NIGHTINGALE SECURITY®

Nightingale Intelligent Systems, Inc.

ANNUAL REPORT 2022

A Delaware Corporation
ARBN: 659 369 221

Contents

Corporate Directory

Company

Nightingale Intelligent Systems, Inc.
ARBN: 659 369 221
ASX Codes: NGL and NGLO

Principal and Registered Office

8450 Central Avenue
Newark, California 94560, USA
Phone: +1 (408) 909-7227
Email: ras@nightingalesecurity.com
Web: www.nightingalesecurity.com

Directors and Company Secretary

Denis Hébert	Independent Non-Executive Chairman
Jack Wu	Chief Executive Officer
Alan Braverman	Independent Non-Executive Director
Stratos Karousos	Independent Non-Executive Director
Tony Zhang	Non-Executive Director
Mike Tschiderer	Company Secretary

Auditors

Grant Thornton Audit Pty Ltd
Level 17/383 Kent Street
Sydney NSW 2000 Australia

Legal Advisers

United States
Troutman Pepper Hamilton Sanders LLP
5 Park Plaza, 14th Floor
Irvine, California 92626, USA

Australia
Maddocks
Angel Place, Level 27, 123 Pitt Street
Sydney, NSW 2000, Australia

Share Registries

United States
Securities Transfer Corporation
2901 N Dallas Parkway Suite 380
Texas, 75093 USA

Australia
Automic Group Pty Ltd
Level 5/126 Phillip Street
Sydney, NSW 2000 Australia

Securities Exchange Listing

CHESS Depository Interests (**CDIs**) over shares of the Company's common stock (**Shares**) are quoted on the Australian Securities Exchange under the ticker code ASX: NGL. One CDI represents one (1) fully paid Share in the Company.

Chairman's Letter

On behalf of the Board and the team, I am pleased to address all our stakeholders through this first Annual Report for Nightingale Intelligent Systems, Inc.

Nightingale provides unmanned aerial systems (**UAS**) for commercial applications. The Nightingale Robotic Aerial Security (**RAS**) system is an autonomous perimeter security system to guard these critical infrastructure locations. Nightingale RAS systems can be operated autonomously using GPS waypoints and its advanced localization software for remote piloting.

Nightingale operates at the intersection of three key market segments:

- **Commercial UAS and drones**: UAS (including drones and other unmanned aerial robotics) are now regularly used for defence, commercial applications and by consumers.

- **Security and Surveillance**: Nightingale is seeking to capture market share from the global security system market with revenue generated from video surveillance, access control and intrusion detection systems1, and the security inspection industry that utilises manual labour-based practices and manpower. Both markets can be displaced or supported by the Nightingale RAS systems including use by police and other emergency response services.

- **Protecting Critical Infrastructure**: The US Government has highlighted 16 categories of critical infrastructure sites that require additional protection and resilience including defence sites, data centres and power generation facilities, whose security could all be augmented by Nightingale RAS.

2022 was an eventful year for Nightingale, growing 10.8% amidst all the activities leading up to our IPO on the ASX last November. This growth is a tribute to the team's focus on customers and their needs, despite the regulatory distraction of a public listing. Key long-term wins, such as the US Air Force, Haliburton and the Los Angeles Department of Water & Power, further solidified the value proposition of autonomous drones. The year was nonetheless dampened somewhat by major post-pandemic supply chain challenges, as well as a persistently backward regulatory framework around "line-of-sight" flight by drones.

The future is extremely bright, as customers begin to realize the tremendous potential of Robotic Aerial Security. Nightingale's autonomous threat response capabilities are becoming a key differentiator in the market and resonate strongly with customers in critical infrastructure. This is now becoming a key market opportunity for the company, attracting very influential channel partners looking at building the sales pipeline. Orders are always subject to budget cycles, affecting the timing of revenue recognition, but the demand is gaining, and Nightingale is very well positioned for growth. I have no doubt that 2023 will be a break-out year for project and partnership announcements.

The board would like to thank the senior executive team of Jack Wu, John Hsu and Michael Tschiderer for their leadership, and the Nightingale team for their outstanding contribution over the past year.

Thank you for the time you have invested to read this letter, and for your attention and consideration. Our sincere thanks to all our stakeholders, from our suppliers to our valued channel partners, and especially our shareholders, for their continued support of Nightingale. Our Board, our executive team and I all take very seriously our responsibility as stewards of our investors' capital.

Sincerely,

Denis Hébert
Non-Executive Chairman
31 March 2023

Directors' Report

The directors present their report for Nightingale Intelligent Systems, Inc. (**Nightingale** or **Company**) together with the financial statements on the Consolidated Entity (referred to hereafter as the **Consolidated Entity** or **Group**) consisting of the Company and its sole subsidiary (Nightingale (UK) Operations Limited) for the financial year ended 31 December 2022.

