FY2022 - Appendix 4E & Preliminary Financial Report

28 February 2023

1. Reporting period

Name of Entity:	Nightingale Intelligent Systems, Inc. (the **Company**)
ARBN:	659 369 221
Reporting period:	For the year ended 31 December 2022
Previous reporting period:	For the year ended 31 December 2021

This Appendix 4E is prepared in US Dollars under US GAAP and is unaudited.

2. Results for announcement to the market

	FY2022	FY2021	Up / Down
Revenue from ordinary activities	2,148,162	1,939,090	Up 11%
Loss from ordinary activities after tax attributable to members	(3,858,414)	(3,409,191)	Up 13%
Net loss for the period attributable to members	(5,752,720)	(3,399,994)	Up 69%

Dividends

The Company does not propose to pay any dividends in relation to the current financial period. No dividends were paid in the preceding financial period. The Company does not operate any dividend reinvestments plans.

3. Net tangible assets

	FY2022 (cents)	FY2021 (cents)
Net tangible assets per security	0.02	0.13

Note: Net tangible assets includes $538,462 of Right-of-Use Assets (net) in accordance with ASU 2016-02, Topic 842. The Company's securities include US shares of common stock and Australian CDIs representing underlying shares of common stock. US shares of common stock are convertible into CDIs on a 1:1 basis. Net tangible assets per security in FY2022 reflects the significant increase in issued shares following the Company's IPO.

4. Commentary on preliminary financial results

The Company designs, develops, builds, deploys, and supports autonomous robotic aerial security technologies. The Company's revenue is generated from contractual arrangements for the sale of drone systems which include the drone and base equipment, deployment of the drone system, and maintenance and support agreements. The Company also leases its equipment to 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.

The Company undertook an IPO and successfully listed on the ASX on 18 November 2022. Prior to that, the Company was privately held. CHESS Depository Interests (**CDIs**) over shares of the Company's common stock are quoted on the ASX. One CDI represents one fully paid share of common stock in the Company. All net losses are attributable to U.S. shareholders and Australian CDI holders on an equal basis.

Although unaudited revenues increased in 2022 over 2021 (audited), management involvement in the IPO process affected sales and marketing efforts in the second half of 2022 which in addition to negatively impacting Q4 2022 revenues is also expected to have a negative impact on Q1 2023 results due to the nature of the sales cycle for selling the Company's products and services.

The Company's sales pipeline is solid with new contracts already being awarded in 2023 and further contracts expected to be awarded in the current financial year. The sales pipeline encompasses the Company's core customer sectors of industrial/commercial, law enforcement and defense. The Company will continue both to sell and lease its products.

The Company's ASX listing also resulted in an increase in general & administrative expenses. Certain of these expenses are not expected to continue into 2023.

The Net Loss for the current year is $5.752M (FY2021 $3.399M). Most of the increase in current year net loss arises from non-cash items related to the conversion of convertible notes including debt discount amortization, changes in derivative liability accounting and mark-to-mark adjustments. Loss from operations in the current year is $3.858M (FY2021 $3.409M).

The Company is closely monitoring its working capital to ensure it has adequate funds to meet its business plans. The Company expects to incur additional losses in the future and will need to raise additional capital to fully implement its business plan. The Company may raise additional capital through the issuance of equity securities, debt financings or other sources in order to further implement its business plan. However, if such financing is not available when needed and at adequate levels, the Company will need to re-evaluate its operating plan and may be required to curtail its business operations.

5. Control gained or lost over entities

There were no changes in control over entities by the Company or its wholly owned subsidiary during the current financial period.

6. Associates and joint venture entities

The Company had no investments in associates or joint ventures during the current financial period.

7. Accounting standards and audit

The Company's financial statements are prepared under US GAAP and are audited under Australian Accounting Standards.

This preliminary financial report is based on financial accounts which are in the process of being independently audited by Grant Thornton and an unqualified opinion is expected to be issued by the auditor, with a note relating to going concern.

Signed by:

Jack Wu
CEO

Nightingale Intelligent Systems, Inc.

