

**Nightingale Intelligent Systems, Inc.**

Financial Statements as of and for the  
Years Ended December 31, 2020 and 2019, and  
Independent Auditors' Report

**NIGHTINGALE INTELLIGENT SYSTEMS, INC.**  
**TABLE OF CONTENTS**

---

	<b>Page</b>
INDEPENDENT AUDITOR’S REPORT	1–2
CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2020 AND 2019:	
Consolidated Balance Sheets	3
Consolidated Statements of Operations	4
Consolidated Statements of Convertible Preferred Stock and Changes in Stockholders’ Deficit	5
Consolidated Statements of Cash Flows	6
Notes to Consolidated Financial Statements	7–28

# Independent Auditor's Report

To the Members of Nightingale Intelligent Systems, Inc.

## Report on the audit of the financial report

### Qualified opinion

We have audited the financial report of Nightingale Intelligent Systems, Inc. (the Company) and its subsidiaries (the Group), which comprises the consolidated statement of financial position as at 31 December 2020 and 31 December 2019, the consolidated statement of profit or loss and other comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the years then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, except for the effects of the matter described in the Basis for Qualified Opinion section of our report, the accompanying financial report of Nightingale Intelligent Systems, Inc. presents fairly, in all material respects, the Group's financial position as at 31 December 2020 and 31 December 2019 and of its performance and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

### Basis for qualified opinion

We were appointed as auditors of the Group on 13 November 2020 and thus did not observe the counting of the physical inventories at either 31 December 2019 or 31 December 2018. We were unable to satisfy ourselves by alternative means concerning inventory quantities held at either 31 December 2019 or 31 December 2018. Since opening inventories at 31 December 2019 and 31 December 2018 enter into the determination of the financial performance and cash flows, we were unable to determine whether adjustments might have been necessary in respect of the income for the years reported in the statement of comprehensive income and the net cash flows from operating activities reported in the statement cash flows.

We conducted our audit in accordance with Australian Auditing Standards. Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Report* section of our report. We are independent of the Group in accordance with the ethical requirements of the Accounting Professional and Ethical Standards Board's APES 110 *Code of Ethics for Professional Accountants (including Independence Standards)* (the Code) that are relevant to our audit of the financial report in Australia. We have also fulfilled our other ethical responsibilities in accordance with the Code.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified opinion.

ACN-130 913 594

[www.grantthornton.com.au](http://www.grantthornton.com.au)

Grant Thornton Audit Pty Ltd ACN 130 913 594 a subsidiary or related entity of Grant Thornton Australia Limited ABN 41 127 556 389 'Grant Thornton' refers to the brand under which the Grant Thornton member firms provide assurance, tax and advisory services to their clients and/or refers to one or more member firms, as the context requires. Grant Thornton Australia Limited is a member firm of Grant Thornton International Ltd (GTIL). GTIL and the member firms are not a worldwide partnership. GTIL and each member firm is a separate legal entity. Services are delivered by the member firms. GTIL does not provide services to clients. GTIL and its member firms are not agents of, and do not obligate one another and are not liable for one another's acts or omissions. In the Australian context only, the use of the term 'Grant Thornton' may refer to Grant Thornton Australia Limited ABN 41 127 556 389 and its Australian subsidiaries and related entities. Liability limited by a scheme approved under Professional Standards Legislation.

**Material uncertainty related to going concern**

We draw attention to Note 1 in the financial statements, which indicates that the Group incurred a loss of \$3.5 million for the year ended 31 December 2020 and a loss of \$7.9 million for the year ended 31 December 2019. As stated in Note 1, these events or conditions, along with other matters as set forth in Note 1, indicate that a material uncertainty exists that may cast significant doubt on the Group's ability to continue as a going concern. Our opinion is not modified in respect of this matter.

**Information other than the financial report and auditor's report thereon**

Management is responsible for the other information. The other information comprises the information included in the Group's annual report for the years ended 31 December 2020 and 31 December 2019, but does not include the financial report and our auditor's report thereon.

Our opinion on the financial report does not cover the other information and accordingly we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial report, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial report or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

**Responsibilities of management and those charged with governance for the financial report**

Management is responsible for the preparation and fair presentation of the financial report in accordance with accounting principles generally accepted in the United States of America. This responsibility also includes such internal control as management determines is necessary to enable the preparation of the financial report to be free from material misstatement, whether due to fraud or error.

In preparing the financial report, management is responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Group or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Group's financial reporting process.

**Auditor's responsibilities for the audit of the financial report**

Our objectives are to obtain reasonable assurance about whether the financial report as a whole is free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the Australian Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of this financial report.

A further description of our responsibilities for the audit of the financial report is located at the Auditing and Assurance Standards Board website at: [http://www.auasb.gov.au/auditors\\_responsibilities/ar3.pdf](http://www.auasb.gov.au/auditors_responsibilities/ar3.pdf). This description forms part of our auditor's report.



Grant Thornton Audit Pty Ltd  
Chartered Accountants



C F Farley  
Partner – Audit & Assurance  
Sydney, 11 July 2022

**NIGHTINGALE INTELLIGENT SYSTEMS, INC.**  
**CONSOLIDATED BALANCE SHEETS**  
DECEMBER 31, 2020 AND 2019

	<b>As of December 31,</b>	
	<b>2020</b>	<b>2019</b>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 2,684,865	\$ 1,680,168
Accounts receivable, net of allowance for doubtful accounts (\$158,150 and \$28,000 at December 31, 2020 and 2019, respectively)	119,765	201,815
Inventory, net	111,042	417,383
Prepaid expenses and other current assets	22,103	13,201
Total current assets	2,937,775	2,312,566
Leased assets	360,397	453,279
Product development assets	66,188	130,594
Property and equipment, net	32,229	49,030
Other assets	17,430	18,173
Total assets	<u>\$ 3,414,019</u>	<u>\$ 2,963,642</u>
<b>Liabilities, Convertible Preferred Stock and Stockholders' Deficit</b>		
Current liabilities:		
Accounts payable	\$ 114,766	\$ 413,675
Accrued expenses	44,055	97,366
Accrued interest	48,606	2,330
Deferred revenue	204,963	119,000
Promissory note, current	296,490	-
Total current liabilities	708,880	632,371
Promissory note, net of current portion	98,830	-
Loan payable	250,000	400,000
Convertible notes, noncurrent	592,558	-
Derivative liability	757,023	-
Total liabilities	2,407,290	1,032,371
Commitments and contingencies (Note 16)		
Convertible preferred stock, \$0.00001 par value; 50,036,091 shares authorized at December 31, 2020 and 2019; 27,039,077 and 15,849,974 shares issued and outstanding at December 31, 2020 and 2019, respectively (aggregate liquidation preference of \$11,568,209 and \$18,840,102 as of December 31, 2020 and 2019, respectively)	12,709,810	20,157,936
Stockholders' deficit:		
Common stock, \$0.00001 par value; 90,433,860 and 35,000,000 shares authorized at December 31, 2020 2019, respectively; 21,570,999 and 8,665,646 shares issued and outstanding at December 31, 2020 and 2019, respectively	173	87
Additional paid-in capital	10,211,828	176,169
Accumulated deficit	(21,915,082)	(18,402,920)
Total stockholders' deficit	(11,703,082)	(18,226,664)
Total liabilities, convertible preferred stock and stockholders' deficit	<u>\$ 3,414,019</u>	<u>\$ 2,963,642</u>

See accompanying notes to financial statements.

**NIGHTINGALE INTELLIGENT SYSTEMS, INC.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**FOR THE YEARS ENDED DECEMBER 31, 2020 AND 2019**

---

	<b>Years Ended December 31,</b>	
	<b>2020</b>	<b>2019</b>
Revenue	\$ 921,160	\$ 943,692
Cost of revenue	<u>796,026</u>	<u>1,011,017</u>
Gross profit (loss)	<u>125,134</u>	<u>(67,325)</u>
<b>Operating expenses:</b>		
Research and development	1,855,057	3,181,326
Sales and marketing	85,501	475,551
General and administrative	<u>1,433,056</u>	<u>2,116,056</u>
Total operating expenses	<u>3,373,614</u>	<u>5,772,933</u>
<b>Loss from operations</b>	<u>(3,248,479)</u>	<u>(5,840,258)</u>
Other income (expense), net:		
Interest expense, net	(257,215)	(2,100,987)
Other expense, net	(6,469)	(32,873)
Gain on loan extinguishment	<u>-</u>	<u>97,119</u>
Total other income (expense), net	<u>(263,684)</u>	<u>(2,036,741)</u>
<b>Net loss</b>	<u>\$ (3,512,163)</u>	<u>\$ (7,876,999)</u>
Net loss per share - basic and diluted	<u>\$ (0.31)</u>	<u>\$ (0.91)</u>
Weighted average shares of common stock - basic and diluted	<u>11,372,571</u>	<u>8,664,863</u>

See accompanying notes to financial statements.

**NIGHTINGALE INTELLIGENT SYSTEMS, INC.**

**CONSOLIDATED STATEMENTS OF CONVERTIBLE PREFERRED STOCK AND CHANGES IN STOCKHOLDERS' DEFICIT**

FOR THE YEARS ENDED DECEMBER 31, 2020 AND 2019

	<b>Convertible Preferred Stock</b>		<b>Common Stock</b>		<b>Additional</b>	<b>Accumulated</b>	<b>Total</b>
	<b>Shares</b>	<b>Amount</b>	<b>Shares</b>	<b>Amount</b>	<b>Paid-In</b>	<b>Deficit</b>	<b>Stockholders'</b>
					<b>Capital</b>		<b>Deficit</b>
<b>Balances at December 31, 2018</b>	8,876,230	\$ 9,490,142	8,664,084	\$ 87	\$ 90,408	\$ (10,525,921)	\$ (10,435,427)
Issuance of common stock upon exercise of stock options	-	-	1,562	-	734	-	734
Issuance of Series B convertible preferred stock, net of issuance costs of \$178,612	1,898,991	2,769,384	-	-	-	-	-
Issuance of Series B-1 convertible preferred stock upon conversion of 2018 convertible notes	5,074,753	6,302,345	-	-	-	-	-
Reclassification of derivative liability upon conversion of convertible notes	-	1,596,064	-	-	-	-	-
Stock-based compensation expense	-	-	-	-	85,027	-	85,027
Net loss	-	-	-	-	-	(7,876,999)	(7,876,999)
<b>Balances at December 31, 2019</b>	15,849,974	20,157,936	8,665,646	87	176,169	(18,402,920)	(18,226,664)
Issuance of Series C convertible preferred stock, net of issuance costs of \$508,348	19,766,598	2,722,376	-	-	-	-	-
Series B issuance costs	-	(32,451)	-	-	-	-	-
Issuance of common stock upon conversion of Series Seed convertible preferred stock	(2,706,972)	(2,161,788)	2,706,972	27	2,161,761	-	2,161,788
Issuance of common stock upon conversion of Series A convertible preferred stock	(2,790,587)	(4,031,282)	2,790,587	28	4,031,254	-	4,031,282
Issuance of common stock upon conversion of Series B-1 convertible preferred stock	(2,693,438)	(3,344,981)	2,693,438	27	3,344,954	-	3,344,981
Issuance of common stock upon conversion of Series B convertible preferred stock	(386,498)	(599,999)	386,498	4	599,995	-	599,999
Issuance of common stock upon exercise of stock options	-	-	2,128	-	1,000	-	1,000
Stock-based compensation expense	-	-	4,325,730	-	(103,305)	-	(103,305)
Net loss	-	-	-	-	-	(3,512,163)	(3,512,163)
<b>Balances at December 31, 2020</b>	27,039,077	\$12,709,810	21,570,999	\$ 173	\$10,211,828	\$ (21,915,083)	\$ (11,703,082)

See accompanying notes to financial statements.

**NIGHTINGALE INTELLIGENT SYSTEMS, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**FOR THE YEARS ENDED DECEMBER 31, 2020 AND 2019**

	<b>Years Ended December 31,</b>	
	<b>2020</b>	<b>2019</b>
<b>Cash flows from operating activities:</b>		
Net loss	\$ (3,512,163)	\$ (7,876,999)
Adjustments to reconcile net loss to net cash used in operating activities:		
Stock-based compensation expense	(103,305)	85,027
Depreciation and amortization	250,090	221,922
Loss on change in fair value of derivative liability	26,106	48,597
Gain on debt extinguishment of convertible notes	-	(97,117)
Amortization of debt discount	170,612	1,361,783
Amortization of issuance costs	19,893	66,037
Reserve on drone assets	-	139,609
Changes in operating assets and liabilities:		
Accounts receivable	82,050	(84,290)
Inventories	306,341	(243,185)
Prepaid expenses and other current assets	(8,902)	53,302
Other assets	-	(847)
Accounts payable	(298,909)	247,212
Accrued expenses	(53,311)	67,080
Accrued interest	46,276	637,376
Deferred revenues	85,963	(299,550)
Net cash used in operating activities	<u>(2,989,259)</u>	<u>(5,674,043)</u>
<b>Cash flows from investing activities:</b>		
Purchase of drones and base stations	(65,557)	(178,779)
Purchase of product development drones	-	(216,076)
Expenditures for leasehold improvements	(9,700)	(59,732)
Purchase of property and equipment	-	(4,303)
Proceeds from sale of investment	-	12,903
Net cash used in investing activities	<u>(75,257)</u>	<u>(445,987)</u>
<b>Cash flows from financing activities:</b>		
Proceeds from issuance of Series B convertible preferred stock, net	-	2,703,355
Proceeds from issuance of Series C convertible preferred stock, net	2,722,376	-
Proceeds from issuance of convertible notes	1,132,969	2,773,000
Proceeds from promissory notes	395,320	-
Proceeds from exercise of stock options	1,000	734
Payment of Series B issuance costs	(32,451)	-
Payment of loan	(150,000)	(300,000)
Net cash provided by financing activities	<u>4,069,214</u>	<u>5,177,089</u>
Increase (decrease) in cash and cash equivalents	1,004,698	(942,941)
Cash and cash equivalents, beginning of year	1,680,168	2,623,110
Cash and cash equivalents, end of year	<u>\$ 2,684,865</u>	<u>\$ 1,680,169</u>
<b>Supplemental disclosure of non-cash investing and financing activities:</b>		
Conversion of convertible notes to preferred stock	<u>\$ -</u>	<u>\$ 6,302,345</u>

#7748478v1 See accompanying notes to consolidated financial statements.



**NIGHTINGALE INTELLIGENT SYSTEMS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE YEARS ENDED DECEMBER 31, 2020 and 2019**

---

**NOTE 1: DESCRIPTION OF BUSINESS AND BASIS OF PRESENTATION**

The Company was incorporated under the laws of the State of Delaware on June 13, 2014, as Nightingale Autonomous Systems, Inc. In October 2017, the Company changed its name from Nightingale Autonomous Solutions, Inc. to Nightingale Intelligent Systems, Inc. (“Nightingale” or the “Company”). Nightingale (UK) Operations Ltd, a UK private limited company is the Company’s wholly-owned subsidiary.

The Company designs, develops, builds, deploys, and supports autonomous robotic aerial security technologies that protect critical infrastructure for Fortune 500 companies. The autonomous perimeter security system features networked base stations and mission-ready drones which can be airborne in less than 30 seconds. The system is driven by the Company’s Mission Control software (Mission Manager), which equips security teams with a real-time decision support system to help keep their facilities safe.

Basis of Presentation

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (“U.S. GAAP”), which require management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes.

Liquidity

The consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. In order to continue its operations, the Company must raise additional equity or debt financings and achieve profitable operations. Although management has historically been successful in raising capital, there can be no assurance that the Company will be able to obtain additional equity or debt financing on terms acceptable to the Company, or at all. The failure to obtain sufficient funds on acceptable terms when needed could have a material adverse effect on the Company’s business, financial position, results of operations, and future cash flows. The Company is seeking to complete an initial public offering (“IPO”) of its common stock. Upon the closing of an IPO, on specified terms, the Company’s outstanding convertible preferred stock and convertible debt will automatically convert into shares of common stock (see Note 9 - *Debt Obligations* and Note 11 - *Preferred Stock*). In the event the Company does not complete an IPO, the Company expects to seek additional funding through other capital sources including through the sale of equity, debt financings or other capital sources including collaborations with other companies or other strategic transactions. However, the Company may be unable to raise additional funds or enter into such agreements or arrangements when needed on acceptable terms, or at all.

Since its inception, the Company has incurred significant operating losses and negative cash flows from operations primarily as a result of significant research and development activities related to the development and continued improvement of the Company’s Mission Manager Software, drone units and base stations. The Company has funded these activities to date primarily through the issuance of convertible preferred stock and debt. The Company must among other things respond to competitive developments, attract, retain and motivate qualified personnel. The Company has generated operating losses and negative cash flows from operations in each year since inception. Although the Company has generated revenue from product sales to date, they have not yet been able to achieve profitability and will continue to incur significant research and development and other expenses related to its ongoing operations. Cash and cash equivalents on hand was \$2.7 million and \$1.7 million at December 31, 2020 and 2019, respectively. The Company has incurred net losses of \$3.5 million and \$7.9 million for each of the years ended December 31, 2020 and 2019, had an accumulated deficit of \$21.9 million at December 31, 2020 and working capital of \$2.2 million. The Company has reviewed the relevant conditions and events surrounding its ability to continue as a going concern including among others: historical losses, projected future results, including the effects of the novel coronavirus (“COVID-19”), cash requirements for the upcoming year, terms of the Company’s current debt arrangements, funding capacity, net working capital, total stockholders’ deficit and future access to capital. Sales of additional equity securities by the Company could result in the dilution of the interests of existing stockholders. These factors, along with the Company’s cash and cash equivalents, raise substantial doubt about the Company’s ability to continue as a going concern for at least one year from the date the consolidated financial statements are issued. The financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result from the outcome of this uncertainty. If future financing is not achieved, the Company may be required to curtail spending to reduce cash outflows.

## NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### Principles of Consolidation

The consolidated financial statements include the accounts of Nightingale and its wholly-owned subsidiary, Nightingale (UK) Operations, Ltd. All significant intercompany transactions and balances have been eliminated in consolidation.

### Comprehensive Loss

Comprehensive loss includes all changes in equity during a period from non-owner sources. Through December 31, 2020, there are no components of comprehensive loss which are not included in net loss; therefore, a separate statement of comprehensive loss has not been presented. The Company does not have any significant foreign currency translation adjustments as a component of other comprehensive loss through December 31, 2020, as the functional currency of its subsidiary is the U.S. dollar.

### Use of Estimates

The Company's financial statements are prepared in accordance with U.S. GAAP. The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and the disclosure of contingent assets and liabilities in the Company's consolidated financial statements and the accompanying notes. The most significant estimates in the Company's consolidated financial statements relate to revenue recognition, determination of the cost and deriving the useful lives of the Company's drone units and base stations, assessing assets for impairment, ability to realize deferred tax assets, fair value measurements, valuation of financial instruments, valuation of stock options and warrants, and contingencies.

These estimates and assumptions are based on current facts, historical experience and various other factors believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities and the recording of revenues and expenses that are not readily apparent from other sources. Actual results could differ from those estimates.

### Financial Instruments – Recognition and Derecognition

The Company's financial instruments include cash and cash equivalents, accounts receivable, accounts payable, accrued liabilities, promissory notes, loan payable, convertible notes and the derivative liability. The Company's cash and cash equivalents, accounts receivable, accounts payable, accrued liabilities, promissory note and loan payable are carried at cost, which management believes approximates fair value due to the short term nature of these instruments. Financial assets and financial liabilities are recognized when the Company becomes a party to the contractual provisions of the financial instrument. Financial assets are derecognized when the contractual rights to the cash flows from the financial asset expire, or when the financial asset and substantially all the risks and rewards are transferred. A financial liability is derecognized when it is extinguished, discharged, cancelled or expires.

### Fair Value Measurements

The Company accounts for fair value measurements under Accounting Standards Codification 820, *Fair Value Measurements and Disclosures*, which establishes a framework for measuring fair value and requires disclosures about fair value measurements by establishing a hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to Level 1 measurements and lowest priority to Level 3 measurements. The three levels of the fair value hierarchy are described below:

- Level 1 – Observable inputs such as quoted prices in active markets
- Level 2 – Inputs other than quoted market prices in active markets that are observable, either directly or indirectly in active markets
- Level 3 – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The estimated fair value of financial instruments disclosed in the consolidated financial statements have been determined by using available market information and appropriate valuation methodologies. In certain cases where there is limited activity or less transparency around inputs to valuation, such as the Company's derivative liability, these financial instruments are classified as Level 3.

The carrying value of all remaining current assets and current liabilities approximates fair value because of their short-term nature.

### Cash Equivalents

The Company considers all highly liquid investments purchased with an original maturity of three months or less from the date of purchase to be cash equivalents. The Company places its cash and cash equivalents in highly liquid instruments with financial institutions with high credit ratings.

### Risks and Uncertainties

In March 2020, the World Health Organization declared COVID-19 a pandemic. The COVID-19 pandemic has negatively impacted the global economy, disrupted global supply chains and created significant volatility and disruption of financial markets. The full extent to which the COVID-19 pandemic will directly or indirectly impact the Company's business, results of operations and financial condition, including expenses and research and development costs, will depend on future developments that are highly uncertain, including as a result of new information that may emerge concerning COVID-19 and the actions taken to contain or treat COVID-19, as well as the economic impact on local, regional, national and international markets. The Company has made estimates of the impact of COVID-19 within its financial statements and there may be changes to those estimates in future periods. Actual results could differ materially from those estimates.