Directors

The following persons were directors of the Company during the whole of the financial year and up to the date of this report, unless otherwise stated:

Denis Hébert	Independent Non-Executive Chairman
Jack Wu	Executive Director and Chief Executive Officer
Alan Braverman	Independent Non-Executive Director (appointed 13 July 2022)
Stratos Karousos	Independent Non-Executive Director (appointed 29 June 2022)
Tony Zhang	Non-Executive Director

Principal Activities

Nightingale designs, develops, builds, deploys, and supports autonomous robotic aerial security technologies that protect critical infrastructure for Fortune 500 companies. The Company's initial focus is on Enterprise, Defence and Emergency Response market segments.

The Company's autonomous perimeter security system features networked base stations and mission-ready drones which can be rapidly airborne to meet the threat. The system is driven by Nightingale's command and control software, which equips security teams with a real-time decision support system to help keep their facilities safe while reducing labor costs.

Nightingale operates its security system as part of a turnkey solution to deliver advanced security and surveillance that can reduce customers' costs, increase their coverage while maintaining staff safety.

Nightingale provides autonomous aerial security through its Nightingale RAS system featuring:

- Blackbird UAV: a mission-ready drone which can be airborne in less than 30 seconds;
- Base station: houses, charges, and provides command and control for the Blackbird UAV; and
- Intelligent Mission Control software: which equips security teams with a real-time decision support system to help keep their facilities safe.

Nightingale pursues a lean and efficient production strategy across its business, focusing on supply chain management, final assembly, integration, quality, and final acceptance testing.

The Company outsources certain production activities, such as the fabrication of certain aerostructures, the manufacture and assembly of electronic printed circuit boards, payload components, and the production of its UAS to qualified hardware suppliers. This outsourcing enables the Company to focus on its core expertise, ensuring high levels of quality and reliability.

The Company has forged strong relationships with key suppliers for all elements of the UAS. It is planned to build redundancy into the supply chain with multiple providers. Suppliers of key components of the UAS include Coretronics, Flir and Microhard.

Final assembly, integration, quality, and final acceptance testing are completed in-house. All customer service for clients is provided from the U.S.

Review of Operations and Financial Results

Nightingale's successful 2022 financial year culminated with the Company completing its Initial Public Offering (**IPO**) and being admitted to the Official List of Australian Securities Exchange on 18 November 2022.

Under the IPO, the Company raised, on a gross basis, AUD$5,000,000 (before costs) through the issue of 22,727,273 CHESS Depositary Interests (**CDIs**) at an issue price of AUD$0.22 per CDI. Each CDI represents one underlying share of common stock (**Share**) in Nightingale. Subscribers to the IPO also received one option for every two CDIs subscribed with an exercise price of AUD$0.35 and an expiry date of 18 November 2025.

The financial report is presented in US Dollars with all references to dollars, cents or $'s in these financial statements presented in US currency, unless otherwise stated.

Results of Operations

The Company had revenues of $2.1M in 2022 compared to $1.9M in 2021, a 10.8% increase. The increase in revenues is from sales of its systems to new customers as well as added revenues from prior year customers who purchase additional systems which validates the Company's "land and expand" sales strategy. The Company sells and leases its units and the mix of sales vs. leases can be expected to vary. Typically, the Company sells and leases units in the U.S. while only selling units to its overseas customers. Revenue from maintenance agreements (sometimes called "MRU") came from new contracts as well as the renewal of maintenance contracts from prior years.

Cost of revenues as a percentage of revenues increased from 64% to 76% year-over-year. Cost of revenues includes the cost of materials sold, other direct costs, and the costs of the Company's operations department which is responsible for new unit deployments at customer sites as well as supporting existing units under maintenance agreements with customers. These costs include labor, materials and direct overhead expenses. In 2022 the Company added personnel to its operations department to support the Company's current and expected growth. Operations costs will grow with revenue but gross profit percentage growth is expected as certain cost investments can be leveraged for growth (i.e. scalable).

The Company's operating expenses are classified as "research and development", "sales and marketing" and "general and administrative". Research and development expenses were $2.3M in 2022 compared to $2.4 in 2021. This decrease was primarily due a decrease in purchases of R&D materials and supplies and less depreciation expense offset by higher stock compensation expense. Salaries increased $0.3M which offset $0.2M less in outside contractors and services (more in-house resources year-over-year). Sales and marketing expenses were $0.2M in 2022 compared to $0.1M in 2021. This increase was due to 2021 being impacted by COVID-19 restrictions which resulted in less travel, fewer trade shows and a general cautionary approach to spending, especially in the first half of 2021. General and administrative expenses were $2.1M in 2022 compared to $1.6M in 2021. This increase was primarily due to costs related to the Company's IPO readiness efforts and included more accounting, legal and other professional services ($0.2M), as well as higher stock compensation expense ($0.3M).

