾	R&D equipment	Leasehold improvements	Sales demo equipment	Total
Balance at September 30, 2023	\$ 143,853	\$ 5,129	\$ 109,578	\$ 97,658	\$239,804	\$ 131,792	\$ 109,234	\$ 837,048
Additions	46,254	–	14,000	41,076	–	–	–	101,330
Disposals	(1,799)	–	(8,645)	–	(26,387)	–	–	(36,831)
Balance at September 30, 2024	\$ 188,308	\$ 5,129	\$ 114,933	\$ 138,734	\$213,417	\$ 131,792	\$ 109,234	\$ 901,547
Additions	43,012	–	92,597	–	5,011	–	–	140,620
Balance at September 30, 2025	\$ 231,320	\$ 5,129	\$ 207,530	\$ 138,734	\$218,428	\$ 131,792	\$ 109,234	\$ 1,042,167

Accumulated depreciation	Computer equipment	Computer software	Office furniture and equipment	LRIP equipment ⁽¹⁾	R&D equipment	Leasehold improvements	Sales demo equipment	Total
Balance at September 30, 2023	\$ 77,462	\$ 2,964	\$ 80,184	\$ 25,751	\$135,124	\$ 57,665	\$ 40,602	\$ 419,752
Depreciation	37,788	1,710	15,342	36,760	32,289	21,371	54,398	199,658
Disposals	(1,799)	–	(8,645)	–	(19,131)	–	–	(29,575)
Balance at September 30, 2024	\$ 113,451	\$ 4,674	\$ 86,881	\$ 62,511	\$148,282	\$ 79,036	\$ 95,000	\$ 589,835
Depreciation	44,027	455	18,454	40,069	34,590	21,371	14,234	173,200
Balance at September 30, 2025	\$ 157,478	\$ 5,129	\$ 105,335	\$ 102,580	\$182,872	\$ 100,407	\$ 109,234	\$ 763,035

Carrying value at September 30, 2024	\$ 74,857	\$ 455	\$ 28,052	\$ 76,223	\$ 65,135	\$ 52,756	\$ 14,234	\$ 311,712
Carrying value at September 30, 2025	\$ 73,842	\$ –	\$ 102,195	\$ 36,154	\$ 35,556	\$ 31,385	\$ –	\$ 279,132

⁽¹⁾Low-rate initial production equipment (“LRIP”) includes moulds for developing PAPA SHOT™ device samples.

7. Right-of-use assets

The following table presents right-of-use assets:

	Offices
Balance at September 30, 2023	\$ 361,036
Additions	–
Depreciation	(130,912)
Balance at September 30, 2024	\$ 230,124
Additions	1,166,652
Disposals	(41,699)
Impairment	(88,596)
Depreciation	(101,300)
Balance at September 30, 2025	\$ 1,165,181

In 2025, the Company made a total deposit of \$44,578 associated with the new lease entered into during the year and to be released at the end of the lease term. This was initially recorded at fair value, discounted using a 10.7% interest rate. At September 30, 2025, \$46,132 (2024 - \$28,806, 2023 - \$26,076) was the carrying value of all deposits and reported as non-current deposit in the consolidated statements of financial position.

8. Intangible assets

The following table shows a breakdown of intangible assets:

	PARA SHOT™ System	PARA SHOT™ Patent	ARWENT™ Tradename	Customer Relationships	Purchase Orders	ARWENT™ 40mm Patent	Total
Balance at September 30, 2023	\$ 3,998,395	\$ 40,295	\$ 28,232	\$ 41,041	\$ 4,387	\$ –	\$ 4,112,350
Additions	9,823	–	–	–	–	–	9,823
Amortization	(933,541)	–	(8,800)	(5,000)	–	–	(947,341)
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	(788,400)	–	(8,800)	(5,000)	–	(4,890)	(807,090)
Recognition of open orders	–	–	–	–	(4,387)	–	(4,387)
Balance at September 30, 2025	\$ 2,286,277	\$ 40,295	\$ 10,632	\$ 31,041	\$ –	\$ 21,785	\$ 2,390,030

The balance at September 30, 2025, for PARA SHOT™ represents the acquired technology asset (i.e. intellectual properties), coupled with additional capitalized development costs. As it is available for its intended use, amortization charge was recorded for the year ended September 30, 2025, of \$788,400 (2024 - \$933,541, 2023 - \$562,639).

PARA SHOT™ was assessed for indicators of impairment at September 30, 2025, as it was available for use. The Company determined that there were no indicators of impairment and therefore did not test for impairment.

On July 1, 2025, the Company reassessed the estimated useful life of its PARA SHOT™ assets, in accordance with IAS 38 – *Intangible Assets* and IAS 8 – *Accounting Policies, Changes in Accounting Estimates and Errors*. As a result of this review, the useful life was extended from January 2028 to April 2032. The revision was made based on updated information regarding the asset's expected economic benefits and technological relevance. The factors driving this change were the continued prospect interest for the product and its functionalities beyond the original estimate and lower than expected rate of technological disruption in the industry. This change in estimate has been applied prospectively from July 1, 2025. The effect of the change on amortization expense is a reduction in annual amortization expense from \$934,000 to \$350,000.

9. Accounts payable and accrued liabilities

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

	September 30, 2025	September 30, 2024
Trade payable	\$ 409,696	\$ 881,835
Sales tax payable	47,427	–
Accrued liabilities	744,320	610,558
Salary, bonus and vacation payable	1,109,219	168,244
Total	\$ 2,310,662	\$ 1,660,637

10. Accrued royalties liability

On April 29, 2021, the Company acquired the Low Energy Cartridge technology, a proprietary non-lethal cartridge-based firing system (subsequently branded as PARA SHOT™ system). This technology acquisition includes all intellectual property rights for the PARA SHOT™ system. As part of that arrangement the Company agreed to pay a 7% royalty on annual sales of the PARA SHOT™ system to the seller, net of taxes and duties, up to a maximum of \$10 million, subject to minimum annual royalty payments starting in 2022.

The minimum annual royalty payments are as follows:

Payment Date	Amount
April 29, 2026	\$ 200,000
April 29, 2027	250,000
April 29, 2028	250,000
April 29, 2029	300,000
April 29, 2030	300,000
April 29, 2031	350,000
April 29, 2032	350,000
Total	\$ 2,000,000

Historically the payment date has been treated as the anniversary of the closing date of the Purchase Agreement (“Agreement”) being the date when the consideration shares were issued.

The royalty payment obligation of the Agreement will expire in 20 years unless terminated earlier under the terms set out in the Agreement. At its sole discretion, the Company may terminate this Agreement for convenience, including if market conditions for sales of the PARA SHOT™ system become unfavorable subject to 60 day’s prior written notice. Upon termination, the Company will be fully released and discharged by the seller for any future royalties. In return, the Company will return all intellectual property rights relating to the PARA SHOT™ system.

The fair value of the minimum royalty payments was determined based on the income approach, specifically discounted cash flows, using a discount rate of 13.7% per annum at the time the agreement was entered into. Using the effective interest rate method the Company is accreting this liability over time up to the principal amount owed.

During the year ended September 30, 2025, the Company recorded \$168,874 of accretion cost relating to the discounted minimum royalty payments, which is included in net finance costs in the consolidated statements of net loss and comprehensive loss (2024 - \$180,965, 2023 - \$170,373). As at September 30, 2025, \$1,287,009 of accrued royalties liability was outstanding (2024 - \$1,318,135, 2023 - \$1,287,170).

11. Related party transactions

Key management personnel compensation

Key management personnel are those having authority and responsibility for planning, directing and controlling the activities of DEFSEC directly or indirectly, including any of Company's directors (executive and non-executive).

Key management personnel compensation comprised the following:

	Year ended September 30, 2025	Year ended September 30, 2024	Year ended September 30, 2023
Wages and benefits	\$ 1,984,172	\$ 907,288	\$ 505,026
Consulting fees	540,000	397,500	628,264
Directors compensation	250,000	228,387	130,000
Share-based compensation	74,394	126,314	167,027
Total	\$ 2,848,566	\$ 1,659,489	\$ 1,430,317

The consulting fees relate to compensation to our Chairman, via his private corporation, DEFSEC Corp.

Following September 30, 2024, the Board of Directors approved special bonuses for the Named Executive Officers totalling \$616,750, in recognition of three major achievements completed in November 2024. This bonus was paid in fiscal 2025. As at September 30, 2025, the Company has \$722,500 of accrued bonuses under the board of directors approved annual incentive plan. This amount was subsequently approved by the board of directors and paid out in December 2025. Both the 2024 special bonus and 2025 annual bonus are included in the table above within the wages and benefits and consulting fees.

At September 30, 2025, there was \$791,946 (2024 - \$471,465) outstanding in accounts payable and accrued liabilities due to Company's officers and directors for unpaid wages, accrued bonuses, accrued vacation, and expense reimbursements.