### Concentrations of Credit Risk and Significant Suppliers

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist primarily of cash and cash equivalents. Cash and cash equivalent deposits with financial institutions may occasionally exceed the limits of insurance on bank deposits. The Company has not experienced any losses on such accounts and management believes that the Company is not exposed to significant credit risk due to the financial position of the depository institution in which those accounts are held.

The Company is also subject to credit risk from its accounts receivable. The Company extends credit to customers in the normal course of business and generally does not perform evaluations of customers' financial condition and generally does not require collateral. Concentrations of credit risk with respect to accounts receivable exist to the full extent of amounts presented in the consolidated financial statements.

The Company is dependent on third-party manufacturers to supply products and services for its drones and base stations. In particular, the Company relies, and expects to continue to rely, on a small number of third-party manufacturers to manufacture and supply the inventory and other materials for its security services. These activities could be adversely affected by a significant interruption in the supply of these items.

### Accounts Receivable

Accounts receivable are derived from the sales and rental of proprietary drones and base station assets along with access to its browser-based interface Mission Manager. The Company reviews its receivables for collectability based on historical loss patterns, aging of the receivables, and assessments of specific identifiable customer accounts considered at risk or uncollectible and provides allowances for potential credit losses, as needed. The Company also considers any changes to the financial condition of its customers and any other external market factors that could impact the collectability of the receivables in the determination of the allowance for doubtful accounts. The allowance for doubtful accounts is \$158,150 and \$28,000 as of December 31, 2020 and 2019, respectively.

At December 31, 2020, the Company had two customers whose accounts receivable balances each totaled 10% or more of the Company's total accounts receivable (50% and 37%) compared with three such customers (63%, 20% and 12%) at December 31, 2019.

For the year ended December 31, 2020, the Company had three customers (23%, 16% and 15%) who individually accounted for 10% or more of the Company's total customer revenue compared with three such customers (23%, 13% and 12%) for the year ended December 31, 2019.

### Inventory

Inventories are valued at the lower of cost or net realizable value and are determined using the average cost method. The Company's inventory consists of raw material components, finished drone units, and base stations. Finished drone units and base stations include materials, labor and other direct and indirect costs used in their production. Finished drone units and base stations are valued using a discrete bill of materials, which includes an allocation of labor and direct overhead based on assembly hours. The Company regularly assesses slow-moving, excess and obsolete inventory and maintains balance sheet reserves in amounts required to reduce the recorded value of inventory to the lower of cost or net realizable value.

### Equipment on Operating Leases

Equipment is recorded at cost and depreciated over the estimated useful lives. Equipment on operating leases is depreciated to estimated salvage value over the lease term. Depreciation is computed using the straight-line method. Significant improvements are capitalized, and maintenance and repairs are expensed. See Note 4 - *Inventories & Equipment on Operating Leases*.

### Property and Equipment

Property and equipment is stated at cost and includes computers, automobiles, leasehold improvements and machinery and equipment. Depreciation is computed using the straight-line method over the estimated useful lives of two to five years for computers, automobiles, machinery and equipment. Leasehold improvements are amortized using the straight-line method over the shorter of the remaining lease term or the estimated useful lives. Expenditures for repairs and maintenance, which do not extend the useful life of the property and equipment, are expensed as incurred and improvements and betterments are capitalized. Gains and losses associated with dispositions are reflected as a non-operating gain or loss in the consolidated statements of operations.

### Product Development Assets

Prior to 2019, the Company classified certain inventory purchases to product development assets as these assets were used for internal product development purposes and not intended for sale. Depreciation expense on product development assets were included in research and development expenses on the Company's consolidated statements of operations and were approximately \$64,000 and \$73,000 for the years ended December 31, 2020 and 2019, respectively. In addition, for the year ended December 31, 2019, approximately \$140,000 of product development assets were determined to be impaired and were recorded in research and development expense in the Company's consolidated statements of operations.

### Impairment of Long-Lived Assets

The Company assesses the impairment of long-lived assets whenever events or changes in circumstances indicate that their carrying value may not be recoverable from the estimated future cash flows expected to result from their use or eventual disposition. If estimates of future undiscounted net cash flows are insufficient to recover the carrying value of the assets, the Company will record an impairment loss in the amount by which the carrying value exceeds the fair value. If the assets are determined to be recoverable, but the useful lives are shorter than originally estimated, the Company will depreciate or amortize the net book value of the assets over the newly determined remaining useful lives. None of the Company's drone units, base stations or property and equipment was determined to be impaired as of December 31, 2020. The Company had a \$140,000 reserve recorded against certain early-generation drone units determined to be obsolete as of December 31, 2019.

### Deferred Revenue

When the Company is entitled to bill its customers and receive payment from its customers in advance of its obligation to provide services or transfer goods to its customers, the Company includes the amounts in deferred revenue on its consolidated balance sheets.

### Revenue Recognition

The Company accounts for all revenue contracts in accordance with ASC Topic 606, *Revenue from Contracts with Customers* ("ASC 606"). A performance obligation is a promise in a contract to transfer distinct goods or services to a customer, and it is the unit of account in ASC 606. A contract's transaction price is allocated to each distinct performance obligation and revenue is recognized when each performance obligation under the terms of a contract is satisfied. For contracts with multiple performance obligations, the Company allocates the contract's transaction price to each performance obligation using observable standalone selling prices for similar products and services.

The substantial majority of our revenue is generated pursuant to written contractual arrangements for drone systems which include the drone and base equipment, deployment of the drone system, and subscriptions for access to the Company's browser-based interface, Nightingale Security Mission Manager, through contracts that typically have 12-month terms and automatically renew upon payment for an additional 12-month term thereafter.

The Company's performance obligations are satisfied over time or at a point in time. Revenue for maintenance, repair, and upgrades ("MRU"), as well as lease subscription revenues, are recognized over the term of the contract which as stated above is generally 12 months, unless different terms are stated in the contract. For MRU, progress is measured via a time-based output method, which is days elapsed since the Company is standing ready to perform. The Company elected the right to invoice practical expedient under which, if an entity has a right to consideration from a customer in an amount that corresponds directly with the value to the customer of the entity's

performance completed to date, such as time elapsed for maintenance, repair, and upgrade services, the entity may recognize revenue in the amount to which the entity has a right to invoice. Training and other time and material-based services are recognized over time using an output method based on days of training/services completed unless the training or other services require less than one month and are therefore recognized as training is completed.

For performance obligations that are not satisfied over time per the criteria above, revenue is recognized at the point in time at which each performance obligation is fully satisfied. The Company's drone and base product, which has embedded software called C4AI, is composed of revenue recognized on contracts for the delivery of the drone, base, and spare parts. Revenue is recognized at the point in time when control transfers to the customer, which generally occurs when title and risk of loss have passed to the customer.

Application of the various accounting principles in U.S. GAAP related to the measurement and recognition of revenue requires us to make judgments and estimates including ASC Topic 606 - *Revenue from Contracts with Customers* and ASC Topic 842 - *Leases*. Complex arrangements with nonstandard terms and conditions may require significant contract interpretation to determine the appropriate accounting. Specifically, the revenue related to the following areas involves significant judgments and estimates:

*Lease Subscription Arrangements:* The Company also leases its equipment direct to end customers under bundled lease subscription arrangements, which typically include the equipment, software, maintenance services, and training for which the customer pays a single negotiated fixed minimum monthly payment for all elements over the contractual lease term. Lease deliverables include the drone and base equipment and software as well as the deployment fee associated with the drone system, while the non-lease deliverables generally consist of the services, which include maintenance, repair, upgrades, and training. Sales made under bundled lease subscription arrangements comprise 37.7% or \$347,500 and 43.7% or \$412,750 of our total sales revenue for the years ending December 31, 2020 and 2019, respectively. Revenues under these bundled lease subscription arrangements are allocated considering the relative standalone selling prices of the lease and non-lease deliverables included in the bundled arrangement. The allocation of revenue among the elements – drone and base equipment, software, and deployment vs. post-sale (maintenance, repair and upgrade services, and training) – has remained fairly consistent at approximately 75% and 25%, respectively, over the past two years ended December 31, 2020 and 2019.

*Sales to Distributors and Resellers:* The Company utilizes distributors and resellers to sell many of its products, supplies and parts to end-user customers. Sales to distributors and resellers are generally recognized as revenue when products are shipped to such distributors and resellers. Distributors and resellers may participate in various discount, rebate, price-support, cooperative marketing and other programs, and the Company records provisions and allowances for these programs as a reduction to revenue when the sales occur. The Company did not record estimates for sales returns and other discounts and allowances when the sales occurred for the year ended December 31, 2020 as none were deemed needed as a result of the measurement of constraint of revenues. Total sales to distributors and resellers were \$522,495 and \$406,970 for the years ended December 31, 2020 and 2019, respectively.

*Service Arrangements:* Revenues associated with our service arrangements – maintenance, repairs, and upgrades, and software-as-a-service pertaining to Nightingale Security Mission Manager – are generally recognized over the term of the service period which is generally 12 months as the customer is typically invoiced for that usage at the beginning of the 12-month period.

Significant management judgments and estimates must be made and used in connection with the recognition of revenue in any accounting period. Material differences in the amount of revenue in any given period may result if these judgments or estimates prove to be incorrect or if management's estimates change on the basis of development of the business or market conditions. Management judgments and estimates have been applied consistently and have been reliable historically. The Company believes that there are two key factors which impact the reliability of management's estimates. The first of those key factors is that the terms of its contracts are typically for one year. The short-term nature of such contracts reduces the risk that material changes in accounting estimates will occur on the basis of market conditions or other factors. The second key factor is that it has numerous contracts in any given accounting period, which reduces the risk that any one change in an accounting estimate on one or several contracts would have a material impact on our consolidated financial statements.

Based on the nature of the contracts and consistent with prior practice, the Company recognizes revenue upon invoicing the customer for the large majority of its revenue. Additionally, the unit of accounting, that is, the identification of performance obligations, is consistent with prior revenue recognition practice. A significant portion of drone and base sales are either recorded as sales-type leases or through direct sales to customers or to distributors and resellers and these revenue streams are not impacted by the adoption of ASC Topic 606. The only change of significance identified in adoption involves a change in the classification of certain revenues that were previously reported in services revenues. These revenues relate to certain analyst services performed in connection with the deployment of drone systems that are being considered part of the drone and base sale performance obligation. Accordingly, these revenues are reported as part of sales.

Deferred contract costs, which include incremental costs of obtaining a contract and costs to fulfill a contract and sales commissions on reseller arrangements, had been minimal under prior Company practices as most costs to obtain a contract and fulfill a contract were

expensed as incurred. As a result of the contract cost guidance included in ASC Topic 606 and ASC Topic 340-40, *Contracts with Customers*, the Company determined that any transition asset would be immaterial related to the incremental cost to obtain contracts as the adjustment would relate to the deferral of sales commissions paid to resellers in connection with the deployment of drone systems with post sale service arrangements which did not have agreements until 2019.

#### Revenue-based Taxes:

Revenue-based taxes assessed by governmental authorities that are both imposed on and concurrent with specific revenue-producing transactions, and that are collected by the Company from a customer, are excluded from revenue. The primary revenue-based taxes are U.S. sales taxes.

#### Shipping and Handling

Shipping and handling costs are accounted for as a fulfillment cost and are included in cost of revenue in the consolidated statements of operations.

Refer to Note 3 - *Revenue Recognition* for additional information regarding revenue recognition policies with respect to contract assets and liabilities as well as contract costs.

#### Warrants Issued in Connection with Financings

The Company generally accounts for warrants issued in connection with financings as a component of equity, unless there is a deemed possibility that it may have to settle the warrants in cash. For warrants issued with a deemed possibility of cash settlement, the Company records the fair value of the issued warrants as a liability at each reporting period and records changes in the estimated fair value as a non-cash gain or loss in the consolidated statements of operations.

#### Derivative Liabilities

The Company evaluates all of its agreements to determine if such instruments have derivatives or contain features that qualify as embedded derivatives. The Company accounts for certain redemption features that are associated with convertible notes as liabilities at fair value and adjusts the instruments to their fair value at the end of each reporting period. For derivative financial instruments that are accounted for as liabilities, the derivative instrument is initially recorded at its fair value and is then re-valued at each reporting date, with changes in the fair value reported in other income (expense), net in the consolidated statements of operations. Derivative instrument liabilities are classified in the consolidated balance sheets as current or non-current based on whether or not net-cash settlement of the derivative instrument could be required within 12 months of the balance sheet date.

#### Stock-Based Compensation

The Company accounts for stock-based compensation in accordance with ASC 718, *Compensation - Stock Compensation*, which requires that the estimated fair value on the date of grant be determined using the Black-Scholes option pricing model with the fair value recognized over the requisite service period of the awards, which is generally the option vesting period. Stock-based awards made to nonemployees are measured and recognized based on the estimated fair value on the vesting date and are re-measured at each reporting period. The Company's determination of the fair value of the stock-based awards on the date of grant, using the Black-Scholes option pricing model, is affected by the Company's value of its common stock as well as other assumptions regarding a number of highly complex and subjective variables. These variables include but are not limited to the Company's expected stock price volatility over the term of the awards, and actual and projected employee option exercise behaviors. Because there is insufficient historical information available to estimate the expected term of the stock-based awards, the Company adopted the simplified method of estimating the expected term of options granted by taking the average of the vesting term and the contractual term of the option.

For awards with graded vesting, the Company recognizes stock-based compensation expense over the service period using the straight-line method, based on shares ultimately expected to vest. The Company also elected to recognize forfeitures as they occur when calculating the stock-based compensation for equity awards.

#### Deferred Rent

Deferred rent consists of the difference between cash payments and the recognition of rent expense on a straight-line basis over the term of the lease.

### Research & Development Costs

Research and development costs primarily consist of employee-related expenses, including salaries and benefits, share-based compensation expense, facilities costs, depreciation and other allocated expenses. Research and development costs are expensed as incurred.

### Advertising Costs

Advertising costs are recorded in sales and marketing expense in the Company's consolidated statements of operations as incurred. Advertising expense was immaterial for the years ended December 31, 2020 and 2019.

### PPP Loan Forgiveness

Any potential gain on the forgiveness of the PPP loans and accrued interest would be recorded as a gain on loan extinguishment in other income (loss), net in the Company's consolidated statements of operations when it is realized or realizable.

### Foreign Currency

The functional and presentation currency of the Company is the U.S. dollar. Transactions denominated in a currency other than the functional currency are recorded on the initial recognition at the exchange rate at the date of the transaction. After initial recognition, monetary assets and liabilities denominated in foreign currency are translated at the end of each reporting period into the functional currency at the exchange rate at that date. The cumulative translation adjustment would be included in accumulated other comprehensive income (loss) within the consolidated statements of convertible preferred stock and stockholders' deficit. Exchange differences would be included in general and administrative expenses in the consolidated statements of operations. Non-monetary assets and liabilities measured at cost are remeasured at the exchange rate at the date of the transaction.

### Income Taxes

The Company uses the liability method of accounting for income taxes as set forth in ASC 740, *Income Taxes*. Under the liability method, deferred taxes are determined based on the temporary differences between the financial statement and tax basis of assets and liabilities using tax rates expected to be in effect during the years in which the basis differences reverse. A valuation allowance is recorded when it is unlikely that the deferred tax assets will not be realized. The Company assesses its income tax positions and record tax benefits for all years subject to examination based upon our evaluation of the facts, circumstances and information available at the reporting date. In accordance with ASC 740-10, for those tax positions where there is a greater than 50% likelihood that a tax benefit will be sustained, the Company's policy will be to record the largest amount of tax benefit that is more likely than not to be realized upon ultimate settlement with a taxing authority that has full knowledge of all relevant information. For those income tax positions where there is less than 50% likelihood that a tax benefit will be sustained, no tax benefit will be recognized in the financial statements.

### Comprehensive Loss

Net loss was equal to comprehensive loss for the years ended December 31, 2020 and 2019.

### Net Loss Per Share

Basic net loss per share is computed by dividing the net loss by the weighted average number of common shares outstanding for the period, without consideration for potentially dilutive securities. Diluted net loss per share is computed by dividing the net loss by the weighted average number of common shares and dilutive common stock equivalents outstanding for the period determined using the treasury-stock and if-converted methods. Dilutive common stock equivalents are comprised of convertible preferred stock, options outstanding under the Company's stock option plan and outstanding common stock warrants. For all periods presented, there is no difference in the number of shares used to calculate basic and diluted shares outstanding as inclusion of the potentially dilutive securities would be anti-dilutive.

Potentially dilutive securities not included in the calculation of diluted net loss per share, because to do so would be anti-dilutive, are as follows (in common stock equivalent shares):

	<b>December 31,</b>	
	<b>2020</b>	<b>2019</b>
Convertible preferred stock	27,039,077	15,849,974
Common stock options	122,000	122,000
Common stock warrant – SVB	20,464	20,464
Common stock warrant – Series C	12,190,248	-
	<u>39,371,789</u>	<u>15,992,438</u>

The table above omits the potentially dilutive shares into which the 2020 Convertible Notes would convert.

#### Recent Accounting Pronouncements - Adopted

In June 2018, the FASB issued ASU 2018-07, *Compensation - Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting*, which simplifies the accounting for non-employee share-based payment transactions. The new standard expands the scope of Topic 718 to include share-based payment transactions for acquiring goods and services from nonemployees. ASU 2018-07 is effective for fiscal years beginning after December 15, 2019. The Company has adopted the new standard effective January 1, 2022, with no material impact on its consolidated financial statements.

In August 2018, the FASB issued ASU 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement*. The new guidance modifies the disclosure requirements for fair value measurements in Topic 820. The amendments in ASU 2018-13 are effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. The Company has adopted the new guidance effective January 1, 2020. The adoption did not have any material impact on the Company's financial position, results of operations or related disclosures.

In December 2019, the FASB issued ASU 2019-12, *Simplifying the Accounting for Income Taxes*. The new guidance is intended to simplify aspects of the accounting for income taxes, including the elimination of certain exceptions to the guidance in ASC 740 related to the approach for intraperiod tax allocation, among other changes. ASU 2019-12 is effective for fiscal years beginning after December 15, 2020, with early adoption permitted. The guidance is to be applied prospectively at the beginning of the year of adoption. The Company has adopted the new guidance effective January 1, 2020. The adoption did not have any material impact on the Company's financial position, results of operations or related disclosures.

#### Recent Accounting Pronouncements – Not Yet Adopted

The following accounting standards, which are not yet effective, are presently being evaluated by the Company to determine the impact that they might have on its financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)* (“ASU 2016-02”). ASU 2016-02 requires companies to generally recognize on the balance sheet operating and financing lease liabilities and corresponding right-of-use assets. In June 2020, the FASB issued ASU No. 2020-05, which defers the effective date for private companies until fiscal years beginning after December 15, 2021. Accordingly, ASU 2016-02 is effective for the Company beginning January 1, 2022 on a modified retrospective basis, and earlier adoption is permitted. The Company is currently assessing the effect that adoption of this standard will have on its financial position, results of operations and related disclosures.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments – Credit Losses: Measurement of Credit Losses on Financial Instruments*, or ASU 2016-13. ASU 2016-13 replaces the incurred loss impairment methodology in current U.S. GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. ASU 2016-13 is effective for fiscal years beginning after December 15, 2021, including interim periods within those fiscal years. In May 2019, the FASB issued ASU 2019-05, *Financial Instruments – Credit Losses*, or ASU 2019-05, to allow entities to irrevocably elect the fair value option for certain financial assets previously measured at amortized cost upon adoption of the new credit losses standard. The new effective dates and transition align with those of ASU 2016-13. The Company is currently assessing the impact ASU 2016-13 and ASU 2019-05 will have on the Company.

In August 2020, the FASB issued ASU 2020-06, *Debt – Debt with Conversion and Other Options (Subtopic 470-20) and Derivatives and Hedging – Contracts in Entity's Own Equity (Subtopic 815-40): Accounting for Convertible Instruments and Contracts in an Entity's Own Equity*. The new guidance, among other things, simplifies the accounting for certain financial instruments with characteristics of liabilities and equity, including convertible instruments, and amends existing earnings-per-share (“EPS”) guidance by requiring that an entity use the if-converted method when calculating diluted EPS for convertible instruments. ASU 2020-06 is effective for fiscal years beginning after December 15, 2021, including interim periods within those fiscal years, with early adoption permitted for fiscal years



beginning after December 15, 2020, including interim periods within those fiscal years. The Company plans to adopt the new guidance effective January 1, 2022 and is currently evaluating the effect adoption will have on its financial position, results of operations and related disclosures.

### NOTE 3: REVENUE RECOGNITION

Revenues are disaggregated by major product lines and sales channels are as follows:

	December 31,	
	2020	2019
<b>Major product and services lines</b>		
Drone and Base Equipment	\$ 440,995	\$ 285,167
Maintenance Agreements (1)	39,000	10,000
Deployment (2)	78,000	85,975
Other (3)	15,665	149,800
Lessor arrangements (4)	347,500	412,750
<b>Total Revenues</b>	<b>\$ 921,160</b>	<b>\$ 943,692</b>
<b>Sales channels:</b>		
Customer direct sales	\$ 51,165	\$ 124,512
Direct equipment lease (4)	347,500	412,750
Distributors & resellers (5)	522,495	406,430
<b>Total Revenues</b>	<b>\$ 921,160</b>	<b>\$ 943,692</b>

(1) Includes revenues from MRU agreements on sold equipment as well as revenues associated with maintenance service agreements sold through our resellers.