Net loss from operations was $4.1M in 2022 compared to $3.4M in 2021 which reflects the factors described above.

Net loss was $6.0M in 2022 compared to $3.4M in 2021. This increase is attributable to the $0.7M increase in loss from operations, the interest expense and other expense activity related to the IPO and the accounting for the conversion of various debt and preferred shares in connection with the IPO, and the one-time $0.7M gain recognized in 2021 from the forgiveness of the Company's Paycheck Protection Programs loans by the U.S. government.

In the Boards' view, earnings per share comparisons between 2021 and 2022 are somewhat meaningless due to the number of shares issued and security conversions in connection with the Company's IPO.

Financial Position

The Company's financial position reflects the net proceeds of the IPO that was finalized on November 18, 2022. Gross proceeds were approximately $3.4M (approximately AUD$5.0M) before issuance costs. Most issuance costs were disbursed in 2022 ($0.8M) although certain costs will be disbursed in 2023 ($0.3M). Cash at December 31, 2022 is $1.4M compared to $1.3M and reflects net proceeds of the IPO, the issuance of certain convertible notes during 2022 ($0.7M) and the related redemption of $0.4M of these notes in 2022. The remainder of these convertible notes were converted to CDIs in 2022.

The change in accounts receivable, net, from $0.8M at December 31, 2021 to $0.2M reflects the timing of customer billings and payments. The IPO efforts in 2022 did result in the distraction of management and has been felt in the slow contract signings in the fourth quarter of 2022 and to date in the first quarter of 2023. However, based on recent sales activity and contract signings, the Company expects to sign and deploy new contracts in 2023 to meet its growth goals.

Accounts payable is $0.7M at December 31, 2022 compared to $0.1M at December 31, 2021 and reflects the timing of payments to suppliers and the incremental (compared to December 31, 2021) of remaining IPO issuance costs to be paid in 2023 ($0.3M).

Deferred revenue represents payments received from customers in advance of delivery, deployment or commencement of maintenance periods for which revenue is not recognized. Deferred revenue at December 31, 2022 is expected to be recognized as revenue in 2023.

The Company has no debt at December 31, 2022 due to the conversion of various convertible debt instruments and preferred shares into Shares as part of the IPO.

Business and Growth Strategies

The Company has a two-prong sales strategy:

- focus on large commercial companies and municipal/defense agencies which have a tangible requirement for its technology; and

- "land and expand" by securing small contracts as an entry point with large customers then increasing both number of systems deployed at a location, and increasing the number of locations. The Company will continue to use its own personnel for sales and marketing, while also growing its reseller distributor network.

The Company believes that its future success depends upon its ability to rapidly develop new products and services and add enhancements to and new applications for its products and services. By investing in research and development, the Company will seek to deliver additional innovative robotics solutions that address market needs within target markets, enabling it to create new opportunities for growth.

An example of this strategy is the recent partnership with Amazon Web Services (**AWS**) to integrate the sensor data from the Company's patented Blackbird drone with AWS systems to provide enterprise and public sectors with a highly advanced data analytics platform for intrusion detection, navigation and life-safety use cases. The Company's drone is the first drone to use Amazon's cloud-based AI services to deliver these capabilities.

Going Concern

The Company has incurred recurring losses and negative cash flows from operating activities since inception. The Company anticipates that it will continue to incur net losses into the near future. As of 31 December 2022, the Company had cash of $1.4M and had an accumulated deficit of $31.3M.

Notwithstanding a strong customer pipeline and revenue from the just-signed Arvensys AU/NZ distribution agreement, among other contracts signed, the directors expect to incur additional losses in the future to fund the Company's operations and will need to raise additional capital to fully implement Nightingale's 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 reevaluate its operating plan and may be required to curtail its business operations.

Significant Changes in the State of Affairs

Other than Nightingale's successful IPO which is outlined in the Review of Operations above, there were no significant changes in the state of affairs of the Group during the reporting period.

Matters Subsequent to the end of the Reporting Period

On 28 March 2023, Nightingale announced a significant distribution agreement with Arvensys Group for Australia and New Zealand. The five-year agreement includes annual minimum purchase obligations on Arvensys for seven complete product systems (with a yearly aggregate value of AUD$1.10 million) each year. Importantly, Nightingale will generate additional recurring revenue from each system deployed at customer locations in the form of continuing maintenance, repair, and upgrade services. The agreement also requires an upfront payment for the first year of the term.