On November 11, 2024, The Company issued 119,047 Common Shares at a deemed price per Common Share of \$0.84 per share, representing a 20% discount on the closing price of the Shares on the TSXV for settlement for reimbursement 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.

12. Borrowings

RBC Credit Facility

The Company maintains corporate credit cards for its key employees with Royal Bank of Canada ("RBC"). To provide security, the Company entered into a cash collateral agreement for \$47,500 (2024 - \$30,000) and a general security agreement providing a first lien on all assets. The \$47,500 (2024 - \$30,000) was invested in a short-term guaranteed investment certificate.

13. Lease obligation

The Company is current entered into three lease contracts which expire on April 30, 2026, October 31, 2026, and May 31, 2031, respectively. The Company has included renewal options in the lease term where it is reasonably certain to exercise the renewal option.

On June 2, 2025, the Company entered into a new office lease with an expiry date of May 31, 2031, and an option to renew for an additional five-year term. The agreement included a rent-free period from June 2, 2025, to May 31, 2026, as a lease inducement. In determining the value of the lease obligation the Company has included the renewal option for the lease as the Company is expecting to renew at expiry. In determining the value of the lease obligation the Company has used an estimated incremental borrowing rate of 10.7%. In addition to rent included in the lease obligation, the Company is also required to pay additional rent of \$269,681 per year beginning in June 2026, which will be recorded on the consolidated statements of net loss and comprehensive loss as incurred.

In fiscal 2025, the Company transferred an office to another lessor and recorded a disposal of the lease obligation as well as the right-of-use asset.

The following table presents the movement in Company's lease obligation for the respective periods:

	Offices
Balance at September 30, 2023	\$ 429,523
Additions	—
Lease payments (including interest)	(197,651)
Interest expense	70,351
Balance at September 30, 2024	\$ 302,223
Additions	1,149,676
Lease payments (including interest)	(172,153)
Interest expense	78,909
Disposal	(55,205)
Balance at September 30, 2025	\$ 1,303,450
Current portion	188,907
Non-current portion	1,114,543
Balance at September 30, 2025	\$ 1,303,450

The following table presents the contractual undiscounted cash flows for the lease obligations:

	September 30, 2025	September 30, 2024
Less than one year	\$ 169,053	\$ 206,828
One to five years	1,031,576	154,445
Five years and beyond	1,049,591	—
Total	\$ 2,250,220	\$ 361,273

DEFSEC TECHNOLOGIES INC.
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Years ended September 30, 2025, 2024 and 2023.
(Expressed in Canadian dollars)

14. Contract liabilities

The following table presents the changes in contract liabilities:

	September 30, 2025	September 30, 2024
Balance, beginning of fiscal year	\$ 120,571	\$ 120,970
Amounts invoiced and revenue deferred	6,471	108,573
Recognition of deferred revenue included in the balance at the beginning of the year	(119,371)	(108,972)
Balance, end of fiscal year	\$ 7,671	\$ 120,571

15. Warrant liabilities

The following table shows a breakdown and balance of warrant liabilities at September 30, 2025:

	<u>U.S IPO and Canadian Offerings</u>		<u>Private Placement</u>		<u>Debt Settlement</u>	<u>Direct Offering</u>	<u>Direct Offering</u>	
	2022 Warrants	Over-allotment Warrants	2023 Warrants	Pre-Funded Warrants	Warrants	Warrants	Public Offering Nov'24	Total
Balance, beginning of year	\$ 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	112,054	(7,644)	(64,314)	(29,959)	1,990	(699,473)	(714,912)	(1,402,258)
Exchange (gain) loss on revaluation	2,289	–	3,941	90	–	44,696	25,693	76,709
Extinguish Warrant Liability/Transfer to equity	–	–	–	–	–	–	(3,301,925)	(3,301,925)
Balance, end of year	\$ 180,108	\$ –	\$ –	\$ 1,469	\$ 3,135	\$ 26,253	\$ –	\$ 210,965
Number of outstanding securities at September 30, 2025 ⁽¹⁾	3,226,392	–	1,542,194	151,734	56,141	4,715,000	–	9,691,461

⁽¹⁾Number of outstanding securities have not been adjusted for the share consolidations discussed in Note 1(b) and (c)

The following table shows a breakdown and balance of warrant liabilities at September 30, 2024:

	<u>U.S IPO and Canadian Offerings</u>			<u>Private Placement</u>		<u>Debt Settlement</u>	<u>Public Offering</u>	<u>Direct Offering</u>	
	2022 Warrants	Over-allotment Pre-Funded Warrants	Over-allotment Warrants	2023 Warrants	Pre-Funded Warrants	Warrants	Pre-Funded Warrants	Warrants	Total
Balance, beginning of year	\$ 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 year	\$ 65,765	\$ –	\$ 7,644	\$ 60,373	\$ 31,338	\$ 1,145	\$ –	\$ 681,030	\$ 847,295
Number of outstanding securities at September 30, 2024 ⁽¹⁾	3,226,392	–	375,000	1,542,194	151,734	56,141	–	4,715,000	10,066,461

⁽¹⁾Number of outstanding securities have not been adjusted for the share consolidations discussed in Note 1(b) and (c)

U.S. IPO and Canadian Offering

On December 9, 2022, the Company closed an underwritten U.S. public offering (the “U.S. IPO”) and an underwritten Canadian offering (the “Canadian Offering”) for aggregate gross proceeds of CAD\$19.4 million (US\$14.1 million) (see Note 16(a)). As part of the U.S. IPO and Canadian Offering, the Company issued 3,226,392 warrants (the “2022 Warrants”) with an exercise price of US\$1,050.00 per share. The warrants have a conversion ratio of 210 warrants for one common share. Additionally, the U.S. underwriter exercised its over-allotment option to purchase:

- 199,000 Pre-Funded Warrants with an exercise price of US\$2.10 per share for \$3.81 per pre-funded warrant (net of underwriter discount); and
- 375,000 warrants with exercise price of US\$1,050.00 per share for \$1.42 per warrant.

Refer to Note 16(a) for further information on the U.S. IPO and Canadian Offering.

In accordance with 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 to Company’s 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 (see Note 3(b)). Gains on revaluation of the warrant liabilities are presented in Other income (expenses) on the consolidated statements of net loss and comprehensive loss.

Warrant liabilities

While the warrants issued in the U.S. IPO were listed on Nasdaq and closed at US\$9.00 per warrant on December 9, 2022, management concluded that this closing price was not reflective of an active market due to the short trading window and therefore not representative of fair value. Accordingly, at inception, the 2022 Warrants were measured at fair value using the Black Scholes option pricing model (Level 2). The Company used the following assumptions:

	2022 Warrants⁽¹⁾	Over- allotment Pre- Funded⁽²⁾	Over- allotment Warrants⁽³⁾
Number of dilutive securities	3,282,533	199,000	375,000
Exercise price (in USD)	\$ 5.00	\$ 0.01	—
Share price (in USD)	\$ 867.30	\$ 646.80	—
Expected life	2.5	—	—
Dividend	\$ —	—	—
Volatility	75%	—	—
Risk free rate	4.20%	—	—
Exchange (USD/CAD)	1.363	—	—
Fair value per warrant (CAD)	\$ 1.43	\$ 4.18	\$ 1.43

(1) Includes debt settlement warrants.

(2) Fair value is measured at the underlying common share closing price on Nasdaq on December 9, 2022, less US\$0.01 exercise price.

(3) Same fair value as calculated for Warrants.

The share price (in USD) for the over-allotment pre-funded warrants was based on the estimated fair value of the common shares issued on December 9, 2022, by deducting the fair value of 210 warrants of US\$220.05 from the US\$867.30 Unit price and the exercise price of US\$2.10 (see Note 16(a)).

Based on the above fair value, the issuance of the over-allotment pre-funded warrants and warrants to the underwriter resulted in a non-cash charge of \$251,877, which is included in the change in fair value of warrant liabilities in the consolidated statements of net loss and comprehensive loss.

During fiscal year 2024, the 199,000 pre-funded warrants were fully exercised for 952 common shares at a weighted average price of US\$2.10 per share (2023 – nil).

During fiscal year 2025, the 375,000 over allotment warrants expired.

At September 30, 2025, the fair value of these warrants was determined using the following assumptions:

	2022 Warrants⁽¹⁾
Number of securities	3,282,533
Exercise price (in USD)	\$ 0.0401
Exchange (USD/CAD)	1.3921
Fair value per warrant (CAD)	\$ 0.06

(1) Fair value is based on the Nasdaq closing pricing on September 30, 2025, for the warrants.