(2) Primarily includes revenues from deployment of drone systems.

(3) Primarily includes revenues from training and consulting services.

(4) Primarily reflects sales through bundled lease arrangements.

(5) Primarily reflects sales through our two-tier distribution channels.

Revenues disaggregated by point-in-time and over-time are as follows:

	December 31,	
	2020	2019
<b>Recognition:</b>		
Point-in-time	\$ 534,660	\$ 520,942
Over-time	386,500	422,750
<b>Total Revenues</b>	<b>\$ 921,160</b>	<b>\$ 943,692</b>

**Contract assets and liabilities:** Company contract assets are generally not material, which are primarily related to costs of deployment to install drone and base systems. Company contract liabilities, which represent billings in excess of revenue recognized, are primarily related to advanced billings and were approximately \$204,963 and \$119,000 at December 31, 2020 and 2019, respectively. The majority of the balance at December 31, 2020 will be amortized to revenue over approximately the next 12 months. See below for the rollforward of contract liabilities.

	Years Ended December 31,	
	2020	2019
Beginning of the year	\$ 119,000	\$ 418,550
Payments in advance	301,263	159,100
Revenue recognized on contract	(215,300)	(458,650)
End of the year	\$ 204,963	\$ 119,000

**Backlog:** We define backlog as remaining unsatisfied performance obligations under firm orders for which work has not been performed. Generally, 90-100% of our backlog will be recognized as revenue during the following fiscal year.

Because of possible future changes in delivery schedules and/or cancellations of orders, backlog at any particular date is not necessarily representative of actual sales to be expected for any succeeding period, and actual sales for the year may not meet or exceed the backlog represented. Our backlog is typically due to maintenance, repairs, and upgrades. As revenues are recognized over time, the backlog and related contract liability decrease. A majority of our contracts do not currently obligate the customer to purchase any goods or services.

#### NOTE 4: INVENTORY & EQUIPMENT ON OPERATING LEASES

Inventory, net, consisted of the following at December 31:

	2020	2019
Finished base stations	\$ 71,673	\$ 275,262
Finished drones	36,940	99,935
Inventory components	2,429	42,186
Drones and base stations, net	\$ 111,042	\$ 417,383

##### Equipment on Operating Lease

Equipment on operating leases and similar arrangements consists of Company equipment rented to customers and depreciated to estimated salvage value at the end of the lease term.

Equipment on operating leases and the related accumulated depreciation at December 31 were as follows:

	2020	2019
Equipment on lease	\$ 695,538	\$ 629,979
Accumulated depreciation	335,141	289,242
Drones and base stations, net	\$ 360,397	\$ 453,279

Depreciable lives generally vary from two to five years consistent with the planned and historical usage of the equipment subject to operating leases. Estimated minimum future revenues associated with equipment on operating leases are as follows:

	December 31,	
	2020	2019
12 months	\$ 166	\$ 182
<b>Total</b>	<b>\$ 166</b>	<b>\$ 182</b>

**NOTE 5: ACCRUED EXPENSES**

A summary of the components of accrued expenses is as follows:

	<b>December 31,</b>	
	<b>2020</b>	<b>2019</b>
Other accrued liabilities	\$ -	\$ 26,423
Accrued payroll	33,011	56,941
Accrued rent	11,044	14,002
	<u>\$ 44,055</u>	<u>\$ 97,366</u>

**NOTE 6: FAIR VALUE MEASUREMENTS**

The following table sets forth by level, within the fair value hierarchy, the financial assets and liabilities that are measured at fair value on a recurring basis at December 31, 2020 and 2019:

<b>Fair Value Measurements at December 31, 2020 using:</b>				
<b>Assets:</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
Money market funds	\$ 2,370,862	\$ -	\$ -	\$ 2,370,862
	<u>\$ 2,370,862</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 2,370,862</u>

**Liabilities:**

2020 Convertible Notes	\$ -	\$ -	\$ 757,023	\$ 757,023
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 757,023</u>	<u>\$ 757,023</u>

<b>Fair Value Measurements at December 31, 2019 using:</b>				
<b>Assets:</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
Money market funds	\$ 1,218,076	\$ -	\$ -	\$ 1,218,076
	<u>\$ 1,218,076</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,218,076</u>

The derivative liability relating to the 2018 Convertible Notes was \$0 at December 31, 2019, as the 2018 Convertible Notes were converted into shares of Series B-1 preferred stock prior to year-end.

The changes in the fair value of the derivative liability for the years ended December 31, 2020 and 2019 are summarized below:

Fair value as of December 31, 2018	\$ 795,109
Derivative liability upon issuance of 2018 Convertible Notes	752,358
Change in fair value recorded in other income (expense), net	48,597
Conversion upon financing	<u>(1,596,064)</u>
Fair value as of December 31, 2019	-
Derivative liability upon issuance of 2020 Convertible Notes	730,916
Change in fair value recorded in other income (expense), net	26,107
Fair value as of December 31, 2020	<u>\$ 757,023</u>

The derivative liabilities in the table above related to the 2018 and 2020 Convertible Notes and represent the fair value of the redemption-like contingent conversion feature. The Company calculated the fair value of the derivative liability using a probability weighted discounted cash flow analysis. The inputs used to determine the estimated fair value of the derivative were based primarily on the probability of an underlying event occurring that would trigger the embedded derivative and the timing of such event. The Company's derivative liability is measured at fair value on a recurring basis and is classified as a Level 3 liability. The Company records subsequent

adjustments to reflect the increase or decrease in estimated fair value at each reporting date in other income (expense), net in the consolidated statements of operations (see Note 9 – *Debt Obligations*).

#### NOTE 7: PROPERTY AND EQUIPMENT

Property and equipment, leasehold improvements and software, as of December 31, 2020 and 2019 are as follows:

	December 31,	
	2020	2019
Computer equipment	\$ 15,782	\$ 15,782
Machinery and equipment	6,493	6,493
Automobiles	4,574	4,574
Leasehold improvements	69,432	59,731
	96,281	86,581
Accumulated depreciation	(64,052)	(37,551)
Property and equipment, net	\$ 32,229	\$ 49,030

Depreciation and amortization expense on property and equipment included in general and administrative expenses amounted to \$25,945 and \$22,708 in 2020 and 2019, respectively. Depreciation and amortization expense of property and equipment relating to cost of services, research and development and sales and marketing was insignificant for all periods presented.

#### NOTE 8: PROMISSORY NOTE

On April 15, 2020, the Company entered into a promissory note agreement with Silicon Valley Bank that provided for the receipt by the Company of loan proceeds of \$395,320 (the “April 2020 PPP Loan”) pursuant to the Paycheck Protection Program under the Coronavirus Aid, Relief and Economic Security Act (the “CARES Act”). Under certain conditions, the loans and accrued interest are forgivable, if the loan proceeds are used for eligible purposes, including payroll, benefits, rent and utilities, and maintaining payroll levels. In October 2020, the Paycheck Protection Program Flexibility Act of 2020 extended the deferral period for borrower payments of principal, interest, and fees on all PPP loans from 6 months to 10 months. As of December 31, 2020, payments were deferred for 10 months. The April 2020 PPP Loan matures on April 15, 2022 and bears interest at a rate of 1.0% per annum. The April 2020 PPP Loan contains events of default and other provisions customary for a loan of this type. The Company has recorded the April 2020 PPP Loan as a promissory note in the December 31, 2020 consolidated balance sheet as both a current and non-current liability.

On September 7, 2021, the Company received notification and confirmation that its April 2020 PPP loan and related accrued interest has been forgiven in its entirety by the U.S. Small Business Administration and automatically cancelled (see Note 17 – *Subsequent Events*).

#### NOTE 9: DEBT OBLIGATIONS

##### Loan and Security Agreement

In April 2018, the Company entered into a Loan and Security Agreement (the “Loan Agreement”) with Silicon Valley Bank (“SVB”) for a committed growth capital line of \$1.5 million available to be used for general working capital purposes. \$750,000 of the capital line is available to be drawn from the effective date of April 2018 through the capital availability end date of September 30, 2018. The remaining \$750,000 of the capital line was available through September 30, 2018 provided the Company had achieved the second tranche milestone which is defined by the Loan Agreement as support satisfactory to SVB that the Company had 30 units deployed across 15 unique verticals, as defined in the Loan Agreement. As security, the Loan is collateralized by all assets of the Company. The Company granted SVB a continuing security interest in all of the Company’s interest in the collateral which includes all goods, equipment, inventory, contract rights or rights to payment of money, leases, license agreements among others but excludes intellectual property. This Loan Agreement will continue in effect until the maturity date of April 1, 2021. Monthly payments of interest only are due in advance for the first month, then principal and interest payments are due monthly for thirty months until maturity. Once repaid, the principal amount of the advance may not be re-borrowed. The Company has the option to prepay the loan in full. Outstanding borrowings under the Loan Agreement bear interest at the greater of (i) 2% above the prime rate (prime rate was 3.25% and 4.75% at December 31, 2020 and 2019, respectively) or (ii) 6.25%. Interest expense on the Loan Agreement during the years ended December 31, 2020 and 2019 was \$43,870 and \$47,874, respectively. The Company repaid \$150,000 and \$300,000 during the years ended December 31, 2020 and 2019, respectively.

The Loan Agreement contains representations, warranties and covenants customary to similar credit facilities. To date, the Company has been compliant with this and all other affirmative and negative covenants in the Loan Agreement. The Company may voluntarily elect to prepay all capital advances in full provided that the Company (i) provides written notice to SVB of its election to prepay the advances at least 10 days prior to such prepayment and (ii) pays, on the date of such prepayment, (a) all outstanding principal and accrued but unpaid interest, plus (b) all other sums, including bank expenses, if any, that shall have become due and payable. Prepayment of the loan will be mandatory upon an acceleration due to an event of default. Mandatory prepayments upon an acceleration that follows or occurs during an event of default would require the Company to pay immediately to SVB the sum of (i) all outstanding principal and accrued but unpaid interest, plus (ii) all other sums including bank expenses, if any, that shall have become due and payable with respect to the maturity date. Events of default which may cause repayment of the loans to be accelerated include, among other customary events of default: (i) the Company fails to deliver the financial statements and other required information within the prescribed period of time; (ii) the Company violates any of the covenants as specified in the Loan Agreement; (iii) the Company fails to pay when due any loan or monetary obligation within three business days after the due date; (iv) the Company fails to perform any obligation or covenant under this or any other loan document, which if such default can be reasonably cured, is not cured within ten days after the date due; (v) SVB determines in its good faith judgment that it is the clear intention of the Company's investors to not continue to fund the Company in the amounts and timeframe necessary to enable the Company to satisfy the obligations as they become due and payable; (vi) there is a material impairment in the perfection or priority of SVB's security interest in the collateral or in the value of such collateral; (vii) any representation or written statement given to SVB by or on behalf of the Company that is untrue or misleading in a material respect; (viii) a default in any given agreement between the Company and a third party the right to accelerate any indebtedness exceeding the contract threshold amount or that could reasonably be expected to cause any material impairment in the Company's business, operations or financial or other condition of the Company; (ix) one or more fines, penalties or final judgments, orders or decrees for the payment of money in an amount, of at least \$50,000 rendered against the Company by any government authority, (x) any document, instrument, or agreement evidencing any Subordinated Debt shall for any reason be revoked or invalidated; (xi) the attachment, seizure, levy or possession by a trustee or receiver of any portion of the Company's assets; (xii) the injunction, restraint or prevention by court order from conducting a material part of the Company's business; (xiii) the dissolution, winding up or insolvency of the Company; or (xiv) the appointment of a receiver, trustee or custodian, for all or part of the property of, assignment for the benefit of creditors by the Company, the Company begins an insolvency proceeding or an insolvency proceeding is begun against the Company.

In connection with the execution of the Loan Agreement, the Company entered into a warrant agreement which granted certain warrants to SVB (the "Warrants") for the purchase of 13,642 shares of common stock at an exercise price of \$0.47 per share. SVB also received a right to purchase additional shares upon the funding of each growth capital advance. At the end of December 31, 2020, warrants exercisable for 20,464 shares of the Company's common stock were issued and outstanding. The warrants expire in April 2028 and are subject to automatic conversion if the fair value of the Company's common stock exceeds the exercise price as of the expiration date. The Company accounted for all the Warrants issued as equity instruments since the Warrants are indexed to the Company's common shares and meet the criteria for classification in stockholders' deficit. The Company determined the fair value of these warrants using the Black-Scholes option pricing model and determined that the aggregate fair value of the warrants to be approximately \$5,400. The fair value of the warrant would be recorded as a debt issuance cost which would be amortized to interest expense using the effective interest method over the term of the loan. As the fair value of the warrants was immaterial, the Company expensed the entire amount to interest expense in the year ended December 31, 2018.

## Convertible Notes

### *2018 Convertible Notes*

During the year ended December 31, 2018, the Company entered into a series of convertible promissory note agreements (the "2018 Convertible Notes") for aggregate borrowings of approximately \$2.9 million ("first tranche"). In 2019, the Company secured an additional \$2.9 million ("second tranche") from this same series of 2018 Convertible Notes. Outstanding borrowings under the 2018 Convertible Notes and accrued interest are due 24 months following the closing of each promissory note agreement, if not previously converted. The 2018 Convertible Notes bear interest at the rate of 15% per annum and cannot be prepaid prior to the maturity date unless approved in writing by a majority of the Noteholders.

Pursuant to the 2018 Convertible Notes, the outstanding principal and accrued and unpaid interest are automatically convertible into equity shares in the next equity financing round with total proceeds of not less than \$2.0 million (a "Next Equity Financing"), at a conversion price per share equal to 80% of the price per share paid by investors purchasing such equity securities in a Next Equity Financing. For purposes of the 2018 Convertible Notes, equity securities means the Company's Common Stock or Preferred Stock or any securities conferring the right to purchase the Company's Common Stock or Preferred Stock or securities convertible into or exchangeable for the Company's Common Stock or Preferred Stock, except (1) any security granted, issued and/or sold by the Company to any director, officer, employee or consultant of the Company for the primary purpose of soliciting or retaining their services or (2) debt securities. If the Company consummates a Change of Control (which includes a Corporate Transaction or IPO) prior to full

repayment of the 2018 Convertible Notes, the principal and accrued and unpaid interest shall convert into shares of common stock at the election of the majority Noteholders at a price determined by dividing \$35 million by the Company's fully diluted capitalization.

The Company evaluated whether the 2018 Convertible Notes contain embedded features that meet the definition of derivatives under FASB ASC 815, *Derivatives and Hedging*. The Company determined that these redemption features contained rights and obligations for conversion contingent upon a potential future financing event or a change in control. Thus, the embedded redemption features were bifurcated from the face value of the note and accounted for as a derivative liability to be remeasured at the end of each reporting period. The fair value of the derivative liability at the inception of the first tranche for the year ended December 31, 2018 was \$768,000 with the offsetting amount being recorded as a debt discount; a mark-to-market adjustment of \$27,000 was recorded to increase the derivative liability at the end of December 31, 2018. The fair value of the derivative liability at the inception of the second tranche was \$752,000 with the offsetting amount being recorded as a debt discount as of December 31, 2019. Debt issuance costs in connection with the 2018 Convertible Notes were \$66,000. The debt discount and debt issuance costs are being amortized to interest expense using the effective interest method over the expected term of the 2018 Convertible Notes. In December 2019, the Company raised approximately \$2.8 million in net proceeds from the sale of Series B Convertible Preferred Stock which triggered the automatic conversion of all the 2018 Convertible Notes and accrued interest into Series B-1 Convertible Preferred Stock. Upon conversion of the 2018 Convertible Notes, the outstanding principal plus accrued interest thereon, net of unamortized debt discounts totaling approximately \$1.6 million was derecognized into stockholders' deficit. The Company remeasured the derivative liability on the date of conversion and recorded a mark-to-market adjustment of \$49,000 to its consolidated statements of operations for the year ended December 31, 2019. For the year ended December 31, 2019, the Company recognized \$1,428,000 for the amortization of the debt discount and debt issuance costs, of which \$1,362,000 pertained to the debt discount and \$66,000 pertained to debt issuance costs. This amortization expense is recognized as interest expense in the consolidated statements of operations for the year ended December 31, 2019. The effective interest rate of the 2018 Convertible Notes was 61.7% at December 31, 2019, compared to the stated rate of 15%. As a result, the Company's reported interest expense was significantly higher than the contractual cash interest payments.

#### *2020 Convertible Notes*

In July 2020, the Company entered into a series of convertible note subscription agreements (the "2020 Convertible Notes") with various investors for aggregate gross borrowings of approximately AUD \$1.8 million or USD \$1.2 million; net proceeds received in USD was approximately \$1.0 million. The proceeds from the 2020 Convertible Notes are to be used for approved purposes only. Outstanding borrowings under the 2020 Convertible Notes and unpaid accrued interest are due and repayable in full on August 1, 2022 (maturity date), if not previously converted. The 2020 Convertible Notes bear interest at the rate of 8% per annum with interest payable beginning on July 31, 2020. The 2020 Convertible Notes will automatically convert into fully paid ordinary shares of the Company upon the completion of a Proposed Transaction which is defined as a listing on the Australian Stock Exchange ("ASX") if not repaid earlier. Conversion of unpaid accrued interest into additional fully paid ordinary shares is at the option of the Company.

The Company determined that the 2020 Convertible Notes contained rights and obligations for conversion contingent upon a listing on the ASX. Thus, the embedded redemption feature was bifurcated from the face value of the note and accounted for as a derivative liability to be remeasured at the end of each reporting period. The fair value of the derivative liability at the inception of the 2020 Convertible Notes was \$731,000 with the offsetting amount being recorded as a debt discount. Debt issuance costs were \$85,000 at December 31, 2020. The debt discount and debt issuance costs are being amortized to interest expense using the effective interest method over the expected term of the 2020 Convertible Notes. The Company recognized approximately \$171,000 of amortization of debt discount and approximately \$20,000 of amortization of debt issuance costs as interest expense in the consolidated statements of operations for the year ended December 31, 2020. The effective interest rate of the 2020 Convertible Notes was 40.4% at December 31, 2020, compared to the stated rate of 8%. During the year ended December 31, 2020, the Company also recognized interest expense in the consolidated statements of operations of approximately \$47,000 related to the 2020 Convertible Notes.

#### **NOTE 10: STOCKHOLDERS' DEFICIT**

As of December 31, 2020, the Company was authorized to issue two classes of stock with a \$0.00001 par value consisting of common stock and preferred stock totaling 140,469,951 shares. The total number of shares the Company has the authority to issue under each class consists of common stock designated as 90,433,860 shares of Common Stock and 50,036,091 shares of Preferred Stock, with convertible Preferred Stock designated as 5,004,380 shares of Series Seed convertible Preferred Stock ("Series Seed Preferred Stock"), 3,871,850 shares of Series A convertible Preferred Stock ("Series A Preferred Stock"), 5,854,086 shares of Series B convertible preferred stock ("Series B Preferred Stock"), 5,074,753 shares of Series B-1 convertible Preferred Stock ("Series B-1 Preferred Stock) and 30,231,022 shares of Series C convertible Preferred Stock ("Series C Preferred Stock"). See Note 11 for further information on the Preferred Stock.

As of December 31, 2020 and 2019, 17,356,842 and 8,665,646 shares of Common Stock were issued and outstanding, respectively. The holders of Common Stock have liquidation rights to receive any of the Company's remaining assets on a pro-rata basis only following

full payment of the preferential amounts payable with respect to Convertible Preferred Stock. The Company has reserved 7,285,626 and 4,085,626 shares of its common stock pursuant to the 2014 Stock Plan ("2014 Plan") as of December 31, 2020 and 2019, respectively. A total of 269,872 and 968,059 stock options are outstanding under the 2014 Plan as of December 31, 2020 and 2019, respectively.

#### Common Stock Reserved for Future Issuance

Shares of common stock reserved for future issuance relate to outstanding preferred stock, stock options and common stock warrants as follows:

	<b>December 31, 2020</b>
Series A Preferred Stock	1,081,263
Series B Preferred Stock	1,464,181
Series B-1 Preferred Stock	2,381,315
Series C Preferred Stock	19,766,598
Series Seed Preferred Stock	2,234,147
Common stock warrants – Series C	12,190,248
Common stock warrants – SVB	20,464
Stock options to purchase common stock	269,872
Stock options available for future issuance	283,244
	<hr/>
Total shares of common stock reserved	<u><u>39,691,332</u></u>

#### **NOTE 11: PREFERRED STOCK**

The following table summarizes shares of Preferred Stock that were issued and outstanding as of December 31, 2020 and 2019:

	<b>December 31, 2020</b>	<b>December 31, 2019</b>
Series A Preferred Stock	1,081,263	3,871,850
Series B Preferred Stock	1,464,181	1,898,991
Series B-1 Preferred Stock	2,381,315	5,074,753
Series C Preferred Stock	19,766,598	-
Series Seed Preferred Stock	2,234,147	5,004,380
	<hr/>	<hr/>
	<u>26,927,504</u>	<u>15,849,974</u>

Other than a change of control, dissolution or winding up of the Company whether voluntary or involuntary or upon the occurrence of a deemed liquidation event, the convertible Preferred Stock is non-redeemable. As a result of the liquidation preference, the convertible preferred stock was not classified as part of stockholders' deficit in the consolidated balance sheets in accordance with ASC 480-10-S99, *SEC Materials*. The Company has excluded all series of convertible preferred stock from being presented within stockholders' deficit in the consolidated balance sheets due to the nature of the liquidation preferences.