The Company keeps its cash funds on deposit with Silicon Valley Bank (**SVB**) in the US, similar to many US start-ups. On 10 March 2023, SVB was closed by California banking regulators and the US Federal Deposit Insurance Corporation (**FIDC**) was appointed as receiver. On 13 March 2023, the US Federal Government and the FIDC announced that the FIDC's deposit guarantee scheme would be extended to cover all deposits at SVB. As a result, although there may be operational inefficiencies in the short-term, the Company has not, and does not expect to, experience any losses.

On 30 January 2023, the Company issued to holders of redeemable convertible notes (**Bridge Loan Notes**) who had in December 2022 elected to convert their Bridge Loan Notes into CHESS Depositary Interests (**CDIs**) over common stock in the Company (**Shares**) a total of 4,229,129 CDIs. The conversion price was a 10% discount to the lower of the IPO price under the Company's recent IPO (i.e. AUD$0.22) and the 15-day volume weighted average price of the Company's CDIs prior to conversion. Based on this formula, the conversion price was AUD$0.126.

On 20 March 2023, the Company announced a partnership with Amazon Web Services (AWS) to integrate the sensor data from its Artificially Intelligent Blackbird Security Drone with AWS systems to provide Enterprise and Public Sector clients with a highly advanced data analytics platform for intrusion detection, navigation, and life-safety use-cases.

Reconciliation of the Audited Consolidated Financial Statements to the Unaudited Preliminary Financial Report (Appendix 4E)

The audited Consolidated Financial Statements in this Annual Report include changes to the unaudited preliminary financial report (Appendix 4E) prepared by the Company and lodged with ASX on 28 February 2023.

The changes primarily relate to:

- Finalization of stock compensation expense accounting that increased Research and Development Expense (USD$142,000) and General and Administrative Expense (USD$142,000). This adjustment also impacted Stockholders' Equity by USD$284,000 USD. This adjustment is a non-cash item.

- Changes to Accounts Payable of USD$139,000 (a decrease in Accounts Payable) due to late negotiation and reconciliation of amounts due to certain vendors.

The impact of all changes is as follows:

- Net Loss – 3.8% increase in Net Loss

- Loss per Share - No impact

- Total assets – No impact

- Total Liabilities – 6.5% decrease in Total Liabilities

Securities on Issue

As at 31 December 2022, the Company had the following securities on issue:

Security	Number
Shares of common stock (**Shares**)	39,767,332
CHESS Depositary Interests (**CDIs**)	89,233,303
CDIs assuming all Shares held as CDIs	**129,000,635**
Listed Options	11,363,610
Unlisted Options	5,930,927
Restricted Stock Units	7,000,000
Silicon Valley Bank Warrants	20,464

Options

Options to acquire Shares and CDIs were granted during the financial year. The number of options outstanding as at the date of this report, and all other movements in share options, are disclosed in the Note 14 to the Financial Statements.

No options over Shares or CDIs have been exercised after the end of the reporting period.

Information on Directors

Denis Hébert, Non-Executive Chairman

Mr. Hébert is currently a board member of Sentry Interactive, a company focused on advance communications and detection platforms in the security domain. He also serves as a board advisor to Proxy.co, a tokenization-based identity provider, AutonomousID, a Bio-sole biometric solutions provider, as well as a consultant to multiple private equity firms. Mr. Hébert also served as Chairman of the Board for the Security Industry Association from 2016 to 2018, after having served on the board since 2008.

Prior to that, Mr. Hébert served as President and CEO of HID Global Corporation (2002-2015), where he provided strategic guidance and leadership, while growing the business tenfold through a mix of strong organic development and acquisitions. As part of his divisional responsibility at HID Global, he was concurrently Executive Vice President of ASSA ABLOY – ASSA-B.ST (2007-2015), where he contributed to corporate and strategic planning for the overall group. In addition, his previous experience includes 17 years at Honeywell International - NYSE: HON (1986-2002), having served in various leadership roles in Canada, France and the US.

Special responsibilities:	Chairman of the Board, Chair of the Audit and Risk Management Committee, member of the Remuneration and Nomination Committee
Other directorships:	Non-Executive Director of Sentry Interactive

Jack Wu, Executive Director and Chief Executive Officer

Mr. Wu has over 20 years of experience in user interface and product development, Mr. Wu has played a pivotal role in the tech industry. He was part of the founding team for eGroups, which was later acquired by Yahoo! in 2000 and became Yahoo! Groups. After leaving Yahoo!, he became the Creative Director for Tickle, an online advertising network acquired by Monster in 2004.

In 2005, Mr. Wu started a software company that developed web-based software for top Fortune 500 companies such as Facebook, Yahoo!, AOL, and Pepsi. His passion for blending art and technology led him to launch 50Cubes, a gaming company that garnered funding from Tencent, one of the largest online gaming platforms in the world.