At September 30, 2024, the fair value of these warrants was determined using the following assumptions:

	2022 Warrants⁽¹⁾	Over- allotment Warrants⁽¹⁾
Number of securities	3,282,533	375,000
Exercise price (in USD)	\$ 0.015	0.015
Exchange (USD/CAD)	1.3499	1.3499
Fair value per warrant (CAD)	\$ 0.02	\$ 0.02

(1) Fair value is based on the Nasdaq closing pricing on September 30, 2024, for the warrants.

December 2022 Debt Settlement

On December 13, 2022, the Company entered into a share for debt arrangements with existing lenders (see Note 16(a)), which resulted in issuing 267 Units, same terms as the Units issued in the Canadian Offering except that the underlying securities are subject to a four-month hold period. Accordingly, this resulted in issuing 267 common shares and 56,141 warrant liabilities with an exercise price of US\$1,050.00 per share and maturing on December 13, 2027. The warrants have a conversion ratio of 210 warrants for one common share. The Company initially recorded the fair value of the warrant liabilities using the Black Scholes option pricing model with an underlying stock price equivalent to the unit price of US\$867.30.

At September 30, 2025, the Company remeasured the fair value of these warrant liabilities using the Nasdaq closing price on September 30, 2025, of US\$0.0401 (2024 – US\$0.0151). The remeasurement resulted in a change in fair value of warrant liabilities of \$1,990 for the year ended September 30, 2025 (2024 - \$16,996, 2023 - \$62,476), which was reported in the consolidated statements of net loss and comprehensive loss.

Private Placement (July 2023)

On July 21, 2023, the Company closed an underwritten U.S. private placement for gross proceeds of CAD\$7.4 million (US\$5.59 million) (see Note 16(a)). As part of the private placement, 1,542,194 warrants were issued (the “2023 Warrants”) with an exercise price of US\$558.60 per share. Additionally, 930,548 pre-funded Warrants with an exercise price of US\$0.21 per share for US\$2.26 per pre-funded warrant were issued.

Refer to Note 16(a) for further information on the private placement.

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 Company’s 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 (see Note 3(b)). Gains on revaluation of the warrant liabilities are presented in other income (expenses) on the consolidated statements of net loss and comprehensive loss.

Warrant liabilities

The 2023 warrants issued in the private placement were not listed on Nasdaq and does not represent an active market Level 1 input. Accordingly, at inception, the 2023 Warrants were measured at fair value using the Black Scholes option pricing model (Level 2), using the following assumptions:

	2023 Warrants	Pre-Funded Warrants⁽¹⁾
Number of dilutive securities	1,542,194	930,548
Exercise price (in USD)	\$ 2.66	\$ 0.001
Share price (in USD)	\$ 436.80	\$ 436.80
Expected life	2.5	
Dividend	\$ —	
Volatility	67%	
Risk free rate	4.44%	
Exchange (USD/CAD)	1.321	1.321
Fair value per warrant (CAD)	\$ 0.99	\$ 1.98

⁽¹⁾Fair value is measured at the underlying common share closing price on Nasdaq on July 21, 2023, less US\$0.21 exercise price per share. The share price is based on the historical share price adjusted for the 2024 and 2025 Reverse Split.

The share price (in USD) of the pre-funded warrants was based on the estimated fair value of the common shares issued on July 21, 2023, by deducting the fair value of the warrants of US\$157.50 from the US\$474.60 Unit price and the exercise price of US\$0.21 (see Note 16(a)). The warrants have a conversion ratio of 210 warrants for one common share.

During fiscal year 2025, none of these July 2023 warrants were exercised (2024 – 778,814 at US\$0.21 weighted average exercise price).

At September 30, 2025, the fair value of these warrants was determined using the following assumptions:

	2023 Warrants⁽¹⁾	Pre-Funded Warrants⁽²⁾
Number of dilutive securities	1,542,194	151,734
Exercise price (in USD)	\$ 2.60	\$ 0.001
Nasdaq closing price (in USD)	\$ –	\$ 0.017
Black Scholes fair value (in USD)	\$ –	–
Volatility	101%	–
Risk free rate	2.44%	–
Exchange (USD/CAD)	1.3921	1.3921
Fair value per warrant (CAD)	\$ –	\$ 0.01

(1) Fair value is based on the Black Scholes model on September 30, 2025, for the warrants

(2) Fair value is measured at the Nasdaq closing price on September 30, 2024, for the underlying common stock less US\$0.21 exercise price per share. The share price is based on the historical share price adjusted for the 2024 and 2025 Reverse Split.

US Public Offering (April 2024)

On April 9, 2024, the Company closed an underwritten U.S. public offering for gross proceeds of CAD\$1.4 million (US\$1 million) (see Note 16(a)). In this offering, 803,500 pre-funded Warrants with an exercise price of US\$0.21 per share for US\$0.649 per pre-funded warrant were issued. The warrants have a conversion ratio of 210 warrants for one common share.

Refer to Note 16(a) for further information on the offering.

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 to Company’s 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 consolidated statements of net loss and comprehensive loss.

Warrant liabilities

In fiscal 2024, all 803,500 warrants were subsequently exercised at a weighted average exercise price of US\$0.21 per common share. The warrants have a conversion ratio of 210 warrants for one common share.

US Registered Direct Offering (August 2024)

On August 13, 2024, the Company closed a direct offering for the purchase and sale of 22,452 common shares at a purchase price of US\$42.00 per common share for gross proceeds of CAD\$1.3 million (US\$0.9 million) (see Note 16(a)). In a concurrent private placement, the Company issued unregistered warrants to purchase up to 22,452 common shares at an exercise price of US\$52.50. This was a unit offering consisting of a share and a warrant. The fair value of the warrants attached to the units were 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 16(a) for further information on the offering.

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 to Company’s 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 consolidated statements of net loss and comprehensive loss.

Warrant liabilities

At September 30, 2025, the fair value of these warrants was determined using the following assumptions:

	2024
	Warrants⁽¹⁾
Number of securities	4,715,000
Exercise price (in USD)	\$ 0.25
Nasdaq closing price (in USD)	\$ 0.017
Black Scholes fair value (in USD)	\$ –
Volatility	100%
Risk free rate	2.65%
Exchange (USD/CAD)	1.329
Fair value per warrant (CAD)	\$ 0.01

(1) Fair value is based on the Black Scholes model on September 30, 2025, for the warrants

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 16(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 Company’s 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 Consolidated 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, the Company 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, the Company recognized a gain of \$689,219 in the change in fair value of warrant liabilities, before reclassifying the pre-funded warrants to equity, which was reported in the Consolidated Statements of Net Loss and Comprehensive Loss.

16. Share capital and Contributed Surplus

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

(a) Share Capital

Authorized

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

Issued Common Shares:

	September 30, 2025		September 30, 2024		September 30, 2023	
	Number	Amount	Number	Amount	Number	Amount
Balance, beginning of year	75,200	\$ 37,822,725	26,744	\$ 33,379,110	3,682	\$ 19,496,640
Issued for U.S. IPO and Canadian Offering	–	–	–	–	15,363	13,675,120
Issued in private placement	50,248	371,154	–	–	7,343	3,050,316
Issued for debt settlements	5,669	100,000	222	97,615	267	233,485
Issued for U.S. public offerings	676,894	3,271,209	39,761	3,608,154	–	–
Issued for conversion of share units	–	–	–	–	67	529,504
Issued for exercise of warrants	588,310	6,234,156	8,473	1,771,239	17	60,000
Issued for exercise of stock options	–	–	–	–	5	5,836
Less: share offering costs for the year	–	(795,253)	–	(1,033,393)	–	(3,671,791)
Balance, end of year	1,396,321	\$ 47,003,991	75,200	\$ 37,822,725	26,744	\$ 33,379,110

2025 Activities

Public Offering (July 2025)

On July 25, 2025, the Company issued 673,084 common shares and 86,795 pre-funded warrants, with an exercise price of \$0.001, of the Company as part of a public offering, together with common share purchase warrants to purchase up to 759,879 common shares at a combined public offering price of \$8.955 per share or pre-funded warrant and accompanying warrant for gross proceeds of \$6.8 million. The warrants have an exercise price of \$10.52 per share, are exercisable upon issuance and expire five years following the date of issuance.

The fair value of the July 2025 common share purchase warrants was calculated using the Black Scholes model, with the following assumptions:

	Initial Recognition
Number of warrants	759,879
Stock price	\$ 6.16
Exercise price	\$ 10.52
Volatility	101%
Dividend yield	Nil
Risk free rate	3.03%
Expected life (in years)	5
Fair value per warrant	\$ 4.24

Subsequent to the issuance, 55,530 pre-funded warrants were exercised at an exercise price of \$0.001.

Brokers' Compensation and Share Issuance Costs

In connection with the July 2025 Offering, Wainwright was 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 July 2025 offering fell within the scope of the tail obligation and resulted in a payment of \$489,868, representing 7.5% of the gross proceeds, within the scope of the tail obligation, to Wainwright upon closing of the transaction.