#### *Series A Preferred Stock*

From October to December 2017, the Company issued 3,871,850 shares of Series A Preferred stock at \$1.4446 per share to various investors for net proceeds of approximately \$5.5 million.

#### *Series B Preferred Stock*

In December 2019, the Company issued 1,898,991 shares of Series B Preferred Stock at \$1.5524 per share to various investors for net proceeds of approximately \$2.8 million.

### *Series B-1 Preferred Stock*

In December 2019, the Company raised approximately \$2.8 million in net proceeds from the sale of Series B Convertible Preferred Stock which triggered the automatic conversion of all the 2018 Notes and accrued interest into Series B-1 Convertible Preferred Stock. The 2018 Convertible Notes converted into 5,074,753 shares of Series B-1 Preferred Stock at a conversion price of \$1.2419 per share which represented a 20% discount from the Series B Preferred Stock price.

### *Series C Preferred Stock and Common Stock Warrants*

In July 2020, the Company issued 19,766,598 shares of Series C convertible preferred stock at \$0.1450 per share to various investors for net proceeds of \$2.7 million. In conjunction with the Series C convertible preferred stock, the Company also issued warrants with the Series C Preferred Stock Offering for the purchase of 12,190,248 shares of the Company's common stock at an exercise price of \$0.01 per share. The warrants have a ten-year contractual life and are immediately exercisable. The Company evaluated the terms of the warrants and determined that the warrants should be classified in equity as the warrants are both indexed to the Company's own stock and would be classified in stockholders' deficit.

### *Series Seed Preferred Stock*

In August 2016, the Company issued 7,396,032 shares of Series Seed Preferred Stock at \$0.7986 per share to various investors for net proceeds of \$2.8 million. In 2020, several Series Seed Preferred Stockholders converted their Series Seed Preferred Stock into common stock of the Company at \$0.7986 per share.

The following tables summarizes convertible preferred stock authorized and outstanding as of December 31, 2020 and 2019:

<b>December 31, 2020</b>	<b>Shares Authorized</b>	<b>Shares Outstanding</b>	<b>Proceeds Net of Issuance Costs</b>	<b>Aggregate Liquidation Preference</b>
Series A Preferred Stock	3,871,850	1,081,263	\$ 5,493,639	\$ 1,561,993
Series B Preferred Stock	5,854,086	1,464,181	2,006,890	2,272,995
Series B-1 Preferred Stock	5,074,753	2,381,315	-	2,957,355
Series C Preferred Stock	30,231,022	19,766,598	2,722,376	2,866,157
Series Seed Preferred Stock	5,004,380	2,234,147	3,996,504	1,784,190
	<u>50,036,091</u>	<u>26,927,504</u>	<u>\$ 14,219,409</u>	<u>\$ 11,442,689</u>

On September 9, 2020, several of the preferred stockholders elected to convert their shares of preferred stock into 8,577,495 shares of common stock. Shares of Series B-1 Preferred Stock were issued upon the automatic conversion of the Company's 2018 Convertible Notes upon the consummation of a "Next Equity Financing" from the issuance of Series B Preferred Stock. See Note 9 for additional information.

<b>December 31, 2019</b>	<b>Shares Authorized</b>	<b>Shares Outstanding</b>	<b>Proceeds Net of Issuance Costs</b>	<b>Aggregate Liquidation Preference</b>
Series A Preferred Stock	3,871,850	3,871,850	\$ 5,493,639	\$ 5,593,275
Series B Preferred Stock	5,854,086	1,898,991	2,006,890	2,947,994
Series B-1 Preferred Stock	5,074,753	5,074,753	-	6,302,336
Series Seed Preferred Stock	5,004,380	5,004,380	3,996,504	3,996,498
	<u>19,805,069</u>	<u>15,849,974</u>	<u>\$ 11,497,033</u>	<u>\$ 18,840,102</u>

All classes of Preferred Stock have a par value of \$0.0001 per share.

### *Conversion Rights*

Each share of Series Seed and Series A Preferred Stock is convertible at the option of the holder at any time after the date of issuance of those shares into fully paid non-assessable shares of Common Stock determined by dividing the applicable original issue price for such series by the applicable conversion price for such series (the "conversion rate") in effect on the date the certificate is surrendered for conversion. Each share of Preferred Stock will be automatically converted into shares Common Stock at the conversion rate



immediately upon the earlier of (i) the closing of the Company's sale of Common Stock in a firm commitment underwritten public offering pursuant to a registration statement on Form S-1 under the Securities Act of 1933, the public offering price of which was not less than \$8,000,000 in the aggregate, or (ii) the date or occurrence of an event, specified by vote or written consent or agreement of (x) the holders of a majority of the then outstanding Preferred Stock (voting together as a single class and not as a separate series, on an as-converted basis) and (y) the holders of at least a majority of the then outstanding shares of Series A Preferred Stock.

#### *Voting Rights*

The holders of each share of Preferred Stock have the right to one vote for each share of Common Stock into which such Preferred Stock could then be converted and with respect to such vote, such holder has full voting rights and powers equal to the voting rights and powers of the Common Stock and shall be entitled to vote, together with holders of the Common Stock.

#### *Dividends*

The holders of the outstanding shares of convertible preferred stock are entitled to receive dividends, when, as and if declared by the Board of Directors, out of any assets at the time legally available payable and in preference to any declaration or payment of any dividend on the common stock of the Company. Dividends would be payable at the following non-cumulative dividend rates: \$0.0639 per share of Series Seed Preferred Stock, \$0.1156 per share of Series A Preferred Stock, \$0.1242 per share of Series B Preferred Stock, \$0.0994 per share of Series B-1 Preferred Stock, and \$0.0116 per share of Series C Preferred Stock. After payment of such dividends, any additional dividends or distributions shall be distributed among all holders of Common Stock and Preferred Stock in proportion to the number of shares of Common Stock that would be held by each holder if all shares of Preferred Stock were converted to Common Stock at the then effective conversion rate. The right to receive dividends is not cumulative. No dividends were declared through December 31, 2020.

#### *Liquidation Rights*

In the event of a liquidation event, either voluntary or involuntary, the holders of the Series C Preferred Stock will be entitled to receive out of the proceeds available for distribution prior to and in preference to the holders of Series B Preferred Stock, Series B-1 Preferred Stock, Series A Preferred Stock and Series Seed Preferred Stock. Upon completion of the distribution to Series C Preferred Stock, Series B and Series B-1 will be entitled to receive out of the proceeds available for distribution prior to and in preference to any distribution made to the holders of Series A Preferred Stock. Upon completion of the distribution to Series B Preferred Stock, Series A will be entitled to receive out of the proceeds available for distribution prior to and in preference to any distribution made to the holders of Series Seed Preferred Stock. A Liquidation Event is defined as (a) the closing of the sale, transfer or other disposition of all or substantially all of the Company's assets, (b) the consummation of a merger or consolidation of the Company with or into another entity where there is a change of control, (c) the closing of the transfer to a person or group of affiliated persons of the Company's securities, if after such closing, such person or group of affiliated persons would hold 50% or more of the outstanding voting stock of the Company or the surviving or acquiring entity, (d) the grant of an exclusive license of or to all or substantially all of the Company's intellectual property or (e) a liquidation, dissolution or winding up of the Company. If upon the occurrence of such event, the proceeds distributed among the holders of the Series A are insufficient to permit the payment to such holders of the full aforesaid preferential amounts, then, the entire proceeds legally available for distribution are to be distributed among the holders of the Series A Preferred Stock in proportion to the full preferential amount that each such holder would otherwise be entitled to receive. After such payment has been made to the holders of Series A, the holders of the Series Seed Preferred Stock are entitled to receive, out of the proceeds, prior and in preference to any distribution of the proceeds of Liquidation Event to the holders of Common Stock, an amount per share equal to the sum of the applicable Original Issue Price of the Series Seed Preferred Stock, plus declared but unpaid dividends on such share. If upon the occurrence of such event, the proceeds distributed among the holders of the Series Seed Preferred Stock are insufficient to permit the payment to such holders of the full preferential amounts, then the entire proceeds legally available for distribution are to be distributed ratably among the holders of the Series Seed Preferred Stock in proportion to the full preferential amount that each such holder is otherwise entitled to receive. After such payments have been made to the holders of all convertible Preferred Stock, no further payments shall be made to the holders of the convertible Preferred Stock and any remaining proceeds available for distribution to stockholders shall be distributed pro rata among the holders of the Company's common stock based on the number of common shares held by each.

The convertible preferred stockholders have liquidation preferences over the common stockholders in the amounts of \$0.7986 per share, \$1.4446 per share, \$1.5524 per share, \$1.2419 per share, and \$0.1450 per share for each share of Series Seed Preferred Stock, Series A Preferred Stock, Series B Preferred Stock, Series B-1 Preferred Stock and Series C Preferred Stock, respectively. The liquidation preferences totaled \$11,442,689 and \$18,840,102 as of December 31, 2020 and 2019, respectively.

## NOTE 12: STOCK-BASED COMPENSATION

### Stock Options

In November 2014, the Board of Directors adopted the 2014 Equity Incentive Plan (the “2014 Plan”) allowing for the issuance of up to 4,085,626 shares of common stock through grants of options or the direct award or sale of shares. The 2014 Plan provides for the granting of stock awards such as incentive stock options and nonstatutory stock options to employees, directors and outside consultants as determined by the Board of Directors.

The Board may grant stock options under the 2014 Plan at a price of not less than 100% of the fair market value of the Company’s common stock on the date the option is granted. The option exercise price generally may not be less than the underlying stock’s fair market value at the date of grant and generally have a term of ten years. Incentive stock options granted to employees who, on the date of grant, own stock representing more than 10% of the voting power of all of the Company’s classes of stock, are granted at an exercise price of not less than 110% of the fair market value of the Company’s common stock. The maximum term of incentive stock options granted to employees who, on the date of grant, own stock having more than 10% of the voting power of all the Company’s classes of stock, may not exceed five years. The Board of Directors also determines the terms and conditions of awards, including the vesting schedule and any forfeiture provisions. Options granted under the 2014 Plan may vest upon the passage of time, generally four years, or upon the attainment of certain performance criteria established by the Board of Directors. The Company may from time to time grant options to purchase common stock to nonemployees for advisory and consulting services. At each measurement date, the Company will remeasure the fair value of these stock options using the Black-Scholes option pricing model and recognize the expense ratably over the vesting period of each stock option award. Stock options comprise all of the awards granted since the Plan’s inception. Shares available for grant under the 2014 Plan amounted to 283,244 and 979,303 as of December 31, 2020 and 2019, respectively.

A summary of the option activity under the 2014 Plan as of December 31, 2020 and changes during the year then ended is as follows:

	Shares Available for Grant	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)
Outstanding at December 31, 2018	829,696	1,119,228	\$ 0.47	8.99
Granted	-	-	0.47	
Exercised	-	(1,562)	-	
Cancelled	149,607	(149,607)	0.47	
Outstanding at December 31, 2019	979,303	968,059	0.47	8.34
Granted	-	-		
Exercised	-	(2,128)		
Cancelled	(696,059)	(696,059)	0.47	
Outstanding at December 31, 2020	283,244	269,872	0.47	7.10
Vested and exercisable at December 31, 2020		24,899	0.47	
Vested and expected to vest at December 31, 2020		110,092		

The weighted average grant date fair value of options granted during the year ended December 31, 2020 was \$0.47 per share. There were no option grants during the years ended December 31, 2020 and 2019. The fair value of the shares subject to stock options that were vested at December 31, 2020 and 2019 were \$25,982 and \$137,445, respectively.

The Company measures employee stock-based awards at grant-date fair value and recognizes employee compensation expense on a straight-line basis over the vesting period of the award. Determining the appropriate fair value of stock-based awards requires the input of subjective assumptions, including the fair value of the Company’s common stock, and, for stock options, the expected life of the option and expected stock price volatility. The Company used the Black-Scholes option pricing model to value its stock option awards. The assumptions used in calculating the fair value of stock-based awards represent management’s best estimates and involve inherent uncertainties and the application of management’s judgment. As a result, if factors change and management uses different assumptions, stock-based compensation expense could be materially different for future awards.

The expected life of the stock options was estimated using the “simplified method,” which is based on the midpoint between the vesting start date and the end of the contractual term, as the Company has limited historical information to develop reasonable expectations about future exercise patterns and employment duration for its stock options grants. The simplified method is based on the average of the vesting tranches and the contractual life of each grant. For stock price volatility, the Company uses comparable public companies as a basis for its expected volatility to calculate the fair value of options grants. The risk-free interest rate is based on U.S. Treasury notes with a term approximating the expected life of the option. The estimation of the number of stock awards that will ultimately vest requires judgment, and to the extent actual results or updated estimates differ from the Company’s current estimates, such amounts are recognized as an adjustment in the period in which estimates are revised.

The assumptions utilized for option grants during the years ended December 31, 2020 and 2019 are as follows:

	<b>December 31,</b>	
	<b>2020</b>	<b>2019</b>
Risk-free interest rate	N/A	2.88 %
Expected dividend yield	N/A	0.00 %
Expected volatility	N/A	45.00 %
Expected term (in years)	N/A	7.00
Fair value per stock option	\$ N/A	\$ 0.47

There were no options granted during the year ended December 31, 2020.

The Company recognized employee stock-based compensation expense for the years ended December 31, 2020 and 2019, which was calculated based upon awards ultimately expected to vest, and thus, this expense was reduced for estimated forfeitures. Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

Stock-based compensation expense of \$(103,305) and \$85,027 was recognized for the years ended December 31, 2020 and 2019, respectively. Total unrecognized compensation cost related to non-vested stock option awards amounted to \$22,916 and \$110,071 for the years December 31, 2020 and 2019, respectively, which will be recognized over a weighted average period of 5 and 23 months as of December 31, 2020 and 2019, respectively.

Stock-based compensation is included in the consolidated statements of operations in cost of revenue, general and administrative, research and development, or sales and marketing expenses, depending on the nature of the services provided. Stock-based compensation expense recorded to operations for stock options was as follows:

	<b>Years ended December 31,</b>	
	<b>2020</b>	<b>2019</b>
Cost of revenue	\$ 2,171	\$ 3,103
General and administrative	(62,654)	62,341
Research and development	(31,028)	15,623
Sales and marketing	(11,794)	3,960
Total	<u>\$ (103,305)</u>	<u>\$ 85,027</u>

#### **NOTE 13: EMPLOYEE BENEFIT PLAN**

The Company has a 401(k) retirement plan (the “401(k) Plan”) administered by a third party in which all eligible employees can participate. The Company has made no matching contributions.

**NOTE 14: INCOME TAXES**

Domestic and foreign components of loss before provision for income taxes for the years ended December 31, 2020 and 2019 are as follows:

	<b>Years Ended December 31,</b>	
	<b>2020</b>	<b>2019</b>
United States	\$ (3,511,363)	\$ (7,876,199)
Loss before provision for income taxes	<u>\$ (3,511,363)</u>	<u>\$ (7,876,199)</u>

The provision for income taxes consisted of the following:

	<b>Years Ended December 31,</b>	
	<b>2020</b>	<b>2019</b>
Current:		
Federal	\$ -	\$ -
State	800	800
Foreign	-	-
Total current	<u>800</u>	<u>800</u>
Deferred:		
Federal	-	-
State	-	-
Foreign	-	-
Total deferred	<u>-</u>	<u>-</u>
Total provision	<u>\$ 800</u>	<u>\$ 800</u>

The components of our deferred tax assets and liabilities consisted of:

	<b>December 31,</b>	
	<b>2020</b>	<b>2019</b>
Deferred tax assets:		
Net operating loss carryforwards	\$ 5,241,809	\$ 4,271,455
Research and development credit carryforwards	376,010	261,166
Stock-based compensation	-	3,310
Fixed assets	34,386	68,773
Accruals and other	99,474	47,071
	<u>5,751,679</u>	<u>4,651,775</u>
Valuation allowance	<u>(5,710,309)</u>	<u>(4,608,219)</u>
Total deferred tax asset	<u>41,370</u>	<u>43,556</u>
Deferred tax liability:		
Acquisition intangible	<u>(41,370)</u>	<u>(43,556)</u>
Total deferred tax liability	<u>(41,370)</u>	<u>(43,556)</u>
Net deferred tax asset (liability)	<u>\$ -</u>	<u>\$ -</u>

As of December 31, 2020, the Company had federal net operating loss carryforwards of \$18,749,004. The federal NOL carryforwards

consist of \$4,829,534 generated before January 1, 2018 which will begin to expire in 2036 but are able to offset 100% of taxable income and \$13,919,470 generated after December 31, 2017 that will carry forward indefinitely but will be subject to 80% of taxable income limitation beginning in tax years after December 31, 2020. The Company has federal research and development credit carryforwards of \$127,437 which will begin to expire in 2036. As of December 31, 2020, the Company has state net operating loss carryforwards of \$18,679,739 which will begin to expire in 2036, and state research and development tax credit carryforwards \$473,303, which do not expire.

Utilization of the federal and state net operating loss and federal and state research and development tax credit carryforwards may be subject to annual limitations due to the ownership percentage change provisions of the Internal Revenue Code Sections 382 and 383 and similar state provisions. The annual limitations may result in an inability to fully offset future annual taxable income and could result in the expiration of the net operating loss or credit carryforwards before utilization. Utilization of foreign net operating loss carryforwards may be limited or disallowed under similar foreign income tax provisions.

As of December 31, 2020, the Company had unrecognized tax benefits of \$150,185. A reversal of the unrecognized tax benefits would not affect the Company's effective tax rate to the extent that it continues to maintain a full valuation allowance against its deferred tax assets. The Company's policy is to recognize interest and penalties related to income matters in income tax expense. No significant interest or penalties were recorded during the year ended December 31, 2020. The Company does not anticipate any significant changes to unrecognized tax benefits within the next twelve months.

The Company files income tax returns in the U.S. federal and California jurisdictions, and in the UK foreign jurisdiction. The Company is subject to U.S. federal income tax examinations for calendar tax years ended 2016 through 2020 due to net operating losses that are being carried forward for tax purposes. Additionally, the Company is subject to state income tax examinations for the 2016 through 2020 calendar tax years due to net operating losses that are being carried forward for tax purposes. The Company is not currently under audit in any major tax jurisdiction.

On March 27, 2020, the Coronavirus Aid, Relief and Economic Security Act ("CARES Act") was enacted and signed into law in response to the COVID-19 pandemic. U.S. GAAP requires recognition of the tax effects of new legislation during the reporting period that includes the enactment date. The CARES Act includes changes to the tax provisions that benefits business entities and makes certain technical corrections to the 2017 Tax Cuts and Jobs Act. The tax relief measures for businesses include a five-year net operating loss carryback, suspension of the annual deduction limitation of 80% of taxable income from net operating losses generated in a tax year beginning after December 31, 2017, changes in the deductibility of interest, acceleration of alternative minimum tax credit refunds, payroll tax relief, technical corrections on net operating loss carryforwards for fiscal year taxpayers and allows accelerated deduction qualified improvement property. The CARES Act also provides other non-tax benefits to assist those impacted by the pandemic. The Company received Paycheck Protections Program ("PPP") loans in 2020 and 2021. The 2020 loan totaling \$395,320, plus accrued interest, and the 2021 loan totaling \$278,272, plus accrued interest, were forgiven in 2021.

#### **NOTE 15: LEASE OBLIGATIONS**

Effective December 2017, the Company entered into a facility lease agreement for manufacturing space located in Newark, California. The lease term commenced May 1, 2018 and expires on June 30, 2021 at which time the lease was amended with a new expiration date of February 14, 2022 and was further amended such that the expiration date of the new lease is now February 14, 2026. Monthly lease obligations under the agreement include base rent starting at \$11,508 per month plus 26.2% of common area operating costs, subject to actual expenses. The base rent was contractually escalated to \$11,853 per month beginning May 1, 2019, to \$12,209 per month beginning May 1, 2020 and to \$12,575 per month beginning May 1, 2021.

Rent expense totaled \$171,000 and \$159,000 for the years ended December 31, 2020 and 2019, respectively, and is included in the Company's consolidated statements of operations.

In October 2017, the Company entered into an agreement to lease a vehicle. The vehicle lease had a term of 48 months with monthly lease payments including tax, of \$561 per month. The Company accounted for this lease as an operating lease. Subsequent to December 31, 2020, the Company purchased the vehicle at the end of the lease in October 2021.

The following are the future minimum lease obligations on the Company's lease agreements as of December 31, 2020:

<u>December 31,</u>	<u>Lease Obligations</u>
2021	79,596
	<u>\$ 79,596</u>

#### **NOTE 16: COMMITMENTS AND CONTINGENCIES**

In the normal course of business, the Company enters into contracts that contain various representations and warranties and provide for general indemnifications. The Company's exposure under these agreements is unknown because any claims that may be made against the Company in the future have not yet been made. To date, the Company has not paid any claims or been required to defend any action related to its indemnification obligations and, accordingly, the Company believes that the fair value of these indemnification obligations is minimal and has not accrued any amounts for these obligations.