Mr. Wu's passion for innovative technology led him to Nightingale Security, where he has overseen the development of autonomous drone-based security solutions that are revolutionizing the industry. Under his leadership, Nightingale Security has developed cutting-edge technology that has been implemented in airports, warehouses, and other critical infrastructure locations.

Throughout his career, Mr. Wu has served as an advisor to numerous companies, including EventBrite, Geni, and Yammer. He is a visionary leader with a track record of success, and his contributions to the tech industry have been significant. As the CEO of Nightingale Security, he is continuing to push the boundaries of what is possible and make the world a safer place.

Special responsibilities:	Chief Executive Officer
Other directorships:	None

Alan Braverman, Non-Executive Director

Mr. Braverman is an entrepreneur and computer programmer currently serving as CEO and co-founder of Textline, a Software-as-a-Service (SaaS) text messaging platform specializing in customer service.

Prior to Textline, Mr. Braverman was a co-founder of several internet software companies, including genealogy social network Geni (acquired by MyHeritage) and its spin-off enterprise social network, Yammer (acquired by Microsoft). Earlier, he co-founded Mollyguard Corporation, a payment-themed software studio that spun-off both Xoom (NASDAQ IPO 2013, acquired by PayPal in 2015) and Eventbrite (NYSE IPO 2018). Earlier in his career, Mr. Braverman programmed web software at Silicon Graphics, eGroups, and Yahoo!.

Special responsibilities:	Chair of the Remuneration and Nomination Committee and member of the Audit and Risk Management Committee
Other directorships:	Executive Director of Textline, Inc.

Stratos Karousos, Non-Executive Director (Australian Resident)

Mr. Karousos has over 25 years of executive management and leadership experience in Australia, Asia and the US. Stratos previously held positions as Director and CEO at Elixinol Wellness Limited (ASX: EXL) and has held senior roles in global organisations, including WiseTech Global Limited (ASX: WTC) and Baker McKenzie.

Mr. Karousos has advised ASX-listed companies throughout his career and has deep experience in strategy and execution, mergers and acquisitions, equity capital markets, corporate restructuring, corporate governance and navigating complex regulatory frameworks. He is currently the Chief Commercial Officer of a productivity tool and workflow group espresso Displays and the Chief Strategy Officer of an aquaculture and agriculture biotechnology group Genics.

Special responsibilities:	Member of the Remuneration and Nomination Committee and member of the Audit and Risk Management Committee
Other directorships:	Chairman and Non-Executive Director of SportsHero Limited (ASX: SHO) and Non-Executive Director of Aumake Limited (ASX: AUK)

Tony Zhang – Non-Executive Director

Mr. Zhang is an entrepreneur and investor. Mr Zhang has 10 years' experience in venture capital and is the founding partner of Ventek Ventures which offers venture investment and business advisory for over 100 start-ups.

Mr. Zhang founded and was the CEO of Foodomo in 2015 which was acquired by Uni President in 2020. Thereafter, Mr Zhang commenced investing in several technology focused companies including Soul App in China and Nightingale in the United States.

Special responsibilities:	None
Other directorships:	None

Securities Held by Directors and Key Management Personnel

The directors and key management personnel of the Company are shown together with their holdings of shares of common stock (**Shares**) and CHESS Depositary Interests (**CDIs**) and options, held directly or indirectly as at 31 December 2022:

	Role	Shares/CDIs	Listed Options	Unlisted Options	Restricted Stock Units
Denis Hébert [1]	Director	1,606,573	-	100,000	-
Alan Braverman [2]	Director	3,607,122	-	-	-
Stratos Karousos	Director	-	-	155,927	-
Tony Zhang [3]	Director	16,528,034	1,023,563	-	-
Jack Wu	Director/CEO	4,250,000	-	2,200,000	3,500,000
John Hsu	CTO	4,933,013	341,056	2,200,000	3,500,000
Mike Tschiderer	CFO	487,460	85,000	600,000	-

1. *Denis Hebert holds shares under the entity name The Hebert Trust*
2. *Alan Braverman holds his shares under the entities Giant Pixel Corporation Inc and Triple AB LP*
3. *Tony Zhang holds shares and options under the entity name BVM Fund LLC*

Meetings Attended by Board

The number of meetings of directors (including meetings of committees of directors) held during the year and the number of meetings attended by each director was as follows:

Name	Board of Directors		Audit & Risk Management Committee		Remuneration & Nomination Committee	
	Eligible	**Attendance**	**Eligible**	**Attendance**	**Eligible**	**Attendance**
Denis Hébert	7	7	1	1	-	-
Jack Wu	7	7				
Alan Braverman	7	7	1	1	-	-
Stratos Karousos	7	7	1	1	-	-
Tony Zhang	7	7				

The Audit & Risk Management Committee and the Remuneration and Nomination Committee were formed as part of the Company's IPO. The Company listed on the ASX on 18 November 2022 and as a result there was only one formal meeting of the committees during the reporting period.