As compensation for services rendered, Wainwright or its designees was granted 56,991 warrants ("July 2025 Broker Warrants") equal to 125% of the offering price per share. The July 2025 Broker Warrants are immediately exercisable and entitle the holder to acquire common shares on a one for one basis. The July 2025 Broker Warrants have an exercise price of \$11.19 per common share for a period of 60 months following the closing of the July 2025 offering.

The fair value of the July 2025 Broker Warrants at the closing of the July 2025 offering was \$238,735 calculated using the Black Scholes model.

The share issuance costs related to the July 2025 recognized in equity were \$1,402,227, inclusive of the July 2025 Broker Warrants.

The fair value of the July 2025 Placement Agent Brokers' warrants was calculated using the Black Scholes model, with the following assumptions:

	Initial Recognition
Number of warrants	56,991
Stock price	\$ 6.16
Exercise price	\$ 11.19
Volatility	101%
Dividend yield	Nil
Risk free rate	3.03%
Expected life (in years)	5
Fair value per warrant (CAD)	\$ 4.19

Private Placement (February 2025)

On February 21, 2025, and February 25, 2025, the Company 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 were 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 bifurcated the fair value based on the residual 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 and second tranche of February 2025 Common Warrants was \$0.58 and \$0.55, respectively. The common shares had a fair value of \$7.308 per share and the pre-funded warrants had a fair value of \$0.348 per warrant.

The fair value of the February 21, 2025, warrants was calculated using the Black Scholes model, with the following assumptions:

<i>February 21 Tranche</i>	Initial Recognition
Number of warrants	3,787,879
Stock price	\$ 0.80
Exercise price	\$ 1.16
Volatility	104%
Dividend yield	Nil
Risk free rate	2.76%
Expected life (in years)	5
Fair value per warrant	\$ 0.58

The fair value of the February 25, 2025, warrants was calculated using the Black Scholes model, with the following assumptions:

<i>February 25 Tranche</i>	Initial Recognition
Number of warrants	151,515
Stock price	\$ 0.77
Exercise price	\$ 1.16
Volatility	104%
Dividend yield	Nil
Risk free rate	2.65%
Expected life (in years)	5
Fair value per warrant	\$ 0.55

The 2,884,179 pre-funded warrants were subsequently exercised into 137,342 common shares at an exercise price of \$0.001 per warrant, for total proceeds of \$2,884 in fiscal 2025.

Brokers' Compensation and Share Issuance Costs

In connection with the February 2025 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 \$274,182, 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 warrants. The 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 February 2025 Placement Agent 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 recognized in equity were \$927,219, inclusive of the February 2025 Placement Agent Warrants.

The fair value of the February 25, 2025, February 2025 Placement Agent Warrants Brokers' warrants was calculated using the Black Scholes model, with the following assumptions:

<i>February 25 Tranche</i>	Initial Recognition
Number of warrants	189,394
Stock price	\$ 0.80
Exercise price	\$ 1.16
Volatility	104%
Dividend yield	Nil
Risk free rate	2.76%
Expected life (in years)	5
Fair value per warrant (CAD)	\$ 0.58

The fair value of the February 25, 2025, Brokers' warrants was calculated using the Black Scholes model, with the following assumptions:

<i>February 25 Tranche</i>	Initial Recognition
Number of warrants	7,576
Stock price	\$ 0.77
Exercise price	\$ 1.16
Volatility	104%
Dividend yield	Nil
Risk free rate	2.65%
Expected life (in years)	5
Fair value per warrant (CAD)	\$ 0.55

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, the Company has 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 15 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 fiscal 2025.

Brokers' Compensation and Share Issuance Costs

In connection with the November 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 \$365,726 (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. 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 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
Stock price (in USD)	\$ 0.93
Exercise price (in USD)	\$ 1.13
Volatility	103%
Dividend yield	Nil
Risk free rate	2.92%
Expected life (in years)	5
Exchange rate (USD/CAD)	\$ 1.3932
Fair value per warrant (CAD)	\$ 0.69

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, the Company 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 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 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 bifurcated the fair value based on the residual 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.

	Initial Recognition
Number of warrants	4,145,200
Stock price (in CAD)	\$ 1.00
Exercise price	\$ 1.03
Volatility	103%
Dividend yield	Nil
Risk free rate	2.92%
Expected life (in years)	5
Fair value per warrant (CAD)	\$ 0.765

In fiscal 2025, the 4,145,200 pre-funded warrants and 350,000 November 2024 Common Warrants were subsequently exercised into 197,391 and 16,667 common shares, respectively. The pre-funded warrants and the Common Warrants were converted at an exercise price is \$0.0610 and \$1.03, respectively for total proceeds of \$880,000 in fiscal 2025.

Brokers’ Compensation and Share Issuance Costs

In connection with the November 2024 Offering, Wainwright was 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 \$21.63 per common share for a period of 60 months following the closing of the November 2024 PP.

The fair value of the Placement Agent 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 Placement Agent Warrants.

	Initial Recognition
Number of warrants	207,260
Stock price (in CAD)	\$ 1.00
Exercise price	\$ 1.03
Volatility	103%
Dividend yield	Nil
Risk free rate	2.92%
Expected life (in years)	5
Fair value per warrant (CAD)	\$ 0.765

2024 Activities

Debt Settlement (January 2024)

On January 10, 2024, the Company 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.

US Public Offering (April 2024)

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

As 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 ("Pre-funded Warrants") at a public offering price of \$184.80 (US\$136.50) per share and \$0.881 (US\$0.649) per Pre-funded Warrant, less the underwriting discount. The warrants have a conversion ratio of 210 warrants for one common share.

Brokers' Compensation and Share Offering Costs

ThinkEquity acted as sole book-running manager for the April 2024 Public Offering. As compensation for services rendered, the placement agent fees represent \$10.24 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 366 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 date of the April 2024 Public Offering at an initial exercise price of \$231.67 (US\$170.63) per Common Share. The share offering costs related to the April 2024 Public Offering that was recognized in the consolidated financial statements of net loss and comprehensive loss was \$339,324 and recognized in equity was \$269,400.

The fair value of the Placement Agent Warrants at the closing of the April 2024 Public Offering was \$43,868, calculated using the Black Scholes model, and total share offering costs were \$608,724.

	Initial Recognition
Number of warrants	76,925
Stock price (in USD)	\$ 156.45
Exercise price (in USD)	\$ 0.81
Black Scholes fair value (in USD)	\$ 0.42
Volatility	66%
Risk free rate	3.86%
Expected life	5
Exchange (USD/CAD)	1.3578
Fair value per warrant (CAD)	\$ 0.57

The share price is based on the historical share price adjusted for the 2024 and 2025 Reverse Split.

US Public Offering (June 2024)

On June 14, 2024, the Company closed a brokered US public offering, resulting in the issuance of 13,809 common shares of DEFSEC, 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 13,809 common shares at a public offering price of \$168.00 (US\$121.80) per share, less the placement agent fees.

Brokers’ Compensation and Share Offering Costs

ThinkEquity acted as sole book-running manager for the June 2024 Public Offering. As compensation for services rendered, the placement agent fees represent \$9.14 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 date of the June 2024 Public Offering. The warrants have a conversion ratio of 210 warrants for one common share. All of the share offering 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 offering costs were \$384,509.

	Initial Recognition
Number of warrants	145,000
Stock price (in USD)	\$ 5.77
Exercise price (in USD)	\$ 7.25
Black Scholes fair value (in USD)	\$ 3.07
Volatility	66%
Dividend yield	Nil
Risk free rate	3.86%
Expected life	5
Exchange (USD/CAD)	1.3571
Fair value per warrant (CAD)	\$ 0.42

US Registered Direct Offering (August 2024)

On August 13, 2024, the Company closed a registered direct offering for the purchase and sale of 22,452 common shares at a purchase price of \$57.54 (US\$42.00) per common share for gross proceeds of \$1.4M (US\$0.9M) (the "August 2024 Offering"). In a concurrent private placement, the Company issued unregistered warrants to purchase up to 471,500 common shares at an exercise price of \$72.03 (US\$52.50) per share that are immediately exercisable upon issuance and will expire five years following the date of issuance. The warrants have a conversion ratio of 210 warrants for one common share.

Brokers' Compensation and Share Offering Costs

H.C. Wainwright & Co. 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, the Company issued Wainwright or its designees warrants to purchase up to an aggregate of 1,683 common shares at an exercise price of US\$52.50 per 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.

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, and November 12, 2024, financings fell entirely within the scope of the tail obligation and resulted in a payment of 7.5% of the gross proceeds to Wainwright upon closing of those transactions.

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 offering costs related to the August 2024 Offering that was recognized in the consolidated financial statements of net loss and comprehensive loss was \$202,242 and recognized in equity was \$281,869.