From time to time, the Company is subject to claims and assessments in the ordinary course of business. The Company is not currently a party to any litigation matters that, individually or in the aggregate, are expected to have a material adverse effect on the Company's business, financial condition, results of operations, or cash flows.

#### **NOTE 17: SUBSEQUENT EVENTS**

Management has evaluated subsequent events through July 11, 2022, the date the consolidated financial statements were issued. Based on this evaluation, no additional material events were identified which require adjustment or disclosure in these consolidated financial statements.

##### PPP Loans

On September 7, 2021, the Company received notification and confirmation from the U.S. Small Business Administration (the "SBA") that its April 2020 PPP loan and related accrued interest had been forgiven in their entirety by the SBA and automatically cancelled.

On February 13, 2021, the Company entered into a separate, new promissory note agreement with Silicon Valley Bank that provided for the receipt by the Company of loan proceeds of \$278,272 (the "February 2021 PPP Loan") pursuant to the Paycheck Protection Program under the Coronavirus Aid, Relief and Economic Security Act (the "CARES Act"). Under certain conditions, the loans and accrued interest are forgivable, if the loan proceeds are used for eligible purposes, including payroll, benefits, rent and utilities, and maintaining payroll levels. On September 3, 2021, the Company received notification and confirmation that its February 2021 PPP loan and related accrued interest had been forgiven in its entirety by the SBA and automatically cancelled.

##### Small Business Administration Loan

In November 2021, the Company entered into a Loan Authorization Agreement with the U.S. Small Business Administration in which the Company would receive a loan for \$150,000 (the "promissory note"). The promissory note would bear interest at 3.5% per annum with installment payments, including principal and interest, of \$731 monthly, to begin twelve months from the date of the promissory note. The principal and interest will be payable thirty years from the date of the promissory note. The proceeds from the promissory note were received in March 2022.

##### Convertible Loan

In June 2022, the Company entered into convertible loan agreements with various investors for gross proceeds of \$1.0 million AUD or approximately \$700,000 USD. The notes are convertible into shares of the Company's common stock issued upon completion of an IPO at a conversion price equal to 90% of the IPO price at any time after the occurrence of an IPO. The convertible notes are convertible at the option of the noteholder. The notes are non-interest bearing and mature within three months after the date of issuance of the convertible notes unless previously redeemed, converted or purchased and cancelled.

**Nightingale Intelligent Systems, Inc.**

Consolidated Financial Statements as of and for the  
Years Ended December 31, 2021 and 2020, and  
Independent Auditors' Report

**NIGHTINGALE INTELLIGENT SYSTEMS, INC.**  
**TABLE OF CONTENTS**

---

	<b>Page</b>
INDEPENDENT AUDITOR’S REPORT	1–2
CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2021 AND 2020	
Consolidated Balance Sheets	3
Consolidated Statements of Operations	4
Consolidated Statements of Convertible Preferred Stock and Changes in Stockholders’ Deficit	5
Consolidated Statements of Cash Flows	6
Notes to Consolidated Financial Statements	7–27



## Independent Auditor's Report

To the Members of Nightingale Intelligent Systems, Inc.

### Report on the audit of the financial report

#### Qualified opinion

We have audited the financial report of Nightingale Intelligent Systems, Inc. (the Company) and its subsidiaries (the Group), which comprises the consolidated statement of financial position as at 31 December 2021, the consolidated statement of profit or loss and other comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, except for the effects of the matter described in the Basis for Qualified Opinion section of our report, the accompanying financial report of Nightingale Intelligent Systems, Inc. presents fairly, in all material respects, the Group's financial position as at 31 December 2021 and of its performance and cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

#### Basis for qualified opinion

We were appointed as auditors of the Group on 13 November 2020 and thus did not observe the counting of the physical inventories at 31 December 2019. We were unable to satisfy ourselves by alternative means concerning inventory quantities held at 31 December 2019. Since opening inventories at 31 December 2019 enter into the determination of the financial performance and cash flows for the comparative 31 December 2020 information, we were unable to determine whether adjustments might have been necessary in respect of the income for the comparative 31 December 2020 period reported in the statement of comprehensive income and the net cash flows from operating activities reported in the statement cash flows.

We conducted our audit in accordance with Australian Auditing Standards. Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Report* section of our report. We are independent of the Group in accordance with the ethical requirements of the Accounting Professional and Ethical Standards Board's APES 110 *Code of Ethics for Professional Accountants (including Independence Standards)* (the Code) that are relevant to our audit of the financial report in Australia. We have also fulfilled our other ethical responsibilities in accordance with the Code.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified opinion.

ACN-130 913 594

[www.grantthornton.com.au](http://www.grantthornton.com.au)

Grant Thornton Audit Pty Ltd ACN 130 913 594 a subsidiary or related entity of Grant Thornton Australia Limited ABN 41 127 556 389 'Grant Thornton' refers to the brand under which the Grant Thornton member firms provide assurance, tax and advisory services to their clients and/or refers to one or more member firms, as the context requires. Grant Thornton Australia Limited is a member firm of Grant Thornton International Ltd (GTIL). GTIL and the member firms are not a worldwide partnership. GTIL and each member firm is a separate legal entity. Services are delivered by the member firms. GTIL does not provide services to clients. GTIL and its member firms are not agents of, and do not obligate one another and are not liable for one another's acts or omissions. In the Australian context only, the use of the term 'Grant Thornton' may refer to Grant Thornton Australia Limited ABN 41 127 556 389 and its Australian subsidiaries and related entities. Liability limited by a scheme approved under Professional Standards Legislation.

**Material uncertainty related to going concern**

We draw attention to Note 1 in the financial statements, which indicates that the Group incurred a loss of \$3.4 million for the year ended 31 December 2021. As stated in Note 1, these events or conditions, along with other matters as set forth in Note 1, indicate that a material uncertainty exists that may cast significant doubt on the Group's ability to continue as a going concern. Our opinion is not modified in respect of this matter.

**Information other than the financial report and auditor's report thereon**

Management is responsible for the other information. The other information comprises the information included in the Group's annual report for the year ended 31 December 2021, but does not include the financial report and our auditor's report thereon.

Our opinion on the financial report does not cover the other information and accordingly we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial report, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial report or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

**Responsibilities of management and those charged with governance for the financial report**

Management is responsible for the preparation and fair presentation of the financial report in accordance with accounting principles generally accepted in the United States of America. This responsibility also includes such internal control as management determines is necessary to enable the preparation of the financial report to be free from material misstatement, whether due to fraud or error.

In preparing the financial report, management is responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Group or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Group's financial reporting process.

**Auditor's responsibilities for the audit of the financial report**

Our objectives are to obtain reasonable assurance about whether the financial report as a whole is free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the Australian Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of this financial report.

A further description of our responsibilities for the audit of the financial report is located at the Auditing and Assurance Standards Board website at: [http://www.auasb.gov.au/auditors\\_responsibilities/ar3.pdf](http://www.auasb.gov.au/auditors_responsibilities/ar3.pdf). This description forms part of our auditor's report.



Grant Thornton Audit Pty Ltd  
Chartered Accountants



C F Farley  
Partner – Audit & Assurance  
Sydney, 11 July 2022

**NIGHTINGALE INTELLIGENT SYSTEMS, INC.**  
**CONSOLIDATED BALANCE SHEETS**  
DECEMBER 31, 2021 AND 2020

	<b>As of December 31,</b>	
	<b>2021</b>	<b>2020</b>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 1,253,277	\$ 2,684,865
Accounts receivable, net of allowance for doubtful accounts (\$158,150 at December 31, 2021 and 2020)	761,676	119,765
Inventory, net	104,519	111,042
Prepaid expenses and other current assets	318,972	22,103
Total current assets	2,438,443	2,937,775
Leased assets	225,386	360,397
Product development assets	19,342	66,188
Property and equipment, net	65,551	32,229
Other assets	46,003	17,430
Total assets	<u>\$ 2,794,725</u>	<u>\$ 3,414,019</u>
<b>Liabilities, Convertible Preferred Stock and Stockholders' Deficit</b>		
Current liabilities:		
Accounts payable	\$ 132,314	\$ 114,766
Accrued expenses	75,662	44,055
Accrued interest	207,391	48,606
Deferred revenue	893,074	204,963
Promissory notes, current	-	296,490
Total current liabilities	1,308,441	708,880
Promissory notes, net of current portion	-	98,830
Loan payable	-	250,000
Convertible notes, noncurrent	1,926,297	592,558
Derivative liability	1,906,429	757,023
Total liabilities	<u>5,141,167</u>	<u>2,407,291</u>
Commitments and contingencies (Note 16)		
Convertible preferred stock, \$0.00001 par value; 50,036,091 shares authorized at December 31, 2021 and 2020; 27,039,077 shares issued and outstanding at December 31, 2021 and 2020, respectively (aggregate liquidation liquidation preference of \$11,568,209 as of December 31, 2021 and 2020)	12,709,219	12,709,810
Stockholders' deficit:		
Common stock, \$0.00001 par value; 90,433,860 shares authorized; 21,570,999 shares issued and outstanding at December 31, 2021 and 2020	173	173
Additional paid-in capital	10,259,243	10,211,828
Accumulated deficit	<u>(25,315,077)</u>	<u>(21,915,083)</u>
Total stockholders' deficit	<u>(15,055,661)</u>	<u>(11,703,082)</u>
Total liabilities, convertible preferred stock and stockholders' deficit	<u>\$ 2,794,725</u>	<u>\$ 3,414,019</u>

See accompanying notes to financial statements.

**NIGHTINGALE INTELLIGENT SYSTEMS, INC.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**FOR THE YEARS ENDED DECEMBER 31, 2021 AND 2020**

---

	<b>Year Ended December 31,</b>	
	<b>2021</b>	<b>2020</b>
Revenue	\$ 1,939,090	\$ 921,160
Cost of revenue	<u>1,235,983</u>	<u>796,026</u>
Gross profit	<u>703,107</u>	<u>125,134</u>
<b>Operating expenses:</b>		
Research and development	2,368,182	1,855,057
Sales and marketing	130,800	85,501
General and administrative	<u>1,613,316</u>	<u>1,433,056</u>
Total operating expenses	<u>4,112,298</u>	<u>3,373,614</u>
<b>Loss from operations</b>	<u>(3,409,191)</u>	<u>(3,248,480)</u>
Other income (expense), net:		
Interest expense, net	(802,771)	(257,215)
Other income, net	138,376	(6,469)
Gain on forgiveness of PPP loan	<u>673,592</u>	<u>-</u>
Total other income (expense), net	<u>9,197</u>	<u>(263,684)</u>
<b>Net loss</b>	<u>\$ (3,399,994)</u>	<u>\$ (3,512,164)</u>
Net loss per share - basic and diluted	<u>\$ (0.20)</u>	<u>\$ (0.41)</u>
Weighted average shares of common stock - basic and diluted	<u>17,245,269</u>	<u>8,664,140</u>

See accompanying notes to financial statements.

**NIGHTINGALE INTELLIGENT SYSTEMS, INC.**

**CONSOLIDATED STATEMENTS OF CONVERTIBLE PREFERRED STOCK AND CHANGES IN STOCKHOLDERS' DEFICIT**

FOR THE YEARS ENDED DECEMBER 31, 2021 AND 2020

	<b>Convertible Preferred Stock</b>		<b>Common Stock</b>		<b>Additional</b>	<b>Accumulated</b>	<b>Total</b>
	<b>Shares</b>	<b>Amount</b>	<b>Shares</b>	<b>Amount</b>	<b>Paid-In</b>	<b>Deficit</b>	<b>Stockholders'</b>
					<b>Capital</b>		<b>Deficit</b>
<b>Balances at December 31, 2019</b>	15,849,974	\$ 20,157,936	8,665,646	\$ 87	\$ 176,169	\$ (18,402,920)	\$ (18,226,664)
Issuance of Series C convertible preferred stock, net of issuance costs	19,766,598	2,722,376	-	-	-	-	-
Series B issuance costs	-	(32,451)	-	-	-	-	-
Issuance of common stock upon conversion of Series Seed convertible preferred stock	(2,706,972)	(2,161,788)	2,706,972	27	2,161,761	-	2,161,788
Issuance of common stock upon conversion of Series A convertible preferred stock	(2,790,587)	(4,031,282)	2,790,587	28	4,031,254	-	4,031,282
Issuance of common stock upon conversion of Series B-1 convertible preferred stock	(2,693,438)	(3,344,981)	2,693,438	27	3,344,954	-	3,344,981
Issuance of common stock upon conversion of Series B convertible preferred stock	(386,498)	(599,999)	386,498	4	599,995	-	599,999
Issuance of common stock upon exercise of stock options	-	-	2,128	-	1,000	-	1,000
Stock-based compensation expense	-	-	4,325,730	-	(103,305)	-	(103,305)
Net loss	-	-	-	-	-	(3,512,163)	(3,512,163)
<b>Balances at December 31, 2020</b>	27,039,077	12,709,811	21,570,999	173	10,211,828	(21,915,083)	(11,703,082)
Issuance of common stock upon exercise of stock options	-	-	-	-	-	-	-
Series C issuance costs	-	(592)	-	-	-	-	-
Stock-based compensation expense	-	-	-	-	47,415	-	47,415
Net loss	-	-	-	-	-	(3,399,994)	(3,399,994)
<b>Balances at December 31, 2021</b>	27,039,077	\$ 12,709,219	21,570,999	\$ 173	\$10,259,243	\$ (25,315,077)	\$ (15,055,661)

See accompanying notes to financial statements.

**NIGHTINGALE INTELLIGENT SYSTEMS, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**FOR THE YEARS ENDED DECEMBER 31, 2021 AND 2020**

	<b>Years Ended December 31,</b>	
	<b>2021</b>	<b>2020</b>
<b>Cash flows from operating activities:</b>		
Net loss	\$ (3,399,994)	\$ (3,512,163)
Adjustments to reconcile net loss to net cash used in operating activities:		
Stock-based compensation expense	47,415	(103,305)
Depreciation and amortization	198,239	250,090
(Gain) loss on change in fair value of derivative liability	(146,272)	26,107
Gain on forgiveness of PPP loan	(673,592)	-
Amortization of debt discount	543,494	170,612
Amortization of debt issuance costs	64,597	19,892
Changes in operating assets and liabilities:		
Accounts receivable	(641,911)	82,050
Inventories	6,523	306,341
Prepaid expenses and other current assets	(283,576)	(8,902)
Other assets	(28,573)	-
Accounts payable	17,548	(298,909)
Accrued expenses	31,607	(53,311)
Accrued interest	158,785	46,277
Deferred revenues	688,111	85,963
Net cash used in operating activities	<u>(3,417,599)</u>	<u>(2,989,258)</u>
<b>Cash flows from investing activities:</b>		
Purchase of drones and base stations	-	(65,557)
Purchase of property and equipment	(49,704)	-
Expenditures for leasehold improvements	-	(9,700)
Net cash used in investing activities	<u>(49,704)</u>	<u>(75,257)</u>
<b>Cash flows from financing activities:</b>		
Proceeds from issuance of Series C convertible preferred stock, net	-	2,722,376
Net proceeds from convertible notes	2,021,326	1,132,967
Proceeds from promissory note	278,272	395,320
Proceeds from exercise of stock options	-	1,000
Offering costs paid	(13,292)	-
Payment of convertible preferred stock issuance costs	(591)	(32,451)
Payment of loan	(250,000)	(150,000)
Net cash provided by financing activities	<u>2,035,715</u>	<u>4,069,212</u>
(Decrease)/increase in cash and cash equivalents	(1,431,588)	1,004,697
Cash and cash equivalents, beginning of year	2,684,865	1,680,168
Cash and cash equivalents, end of year	<u>\$ 1,253,277</u>	<u>\$ 2,684,865</u>

See accompanying notes to consolidated financial statements.

**NIGHTINGALE INTELLIGENT SYSTEMS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE YEARS ENDED DECEMBER 31, 2021 AND 2020**

---

**NOTE 1: DESCRIPTION OF BUSINESS AND BASIS OF PRESENTATION**

The Company was incorporated under the laws of the State of Delaware on June 13, 2014, as Nightingale Autonomous Systems, Inc. In October 2017, the Company changed its name from Nightingale Autonomous Solutions, Inc. to Nightingale Intelligent Systems, Inc. (“Nightingale” or the “Company”). Nightingale (UK) Operations Ltd, a UK private limited company is the Company’s wholly-owned subsidiary.

The Company designs, develops, builds, deploys, and supports autonomous robotic aerial security technologies that protect critical infrastructure for Fortune 500 companies. The autonomous perimeter security system features networked base stations and mission-ready drones which can be airborne in less than 30 seconds. The system is driven by the Company’s Mission Control software (Mission Manager), which equips security teams with a real-time decision support system to help keep their facilities safe.

Basis of Presentation

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (“U.S. GAAP”), which require management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes.

Liquidity

The financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. In order to continue its operations, the Company must raise additional equity or debt financings and achieve profitable operations. Although management has historically been successful in raising capital, there can be no assurance that the Company will be able to obtain additional equity or debt financing on terms acceptable to the Company, or at all. The failure to obtain sufficient funds on acceptable terms when needed could have a material adverse effect on the Company’s business, financial position, results of operations, and future cash flows. The Company is seeking to complete an initial public offering (“IPO”) of its common stock. Upon the closing of an IPO, on specified terms, the Company’s outstanding convertible preferred stock and convertible debt will automatically convert into shares of common stock (see Note 9, *Debt Obligations* and Note 11, *Preferred Stock*). In the event the Company does not complete an IPO, the Company expects to seek additional funding through other capital sources including through the sale of equity, debt financings or other capital sources including collaborations with other companies or other strategic transactions. However, the Company may be unable to raise additional funds or enter into such agreements or arrangements when needed on acceptable terms, or at all.

Since its inception, the Company has incurred significant operating losses and negative cash flows from operations primarily as a result of significant research and development activities related to the development and continued improvement of the Company’s Mission Manager Software, drone units and base stations. The Company has funded these activities to date primarily through the issuance of convertible preferred stock and debt. The Company must among other things respond to competitive developments, attract, retain and motivate qualified personnel. The Company has generated operating losses and negative cash flows from operations in each year since inception. Although the Company has generated revenue from product sales to date, they have not yet been able to achieve profitability and will continue to incur significant research and development and other expenses related to its ongoing operations. Cash and cash equivalents on hand was \$1.3 million and \$2.7 million at December 31, 2021 and 2020, respectively. The Company has incurred net losses of \$3.4 million and \$3.5 million for each of the years ended December 31, 2021 and 2020, had an accumulated deficit of \$25.3 million at December 31, 2021 and working capital of \$1.1 million. The Company has reviewed the relevant conditions and events surrounding its ability to continue as a going concern including among others: historical losses, projected future results, including the effects of the novel coronavirus (“COVID-19”), cash requirements for the upcoming year, terms of the Company’s current debt arrangements, funding capacity, net working capital, total stockholders’ deficit and future access to capital. Sales of additional equity securities by the Company could result in the dilution of the interests of existing stockholders. These factors along with the Company’s cash and cash equivalents, raise substantial doubt about the Company’s ability to continue as a going concern for at least one year from the date the consolidated financial statements are issued. The financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result from the outcome of this uncertainty. If future financing is not achieved, the Company may be required to curtail spending to reduce cash outflows.

## NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### Principles of Consolidation

The consolidated financial statements include the accounts of Nightingale, and its wholly-owned subsidiary, Nightingale (UK) Operations, Ltd. All significant intercompany transactions and balances have been eliminated in consolidation.

### Comprehensive Loss

Comprehensive loss includes all changes in equity during a period from non-owner sources. Through December 31, 2021, there are no components of comprehensive loss which are not included in net loss; therefore, a separate statement of comprehensive loss has not been presented. The Company does not have any significant foreign currency translation adjustments as a component of other comprehensive loss through December 31, 2020, as the functional currency of its subsidiary is the U.S. dollar.

### Use of Estimates

The Company's financial statements are prepared in accordance with U.S. GAAP. The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and the disclosure of contingent assets and liabilities in the Company's consolidated financial statements and the accompanying notes. The most significant estimates in the Company's consolidated financial statements relate to revenue recognition, determination of the cost and deriving the useful lives of the Company's drone units and base stations, assessing assets for impairment, ability to realize deferred tax assets, fair value measurements, valuation of financial instruments, valuation of stock options and warrants, and contingencies.

These estimates and assumptions are based on current facts, historical experience and various other factors believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities and the recording of revenues and expenses that are not readily apparent from other sources. Actual results could differ from those estimates.

### Financial Instruments – Recognition and Derecognition

The Company's financial instruments include cash and cash equivalents, accounts receivable, accounts payable, accrued liabilities, promissory notes, loan payable, convertible notes and the derivative liability. The Company's cash and cash equivalents, accounts receivable, accounts payable, accrued liabilities, promissory notes and loan payable are carried at cost, which management believes approximates fair value due to the short term nature of these instruments. Financial assets and financial liabilities are recognized when the Company becomes a party to the contractual provisions of the financial instrument. Financial assets are derecognized when the contractual rights to the cash flows from the financial asset expire, or when the financial asset and substantially all the risks and rewards are transferred. A financial liability is derecognized when it is extinguished, discharged, cancelled or expires.