Preliminary Consolidated Financial Statements
as of and for the Years Ended December 31, 2022 and 2021

NIGHTINGALE INTELLIGENT SYSTEMS, INC.
PRELIMINARY CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2022 AND 2021

	As of December 31,	
	2022	**2021**
Assets		
Current assets		
Cash and cash equivalents	$ 1,441,248	$ 1,253,277
Accounts receivable, net of allowance for doubtful accounts ($158,150 at December 31, 2022 and 2021)	224,361	761,676
Inventory, net	203,301	104,519
Prepaid expenses and other current assets	84,133	318,971
Total current assets	1,953,043	2,438,443
Operating lease right-of-use asset	538,462	—
Leased assets, net	108,930	225,386
Product development assets, net	—	19,342
Property and equipment, net	33,086	65,551
Other assets	23,407	46,003
Total assets	$ 2,656,928	$ 2,794,725
Liabilities, Convertible Preferred Stock and Stockholders' Equity (Deficit)		
Current liabilities		
Accounts payable	$ 860,056	$ 132,314
Accrued expenses	73,624	75,662
Deferred revenue	569,458	893,074
Operating lease liability, current	164,626	—
Accrued interest	—	207,391
Total current liabilities	1,667,764	1,308,441
Loan payable	150,000	—
Operating lease liability, noncurrent	412,966	—
Convertible notes, noncurrent	—	1,926,297
Derivative liability	—	1,906,429
Total liabilities	2,230,730	5,141,167
Commitments and Contingencies		
Convertible preferred stock, \$0.00001 par value; 50,036,091 shares authorized at December 31, 2022 and 2021; 0 and 27,039,077 shares issued and outstanding at December 31, 2022 and 2021, respectively (aggregate liquidation preference of \$0 and \$11,568,209 as of December 31, 2022 and 2021)	—	12,709,219
Stockholders' Equity (Deficit):		
Common stock, \$0.00001 par value; 250,000,000 and 90,433,860 shares authorized at December 31, 2022 and 2021, respectively; 133,222,854 and 21,570,999 shares issued and outstanding at December 31, 2022 and 2021, respectively	17,414,412	173
Additional paid-in capital	14,079,583	10,259,243
Accumulated deficit	(31,067,797)	(25,315,077)
Total stockholders' equity (deficit)	426,198	(15,055,661)
Total liabilities, convertible preferred stock and stockholders' equity (deficit)	$ 2,656,928	$ 2,794,725

NIGHTINGALE INTELLIGENT SYSTEMS, INC.
PRELIMINARY CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE YEARS ENDED DECEMBER 31, 2022 AND 2021

	Years Ended December 31,	
	2022	**2021**
Revenue	$ 2,148,162	$ 1,939,090
Cost of revenue	1,621,560	1,235,983
Gross profit	526,602	703,107
Operating expenses:		
Research and development	2,146,538	2,368,182
Sales and marketing	235,203	130,800
General and administrative	2,003,275	1,613,316
Total operating expenses	4,385,016	4,112,298
Loss from operations	(3,858,414)	(3,409,191)
Other income (expense), net:		
Interest expense, net	(1,765,673)	(802,771)
Other income (expense), net	(128,633)	138,376
Gain on forgiveness of PPP loan	—	673,592
Total other income (expense), net	(1,894,306)	9,197
Net loss	$ (5,752,720)	$ (3,399,994)
Net loss per share - basic and diluted	$ (0.17)	$ (0.20)
Weighted average shares of common stock - basic and diluted	33,952,429	17,245,269

NIGHTINGALE INTELLIGENT SYSTEMS, INC.
PRELIMINARY CONSOLIDATED STATEMENTS OF CONVERTIBLE PREFERRED STOCK AND CHANGES IN STOCKHOLDERS' EQUITY (DEFICIT)
FOR THE YEARS ENDED DECEMBER 31, 2022 AND 2021

	Convertible Preferred Stock		Common Stock		Additional Paid-In Capital	Accumulated Deficit	Total Stockholders' Equity (Deficit)
	Shares	Amount	Shares	Amount			
Balances at December 31, 2020	27,039,077	$ 12,709,811	21,570,999	$ 173	$ 10,211,828	$ (21,915,083)	$ (11,703,082)
Series C issuance costs	—	(592)	— —	—	—	—	—
Stock-based compensation expense	—	—	— —	—	47,415		47,415
Net loss	—	—	— —	—	—	(3,399,994)	(3,399,994)
Balances at December 31, 2021	27,039,077	12,709,219	21,570,999	173	10,259,243	(25,315,077)	(15,055,661)
Issuance of common stock upon conversion of Series Seed, Series A, Series B, Series B-1 and Series C convertible preferred stock	(27,039,077)	(12,709,219)	27,039,068	11,113,155	1,596,064	—	12,709,219
Issuance of common stock from initial public offering, net of offering costs	—	—	22,727,273	2,179,735	—	—	2,179,735
Issuance of common stock upon conversion of convertible notes	—	—	49,882,676	4,121,229	—	—	4,121,229
Conversion of derivative liability	—	—	—	—	2,094,520	—	2,094,520
Issuance of common stock upon exercise of Series C stock warrants	—	—	12,002,838	120	119,913	—	120,033
Stock-based compensation expense	—	—	—	—	9,843	—	9,843
Net loss	—	—	—	—	—	(5,752,720)	(5,752,720)
Balances at December 31, 2022	—	$ —	133,222,854	$17,414,412	$ 14,079,583	$ (31,067,797)	$ 426,198