Indemnity and Insurance of Directors and Officers

The Company has entered into customary indemnification agreements under which it has indemnified directors and officers of the Company for losses incurred, or claims made and associated expenses incurred, in their capacity as a director or officer, for which they may be held personally liable, subject to certain limitations and exceptions.

Dividends

No dividends were paid or declared during the reporting period and the Company does not intend to pay any dividends for the year ended 31 December 2022 (2021: $Nil).

Corporate Governance

During the reporting period, the Company, as a Delaware incorporated corporation, sought to achieve substantive compliance with the governance recommendations set out in the 'Corporate Governance Principles and Recommendations (4th Edition)', published by the ASX Corporate Governance Council. Nightingale's Corporate Governance Statement can be viewed at https://www.nightingalesecurity.com/investors/. The Corporate Governance Statement sets out the extent to which Nightingale has followed the ASX Corporate Governance Council's Recommendations during the reporting period.

Environmental Regulation

The Group is not subject to any significant environmental regulation under United States of America legislation. The Group is committed to the sustainable management of environmental, health, and safety concerns as a core business principle. This includes ensuring compliance with all applicable government standards and regulations and providing a safe and healthy workplace, while reducing our environmental footprint. The Board of Directors considers that adequate systems are in place to manage the Group's obligations and is not aware of any breach of environmental requirements as they relate to the Group.

Proceedings on behalf of the Company

No proceedings have been brought or intervened in on behalf of the Company.

Presentation Currency

The functional and presentation currency of the Group is United States Dollars (**US Dollars**). The financial report is presented in US Dollars with all references to dollars, cents or $'s in these financial statements presented in US currency, unless otherwise stated.

Jurisdiction of Incorporation

The Company is incorporated in the State of Delaware, United States of America and is a registered foreign entity in Australia. As a foreign company registered in Australia, the Company is subject to different reporting and regulatory regimes than Australian companies.

Delaware Law, Certificate of Incorporation and Bylaws

As a foreign company registered in Australia, the Company is not subject to Chapters 6, 6A, 6B and 6C of the Corporations Act dealing with the acquisition of shares (including substantial shareholdings and takeovers).

Under the provisions of Delaware General Corporation Law (**DGCL**), shares are freely transferable subject to restrictions imposed by US federal or state securities laws, by the Company's certificate of incorporation or bylaws, or by an agreement signed with the holders of the shares at issue. The Company's amended and restated certificate of incorporation and bylaws do not impose any specific restrictions on transfer.

However, provisions of the DGCL, the Company's Certificate of Incorporation and the Company's Bylaws could make it more difficult to acquire the Company by means of a tender offer (takeover), a proxy contest or otherwise, or to remove incumbent officers and Directors of the Company.

These provisions could discourage certain types of coercive takeover practices and takeover bids that the Board may consider inadequate and to encourage persons seeking to acquire control of the Company to first negotiate with the Board. The Company believes that the benefits of increased protection of its ability to negotiate with the proponent of an unfriendly or unsolicited proposal to acquire or restructure the Company outweigh the disadvantages of discouraging takeover or acquisition proposals because, among other things, negotiation of these proposals could result in an improvement of their terms.

Indemnity and Insurance of Auditor

The Company has not, during or since the end of the reporting period, indemnified or agreed to indemnify its auditor, Grant Thornton Audit Pty Limited or any related entity against a liability incurred by the auditor.

During the reporting period, the Company has not paid a premium in respect of a contract to insure Grant Thornton Audit Pty Limited or any related entity.

Non-Audit Services

During the reporting period a total of USD$189,350 was paid to entities associated with the Company's independent external auditor, Grant Thornton Audit Pty Limited for non-audit services connected with the Company's IPO, including the preparation of the Investigating Account's Report (Grant Thornton Corporate Finance Pty Limited) and related US tax due diligence (Grant Thornton LLP).

The Directors are satisfied that the provision of the non-audit services during the reporting period by the Grant Thornton associated entities is compatible with the general standard of independence for auditors.

The directors are of the opinion that the non-audit services do not compromise Grant Thornton's independence for the following reasons:

- the non-audit services have been reviewed and approved to ensure that they do not impact on the integrity and objectivity of the auditor; and
- none of the services undermine the general principles relating to auditor independence issued by the Accounting Professional and Ethics Standards Board, including reviewing or auditing the auditors own work, acting in a management or decision-making capacity for the Company, acting as an advocate for the Company or jointly sharing economic risks and rewards.

Remuneration Report (unaudited)

The directors present their report on the remuneration of non-executive directors, executive directors and key management personnel.

For the purposes of this report key management personnel are defined as those persons having authority and responsibility for planning, directing and controlling the major activities of the Group, directly or indirectly, including directors.