### Fair Value Measurements

The Company accounts for fair value measurements under Accounting Standards Codification 820, *Fair Value Measurements and Disclosures*, which establishes a framework for measuring fair value and requires disclosures about fair value measurements by establishing a hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to Level 1 measurements and lowest priority to Level 3 measurements. The three levels of the fair value hierarchy are described below:

- Level 1 – Observable inputs such as quoted prices in active markets
- Level 2 – Inputs other than quoted market prices in active markets that are observable, either directly or indirectly in active markets
- Level 3 – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The estimated fair value of financial instruments disclosed in the consolidated financial statements have been determined by using available market information and appropriate valuation methodologies. In certain cases where there is limited activity or less transparency around inputs to valuation, such as the Company's derivative liability, these financial instruments are classified as Level 3.

The carrying value of all remaining current assets and current liabilities approximates fair value because of their short-term nature.



### Cash Equivalents

The Company considers all highly liquid investments purchased with an original maturity of three months or less from the date of purchase to be cash equivalents. The Company places its cash and cash equivalents in highly liquid instruments with financial institutions with high credit ratings.

### Risks and Uncertainties

In March 2020, the World Health Organization declared COVID-19 a pandemic. The COVID-19 pandemic has negatively impacted the global economy, disrupted global supply chains and created significant volatility and disruption of financial markets. The full extent to which the COVID-19 pandemic will directly or indirectly impact the Company's business, results of operations and financial condition, including expenses and research and development costs, will depend on future developments that are highly uncertain, including as a result of new information that may emerge concerning COVID-19 and the actions taken to contain or treat COVID-19, as well as the economic impact on local, regional, national and international markets. The Company has made estimates of the impact of COVID-19 within its financial statements and there may be changes to those estimates in future periods. Actual results could differ materially from those estimates.

### Concentrations of Credit Risk and Significant Suppliers

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist primarily of cash and cash equivalents. Cash and cash equivalent deposits with financial institutions may occasionally exceed the limits of insurance on bank deposits. The Company has not experienced any losses on such accounts and management believes that the Company is not exposed to significant credit risk due to the financial position of the depository institution in which those accounts are held.

The Company is also subject to credit risk from its accounts receivable. The Company extends credit to customers in the normal course of business and generally does not perform evaluations of customers' financial condition and generally does not require collateral. Concentrations of credit risk with respect to accounts receivable exist to the full extent of amounts presented in the consolidated financial statements.

The Company is dependent on third-party manufacturers to supply products and services for its drones and base stations. In particular, the Company relies, and expects to continue to rely, on a small number of third-party manufacturers to manufacture and supply the inventory and other materials for its security services. These activities could be adversely affected by a significant interruption in the supply of these items.

### Deferred Offering Costs

The Company capitalizes certain legal, professional, accounting and other third-party fees that are directly associated with in-process financings as deferred offering costs until such financings are consummated. After consummation of the financing, these costs are recorded as a reduction of the proceeds received from the financing. If a planned financing is abandoned, the deferred offering costs are expensed as a charge to operating expenses in the consolidated statements of operations.

Deferred offering costs were approximately \$13,000 and \$0 for the years ended December 31, 2021 and 2020, respectively, and are included in the Company's consolidated balance sheets within prepaid expenses and other current assets.

### Accounts Receivable

Accounts receivable are derived from sales and rental of proprietary drones and base station assets along with access to its browser-based interface Mission Manager. The Company reviews its receivables for collectability based on historical loss patterns, aging of the receivables, and assessments of specific identifiable customer accounts considered at risk or uncollectible and provides allowances for potential credit losses, as needed. The Company also considers any changes to the financial condition of its customers and any other external market factors that could impact the collectability of the receivables in the determination of the allowance for doubtful accounts. The allowance for doubtful accounts is \$158,150 as of both December 31, 2021 and 2020.

At December 31, 2021, the Company had three customers whose accounts receivable balance each totaled 10% or more of the Company's total accounts receivable (31%, 30%, 12%,) compared with two such customers (50% and 37%) at December 31, 2020.

For the year ended December 31, 2021, the Company had three customers (31%, 30%, 12%,) who individually accounted for 10% or more of the Company's total customer revenue compared with three such customers (23%, 16% and 15%) for the year ended December 31, 2020.

### Inventory

Inventories are valued at the lower of cost or net realizable value and are determined using the average cost method. The Company's inventory consists of raw material components, finished drone units, and base stations. Finished drone units and base stations include materials, labor and other direct and indirect costs used in their production. Finished drone units and base stations are valued using a discrete bill of materials, which includes an allocation of labor and direct overhead based on assembly hours. The Company regularly assesses slow-moving, excess and obsolete inventory and maintains balance sheet reserves in amounts required to reduce the recorded value of inventory to the lower of cost or net realizable value.

### Equipment on Operating Leases

Equipment is recorded at cost and depreciated over the estimated useful lives. Equipment on operating leases is depreciated to estimated salvage value over the lease term. Depreciation is computed using the straight-line method. Significant improvements are capitalized, and maintenance and repairs are expensed. See Note 4 - *Inventories & Equipment on Operating Leases*.

### Property and Equipment

Property and equipment is stated at cost and includes computers, automobiles, leasehold improvements and machinery and equipment. Depreciation is computed using the straight-line method over the estimated useful lives of two to five years for computers, automobiles, machinery and equipment. Leasehold improvements are amortized using the straight-line method over the shorter of the remaining lease term or the estimated useful lives. Expenditures for repairs and maintenance, which do not extend the useful life of the property and equipment, are expensed as incurred and improvements and betterments are capitalized. Gains and losses associated with dispositions are reflected as a non-operating gain or loss in the consolidated statements of operations.

### Product Development Assets

Depreciation expense on product development assets were included in research and development expenses on the Company's consolidated statements of operations and were approximately \$98,000 and \$64,000 for the years ended December 31, 2021 and 2020, respectively.

### Impairment of Long-Lived Assets

The Company assesses the impairment of long-lived assets whenever events or changes in circumstances indicate that their carrying value may not be recoverable from the estimated future cash flows expected to result from their use or eventual disposition. If estimates of future undiscounted net cash flows are insufficient to recover the carrying value of the assets, the Company will record an impairment loss in the amount by which the carrying value exceeds the fair value. If the assets are determined to be recoverable, but the useful lives are shorter than originally estimated, the Company will depreciate or amortize the net book value of the assets over the newly determined remaining useful lives. The Company had a \$140,000 reserve recorded against certain early-generation drone units determined to be obsolete as of December 31, 2021. None of the Company's drone units, base stations or property and equipment was determined to be impaired as of December 31, 2021.

### Deferred Revenue

When the Company is entitled to bill its customers and receive payment from its customers in advance of its obligation to provide services or transfer goods to its customers, the Company includes the amounts in deferred revenue on its consolidated balance sheets.

### Revenue Recognition

The Company accounts for all revenue contracts in accordance with ASC Topic 606, *Revenue from Contracts with Customers* ("ASC 606"). A performance obligation is a promise in a contract to transfer distinct goods or services to a customer, and it is the unit of account in ASC 606. A contract's transaction price is allocated to each distinct performance obligation and revenue is recognized when each performance obligation under the terms of a contract is satisfied. For contracts with multiple performance obligations, the Company allocates the contract's transaction price to each performance obligation using observable standalone selling prices for similar products and services.

The substantial majority of the Company's revenue is generated pursuant to written contractual arrangements for drone systems which include the drone and base equipment, deployment of the drone system, and subscriptions for access to the Company's browser-based interface, Nightingale Security Mission Manager, through contracts that typically have 12-month terms and automatically renew upon payment for an additional 12-month term thereafter.

The Company's performance obligations are satisfied over time or at a point in time. Revenue for maintenance, repair, and upgrades ("MRU"), as well as lease subscription revenues, are recognized over the term of the contract which as stated above is generally 12 months, unless different terms are stated in the contract. For MRU, progress is measured via a time-based output method, which is days elapsed since the Company is standing ready to perform. The Company elected the right to invoice practical expedient under which, if an entity has a right to consideration from a customer in an amount that corresponds directly with the value to the customer of the entity's performance completed to date, such as time elapsed for maintenance, repair, and upgrade services, the entity may recognize revenue in the amount to which the entity has a right to invoice. Training and other time and material-based services are recognized over time using an output method based on days of training/services completed unless the training or other services require less than one month and are therefore recognized as training is completed.

For performance obligations that are not satisfied over time per the criteria above, revenue is recognized at the point in time at which each performance obligation is fully satisfied. The Company's drone and base product, which has embedded software called C4AI, is composed of revenue recognized on contracts for the delivery of the drone, base, and spare parts. Revenue is recognized at the point in time when control transfers to the customer, which generally occurs when title and risk of loss have passed to the customer.

Application of the various accounting principles in U.S. GAAP related to the measurement and recognition of revenue requires us to make judgments and estimates including ASC Topic 606 - *Revenue from Contracts with Customers* and ASC Topic 842 - *Leases*. Complex arrangements with nonstandard terms and conditions may require significant contract interpretation to determine the appropriate accounting. Specifically, the revenue related to the following areas involves significant judgments and estimates:

*Lease Subscription Arrangements:* The Company also leases its equipment direct to end customers under bundled lease subscription arrangements, which typically include the equipment, software, maintenance services, and training for which the customer pays a single negotiated fixed minimum monthly payment for all elements over the contractual lease term. Lease deliverables include the drone and base equipment and software as well as the deployment fee associated with the drone system, while the non-lease deliverables generally consist of the services, which include maintenance, repair, upgrades, and training. Sales made under bundled lease subscription arrangements comprise 9.3% or \$180,751 and 37.7% or \$347,500 of total sales revenue for the years ended December 31, 2021 and 2020, respectively. Revenues under these bundled lease subscription arrangements are allocated considering the relative standalone selling prices of the lease and non-lease deliverables included in the bundled arrangement. The allocation of revenue among the elements – drone and base equipment, software, and deployment vs. post-sale (maintenance, repair and upgrade services, and training) – has remained fairly consistent at approximately 75% and 25%, respectively, over the past two years ended December 31, 2021 and 2020.

*Sales to Distributors and Resellers:* The Company utilizes distributors and resellers to sell many of its products, supplies and parts to end-user customers. Sales to distributors and resellers are generally recognized as revenue when products are shipped to such distributors and resellers. Distributors and resellers may participate in various discount, rebate, price-support, cooperative marketing and other programs, and the Company records provisions and allowances for these programs as a reduction to revenue when the sales occur. The Company did not record estimates for sales returns and other discounts and allowances when the sales occurred for the year ended December 31, 2021 as none were deemed needed as a result of the measurement of constraint of revenues. Total sales to distributors and resellers were \$1,008,816 and \$522,495 for the years ended December 31, 2021 and 2020, respectively.

*Service Arrangements:* Revenues associated with service arrangements – maintenance, repairs, and upgrades (or "MRU"), and software-as-a-service pertaining to Nightingale Security Mission Manager – are generally recognized over the term of the service period which is generally 12 months as the customer is typically invoiced for that usage at the beginning of the 12-month period.

Significant management judgments and estimates must be made and used in connection with the recognition of revenue in any accounting period. Material differences in the amount of revenue in any given period may result if these judgments or estimates prove to be incorrect or if management's estimates change on the basis of development of the business or market conditions. Management judgments and estimates have been applied consistently and have been reliable historically. The Company believes that there are two key factors which impact the reliability of management's estimates. The first of those key factors is that the terms of its contracts are typically for one year. The short-term nature of such contracts reduces the risk that material changes in accounting estimates will occur on the basis of market conditions or other factors. The second key factor is that it has numerous contracts in any given accounting period, which reduces the risk that any one change in an accounting estimate on one or several contracts would have a material impact on the Company's consolidated financial statements.

Based on the nature of the contracts and consistent with prior practice, the Company recognizes revenue upon invoicing the customer for the large majority of its revenue. Additionally, the unit of accounting, that is, the identification of performance obligations, is consistent with prior revenue recognition practice. A significant portion of drone and base sales are either recorded as sales-type leases or through direct sales to customers or to distributors and resellers and these revenue streams are not impacted by the adoption of ASC Topic 606. The only change of significance identified in adoption involves a change in the classification of certain revenues that were previously reported in services revenues. These revenues relate to certain analyst services performed in connection with the deployment of drone systems that are being considered part of the drone and base sale performance obligation. Accordingly, these revenues are reported as part of sales.

Deferred contract costs, which include incremental costs of obtaining a contract and costs to fulfill a contract and sales commissions on reseller arrangements, had been minimal under prior Company practices as most costs to obtain a contract and fulfill a contract were expensed as incurred. As a result of the contract cost guidance included in ASC Topic 606 and ASC Topic 340-40 *Contracts with Customers*, the Company determined that any transition asset would be immaterial related to the incremental cost to obtain contracts as the adjustment would relate to the deferral of sales commissions paid to resellers in connection with the deployment of drone systems with post sale service arrangements.

#### Revenue-based Taxes:

Revenue-based taxes assessed by governmental authorities that are both imposed on and concurrent with specific revenue-producing transactions, and that are collected by the Company from a customer, are excluded from revenue. The primary revenue-based taxes are U.S. sales taxes.

#### Shipping and Handling

Shipping and handling costs are accounted for as a fulfillment cost and are included in cost of revenue in the consolidated statements of operations.

Refer to Note 3 - *Revenue Recognition* for additional information regarding revenue recognition policies with respect to contract assets and liabilities as well as contract costs.

#### Warrants Issued in Connection with Financings

The Company generally accounts for warrants issued in connection with financings as a component of equity, unless there is a deemed possibility that it may have to settle the warrants in cash. For warrants issued with a deemed possibility of cash settlement, the Company records the fair value of the issued warrants as a liability at each reporting period and records changes in the estimated fair value as a non-cash gain or loss in the consolidated statements of operations.

#### Derivative Liabilities

The Company evaluates all of its agreements to determine if such instruments have derivatives or contain features that qualify as embedded derivatives. The Company accounts for certain redemption features that are associated with convertible notes as liabilities at fair value and adjusts the instruments to their fair value at the end of each reporting period. For derivative financial instruments that are accounted for as liabilities, the derivative instrument is initially recorded at its fair value and is then re-valued at each reporting date, with changes in the fair value reported in other income (expense), net in the consolidated statements of operations. Derivative instrument liabilities are classified in the consolidated balance sheets as current or non-current based on whether or not net-cash settlement of the derivative instrument could be required within 12 months of the balance sheet date.

#### Stock-Based Compensation

The Company accounts for stock-based compensation in accordance with ASC 718, *Compensation - Stock Compensation*, which requires that the estimated fair value on the date of grant be determined using the Black-Scholes option pricing model with the fair value recognized over the requisite service period of the awards, which is generally the option vesting period. Stock-based awards made to nonemployees are measured and recognized based on the estimated fair value on the vesting date and are re-measured at each reporting period. The Company's determination of the fair value of the stock-based awards on the date of grant, using the Black-Scholes option pricing model, is affected by the Company's value of its common stock as well as other assumptions regarding a number of highly complex and subjective variables. These variables include but are not limited to the Company's expected stock price volatility over the term of the awards, and actual and projected employee option exercise behaviors. Because there is insufficient historical information available to estimate the expected term of the stock-based awards, the Company adopted the simplified method of estimating the expected term of options granted by taking the average of the vesting term and the contractual term of the option.

For awards with graded vesting, the Company recognizes stock-based compensation expense over the service period using the straight-line method, based on shares ultimately expected to vest. The Company also elected to recognize forfeitures as they occur when calculating the stock-based compensation for equity awards.

#### Deferred Rent

Deferred rent consists of the difference between cash payments and the recognition of rent expense on a straight-line basis over the term of the lease.

#### Research & Development Costs

Research and development costs primarily consist of employee-related expenses, including salaries and benefits, share-based compensation expense, facilities costs, depreciation and other allocated expenses. Research and development costs are expensed as incurred.

#### Advertising Costs

Advertising costs are recorded in sales and marketing expense in the Company's consolidated statements of operations as incurred. Advertising expense was immaterial for the years ended December 31, 2021 and 2020.

#### PPP Loan Forgiveness

Any potential gain on the forgiveness of the PPP loans and accrued interest would be recorded as a gain on loan extinguishment in other income (loss), net in the Company's consolidated statements of operations when it is realized or realizable.

#### Foreign Currency

The functional and presentation currency of the Company is the U.S. dollar. Transactions denominated in a currency other than the functional currency are recorded on the initial recognition at the exchange rate at the date of the transaction. After initial recognition, monetary assets and liabilities denominated in foreign currency are translated at the end of each reporting period into the functional currency at the exchange rate at that date. The cumulative translation adjustment is included in the accumulated other comprehensive income (loss) within the consolidated statements of convertible preferred stock and stockholders' deficit. Exchange differences are included in general and administrative expenses in the consolidated statements of operations. Non-monetary assets and liabilities measured at cost are remeasured at the exchange rate at the date of the transaction.

#### Income Taxes

The Company uses the liability method of accounting for income taxes as set forth in ASC 740, *Income Taxes*. Under the liability method, deferred taxes are determined based on the temporary differences between the financial statement and tax basis of assets and liabilities using tax rates expected to be in effect during the years in which the basis differences reverse. A valuation allowance is recorded when it is unlikely that the deferred tax assets will not be realized. The Company assesses its income tax positions and record tax benefits for all years subject to examination based upon the Company's evaluation of the facts, circumstances and information available at the reporting date. In accordance with ASC 740-10, for those tax positions where there is a greater than 50% likelihood that a tax benefit will be sustained, the Company's policy will be to record the largest amount of tax benefit that is more likely than not to be realized upon ultimate settlement with a taxing authority that has full knowledge of all relevant information. For those income tax positions where there is less than 50% likelihood that a tax benefit will be sustained, no tax benefit will be recognized in the financial statements.

#### Comprehensive Loss

Net loss was equal to comprehensive loss for the years ended December 31, 2021 and 2020.

#### Net Loss Per Share

Basic net loss per share is computed by dividing the net loss by the weighted average number of common shares outstanding for the period, without consideration for potentially dilutive securities. Diluted net loss per share is computed by dividing the net loss by the weighted average number of common shares and dilutive common stock equivalents outstanding for the period determined using the treasury-stock and if-converted methods. Dilutive common stock equivalents are comprised of convertible preferred stock, options

outstanding under the Company's stock option plan and outstanding common stock warrants. For all periods presented, there is no difference in the number of shares used to calculate basic and diluted shares outstanding as inclusion of the potentially dilutive securities would be anti-dilutive.

Potentially dilutive securities not included in the calculation of diluted net loss per share, because to do so would be anti-dilutive, are as follows (in common stock equivalent shares):

	<b>December 31,</b>	
	<b>2021</b>	<b>2020</b>
Convertible preferred stock	27,039,077	27,039,077
Common stock options	314,872	269,872
Common stock warrant - SVB	20,464	20,464
Common stock warrant – Series C	12,190,248	12,190,248
	<u>39,564,661</u>	<u>39,519,661</u>

The table above omits the potentially dilutive shares into which the 2020 and 2021 Convertible Notes would convert.

#### Recent Accounting Pronouncements - Adopted

In June 2018, the FASB issued ASU 2018-07, *Compensation - Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting*, which simplifies the accounting for non-employee share-based payment transactions. The new standard expands the scope of Topic 718 to include share-based payment transactions for acquiring goods and services from nonemployees. ASU 2018-07 is effective for fiscal years beginning after December 15, 2019. The Company adopted this new guidance on January 1, 2021, with no material impact on its consolidated financial statements.

In August 2018, the FASB issued ASU 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement*. The new guidance modifies the disclosure requirements for fair value measurements in Topic 820. The amendments in ASU 2018-13 are effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. The Company has adopted the new guidance effective January 1, 2020. The adoption did not have any material impact on the Company's financial position, results of operations or related disclosures.

In December 2019, the FASB issued ASU 2019-12, *Simplifying the Accounting for Income Taxes*. The new guidance is intended to simplify aspects of the accounting for income taxes, including the elimination of certain exceptions to the guidance in ASC 740 related to the approach for intraperiod tax allocation, among other changes. ASU 2019-12 is effective for fiscal years beginning after December 15, 2020, with early adoption permitted. The guidance is to be applied prospectively at the beginning of the year of adoption. The Company has adopted the new guidance effective January 1, 2020. The adoption did not have any material impact on the Company's financial position, results of operations or related disclosures.

#### Recent Accounting Pronouncements – Not Yet Adopted

The following accounting standards, which are not yet effective, are presently being evaluated by the Company to determine the impact that they might have on its financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)* ("ASU 2016-02"). ASU 2016-02 requires companies to generally recognize on the balance sheet operating and financing lease liabilities and corresponding right-of-use assets. In June 2020, the FASB issued ASU No. 2020-05 which defers the effective date for private companies until fiscal years beginning after December 15, 2021. Accordingly, ASU 2016-02 is effective for the Company beginning January 1, 2022 on a modified retrospective basis, and earlier adoption is permitted. The Company is currently assessing the effect that adoption of this standard will have on its financial position, results of operations and related disclosures.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments – Credit Losses: Measurement of Credit Losses on Financial Instruments*, or ASU 2016-13. ASU 2016-13 replaces the incurred loss impairment methodology in current U.S. GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. ASU 2016-13 is effective for fiscal years beginning after December 15, 2021, including interim periods within those fiscal years. In May 2019, the FASB issued ASU 2019-05, *Financial Instruments – Credit Losses*, or ASU 2019-05, to allow entities to irrevocably elect the fair value option for certain financial assets previously measured at amortized cost upon adoption of the new credit losses standard. The new effective dates and transition align with those of ASU 2016-13. The Company is currently assessing the impact ASU 2016-13 and ASU 2019-05 will have on the Company.