	Initial Recognition
Number of warrants	353,625
Stock price (in USD)	\$ 30.09
Exercise price (in USD)	\$ 0.25
Black Scholes fair value (in USD)	\$ 0.06
Volatility	91%
Dividend yield	Nil
Risk free rate	3.12%
Expected life	2.5
Exchange (USD/CAD)	1.3723
Fair value per warrant (CAD)	\$ 0.08

2023 Activities

Share Consolidation

On October 28, 2022, the Company finalized the consolidation of Company's common shares on the basis of one post-consolidation common share for every seventy pre-consolidation common shares issued and outstanding.

U.S. IPO and Canadian Offering

On December 9, 2022, we closed the U.S. IPO and the Canadian Offering. In the U.S. IPO, we sold 11,904 common shares and 2,500,000 warrants at a public offering price of US\$867.30 per common share and \$4.13 per warrant. The warrants have a per share exercise price of US\$1,050.00 and can be exercised immediately. The warrants have a conversion ratio of 210 warrants for one common share. In connection with the closing of the U.S. IPO, the underwriter partially exercised its over-allotment option to purchase an additional 199,000 pre-funded common share purchase warrants ("Pre-Funded Warrants") at US\$4.12 (before underwriter discount) and 375,000 option warrants to purchase common shares at US\$0.021 each. The warrants have a conversion ratio of 210 warrants for one common share. A Pre-Funded Warrant is a financial instrument that requires the holder to pay little consideration (exercise price of US\$2.10 per share) to receive the common share upon exercise of the Pre-Funded Warrant (see Note 15). The holder of Pre-Funded Warrants has no voting rights. All of these warrants expire on December 9, 2027.

In the Canadian Offering, we sold 3,459 common shares and 726,392 warrants at a price to the public of US\$867.30 per common share and \$4.13 per warrant. The warrants will have a per common share exercise price of US\$1,050.00, are exercisable immediately and expire in five years on December 9, 2027. The warrants have a conversion ratio of 210 warrants for one common share. Effective May 1, 2023, the warrants are listed on the TSX-V under the stock symbol of DFSC.WT.U.

The closing of the U.S. IPO and Canadian Offering resulted in aggregate gross proceeds of \$19.4 million (US \$14.1 million), before deducting underwriting discounts and offering expenses.

The common shares of DEFSEC and the Warrants sold in the U.S. IPO began trading on the Nasdaq Capital Market under the symbols "DFSC" and "DFSCW", respectively, on December 7, 2022.

ThinkEquity acted as sole book-running manager for the U.S. IPO and PI Financial acted as sole book-running manager for the Canadian Offering.

Accounting Treatment

Refer to Note 15 for the accounting of the warrants issued in the U.S. IPO and Canadian Offering and the July 2023 Private Placement accounted for as warrant liabilities.

The U.S. underwriter warrants as well as the Canadian broker options from the U.S. IPO and Canadian Offering, 134,950 warrants and 50,848 warrants respectively, were accounted for as equity on initial recognition. The U.S. underwriter warrants from the July 2023 Private Placement, 123,637 warrants, was accounted for as equity on initial recognition.

Brokers' Compensation and Share Offering Costs

As consideration for the services provided in connection with the U.S. IPO, ThinkEquity received: (a) a broker-dealer cash commission of US\$835,000 (or CAD\$1,138,105) equal to 7.5% of the gross offering proceeds of the U.S. Offering; and (b) underwriter warrants (the "U.S. Underwriter Warrants") to purchase up to 642 common shares equal to 5% of the common shares and pre-funded common share purchase warrants issued under the U.S. Offering. 14,700 U.S. Underwriter Warrants are exercisable to acquire one common share at a price of US\$1,084.13 per share, exercisable as of June 4, 2023, and expiring on December 9, 2027.

As consideration for the services provided in connection with the Canadian Offering, PI Financial received: (a) a cash commission of approximately US\$210,000 (or CAD\$286,230); and (b) 50,848 compensation options (the "Canadian Compensation Options"). Each Canadian Compensation Option is exercisable to acquire one Canadian Unit at a price of US\$867.30 per share and expiring on December 9, 2024.

In addition to the above brokers' compensation, we also incurred US\$2.1 million of share offering costs (or CAD\$2.8 million) for the U.S. IPO and Canadian Offering, of which CAD\$628,262 was incurred and deferred at September 30, 2022.

The total brokers compensation (including fair value of U.S. Underwriter Warrants and Canadian Compensation Options) and share offering costs was US\$3.2 million (or CAD\$4.4 million). This total was allocated proportionately to the fair value of common shares and to share offering costs for the portion allocated to warrants accounted for as warrant liabilities.

Shares for Debt Settlement (December 2022)

We entered into share for debt arrangements with existing lenders, which closed on December 13, 2022, following TSXV's conditional approval. This resulted in issuing 267 Units to settle \$12,000 of the March 2022 Loans and USD\$223,321 (or CAD\$302,197) of the August 2022 Loans, including unpaid accrued interest and 10% premium at maturity (the "Debt Settlements"). The terms of the Units are the same as the Units issued in the Canadian Offering.

Private Placement (July 2023)

On July 21, 2023, the Company closed a brokered private placement, resulting in the issuance of 7,343 common shares of DEFSEC, for aggregate gross proceeds of USD\$5,588,397 (approximately CAD\$7.4M) (the "July 2023 Offering").

As part of the July 2023 Offering, the Company issued 7,343 common shares at a price of US\$474.60 (CAD\$625.80) per common share (each a "Common Share") and 930,548 pre-funded warrants at price of US\$2.26 (CAD\$2.98) per pre-funded warrant (each a "Pre-funded Warrant"). Each Common Share and Pre-funded Warrant being bundled with one common share purchase warrant of the Company (each a "Common Warrant"). For every 210 Pre-funded Warrants the holder is entitled to acquire one Common Share at an exercise

price of US\$0.21 per Common Share, and each Common Warrant is immediately exercisable and 210 Common Warrants entitles the holder to acquire one Common Share at an exercise price of US\$558.60 (CAD\$735.00) per Common Share for a period of 60 months following the closing of the July 2023 Offering. Although the Common Shares and Pre-funded Warrants are each bundled with a Common Warrant, each security is issued separately.

Brokers' Compensation and Share Offering Costs

ThinkEquity acted as sole placement agent for the Offering. As compensation for services rendered, the Company paid to ThinkEquity a cash fee of \$475,013.14 representing 8.5% of the aggregate gross proceeds of the Offering and issued 123,367 warrants to purchase a 587 Common Shares (the "Placement Agent Warrants"), representing 5% of the Common Shares and Pre-Funded Warrants sold in the Offering. The Placement Agent Warrants will be exercisable, in whole or in part, immediately upon issuance and will expire 60 months after the closing date of the Offering at an initial exercise price of US\$558.60 (CAD\$735.00) per Common Share.

(b) Warrants

The following reflects the warrant activities:

	September 30, 2025		September 30, 2024	
	Number of warrants	Weighted average exercise price	Number of warrants	Weighted average exercise price
Balance, beginning of year	11,600,589	\$ 3.04	15,507,862	\$ 2.24
Issued	20,425,318	0.50	6,094,050	0.32
Exercised	(11,243,900)	0.09	(1,781,323)	0.00
Expired	(575,000)	5.01	(8,220,000)	0.21
Balance, end of year	20,207,007	\$ 2.45	11,600,589	\$ 3.04
Exercisable, end of year	20,207,007	\$ 2.45	11,475,598	\$ 3.07

DEFSEC TECHNOLOGIES INC.
(formerly KWESST Micro Systems Inc.)
Notes to Consolidated Financial Statements
Years ended September 30, 2025, 2024 and 2023.
(Expressed in Canadian dollars)

The following table provides additional information on the total outstanding warrants at September 30, 2025:

	Exercise Price	Number outstanding	Conversion ratio to Common Shares	Underlying Securities	Book value	Expiry Date
Classified as Equity:						
LEC's Warrants	CAD\$0.70	500,000	14,700 for 1	34	\$ 425,000	April 29, 2026
December 2022 U.S. Underwriter Warrants	US\$5.1625	134,950	210 for 1	643	189,592	December 9, 2027
July 2023 U.S. Underwriter Warrants	US\$2.66	123,637	210 for 1	589	204,187	July 21, 2028
April 2024 U.S. Underwriter Warrants	US\$0.8125	76,925	210 for 1	366	43,869	April 9, 2029
June 2024 U.S. Underwriter Warrants	US\$0.725	145,000	210 for 1	690	61,213	June 14, 2029
August 2024 U.S. Underwriter Warrants	US\$0.25	353,625	210 for 1	1,684	28,826	August 9, 2029
November 2024 U.S. Underwriter Warrants	US\$1.125	194,450	21 for 1	9,260	187,468	November 1, 2029
November 2024 Private Placement Warrants	US\$1.03	3,795,200	21 for 1	180,724	2,903,328	November 11, 2029
November 2024 PP Underwriter Warrants	US\$1.03	207,260	21 for 1	9,870	158,554	November 11, 2029
February 21, 2025 PP Warrants	CAD\$1.16	3,787,879	21 for 1	180,375	2,196,970	February 21, 2030
February 21, 2025 PP Underwriter Warrants	CAD\$1.16	189,394	21 for 1	9,019	109,991	February 21, 2030
February 25, 2025 PP Warrants	CAD\$1.16	151,515	21 for 1	7,215	83,939	February 25, 2030
February 25, 2025 PP Underwriter Warrants	CAD\$1.16	7,576	21 for 1	361	4,197	February 25, 2030
July 2025 Public Offering Warrants	CAD\$10.52	759,879	1 for 1	759,879	3,129,057	July 25, 2030
July 2025 Prefunded Warrants	CAD\$0.001	31,265	1 for 1	31,265	29,667	July 25, 2030
July 2025 Broker Warrants	CAD\$10.52	56,991	1 for 1	56,991	451,255	July 25, 2030
November 2024 Issuance Costs					(868,653)	
February 2025 Issuance Costs					(803,109)	
July 2025 Issuance Costs					(770,939)	
		10,515,546		1,248,965	\$ 7,764,412	
Classified as liability:						
December 2022 Public Offerings	US\$5.00	3,226,392	210 for 1	15,363	180,107	December 9, 2027
December 2022 Debt Settlement	US\$5.00	56,141	210 for 1	267	3,135	December 9, 2027
July 2023 Public Offerings	US\$2.66	1,542,194	210 for 1	7,343	–	July 21, 2028
July 2023 Pre-Funded Warrants	US\$0.001	151,734	210 for 1	723	1,469	No expiry
August 2024 Public Offering	US\$0.25	4,715,000	210 for 1	22,452	26,254	August 9, 2029
		9,691,461		46,148	210,965	
Total outstanding warrants		20,207,007		1,295,113	\$ 7,975,377	

The fair value for the warrants issued during the year ended September 30, 2025, was determined by the Black Scholes option pricing model using the assumptions outline in Note 16(a).

(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.

Broker Compensation Options

In the 2023 Canadian Offering, 50,848 Canadian Compensation Options were issued. For every 210 Canadian Compensation Option are exercisable to acquire one common share, as defined in Note 16(a), at a price equal to \$1,182.09 (US\$867.30) for a period of two years (expiring on December 9, 2024). Based on the structure of the Compensation Option, management estimated its fair value using the Monte Carlo method (Level 2). The Company used the following key inputs in the Monte Carlo model (100,000 simulations):

	Initial Recognition
Number of securities	50,848
Exercise price – compensation option (in USD)	\$ 4.13
1 – Year CAD/USD forward exchange rate	\$ 1.3560
Exercise price – compensation warrant (in USD)	\$ 1,050.00
2 – Year CAD/USD forward exchange rate	\$ 1.3483
Share price (in CAD)	\$ 882.00
Expected life – compensation option	1.00
Expected life – compensation warrant	2.50
Dividend	\$ Nil
Volatility – compensation option	90%
Volatility – compensation warrant	75%
Risk free rate – compensation option	4.38%
Risk free rate – compensation warrant	3.15%
Fair value per warrant (CAD)	\$ 2.46

In 2024 the Company recorded \$125,086 of Canadian Compensation Options in contributed surplus, with an equal offset to share offering costs (a non-cash transaction).

Share-based compensation

On August 26, 2024, DEFSEC shareholders approved the renewal of the Long-Term Incentive Plan (the “LTIP”). The number of RSUs, PSUs, DSUs, and SARs (collectively “Share Units”) authorized for issuance pursuant to the LTIP is 1,939 Share Units. Accordingly, the Company has 710 Share Units available for future grants.

Further, the disinterested shareholders (shareholders that are not directors, officers, or other insiders of the Company) of DEFSEC approved to revise the exercise price of 2,427 stock options to \$756.00, the closing price of DEFSEC common shares on the TSX-V on March 31, 2023. In accordance with IFRS 2, this resulted in an immediate fair value increase of \$77,001 included in share-based compensation, with an offset to contributed surplus.

For the year ended September 30, 2025, the Company recorded share-based compensation of \$113,692 (2024 - \$291,761, 2023 - \$373,554).

(i) Stock Options

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The following is summary of changes in outstanding stock options for the respective periods:

	Number of options	Weighted average exercise price
Outstanding, at September 30, 2023	1,856	\$ 588.00
Cancelled	(627)	653.10
Outstanding, at September 30, 2024	1,229	555.24
Cancelled	(234)	664.41
Outstanding, at September 30, 2025	995	\$ 555.42
Options Exercisable, at September 30, 2025	995	\$ 555.42

At September 30, 2025, all stock options had vested; therefore, the weighted average remaining vesting period was nil years (2024 – 0.87 years, 2023 - 1.87 years).

The following table summarizes information about stock options outstanding at September 30, 2025:

Exercise Price	Number outstanding	Weighted average remaining contractual life	Weighted average outstanding strike price	Exercisable	Remaining exercisable contractual life	Weighted average exercisable strike price
\$ 535.50	905	0.88	\$ 535.50	905	0.88	\$ 535.50
\$ 756.00	90	0.49	756.00	90	0.49	756.00
	995	0.84	\$ 555.42	995	0.84	\$ 555.42

Amendment to stock option grants

For the years ended September 30, 2025 and 2024, the Company had no amended stock option grants.

(ii) Share Units

The following table shows the changes in Share Units:

	RSUs	PSUs	SARs	Total
Balance at September 30, 2023	108	\$ –	\$ 265	\$ 373
Granted	–	–	–	–
Vested and converted to common shares	–	–	–	–
Vested and repurchased for withholding taxes	–	–	–	–
Expired/Cancelled	(108)	–	(265)	(373)
Balance at September 30, 2024	–	–	–	–
Granted	–	–	–	–
Expired/Cancelled	–	–	–	–
Balance at September 30, 2025	–	–	–	–

RSUs:

Each RSU entitles the holder to receive one common share in the future, based on continued service during the applicable period.

During the year ended September 30, 2025, the Company did not grant any RSUs (2024 – nil, 2023 – nil). There were no outstanding RSUs at September 30, 2025 (2024 – nil outstanding).

PSUs:

Each PSU entitles the holder to receive one common share in the future, based on the achievement of established performance criteria and continued service during the applicable performance period.

During the year ended September 30, 2025, the Company did not grant any PSUs (2024 – nil, 2023 – nil). There were no outstanding PSUs at September 30, 2025 (2024 – nil, 2023 – fully vested).

SARs:

Each SAR entitles the holder to receive cash or common share at Company's discretion in the future, based on continued service during the applicable period. The amount of the cash payment or the value of common shares is determined based on the increase of the share price of DEFSEC between the grant date and the exercise date. Because the Company intends to always settle in common shares, the SARs are recorded as equity-settled awards.

During the year ended September 30, 2025, the Company did not grant any SARs (2024 – nil, 2023 – nil). There were no outstanding SARs at September 30, 2025 (2024 – nil).

(iii) Share-based Compensation

For the year ended September 30, 2025, the Company recorded share-based compensation of \$113,692 (2024 - \$291,761, 2023 - \$373,554).

17. Loss per share

As disclosed in Note 1(b), and Note 1(c), the Reverse Splits have 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 statements of net loss and comprehensive loss:

	Year ended September 30, 2025	Year ended September 30, 2024	Year ended September 30, 2023
Issued common shares, beginning of year	75,200	26,744	3,682
<i>Effect of shares issued from:</i>			
Debt settlements	5,017	160	213
2025 Private Placement	30,345	—	—
2025 U.S Public Offerings	127,028	—	—
Exercise of warrants	372,579	3,797	1
April 2024 U.S. Public Offering (Note 16(a))	—	1,663	—
June 2024 U.S. Public Offering (Note 16(a))	—	4,074	—
August 2024 U.S. Public Offering (Note 16(a))	—	2,944	—
December 2022 U.S. IPO and Canadian Offering (Note 16(a))	—	—	12,417
Over-allotment Pre-Funded Warrants (Note 15)	—	—	765
July 2023 Private Placement (Note 16(a))	—	—	1,428
July 2023 Pre-Funded Warrants (Note 15)	—	—	861
Conversion of stock units	—	—	56
Exercise of options	—	—	12
Weighted average number of basic common shares	610,169	39,382	19,435
<i>Dilutive securities</i>			
Stock options	—	—	—
Warrants	—	—	—
Weighted average number of dilutive common shares	610,169	39,382	19,435

At September 30, 2025, 2024 and 2023, all dilutive securities were anti-dilutive because of net loss recorded for each of those years.

18. Revenue

a) Revenue streams

DEFSEC generates revenue from the sale of products and services 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.