Directors and Key Management Personnel

Directors

Denis Hébert	Independent Non-Executive Chairman
Jack Wu	Executive Director and Chief Executive Officer
Alan Braverman	Independent Non-Executive Director (appointed 13 July 2022)
Stratos Karousos	Independent Non-Executive Director (appointed 29 June 2022)
Tony Zhang	Non-Executive Director

Key Management Personnel

John Hsu	Chief Technology Officer
Mike Tschiderer	Chief Financial Officer

There were no changes of Key Management Personnel after the reporting date and before the date of this report.

Remuneration Policy

The remuneration policy of Nightingale has been designed:

- to attract and retain the highest calibre of executives and directors to manage the Company development in an environment of intense competition for such senior staff;

- to align the interests of executives and directors with the interests of shareholders to generate long-term growth in shareholder wealth; and

- to satisfy good remuneration governance practice by ensuring remuneration of directors and executives is: competitive and reasonable; acceptable to shareholders; aligns executive remuneration to performance; transparent and results in appropriate capital management.

Remuneration and Nomination Committee

The board has established a Nomination and Remuneration Committee to determine the appropriate nature and amount of remuneration of executives. The committee is primarily responsible for making decisions on:

- non-executive director fees;

- remuneration levels of executive directors and other key management personnel;

- the executive remuneration framework and operation of the Company's equity incentive plans; and

- the key performance indicators and performance hurdles for the executive team.

Non-Executive Director Remuneration

In respect of non-executive directors, board policy is to determine remuneration based on time, commitment and the demands which are made on non-executive directors in the current corporate governance environment together with an appreciate of the Company's development stage and need to conserve cash to invest in its business. The Bylaws and the ASX Listing Rules specify that the aggregate remuneration of non-executive directors shall be determined from time to time by a general meeting. The aggregate annual cash fee pool from which non-executive directors may be paid for their services US$300,000.

Non-executive directors are entitled to participate in the Company's 2014 Equity Plan.

The following table sets out the Non-Executive Directors' annual remuneration payable for the year ending 31 December 2022:

Director	Director's Fees		Committee Fees
	Cash	Securities	
Denis Hébert	$Nil	100,000 Unlisted Options	USD$10,000
Alan Braverman	$Nil	-	USD$10,000
Stratos Karousos	AUD$60,000	155,927 Unlisted Options	-
Tony Zhang	$Nil	-	USD$10,000

The Options issued to Mr. Hébert and Mr. Karousos during the reporting period have the following key terms:

- Exercise price – USD$0.07.
- Expiry date – 10 years after the date of grant.
- There are no performance hurdles or vesting conditions attaching to these options except for continued service.

Each of these Options issued to Mr. Hébert and Mr. Karousos entitles them to one share of common stock upon vesting and exercise.

Executive Remuneration

The Company aims to reward executives with a level and mix of remuneration commensurate with their position and responsibilities within the Company and so as to:

- reward executives for company and individual performance against targets set by reference to appropriate benchmarks;
- align the interests of executives with those of shareholders;
- link reward with the strategic goals; and
- ensure total remuneration is competitive by market standards.

Executives receive a base pay and are eligible to receive performance-based remuneration in the form of short-term cash bonuses and participation in Nightingale's 2014 Equity Plan.

The performance of executives is measured against criteria agreed annually with individuals and is based predominantly on the creation of shareholder value through each person's respective role.

An important part of Nightingale's executive remuneration policy is the alignment of the interests of executives with the interests of shareholders to generate long-term growth in shareholder wealth. The board seeks to achieve this outcome through inviting executives to participate in Nightingale's 2014 Equity Plan

Base pay and benefits

Executives receive a base pay which is based on factors such as responsibilities, length of service and experience. There are no guaranteed base pay increases in any executives' contracts.

Executive officers who are also employees are also eligible to participate in Nightingale's 401(k)-retirement plan as well as medical and other benefit plans.

Long term incentives

The Company is a growth phase company and requires equity incentives to attract and retain highly talented individuals in the industry. This is particularly the case given the Company seeks to conserve cash including by keeping its salaries relatively low.

Long term incentives are provided to executives via Nightingale's 2014 Equity Plan. The Plan is designed to provide long-term incentives for executives to deliver long-term shareholder returns.

The Company's 2014 Equity Plan provides for the grant of stock options, stock appreciation rights, restricted stock, restricted stock units, unrestricted stock, other stock-based awards and cash awards. Any of these awards may, but need not, be made as performance incentives to reward attainment of performance goals. Stock options granted under the 2014 Equity Plan may be non-qualified stock options or incentive stock options.

Participation in the plan is at the Board's discretion and no individual has a contractual right to participate in the plan or to receive any guaranteed benefits.