In August 2020, the FASB issued ASU 2020-06, *Debt – Debt with Conversion and Other Options (Subtopic 470-20) and Derivatives and Hedging – Contracts in Entity’s Own Equity (Subtopic 815-40): Accounting for Convertible Instruments and Contracts in an Entity’s Own Equity*. The new guidance, among other things, simplifies the accounting for certain financial instruments with characteristics of liabilities and equity, including convertible instruments, and amends existing earnings-per-share (“EPS”) guidance by requiring that an entity use the if-converted method when calculating diluted EPS for convertible instruments. ASU 2020-06 is effective for fiscal years beginning after December 15, 2021, including interim periods within those fiscal years, with early adoption permitted for fiscal years beginning after December 15, 2020, including interim periods within those fiscal years. The Company plans to adopt the new guidance effective January 1, 2022 and is currently evaluating the effect adoption will have on its financial position, results of operations and related disclosures.

### NOTE 3: REVENUE RECOGNITION

Revenues are disaggregated by major product lines and sales channels are as follows:

	December 31,	
	2021	2020
<b>Major product and services lines</b>		
Drone and Base Equipment	\$ 1,319,507	\$ 440,995
Maintenance Agreements (1)	50,649	39,000
Deployment (2)	65,083	78,000
Other (3)	323,100	15,665
Lessor arrangements (4)	180,751	347,500
<b>Total Revenues</b>	<b>\$ 1,939,090</b>	<b>\$ 921,160</b>
<b>Sales channels:</b>		
Customer direct sales	\$ 749,523	\$ 51,165
Direct equipment lease (4)	180,751	347,500
Distributors & resellers (5)	1,008,816	522,495
<b>Total Revenues</b>	<b>\$ 1,939,090</b>	<b>\$ 921,160</b>

(1) Includes revenues from MRU agreements on sold equipment as well as revenues associated with maintenance service agreements sold through our resellers.

(2) Primarily includes revenues from deployment of drone systems.

(3) Primarily includes revenues from training and consulting services.

(4) Primarily reflects sales through bundled lease arrangements.

(5) Primarily reflects sales through two-tier distribution channels.

Revenues disaggregated by point-in-time and over-time are as follows:

	December 31,	
	2021	2020
<b>Recognition:</b>		
Point-in-time	\$ 1,707,690	\$ 534,660
Over-time	231,400	386,500
<b>Total Revenues</b>	<b>\$ 1,939,090</b>	<b>\$ 921,160</b>

**Contract assets and liabilities:** Company contract assets are generally not material, which are primarily related to costs of deployment to install drone and base systems. Company contract liabilities, which represent billings in excess of revenue recognized, are primarily related to advanced billings and were approximately \$893,074 and \$204,963 at December 31, 2021 and 2020, respectively. The majority of the balance at December 31, 2021 will be amortized to revenue over approximately the next 12 months. See below for the rollforward of contract liabilities.

**Years Ended December 31,**

Year Ended December 31,	2021	2020
Beginning of the year	\$ 204,963	\$ 119,000
Payments in advance	2,235,974	301,263
Revenue recognized on contract	(1,547,863)	(215,300)
End of the year	<u>\$ 893,074</u>	<u>\$ 204,963</u>

**Backlog:** Backlog is defined as remaining unsatisfied performance obligations under firm orders for which work has not been performed. Generally, 90-100% of backlog will be recognized as revenue during the following fiscal year.

Because of possible future changes in delivery schedules and/or cancellations of orders, backlog at any particular date is not necessarily representative of actual sales to be expected for any succeeding period, and actual sales for the year may not meet or exceed the backlog represented. Backlog is typically due to maintenance, repairs, and upgrades. As revenues are recognized over time, the backlog and related contract liability decrease.

#### NOTE 4: INVENTORY & EQUIPMENT ON OPERATING LEASES

Inventory, net, consisted of the following at December 31:

	2021	2020
Finished base stations	\$ -	\$ 71,673
Finished drones	20,800	36,940
Inventory components	83,719	2,429
Drones and base stations, net	<u>\$ 104,519</u>	<u>\$ 111,042</u>

##### Equipment on Operating Lease

Equipment on operating leases and similar arrangements consists of Company equipment rented to customers and depreciated to estimated salvage value at the end of the lease term.

Equipment on operating leases and the related accumulated depreciation at December 31 were as follows:

	2021	2020
Equipment on lease	\$ 695,537	\$ 695,538
Accumulated depreciation	470,152	335,141
Drones and base stations, net	<u>\$ 225,386</u>	<u>\$ 360,397</u>

Depreciable lives generally vary from two to five years consistent with the planned and historical usage of the equipment subject to operating leases. Estimated minimum future revenues associated with equipment on operating leases are as follows:

	December 31,	
	2021	2020
12 months	\$ 120,000	\$ 166,000
<b>Total</b>	<u>\$ 120,000</u>	<u>\$ 166,000</u>



**NOTE 5: ACCRUED EXPENSES**

A summary of the components of accrued expenses is as follows:

	<b>December 31,</b>	
	<b>2021</b>	<b>2020</b>
Accrued payroll	\$ 35,901	\$ 33,011
Accrued rent	11,044	11,044
Other accrued liabilities	28,717	-
	<u>\$ 75,662</u>	<u>\$ 44,055</u>

**NOTE 6: FAIR VALUE MEASUREMENTS**

The following tables set forth by level, within the fair value hierarchy, the financial assets and liabilities that are measured at fair value on a recurring basis at December 31, 2021 and 2020:

<b>Fair Value Measurements at December 31, 2021 using:</b>				
<b>Assets:</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
Money market funds	\$ 1,158,879	\$ -	\$ -	\$ 1,158,879
	<u>\$ 1,158,879</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,158,879</u>

**Liabilities:**

2020 Convertible Notes	\$ -	\$ -	\$ 1,084,982	\$ 1,084,982
2021 Convertible Notes	-	-	821,447	821,447
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,906,429</u>	<u>\$ 1,906,429</u>

<b>Fair Value Measurements at December 31, 2020 using:</b>				
<b>Assets:</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
Money market funds	\$ 2,370,862	\$ -	\$ -	\$ 2,370,862
	<u>\$ 2,370,862</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 2,370,862</u>

**Liabilities:**

2020 Notes	\$ -	\$ -	\$ 757,023	\$ 757,023
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 757,023</u>	<u>\$ 757,023</u>

The change in the fair value of the derivative liabilities for the years ended December 31, 2021 and 2020 are summarized below:

Fair value as of December 31, 2019	\$ -
Derivative liability upon issuance of 2020 Convertible Notes	730,916
Change in fair value recorded in other income (expense), net	26,107
Fair value as of December 31, 2020	757,023
Derivative liability upon issuance of 2021 Convertible Notes	1,295,679
Change in fair value on 2020 Notes	327,959
Change in fair value on 2021 Notes	(474,232)
Fair value as of December 31, 2021	<u>\$ 1,906,429</u>

The derivative liabilities in the table above related to the 2020 and 2021 Convertible Notes and represent the fair value of the redemption-like contingent conversion feature. The Company calculated the fair value of the derivative liability using a probability weighted discounted cash flow analysis. The inputs used to determine the estimated fair value of the derivative were based primarily on the probability of an underlying event occurring that would trigger the embedded derivative and the timing of such event. The Company's derivative liability is measured at fair value on a recurring basis and is classified as a Level 3 liability. The Company

records subsequent adjustments to reflect the increase or decrease in estimated fair value at each reporting date in other income (expense), net in the consolidated statements of operations (see Note 9 – *Debt Obligations*).

#### **NOTE 7: PROPERTY AND EQUIPMENT**

Property and equipment, leasehold improvements and software, as of December 31, 2021 and 2020 are as follows:

	<b>December 31,</b>	
	<b>2021</b>	<b>2020</b>
Computer equipment	\$ 20,337	\$ 15,782
Machinery and equipment	6,493	6,493
Automobiles	49,722	4,574
Leasehold improvements	69,432	69,432
	<u>145,984</u>	<u>96,281</u>
Accumulated depreciation	(80,443)	(64,052)
Property and equipment, net	<u>\$ 65,551</u>	<u>\$ 32,229</u>

Depreciation and amortization expense on property and equipment included in general and administrative expenses amounted to approximately \$16,381 and \$25,945 in 2021 and 2020, respectively. Depreciation and amortization expense of property and equipment relating to cost of services, research and development and sales and marketing was insignificant for all periods presented.

#### **NOTE 8: PROMISSORY NOTES**

On April 15, 2020, the Company entered into a promissory note agreement with Silicon Valley Bank that provided for the receipt by the Company of loan proceeds of \$395,320 (the “April 2020 PPP Loan”) pursuant to the Paycheck Protection Program under the Coronavirus Aid, Relief and Economic Security Act (the “CARES Act”). Under certain conditions, the loans and accrued interest are forgivable, if the loan proceeds are used for eligible purposes, including payroll, benefits, rent and utilities, and maintaining payroll levels. In October 2020, the Paycheck Protection Program Flexibility Act of 2020 extended the deferral period for borrower payments of principal, interest, and fees on all PPP loans from 6 months to 10 months. As of December 31, 2020, payments were deferred for 10 months. The April 2020 PPP Loan matures on April 15, 2022 and bears interest at a rate of 1.0% per annum. The April 2020 PPP Loan contains events of default and other provisions customary for a loan of this type. The Company has recorded the April 2020 PPP Loan as a promissory note in the December 31, 2020 consolidated balance sheet as both a current and non-current liability.

On February 13, 2021, the Company entered into a separate, new promissory note agreement with Silicon Valley Bank that provided for the receipt by the Company of loan proceeds of \$278,272 (the “February 2021 PPP Loan”) pursuant to the Paycheck Protection Program under the Coronavirus Aid, Relief and Economic Security Act (the “CARES Act”). Under certain conditions, the loans and accrued interest are forgivable, if the loan proceeds are used for eligible purposes, including payroll, benefits, rent and utilities, and maintaining payroll levels.

In September 2021, the Company received notification and confirmation from the U.S. Small Business Administration (the “SBA”) that its April 2020 and February 2021 PPP loans and related accrued interest had been forgiven in their entirety by the SBA and automatically cancelled. The Company recorded the gain on forgiveness of the PPP Loans of \$673,592 in other income in the consolidated statement of operations for the year ended December 31, 2021.

#### **NOTE 9: DEBT OBLIGATIONS**

##### Loan and Security Agreement

In April 2018, the Company entered into a Loan and Security Agreement (the “Loan Agreement”) with Silicon Valley Bank (“SVB”) for a committed growth capital line of \$1.5 million available to be used for general working capital purposes. \$750,000 of the capital line is available to be drawn from the effective date of April 2018 through the capital availability end date of September 30, 2018. The remaining \$750,000 of the capital line was available through September 30, 2018 provided the Company had achieved the second tranche milestone which is defined by the Loan Agreement as support satisfactory to SVB that the Company had 30 units deployed across 15 unique verticals, as defined in the Loan Agreement. As security, the Loan is collateralized by all assets of the Company. The Company granted SVB a continuing security interest in all of the Company’s interest in the collateral which includes all goods, equipment, inventory, contract rights or rights to payment of money, leases, license agreements among others but excludes intellectual property. This Loan Agreement continued in effect until the maturity date of April 1, 2021. Monthly payments of interest only were

due in advance for the first month, then principal and interest payments are due monthly for thirty months until maturity. Once repaid, the principal amount of the advance could not be re-borrowed. The Company had the option to prepay the loan in full. Outstanding borrowings under the Loan Agreement bear interest at the greater of (i) 2% above the prime rate (prime rate was 3.25% at December 31, 2021 and 2020) or (ii) 6.25%. Interest expense on the Loan Agreement during the years ended December 31, 2021 and 2020 was \$7,323 and \$43,870, respectively. The Company repaid \$250,000 and \$150,000 during the years ended December 31, 2021 and 2020, respectively and as of the end of December 31, 2021, the loan has been repaid in full.

The Loan Agreement contains representations, warranties and covenants customary to similar credit facilities. To date, the Company has been compliant with this and all other affirmative and negative covenants in the Loan Agreement. The Company may voluntarily elect to prepay all capital advances in full provided that the Company (i) provides written notice to SVB of its election to prepay the advances at least 10 days prior to such prepayment and (ii) pays, on the date of such prepayment, (a) all outstanding principal and accrued but unpaid interest, plus (b) all other sums, including bank expenses, if any, that shall have become due and payable. Prepayment of the loan will be mandatory upon an acceleration due to an event of default. Mandatory prepayments upon an acceleration that follows or occurs during an event of default would require the Company to pay immediately to SVB the sum of (i) all outstanding principal and accrued but unpaid interest plus, (ii) all other sums including bank expenses, if any, that shall have become due and payable with respect to the maturity date. Events of default which may cause repayment of the loans to be accelerated include, among other customary events of default: (i) the Company fails to deliver the financial statements and other required information within the prescribed period of time; (ii) the Company violates any of the covenants as specified in the Loan Agreement; (iii) the Company fails to pay when due any loan or monetary obligation within three business days after the due date; (iv) the Company fails to perform any obligation or covenant under this or any other loan document, which if such default can be reasonably cured, is not cured within ten days after the date due; (v) SVB determines in its good faith judgment that it is the clear intention of the Company's investors to not continue to fund the Company in the amounts and timeframe necessary to enable the Company to satisfy the obligations as they become due and payable; (vi) there is a material impairment in the perfection or priority of SVB's security interest in the collateral or in the value of such collateral; (vii) any representation or written statement given to SVB by or on behalf of the Company that is untrue or misleading in a material respect; (viii) a default in any given agreement between the Company and a third party the right to accelerate any indebtedness exceeding the contract threshold amount or that could reasonably be expected to cause any material impairment in the Company's business, operations or financial or other condition of the Company; (ix) one or more fines, penalties or final judgments, orders or decrees for the payment of money in an amount, of at least \$50,000 rendered against the Company by any government authority, (x) any document, instrument, or agreement evidencing any Subordinated Debt shall for any reason be revoked or invalidated; (xi) the attachment, seizure, levy or possession by a trustee or receiver of any portion of the Company's assets; (xii) the enjoinder, restraint or prevention by court order from conducting a material part of the Company's business; (xiii) the dissolution, winding up or insolvency of the Company; or (xiv) the appointment of a receiver, trustee or custodian, for all or part of the property of, assignment for the benefit of creditors by the Company, the Company begins an insolvency proceeding or an insolvency proceeding is begun against the Company.

In connection with the execution of the Loan Agreement, the Company entered into a warrant agreement which granted certain warrants to SVB (the "Warrants") for the purchase of 13,642 shares of common stock at an exercise price of \$0.47 per share. SVB also received a right to purchase additional shares upon the funding of each growth capital advance. At the end of December 31, 2021, warrants exercisable for 20,464 shares of the Company's common stock were issued and outstanding. The warrants expire in April 2028 and are subject to automatic conversion if the fair value of the Company's common stock exceeds the exercise price as of the expiration date. The Company accounted for all the warrants issued as equity instruments since the warrants are indexed to the Company's common shares and meet the criteria for classification in stockholders' deficit.

## Convertible Notes

### *2020 Convertible Notes*

In July 2020, the Company entered into a series of convertible note subscription agreements (the "2020 Convertible Notes") with various investors for aggregate gross borrowings of approximately AUD \$1.8 million or USD \$1.2 million; net proceeds received in USD was approximately \$1.0 million. The proceeds from the 2020 Convertible Notes are to be used for approved purposes only. Outstanding borrowings under the 2020 Convertible Notes and unpaid accrued interest are due and repayable in full on August 1, 2022 (maturity date), if not previously converted. The 2020 Convertible Notes bear interest at the rate of 8% per annum with interest payable beginning on July 31, 2020. The 2020 Convertible Notes will automatically convert into fully paid ordinary shares of the Company upon the completion of a Proposed Transaction which is defined as a listing on the Australian Stock Exchange ("ASX") if not repaid earlier at 50% of the IPO price. Conversion of unpaid accrued interest into additional fully paid ordinary shares is at the option of the Company.

The Company determined that the 2020 Convertible Notes contained rights and obligations for conversion contingent upon a listing on the ASX. Thus, the embedded redemption feature was bifurcated from the face value of the note and accounted for as a derivative

liability to be remeasured at the end of each reporting period. The fair value of the derivative liability at the inception of the 2020 Convertible Notes was \$731,000 with the offsetting amount being recorded as a debt discount. Debt issuance costs were \$85,000 at December 31, 2020. The debt discount and debt issuance costs are being amortized to interest expense using the effective interest method over the expected term of the 2020 Convertible Notes. The Company recognized approximately \$354,000 of amortization of debt discount and approximately \$41,000 of amortization of debt issuance costs as interest expense in the consolidated statement of operations for the year ended December 31, 2021. The Company recognized approximately \$171,000 of amortization of debt discount and approximately \$20,000 of amortization of debt issuance costs as interest expense in the consolidated statements of operations for the year ended December 31, 2020. The effective interest rate of the 2020 Convertible Notes was 40.4% at December 31, 2021 and 2020 compared to the stated rate of 8%. During the years ended December 31, 2021 and 2020, the Company also recognized interest expense in the consolidated statements of operations of approximately \$97,000 and \$47,000, respectively, related to the 2020 Convertible Notes.

#### *2021 Convertible Notes*

In August 2021, the Company entered into a series of convertible note subscription agreements (the “2021 Convertible Notes”) with investors for aggregate gross borrowings of approximately AUD \$3.0 million or USD \$2.2 million; net proceeds received in USD totaled approximately \$2.0 million. Outstanding borrowings under the 2021 Convertible Notes and unpaid accrued interest are due and repayable in full within 24 months from the date the Company signs the notes (maturity date), if not previously converted. The 2021 Convertible Notes bear interest at the rate of 8% per annum. The 2021 Convertible Notes and any accrued interest will automatically convert into shares of common stock of the Company or CHES Depository Interests (CDI) over shares in respect of an ASX listing at 70% of the IPO offer price or the Trade Sales price, as applicable. In the event the Company completes an alternative capital raising (other than pursuant to an IPO or the issue of Notes under this Convertible Note issue), the noteholders may voluntarily elect to convert some or all of their Notes into shares at the Alternative Capital Raising Price.

The Company determined that the 2021 Convertible Notes contained rights and obligations for conversion contingent upon 1) the Company’s receipt of a listing approval to be admitted to an Approved Stock Exchange or 2) a potential future alternative capital raise. Thus, the embedded redemption feature was bifurcated from the face value of the 2021 Convertible Notes and accounted for as a derivative liability to be remeasured at the end of each reporting period. The fair value of the derivative liability at the inception of the 2021 Convertible Notes was \$1.1 million, with the offsetting amount being recorded as a debt discount. Debt issuance costs were \$131,000 at December 31, 2021. The debt discount and debt issuance costs are being amortized to interest expense using the effective interest method over the expected term of the 2021 Convertible Notes. The Company recognized approximately \$190,000 and \$23,000 in interest expense relating to amortization of the debt discount and debt issuance costs, respectively, for the year ended December 31, 2021. The Company also recognized the stated interest expense of approximately \$61,000 for the year ended December 31, 2021. The effective interest rate of the 2021 Convertible Notes was 35.8% at December 31, 2021 compared to the stated rate of 8%.

#### **NOTE 10: STOCKHOLDERS’ DEFICIT**

As of December 31, 2021, the Company was authorized to issue two classes of stock with a \$0.00001 par value consisting of common stock and preferred stock totaling 140,469,951 shares. The total number of shares the Company has the authority to issue under each class consists of common stock designated as 90,433,860 shares of Common Stock and 50,036,091 shares of Preferred Stock, with convertible Preferred Stock designated as 5,004,380 shares of Series Seed convertible Preferred Stock (“Series Seed Preferred Stock”), 3,871,850 shares of Series A convertible Preferred Stock (“Series A Preferred Stock”), 5,854,086 shares of Series B convertible preferred stock (“Series B Preferred Stock”), 5,074,753 shares of Series B-1 convertible Preferred Stock (“Series B-1 Preferred Stock”) and 30,231,022 shares of Series C convertible Preferred Stock (“Series C Preferred Stock”). See Note 11 for further information on the Preferred Stock.

As of December 31, 2021 and 2020, 17,245,269 shares of Common Stock were issued and outstanding. The holders of Common Stock have liquidation rights to receive any of the Company’s remaining assets on a pro-rata basis only following full payment of the preferential amounts payable with respect to Convertible Preferred Stock. The Company has reserved 7,285,626 shares of its common stock pursuant to the 2014 Stock Plan (“2014 Plan”) as of December 31, 2021 and 2020. A total of 314,872 and 269,872 stock options are outstanding under the 2014 Plan as of December 31, 2021 and 2020, respectively.