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	Year ended September 30, 2025	Year ended September 30, 2024	Year ended September 30, 2023
Major products/service lines			
Digitization	\$ 4,018,625	\$ 1,034,257	\$ 819,604
Less-Lethal	914,150	465,082	411,758
Training and services	8,700	1,028	–
Other	1,151	3,961	3,088
	\$ 4,942,626	\$ 1,504,328	\$ 1,234,450
Primary geographic market			
United States	\$ 364,362	\$ 155,103	\$ 42,780
Canada	4,578,264	1,349,225	743,200
Europe	–	–	448,470
	\$ 4,942,626	\$ 1,504,328	\$ 1,234,450
Timing of revenue recognition			
Products and services transferred over time	4,027,325	1,035,285	\$ 819,604
Products transferred at a point in time	915,301	469,043	414,846
	\$ 4,942,626	\$ 1,504,328	\$ 1,234,450

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 September 30, 2025, Company’s contracted not yet recognized revenue was \$12,000 (2024 - \$261,815, 2023 - \$496,199), of which 100% of this amount is expected to be recognized over the next 12 months.

For the year ended September 30, 2025, two customers accounted for 65% and 12% (2024 – two customers accounted for 36% and 20%, 2023 - two customers accounted for 23% and 18%) of revenue.

19. Expenses by nature

The following table presents a breakdown of expenses by nature for the following years:

	Year ended September 30, 2025	Year ended September 30, 2024	Year ended September 30, 2023
Employee benefits	\$ 7,389,432	\$ 4,378,885	\$ 2,638,369
Professional fees	1,364,773	967,938	940,667
R&D consulting and material costs, net	758,485	774,261	556,013
Consulting fees	638,366	1,294,949	2,743,272
Insurance	636,967	690,014	716,931
Other expenses	544,798	434,682	691,566
Travel and conferences	222,405	385,759	804,481
Transfer agent and listing fees	175,878	151,854	120,690
Advertising and promotion	636	60,823	19,090
Impairment of inventory	–	113,283	–
Impairment of intangible assets	–	–	1,174,354
Royalty and license costs	–	–	305,918
Total expenses	\$ 11,731,740	\$ 9,252,448	\$ 10,711,351
Allocation of cost of sales			
Employee benefits	(2,100,660)	(536,245)	(123,803)
Total operating expenses	\$ 9,631,080	\$ 8,716,203	\$ 10,587,548

20. Net finance costs

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

	Year ended September 30, 2025	Year ended September 30, 2024	Year ended September 30, 2023
Interest expense from:			
Unsecured loan	\$ –	\$ –	\$ 503,251
Accretion cost – accrued royalties liability	168,874	180,965	170,373
Lease obligations	78,909	70,351	37,786
CEBA term loan	–	–	8,281
Other	6,930	694	3,857
Total interest expense	254,713	252,010	723,548
Interest income	(81,838)	(55,687)	(55,514)
Gain on debt settlement	500	–	–
Net finance costs	\$ 173,375	\$ 196,323	\$ 668,034

21. Income taxes

a) Income tax recovery

Income tax recovery is made up of the following components:

	Year ended September 30, 2025	Year ended September 30, 2024	Year ended September 30, 2023
Current income tax recovery (expense):	\$ –	\$ –	\$ –
Deferred income tax (recovery) expense:	–	–	–
Net finance costs	\$ –	\$ –	\$ –

b) Reconciliation of effective income tax rate

The Company's effective income tax rate differs from the statutory rate of 26.5% that would be obtained by applying the combined Canadian basic federal and provincial income tax rate to loss before income taxes. These differences result from the following:

	Year ended September 30, 2025	Year ended September 30, 2024	Year ended September 30, 2023
Loss before income taxes	\$ (9,626,694)	\$ (7,437,759)	\$ (9,306,360)
Expected statutory tax rate	26.5%	26.5%	26.5%
Expected tax recovery resulting from loss	(2,551,074)	(1,971,006)	(2,466,185)
Increase (reduction) in income taxes resulting from:			
Non-deductible expenses	96,873	130,295	149,270
Foreign operations subject different tax rates	–	(21)	1,447
Fair value of warrant liabilities	(351,270)	(814,569)	(1,547,916)
Unrecognized temporary differences	2,805,471	2,655,301	3,863,384
	\$ –	\$ –	\$ –

c) Deferred tax balances

The following tables deferred tax assets (liabilities) have been recognized in the consolidated financial statements:

	Balance at September 30, 2024	Recognized in profit or loss	Balance at September 30, 2025
Deferred tax assets (liabilities)			
Net operating loss carry forwards	\$ 13,598	\$ 17,489	\$ 31,087
Unrealized foreign exchange gains on loans	–	(13,108)	(13,108)
Intangibles and development costs	(13,598)	(4,381)	(17,979)
	\$ –	\$ –	\$ –

	Balance at September 30, 2023	Recognized in profit or loss	Balance at September 30, 2024
Deferred tax assets (liabilities)			
Net operating loss carry forwards	\$ 16,869	\$ (3,271)	\$ 13,598
Intangibles and development costs	(16,869)	3,271	(13,598)
	\$ –	\$ –	\$ –

	Balance at September 30, 2022	Recognized in profit or loss	Balance at September 30, 2023
Deferred tax assets (liabilities)			
Net operating loss carry forwards	\$ 26,459	\$ (9,590)	\$ 16,869
Intangibles and development costs	(26,459)	9,590	(16,869)
	\$ –	\$ –	\$ –

d) Unrecognized net deferred tax assets

Deferred taxes reflect the impact of loss carry forwards and of temporary differences between amounts of assets and liabilities for financial reporting purposes and such amounts as measured by enacted tax laws. However, DEFSEC has not recorded net deferred tax assets at September 30, 2025, and 2024 on the following deductible temporary differences, due to the uncertainty involved in determining whether these deferred tax assets will be realized upon expiration due to DEFSEC's limited history and cumulative operating losses since its inception.

The following is a summary of DEFSEC's unrecognized deductible temporary differences:

	Year ended September 30, 2025	Year ended September 30, 2024	Year ended September 30, 2023
Net operating loss carry forwards	\$ 53,821,414	\$ 42,737,987	\$ 30,178,141
Share issuance costs	7,146,906	5,072,949	5,275,081
Property and equipment	226,120	1,379,540	1,399,023
Intangibles and development costs	3,501,940	171,182	1,356,922
Scientific R&D expenditures	1,583,058	1,583,058	1,583,058
Right of use asset and lease obligation	(1,165,181)	(130,912)	(75,115)
Right of use asset and lease obligation	1,303,444	203,068	143,601
Other	33,945	45,201	—
	\$ 66,451,646	\$ 51,062,073	\$ 39,860,711

e) Available net operating losses

At September 30, 2025, DEFSEC has the following net operating losses in Canada available to reduce future year's taxable income which expire as follows:

	Year ended September 30, 2025
2036	\$ 391,014
2037	747,861
2038	1,174,797
2039	1,732,039
2040	338,504
2041	5,518,336
2042	8,592,392
2043 and thereafter	35,326,471
	\$ 53,821,414

f) Available research and development investment tax credits

The Company has the following research and development investment tax credits available to reduce future years' income taxes payable which expire as follows:

	Year ended September 30, 2025
2038	\$ 13,361
2039	6,742
2040	—
2041	328,480
2043 and thereafter	—
	\$ 348,583

22. Financial instruments

Fair value of financial instruments

The fair values of cash and cash equivalents, restricted short-term investment, trade and other receivables (excluding sales tax recoverable), accounts payable and accrued liabilities, and deposit (included in non-current other assets), approximate carrying value because of the short-term nature of these instruments.

Under IFRS, the levels of fair value hierarchy are as follows:

Level 1: Unadjusted quoted prices 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 observable market data (unobservable inputs).

The warrant liabilities were recorded at fair value at initial recognition and are subsequently revalued at the end of each accounting period. The fair value measurement for these was Level 2.

The Company's lease deposits and accrued royalties are initially recorded at their fair value and are accreted to their nominal value over their respective terms. The fair value measurement for these is considered to be Level 2.

Financial risk management

The Company is exposed to a number of financial risks arising through the normal course of business as well as through its financial instruments. The Company's overall business strategies, tolerance of risk and general risk management philosophy are determined by the Board of Directors in accordance with prevailing economic and operating conditions.

(b) Foreign currency risk

Foreign currency risk is the risk that the future cash flows or fair value of financial instruments that are denominated in a currency that is not the Company's functional currency will fluctuate due to a change in foreign exchange rates.

For the year ended September 30, 2025, 7% (2024 – 10%, 2023 - 3%) of the Company's revenue was denominated in U.S. dollars. The Company also procures certain raw materials denominated in U.S. dollar for product development. Accordingly, the Company is 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 the Company's financial performance, financial position, and cash flows. Currently, the Company does not use derivative instruments to hedge its U.S. dollar exposure. Throughout the year the Company held the majority of its cash assets in USD and converted to CAD on an as needed basis as the Company raises the majority of capital in USD.