NIGHTINGALE INTELLIGENT SYSTEMS, INC.
PRELIMINARY CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2022 AND 2021

	For the Years Ended December 31,	
	2022	**2021**
Cash flows from operating activities:		
Net loss	$ (5,752,720)	$ (3,399,994)
Adjustments to reconcile net loss to net cash used in operating activities:		
Stock-based compensation expense	9,843	47,415
Depreciation and amortization	168,263	198,239
(Gain)/Loss on change in fair value of derivative liability	138,962	(146,272)
Gain on forgiveness of PPP loan	—	(673,592)
Reduction of operating lease ROU asset	174,636	—
Amortization of debt discount	665,496	543,494
Amortization of debt issuance costs	123,437	64,597
Loss on release of convertible notes, net	749,556	—
Foreign exchange gain	(1,924)	—
Changes in operating assets and liabilities:		
Accounts receivable	537,315	(641,911)
Inventories	(98,782)	6,523
Prepaid expenses and other current assets	221,546	(283,576)
Other assets	22,596	(28,573)
Accounts payable	344,682	17,548
Accrued expenses	(2,038)	31,607
Accrued interest	213,346	158,785
Deferred revenues	(323,616)	688,111
Operating lease liability	(135,506)	—
Net cash used in operating activities	(2,944,908)	(3,417,599)
Cash flows from investing activity:		
Purchase of property and equipment	—	(49,704)
Net cash used in investing activity	—	(49,704)
Cash flows from financing activities:		
Proceeds from issuance of common stock	3,379,464	—
Proceeds from convertible notes	654,012	2,021,326
Proceeds from Economic Injury Disaster Loan	150,000	—
Proceeds from exercise of Series C stock warrants	120,033	—
Proceeds from issuance of promissory note	—	278,272
Offering costs paid	(803,377)	(13,292)
Payment for redemption of convertible notes	(342,719)	—
Payment of loan	—	(250,000)
Payment of convertible preferred stock issuance costs	—	(591)
Net cash provided by financing activities	3,157,413	2,035,715
Effects of foreign exchange rate on cash and cash equivalents	(24,534)	—
Increase/(Decrease) in cash and cash equivalents	**187,971**	**(1,431,588)**
Cash and cash equivalents, beginning of year	**1,253,277**	**2,684,865**
Cash and cash equivalents, end of year	$ **1,441,248**	$ **1,253,277**

NIGHTINGALE INTELLIGENT SYSTEMS, INC.
PRELIMINARY CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2022 AND 2021

	For the Years Ended December 31,	
	2022	2021
Supplemental disclosure of non-cash investing and financing activities:		
Reclassification of deferred offering costs	$ 869,121	$ —
Deferred offering cost included in accounts payable	$ 383,060	$ —
ROU assets obtained for operating lease liabilities	$ 713,098	$ —
Conversion of convertible notes and accrued liabilities	$ 4,121,229	$ —
Conversion of derivative liability	$ 2,094,520	$ —
Conversion of Series Seed, Series A, Series B, Series B-1 and Series C convertible preferred stock	$ 12,709,219	$ —

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.

<u>Basis of Presentation</u>

The accompanying preliminary 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 preliminary consolidated financial statements and accompanying notes.

<u>Liquidity</u>

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 completed an initial public offering ("IPO") of its common stock on November 18, 2022. Upon the closing of the IPO, on specified terms, the Company's outstanding convertible preferred stock and convertible debt automatically converted into shares of common stock. 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 $1.4 million and $1.3 million at December 31, 2022 and 2021, respectively. The Company has incurred net losses of $5.7 million and $3.4 million for each of the years ended December 31, 2022 and 2021, had an accumulated deficit of $31.1 million at December 31, 2022 and working capital of $.3 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 preliminary 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 preliminary 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, 2022, 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 significant foreign currency translation adjustments as a component of other comprehensive loss through December 31, 2022, 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 preliminary consolidated financial statements and the accompanying notes. The most significant estimates in the Company's preliminary 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 preliminary 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 preliminary 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 capitalized certain legal, professional, accounting and other third-party fees that were directly associated with in-process financings as deferred offering costs until such financings were 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 preliminary consolidated statements of operations.

Deferred offering costs were approximately $0 and $13,000 for the years ended December 31, 2022 and 2021, respectively, and are included in the Company's preliminary 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 December 31, 2022 and 2021, respectively.

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.

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 preliminary consolidated statements of operations.

Product Development Assets

Depreciation expense on product development assets were included in research and development expenses on the Company's preliminary consolidated statements of operations and were approximately $19,000 and $98,000 for the years ended December 31, 2022 and 2021, 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, 2022. None of the Company's drone units, base stations or property and equipment was determined to be impaired as of December 31, 2022.