### *Common Stock Reserved for Future Issuance*

Shares of common stock reserved for future issuance relate to outstanding preferred stock, stock options and common stock warrants as follows:

	<b>December 31, 2021</b>
Series A Preferred Stock	1,081,263
Series B Preferred Stock	1,464,181
Series B-1 Preferred Stock	2,381,315
Series C Preferred Stock	19,766,598
Series Seed Preferred Stock	2,234,147
Common stock warrants – Series C	12,190,248
Common stock warrants – SVB	20,464
Stock options to purchase common stock	314,872
Stock options available for future issuance	238,244
	<hr/>
Total shares of common stock reserved	<u><u>39,691,332</u></u>

### **NOTE 11: PREFERRED STOCK**

The following table summarizes shares of Preferred Stock that were issued and outstanding as of December 31, 2021 and 2020:

	<b>December 31, 2021</b>
Series A Preferred Stock	1,081,263
Series B Preferred Stock	1,512,493
Series B-1 Preferred Stock	2,381,315
Series C Preferred Stock	19,766,598
Series Seed Preferred Stock	2,297,408
	<hr/>
	<u><u>27,039,077</u></u>

Other than a change of control, dissolution or winding up of the Company whether voluntary or involuntary or upon the occurrence of a deemed liquidation event, the convertible Preferred Stock is non-redeemable. As a result of the liquidation preference, the convertible preferred stock was not classified as part of stockholders' deficit in the consolidated balance sheets in accordance with ASC 480-10-S99, *SEC Materials*. The Company has excluded all series of convertible preferred stock from being presented within stockholders' deficit in the consolidated balance sheets due to the nature of the liquidation preferences.

#### *Series A Preferred Stock*

From October to December 2017, the Company issued 3,871,850 shares of Series A Preferred stock at \$1.4446 per share to various investors for net proceeds of approximately \$5.5 million.

#### *Series B Preferred Stock*

In December 2019, the Company issued 1,898,991 shares of Series B Preferred Stock at \$1.5524 per share to various investors for net proceeds of approximately \$2.8 million.

#### *Series B-1 Preferred Stock*

In December 2019, the Company raised approximately \$2.8 million in net proceeds from the sale of Series B Convertible Preferred Stock which triggered the automatic conversion of all the 2018 Notes and accrued interest into Series B-1 Convertible Preferred Stock. The 2018 Convertible Notes converted into 5,074,753 shares of Series B-1 Preferred Stock at a conversion price of \$1.2419 per share which represented a 20% discount from the Series B Preferred Stock price.

### *Series C Preferred Stock and Common Stock Warrants*

In July 2020, the Company issued 19,766,598 shares of Series C convertible preferred stock at \$0.1450 per share to various investors for net proceeds of \$2.7 million. In conjunction with the Series C convertible preferred stock, the Company also issued warrants with the Series C Preferred Stock Offering for the purchase of 12,190,248 shares of the Company's common stock at an exercise price of \$0.01 per share. The warrants have a ten-year contractual life and are immediately exercisable. The Company evaluated the terms of the warrants and determined that the warrants should be classified in equity as the warrants are both indexed to the Company's own stock and would be classified in stockholders' deficit.

The following table summarizes convertible preferred stock authorized and outstanding as of December 31, 2021 and 2020:

December 31, 2021 and 2020	Shares Authorized	Shares Outstanding	Proceeds, Net of Issuance Costs	Aggregate Liquidation Preference
Series A Preferred Stock	3,871,850	1,081,263	\$ 5,081,334	\$ 1,561,993
Series B Preferred Stock	5,854,086	1,512,493	2,947,994	2,347,994
Series B-1 Preferred Stock	5,074,753	2,381,315	-	2,957,355
Series C Preferred Stock	30,231,022	19,766,598	2,875,301	2,866,157
Series Seed Preferred Stock	5,004,380	2,297,408	2,834,994	1,834,710
	50,036,091	27,039,077	\$ 13,739,623	\$ 11,568,209

On September 9, 2020, several of the preferred stockholders elected to convert their shares of preferred stock into 8,577,495 shares of common stock. Shares of Series B-1 Preferred Stock were issued upon the automatic conversion of the Company's 2018 Convertible Notes upon the consummation of a "Next Equity Financing" from the issuance of Series B Preferred Stock. See Note 9 for additional information.

All classes of Preferred Stock have a par value of \$0.0001 per share.

### *Conversion Rights*

Each share of Series Seed and Series A Preferred Stock is convertible at the option of the holder at any time after the date of issuance of those shares into fully paid non-assessable shares of Common Stock determined by dividing the applicable original issue price for such series by the applicable conversion price for such series (the "conversion rate") in effect on the date the certificate is surrendered for conversion. Each share of Preferred Stock will be automatically converted into shares Common Stock at the conversion rate immediately upon the earlier of (i) the closing of the Company's sale of Common Stock in a firm commitment underwritten public offering pursuant to a registration statement on Form S-1 under the Securities Act of 1933, the public offering price of which was not less than \$8,000,000 in the aggregate, or (ii) the date or occurrence of an event, specified by vote or written consent or agreement of (x) the holders of a majority of the then outstanding Preferred Stock (voting together as a single class and not as a separate series, on an as-converted basis) and (y) the holders of at least a majority of the then outstanding shares of Series A Preferred Stock.

### *Voting Rights*

The holders of each share of Preferred Stock have the right to one vote for each share of Common Stock into which such Preferred Stock could then be converted and with respect to such vote, such holder has full voting rights and powers equal to the voting rights and powers of the Common Stock and shall be entitled to vote, together with holders of the Common Stock.

### *Dividends*

The holders of the outstanding shares of convertible preferred stock are entitled to receive dividends, when, as and if declared by the Board of Directors, out of any assets at the time legally available payable and in preference to any declaration or payment of any dividend on the common stock of the Company. Dividends would be payable at the following non-cumulative dividend rates: \$0.0639 per share of Series Seed Preferred Stock, \$0.1156 per share of Series A Preferred Stock, \$0.1242 per share of Series B Preferred Stock, \$0.0994 per share of Series B-1 Preferred Stock, and \$0.0116 per share of Series C Preferred Stock. After payment of such dividends, any additional dividends or distributions shall be distributed among all holders of Common Stock and Preferred Stock in proportion to the number of shares of Common Stock that would be held by each holder if all shares of Preferred Stock were converted to Common Stock at the then effective conversion rate. The right to receive dividends is not cumulative. No dividends were declared through December 31, 2021.

### *Liquidation Rights*

In the event of a liquidation event, either voluntary or involuntary, the holders of the Series C Preferred Stock will be entitled to receive out of the proceeds available for distribution prior to and in preference to the holders of Series B Preferred Stock, Series B-1 Preferred Stock, Series A Preferred Stock and Series Seed Preferred Stock. Upon completion of the distribution to Series C Preferred Stock, Series B and Series B-1 will be entitled to receive out of the proceeds available for distribution prior to and in preference to any distribution made to the holders of Series A Preferred Stock. Upon completion of the distribution to Series B Preferred Stock, Series A will be entitled to receive out of the proceeds available for distribution prior to and in preference to any distribution made to the holders of Series Seed Preferred Stock. A Liquidation Event is defined as (a) the closing of the sale, transfer or other disposition of all or substantially all of the Company's assets, (b) the consummation of a merger or consolidation of the Company with or into another entity where there is a change of control, (c) the closing of the transfer to a person or group of affiliated persons of the Company's securities, if after such closing, such person or group of affiliated persons would hold 50% or more of the outstanding voting stock of the Company or the surviving or acquiring entity, (d) the grant of an exclusive license of or to all or substantially all of the Company's intellectual property or (e) a liquidation, dissolution or winding up of the Company. If upon the occurrence of such event, the proceeds distributed among the holders of the Series A are insufficient to permit the payment to such holders of the full aforesaid preferential amounts, then, the entire proceeds legally available for distribution are to be distributed among the holders of the Series A Preferred Stock in proportion to the full preferential amount that each such holder would otherwise be entitled to receive. After such payment has been made to the holders of Series A, the holders of the Series Seed Preferred Stock are entitled to receive, out of the proceeds, prior and in preference to any distribution of the proceeds of Liquidation Event to the holders of Common Stock, an amount per share equal to the sum of the applicable Original Issue Price of the Series Seed Preferred Stock, plus declared but unpaid dividends on such share. If upon the occurrence of such event, the proceeds distributed among the holders of the Series Seed Preferred Stock are insufficient to permit the payment to such holders of the full preferential amounts, then the entire proceeds legally available for distribution are to be distributed ratably among the holders of the Series Seed Preferred Stock in proportion to the full preferential amount that each such holder is otherwise entitled to receive. After such payments have been made to the holders of all convertible Preferred Stock, no further payments shall be made to the holders of the convertible Preferred Stock and any remaining proceeds available for distribution to stockholders shall be distributed pro rata among the holders of the Company's common stock based on the number of common shares held by each.

The convertible preferred stockholders have liquidation preferences over the common stockholders in the amounts of \$0.7986 per share, \$1.4446 per share, \$1.5524 per share, \$1.2419 per share, and \$0.1450 per share for each share of Series Seed Preferred Stock, Series A Preferred Stock, Series B Preferred Stock, Series B-1 Preferred Stock and Series C Preferred Stock, respectively. The liquidation preferences totaled \$11,442,689 as of December 31, 2021 and 2020.

### **NOTE 12: STOCK-BASED COMPENSATION**

#### Stock Options

In November 2014, the Board of Directors adopted the 2014 Equity Incentive Plan (the "2014 Plan") allowing for the issuance of up to 4,085,626 shares of common stock through grants of options or the direct award or sale of shares. The 2014 Plan provides for the granting of stock awards such as incentive stock options and nonstatutory stock options to employees, directors and outside consultants as determined by the Board of Directors.

The Board may grant stock options under the 2014 Plan at a price of not less than 100% of the fair market value of the Company's common stock on the date the option is granted. The option exercise price generally may not be less than the underlying stock's fair market value at the date of grant and generally have a term of ten years. Incentive stock options granted to employees who, on the date of grant, own stock representing more than 10% of the voting power of all of the Company's classes of stock, are granted at an exercise price of not less than 110% of the fair market value of the Company's common stock. The maximum term of incentive stock options granted to employees who, on the date of grant, own stock having more than 10% of the voting power of all the Company's classes of stock, may not exceed five years. The Board of Directors also determines the terms and conditions of awards, including the vesting schedule and any forfeiture provisions. Options granted under the 2014 Plan may vest upon the passage of time, generally four years, or upon the attainment of certain performance criteria established by the Board of Directors. The Company may from time to time grant options to purchase common stock to nonemployees for advisory and consulting services. At each measurement date, the Company will remeasure the fair value of these stock options using the Black-Scholes option pricing model and recognize the expense ratably over the vesting period of each stock option award. Stock options comprise all of the awards granted since the Plan's inception. Shares available for grant under the 2014 Plan amounted to 238,244 and 283,244 as of December 31, 2021 and 2020, respectively.

A summary of the option activity under the 2014 Plan as of December 31, 2021 and changes during the year then ended is as follows:

	<b>Shares Available for Grant</b>	<b>Number of Shares</b>	<b>Weighted Average Exercise Price</b>	<b>Weighted Average Remaining Contractual Life (Years)</b>
Outstanding at December 31, 2019	979,303	968,059	\$ 0.47	8.34
Granted	-	-		
Exercised	-	(2,128)		
Cancelled	696,059	(696,059)	0.47	
Outstanding at December 31, 2020	283,244	269,872	0.47	7.10
Granted	(120,000)	120,000		
Exercised	-	-		
Cancelled	75,000	(75,000)		
Outstanding at December 31, 2021	238,244	314,872		
Vested and exercisable at December 31, 2021		304,347	0.47	7.21
Vested and expected to vest at December 31, 2021		380,000		

The weighted average grant date fair value of options granted during the year ended December 31, 2021 was \$0.47 per share. There were no option grants during the years ended December 31, 2021 and 2020. The fair value of the shares subject to stock options that were vested at December 31, 2021 and 2020 were \$72,895 and \$25,982, respectively.

The Company measures employee stock-based awards at grant-date fair value and recognizes employee compensation expense on a straight-line basis over the vesting period of the award. Determining the appropriate fair value of stock-based awards requires the input of subjective assumptions, including the fair value of the Company's common stock, and for stock options, the expected life of the option, and expected stock price volatility. The Company used the Black-Scholes option pricing model to value its stock option awards. The assumptions used in calculating the fair value of stock-based awards represent management's best estimates and involve inherent uncertainties and the application of management's judgment. As a result, if factors change and management uses different assumptions, stock-based compensation expense could be materially different for future awards.

The expected life of the stock options was estimated using the "simplified method," which is based on the midpoint between the vesting start date and the end of the contractual term, as the Company has limited historical information to develop reasonable expectations about future exercise patterns and employment duration for its stock options grants. The simplified method is based on the average of the vesting tranches and the contractual life of each grant. For stock price volatility, the Company uses comparable public companies as a basis for its expected volatility to calculate the fair value of options grants. The risk-free interest rate is based on U.S. Treasury notes with a term approximating the expected life of the option. The estimation of the number of stock awards that will ultimately vest requires judgment, and to the extent actual results or updated estimates differ from the Company's current estimates, such amounts are recognized as an adjustment in the period in which estimates are revised.

The Company recognized employee stock-based compensation expense for the years ended December 31, 2021 and 2020, which was calculated based upon awards ultimately expected to vest, and thus, this expense was reduced for estimated forfeitures. Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

Stock-based compensation expense of \$47,415 and \$(103,305) was recognized for the years ended December 31, 2021 and 2020, respectively. Total unrecognized compensation cost related to non-vested stock option awards amounted to \$17,854 and \$22,916 for the years December 31, 2021 and 2020, respectively, which will be recognized over a weighted average period of 2.7 and 0.8 years as of December 31, 2021 and 2020, respectively.



Stock-based compensation is included in the consolidated statements of operations in cost of revenue, general and administrative, research and development, or sales and marketing expenses, depending on the nature of the services provided. Stock-based compensation expense recorded to operations for stock options was as follows:

	<b>Years ended December 31,</b>	
	<b>2021</b>	<b>2020</b>
Cost of revenue	\$ 12,557	\$ 2,171
General and administrative	-	(62,654)
Research and development	34,858	(31,028)
Sales and marketing	-	(11,794)
Total	<u>\$ 47,415</u>	<u>\$ (103,305)</u>

#### **NOTE 13: EMPLOYEE BENEFIT PLAN**

The Company has a 401(k) retirement plan (the “401(k) Plan”) administered by a third party in which all eligible employees can participate. The Company has made no matching contributions.

#### **NOTE 14: INCOME TAXES**

Domestic and foreign components of loss before provision for income taxes for the years ended December 31, 2021 and 2020 are as follows:

	<b>Years ended December 31,</b>	
	<b>2021</b>	<b>2020</b>
United States	\$ (3,399,194)	\$ (3,511,363)
Income (Loss) before income taxes	<u>\$ (3,399,194)</u>	<u>\$ (3,511,363)</u>

The provision for income taxes consisted of the following:

	<b>Years ended December 31,</b>	
	<b>2021</b>	<b>2020</b>
Current:		
Federal	\$ -	\$ -
State	800	800
Foreign	-	-
Total Current	<u>800</u>	<u>800</u>
Deferred:		
Federal	-	-
State	-	-
Foreign	-	-
	<u>-</u>	<u>-</u>
<b>Total Provision</b>	<u>\$ 800</u>	<u>\$ 800</u>

The components of the Company's deferred tax assets and liabilities consisted of:

	<b>December 31,</b>	
	<b>2021</b>	<b>2020</b>
Deferred tax assets:		
Net operating loss carryforwards	\$ 6,230,342	\$ 5,241,809
Research and development credit carryforwards	536,301	376,010
Stock based Compensation	-	-
Intangibles	-	34,386
Accruals and Other	286,290	99,473
	<u>7,052,933</u>	<u>5,751,678</u>
Valuation allowance	<u>(6,995,925)</u>	<u>(5,710,309)</u>
Total Deferred Tax Asset	<u>57,009</u>	<u>41,370</u>
Deferred tax liability:		
Fixed Assets	<u>(57,009)</u>	<u>(41,370)</u>
Total Deferred Tax Liability	<u>(57,009)</u>	<u>(41,370)</u>
Net Deferred Tax Asset/(Liability)	<u>\$ -</u>	<u>\$ -</u>

As of December 31, 2021, the Company had U.S. federal and state net operating loss ("NOL") carryforwards of \$22,310,681. The federal NOL carryforward consists of \$4,829,534 generated before January 1, 2018 which will begin to expire in 2036 but are able to offset 100% of taxable income and \$17,481,147 generated after December 31, 2017 that will carry forward indefinitely but will be subject to 80% of taxable income limitation.

The Company has federal research and development tax credit carryforwards of \$249,564 which will begin to expire in 2036. As of December 31, 2021, the Company had state net operating loss carryforwards of \$22,124,672 which will begin to expire in 2036 and state research and development tax credit carryforwards of \$589,247, which do not expire.

Utilization of the federal and state net operating loss and federal and state research and development tax credit carryforwards may be subject to annual limitations due to the ownership percentage change provisions of the Internal Revenue Code Sections 382 and 383 and similar state provisions. The annual limitations may result in an inability to fully offset future annual taxable income and could result in the expiration of the net operating loss or credit carryforwards before utilization. Utilization of foreign net operating loss carryforwards may be limited or disallowed under similar foreign income tax provisions.

As of December 31, 2021, the Company had unrecognized tax benefits of \$209,703. The reversal of the unrecognized tax benefits would not affect the Company's effective tax rate to the extent that it continues to maintain a full valuation allowance against its deferred tax assets. The Company's policy is to recognize interest and penalties related to income matters in income tax expense. No significant interest or penalties were recorded during the year ended December 31, 2021. The Company does not anticipate any significant changes to unrecognized tax benefits within the next twelve months.

The Company files income tax returns in the U.S. federal and California jurisdictions, and in the UK foreign jurisdiction. The Company is subject to U.S. federal income tax examinations for calendar tax years ended 2016 through 2020 due to net operating losses that are being carried forward for tax purposes. Additionally, the Company is subject to state income tax examinations for the 2016 through 2021 calendar tax years due to net operating losses that are being carried forward for tax purposes. The Company is not currently under audit in any major tax jurisdiction..

#### **NOTE 15: LEASE OBLIGATIONS**

Effective December 2017, the Company entered into a facility lease agreement for manufacturing space located in Newark, California. The lease term commenced May 1, 2018 and expired on June 30, 2021 at which time the lease was amended with a new expiration date of February 14, 2022 and was further amended such that the expiration date of the new lease is now February 14, 2026. Monthly lease obligations under the amended agreement include base rent starting at \$13,339 per month plus 26.2% of common area operating costs, subject to actual expenses. The base rent was contractually escalated to \$13,801 per month beginning December 15, 2020 and to \$14,216 per month beginning December 15, 2021.

Rent expense totaled \$166,000 and \$171,000 for the years ended December 31, 2021 and 2020, respectively, and is included in the Company's consolidated statements of operations.

In October 2017, the Company entered into an agreement to lease a vehicle. The vehicle lease had a term of 48 months with monthly lease payments including tax, of \$561 per month. The Company accounted for this lease as an operating lease. The Company purchased the vehicle at the end of the lease in October 2021.

The following are the future minimum lease obligations on the Company's lease agreements as of December 31, 2021:

<u>December 31,</u>	<u>Lease Obligations</u>
2022	\$ 189,000
2023	194,000
2024	201,000
2025	207,000
2026	26,000
Thereafter	-
	<u>\$ 817,000</u>

#### **NOTE 16: COMMITMENTS AND CONTINGENCIES**

In the normal course of business, the Company enters into contracts that contain various representations and warranties and provide for general indemnifications. The Company's exposure under these agreements is unknown because any claims that may be made against the Company in the future have not yet been made. To date, the Company has not paid any claims or been required to defend any action related to its indemnification obligations and, accordingly, the Company believes that the fair value of these indemnification obligations is minimal and has not accrued any amounts for these obligations.

From time to time, the Company is subject to claims and assessments in the ordinary course of business. The Company is not currently a party to any litigation matters that, individually or in the aggregate, are expected to have a material adverse effect on the Company's business, financial condition, results of operations, or cash flows.

#### **NOTE 17: SUBSEQUENT EVENTS**

Management has evaluated subsequent events through July 11, 2022, the date the consolidated financial statements were issued. Based on this evaluation, no additional material events were identified which require adjustment or disclosure in these consolidated financial statements.

##### *Small Business Administration Loan*

In November 2021, the Company entered into a Loan Authorization Agreement with the U.S. Small Business Administration in which the Company would receive a loan for \$150,000 (the "promissory note"). The promissory note would bear interest at 3.5% per annum with installment payments, including principal and interest, of \$731 per month, to begin twelve months from the date of the promissory note. The principal and interest will be payable thirty years from the date of the promissory note. The proceeds from the promissory note were received in March 2022.

##### *Convertible Loan*

In June 2022, the Company entered into convertible loan agreements with various investors for gross proceeds of approximately \$1.0 million AUD or approximately \$700,000 USD. The notes are convertible into shares of the Company's common stock issued upon completion of an IPO at a conversion price equal to 90% of the IPO price at any time after the occurrence of an IPO. The convertible notes are convertible at the option of the noteholder. The notes are non-interest bearing and mature within three months after the date of issuance of the convertible notes unless previously redeemed, converted or purchased and cancelled.