At September 30, 2025, the Company had the following net U.S. dollar exposure:

	Year ended September 30, 2025
US denominated	
Assets	\$ 4,627,168
Liabilities	(218,577)
Net US\$ exposure	\$ 4,408,591
Impact to profit if 5% movement in US\$	\$ 220,430

During the year ended September 30, 2025, the Company recorded foreign exchange gain of \$114,347 (2024 - \$59,191, 2023 - foreign exchange loss of \$98,275).

(c) Credit risk

Credit risk is the risk of financial loss to DEFSEC if a counterparty to a financial instrument fails to meet its contractual obligations. The Company's credit risk exposure is limited to cash, and trade and other receivables. Refer to Note 4 for the breakdown of the Company's trade and other receivables. The Company enter into contracts with either large, financially sound global general contractors or law enforcement agencies, which mitigates the credit risk. At September 30, 2025, trade receivable balance was \$1,352,216 (2024 - \$455,049, 2023 - \$68,530), of which \$874,252 (2024 - \$319,777) was current. Included in this balance are two customers representing 75% and 20% (2024 – four customers representing 28%, 21%, 16% and 11%) of trade receivables, which is a potential concentration risk; however, as these relate to government of Canada contracts the risk of being uncollectable is very low.

(d) Liquidity risk

Liquidity risk is the risk that the Company will be unable to meet the Company's financial obligations as they become due. the Company's objective is to ensure that the Company has sufficient cash to meet near-term obligations when they become due, under both normal and stressed condition, without incurring unacceptable losses or risking reputational damage to DEFSEC. A key risk in managing liquidity is the degree of uncertainty in the Company's cash flows due to its early stage in operations and the need for additional capital to fund business strategies.

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At September 30, 2025, contractual obligations were as follows:

<i>Payment due:</i>	Total	Within 1 year	1 to 3 years	3 to 5 years	5 years and beyond
Minimum royalty commitments	\$ 2,000,000	\$ 200,000	\$ 500,000	\$ 600,000	\$ 700,000
Accounts payable and accrued liabilities	2,310,662	2,310,662	—	—	—
Lease obligations	2,250,220	169,053	617,088	414,488	1,049,591
Total contractual obligations	\$ 6,560,882	\$ 2,679,715	\$ 1,117,088	\$ 1,014,488	\$ 1,749,591

At September 30, 2025, the Company had \$6,686,429 in cash and \$6,027,820 in working capital (current assets less current liabilities).

23. Supplemental cash flow information

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

	Year ended September 30, 2025	Year ended September 30, 2024	Year ended September 30, 2023
Trade and other receivables	\$ (925,914)	\$ (267,606)	\$ (128,387)
Inventories	13,554	9,225	(148,850)
Prepaid expenses and other	397	383,357	(440,242)
Deferred costs	(94,153)	(35,596)	—
Accounts payable and accrued liabilities	960,770	(257,257)	(1,666,486)
Contract liabilities	(112,900)	(399)	73,699
Warrant liabilities	—	(25,395)	—
Accrued royalties liability	(200,000)	(150,000)	—
	\$ (358,246)	\$ (343,671)	\$ (2,310,266)

The following is a summary of non-cash items that were excluded from the consolidated statements of cash flows for the year ended September 30, 2025:

- \$1,166,652 related to new leases entered into during the year;
- \$132,000 of warrants which expired during the year;
- 207,260 November 2024 private placement underwriter warrants as compensation for the offering;
- 194,450 November 2024 U.S. underwriter warrants as compensation for the offering;
- 196,970 February 2025 private placement underwriter warrants as compensation for the offering; and
- 56,991 July 2025 broker warrants.

The following is a summary of non-cash items that were excluded from the Statements of Cash Flows for the year ended September 30, 2024:

- 4,670 shares issued for debt settlement of \$97,615. The debt resulted in a tail obligation relating to services rendered by a third-party consultant;
- \$44,868 non-cash share offering costs as part of the net proceeds settlement at the closing of the April 2024 US Public Offering (see Note 16(a));
- \$61,213 non-cash share offering costs as part of the net proceeds settlement at the closing of the June 2024 US Public Offering (see Note 16(a));

- \$28,631 non-cash share offering costs as part of the net proceeds settlement at the closing of the August 2024 US Registered Direct Offering (see Note 16(a)); and
- 178,131 warrants exercised throughout Fiscal 2024 in connection with past financings (see Note 15).

The following is a summary of non-cash items that were excluded from the Statements of Cash Flows for the year ended September 30, 2023:

- \$2,924,880 non-cash share offering costs and \$453,102 accounts payables as part of the net proceeds settlement at the closing of the U.S. IPO and Canadian Offering;
- 25,000 warrants exercised in connection with the GhostStep™ acquisition in June 2020; and
- \$529,504 of shares issued for vested RSUs and PSUs.

24. Segmented information

The Company's Chairman has been identified as the chief operating decision maker. The Chairman evaluates the performance of DEFSEC and allocates resources based on the information provided by the Company's internal management system at a consolidated level. The Company has determined that there is only one operating segment.

At September 30, 2025, we had no right-of-use assets (2024 – one for \$49,563), inventory of \$nil (2024 – \$153,087), and equipment \$nil (2024 – \$76,222,) in the United States while all other property and equipment are located in Canada.

25. Commitments and contingencies

The Company, under its LC4ISR Sub-Tier Subcontract, shall meet certain Industrial and Technological Benefits ("ITBs") targets as a condition for fulfilling the obligations in the contract. Such requirements are part of Canada's effort to promote economic development and increased competitiveness of the defence sector and develop, grow and sustain a diverse, talented, and innovative Canadian workforce. Under the obligations, DEFSEC will spend 100% of the contract-value as Supplier Development in Canada, specifically involving Small and Medium Business (employing fewer than 250 full-time personnel), and spend 20% of the contract value as transactions involving Skills Development and Training in the areas of Defence Systems Integration, Artificial Intelligence, Cyber Resilience, or In-Service Support. As all work under the contract is being executed in Canada by DEFSEC, 100% of the Small and Medium Business requirement is expected to be met. Achievement of the Company's Skills Development and Training requirement is expected to be met by transactions related to Senior Integrated Logistics Support Specialist ("ILS") related roles filled under its taskings, as these have been deemed by Canada to be eligible, and DEFSEC currently has four (4) such roles of its total 17 under current taskings. While these roles are expected to fulfill its obligations over the achievement period, any penalty by way of liquidated damages, is limited in its financial impact to a maximum of 20% of the shortfall (up to 4% of total contract value). Further mitigating any potential shortfall is the ability to achieve a five (5) times multiplier for any contribution to Skills Development and Training for Indigenous Peoples or majority Indigenous-controlled educational or training facilities. Based on billings to date under this contract, the Company may have an ITB spend obligation of \$134,000. Management believes it will meet the required targets within the specified timeframes. Accordingly, no liability has been recorded in these consolidated financial statements related to this commitment.

26. Capital management

The Company's objective in managing capital is to safeguard its ability to continue as a going concern and to sustain future development of the business. The senior management is responsible for managing the capital through regular review of financial information to ensure sufficient resources are available to meet operating requirements and investments to support the Company's growth strategy. The Board of Directors is responsible for overseeing this process. From time to time, the Company could issue equity instruments or debt to maintain or adjust the capital structure. DEFSEC is not subject to any externally imposed capital requirements.

DEFSEC's capital is composed of the following:

	September 30, 2025	September 30, 2024
Debt:		
Lease obligations	\$ 1,303,450	\$ 302,223
Warrant liability	210,965	847,295
Equity:		
Share capital	\$ 47,003,991	\$ 37,822,725
Warrants	7,764,412	1,084,687
Contributed surplus	5,398,445	5,152,753
Accumulated other comprehensive loss	(85,077)	(38,520)
Accumulated deficit	(52,280,052)	(42,653,358)
Total capital	\$ 9,316,134	\$ 2,517,805

27. Subsequent events

On October 31, 2025, the Company issued 31,265 shares of common stock upon the exercise of 31,265 pre-funded warrants, which were issued as part of the July 25, 2025, share offering. The exercise price of each pre-funded warrant was \$0.001 per share. The issuance was completed in accordance with the terms of the warrant agreements.

One December 17, 2025, the Company entered into definitive agreements for the purchase and sale of 566,040 Common Shares at a purchase price of CAD\$3.64 (US\$2.65) per Common Share in a registered direct offering. In a concurrent private placement, we issued unregistered warrants to purchase up to 566,040 Common Shares at an exercise price of CAD\$4.27 per Common Share that are immediately exercisable upon issuance and expire five years following the date of issuance. The closing of the offering occurred on December 18, 2025.