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 preliminary 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 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, 2022 as none were deemed needed as a result of the measurement of constraint of revenues.

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 preliminary 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 preliminary consolidated statements of operations.

Refer to footnotes 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 preliminary 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 preliminary consolidated statements of operations. Derivative instrument liabilities are classified in the preliminary 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.

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 preliminary consolidated statements of operations as incurred. Advertising expense was immaterial for the years ended December 31, 2022 and 2021.

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 preliminary consolidated statements of convertible preferred stock and stockholders' deficit. Exchange differences are included in general and administrative expenses in the preliminary 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.

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 are not included in the calculation of diluted net loss per share, because to do so would be anti-dilutive.

Recent Accounting Pronouncements - Adopted

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 deferred the effective date for private companies until fiscal years beginning after December 15, 2021. The Company adopted ASU 2016-02 effective January 1, 2022 on a modified retrospective basis.

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. 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 adopted ASU 2016-13 effective January 1, 2022.

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 adopted the new guidance effective January 1, 2022.

NOTE 3: PROPERTY AND EQUIPMENT

Property and equipment, leasehold improvements and software, as of December 31, 2022 and 2021 are as follows:

	December 31, 2022	December 31, 2021
Computer equipment	$ 20,337	$ 20,337
Machinery and equipment	6,493	6,493
Automobiles	49,722	49,722
Leasehold improvements	69,432	69,432
		145,984
Accumulated depreciation	(112,948)	(80,443)
Property and equipment, net	$ 33,086	$ 65,551

Depreciation and amortization expense on property and equipment included in general and administrative expenses amounted to approximately $27,718 and $16,381 in 2022 and 2021, 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 4: 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. The April 2020 PPP Loan was scheduled to mature on April 15, 2022 and bore interest at a rate of 1.0% per annum. The April 2020 PPP Loan contained events of default and other provisions customary for a loan of this type.

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 would be forgivable, if the loan proceeds were 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 preliminary consolidated statement of operations for the year ended December 31, 2021.

NOTE 5: DEBT OBLIGATIONS

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.

SVB 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 (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 bore interest at the greater of (i) 2% above the prime rate (prime rate was 3.25% at December 31, 2021) or (ii) 6.25%. Interest expense on the Loan Agreement during the year ended December 31, 2021 was $7,323. The Company repaid $250,000 during the year ended December 31, 2021 and, as of the end of December 31, 2021, the Loan had been repaid in full.

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, 2022, 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 were 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 or extended. The 2020 Convertible Notes bore interest at the rate of 8% per annum with interest payable beginning on July 31, 2020. The 2020 Convertible Notes were extended and then automatically converted into fully paid ordinary shares of the Company upon the completion of the IPO on the Australian Stock Exchange ("ASX") in November 2022 .

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.

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 were 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 bore interest at the rate of 8% per annum. With the November 2022 IPO, the 2021 Convertible Notes and any accrued interest automatically converted into shares of common stock of the Company or CHESS 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.

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.

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 were 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 bore interest at 10% of face value. Approximately 50% of the notes were converted into common shares of the Company in conjunction with the November 2022 IPO and approximately 50% were redeemed for cash.

NOTE 6: PREFERRED STOCK

The Company had the following Preferred Stock tranches that were issued and outstanding as of December 31, 2021. All were converted into common shares with the November 2022 IPO and are $nil at December 31, 2022.

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 preliminary 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 preliminary 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.

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.

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, 2022. *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 f 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.

NOTE 7: STOCK-BASED COMPENSATION

Stock Options

In November 2014, the Board of Directors adopted the 2014 Equity Incentive Plan (the "2014 Plan") allowing for common stock grants 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.

NOTE 8: 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 9: INCOME TAXES

Domestic and foreign components of loss before provision for income taxes for the years ended December 31, 2022 and 2021 are as follows:

	December 31, 2022	December 31, 2021
United States	$ (5,752,720)	$ (3,399,194)
Income (loss) before income taxes	$ (5,752,720)	$ (3,399,194)

The provision for income taxes consisted of the following:

	December 31, 2022	December 31, 2021
Current:		
Federal	$ -	$ -
State	1,500	800
Foreign	-	-
Total current	1,500	800
Deferred:		
Federal	-	-
State	-	-
Foreign	-	-
Total deferred	-	-
Total provision for income taxes	$ 1,500	$ 800

NOTE 10: 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.

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, 2022:

December 31,	Lease Obligations
2023	$ 194,000
2024	201,000
2025	207,000
2026	26,000
2027	0
Thereafter	0
	$ 628,000

NOTE 11: 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.