The total number of Shares reserved for issuance under the 2014 Equity Plan shall not exceed 25,000,000 Shares.

During the reporting period, the following unlisted options were issued to executives under the 2014 Equity Plan as part of their overall remuneration packages:

Executive	Number	Exercise Price	Expiry Date	Vesting Conditions
Jack Wu	2,200,000	USD$0.03	9 March 2031	4 years, 25% vest after 1 year, then monthly
John HSU	2,200,000	USD$0.03	9 March 2031	4 years, 25% vest after 1 year, then monthly
Mike Tschiderer	400,000	AUD$0.22	8 December 2031	36-month vesting period from 18 November 2022
Mike Tschiderer	200,000	USD$0.07	8 December 2031	36-month vesting period from 18 November 2022

Each of these options entitles the grantees to one share of common stock upon vesting and exercise.

Restricted Stock Units

During the reporting period, and prior to the Company's IPO, Nightingale issued performance based restricted stock units to the founders of the Company, being Jack Wu (Chief Executive Officer) and John Hsu (Chief Technical Officer), which were split equally between Mr. Wu and Mr. Hsu:

- an aggregate of 3,500,000 of Class A RSUs; and
- an aggregate of 3,500,000 of Class B RSUs;

(together, the **RSUs**).

The RSUs were issued as part of the overall remuneration packages of the two founders for the purpose of incentivising them to achieve certain milestones and targets in relation to the Company's products and revenue.

The key terms of the Class A RSUs are as follows:

- each Class A RSU was issued for nil consideration with a nil exercise price;
- each Class A RSU entitles the holder to be issued one share of common stock in the Company on vesting and satisfaction of the applicable performance hurdles;
- the Class A RSUs only vest if certain performance-based hurdles are satisfied as follows;
    - 80% vest on the Company achieving a minimum revenue target of US$2,500,000 from 1 January 2022 to 1 June 2023; and
    - remaining 20% vest on the Company reaching a revenue target of US$3,000,000 from 1 January 2022 to 1 June 2023;
- the vesting of the Class A RSUs is subject to the holder being continuously employed by the Company (or an affiliated entity) from the date of grant;
- the Class A RSUs expire on 1 June 2023;
- Class A RSUs are not quoted on the ASX;
- Class A RSUs are not transferable, do not entitle the holder to a right to vote until such time as the Class B RSUs vest and the holder is issued Shares or CDIs and do not carry any entitlement to a dividend; and
- Class A RSUs do not permit the holder to participate in new issues of capital such as bonus issues and entitlement issues.

The key terms for the Class B RSUs are noted below:

- each Class B RSU was issued for nil consideration with a nil exercise price;
- each Class B RSU entitles the holder to be issued one share of common stock in the Company on vesting and satisfaction of applicable performance hurdles;
- the Class B RSUs only vest if certain performance-based hurdles are satisfied including;
    - obtaining US BVLOS (Beyond Visual Line of Sight) approval; and
    - reaching a revenue target of US$6,000,000 within 18 months of the date of the Company receiving US BVLOS approval;

- the vesting of the Class B RSUs is subject to the holder being continuously employed by the Company (or an affiliated entity) from the date of grant;
- the Class B RSUs expire 18 months following the date of approval of US BVLOS approval, provided that in no event shall the expiration date of the Class B RSUs be later than 10 years from the date of grant;
- Class B RSUs are not quoted on the ASX;
- Class B RSUs are not transferable, do not entitle the holder to a right to vote until such time as the Class B RSUs vest and the holder is issued Shares or CDIs and do not carry any entitlement to a dividend; and
- the Class B RSUs do not permit the holder to participate in new issues of capital such as bonus issues and entitlement issues.

Details of Remuneration

The details of the remuneration received by the directors and key management personnel of the Group for the current and previous financial year are shown below.

2022	Salary and Fees	Bonus	401k & other benefits	Share based compensation	Total
	$	$	$	$	$
Denis Hébert	0	0	0	1,325	1,325
Jack Wu	294,435	0	0	166,167	460,602
Alan Braverman	0	0	0	0	0
Stratos Karousos	8,125	0	0	18,711	26,836
Tony Zhang	0	0	0	0	0
John Hsu	291,512	0	0	166,167	457,679
Mike Tschiderer	0	0	0	2,651	2,651

2021	Salary and Fees	Bonus	401k & other benefits	Share based compensation	Total
	$	$	$	$	$
Denis Hébert	0	0	0	0	0
Jack Wu	293,652	0	0	0	293,652
Tony Zhang	0	0	0	0	0
John Hsu	293,159	0	0	0	293,159
Mike Tschiderer	0	0	0	0	0

Non-Executive Director Service Agreements

On appointment to the Board, all non-executive directors enter into service agreements with the Company in the form of a letter of appointment.

Executive Employment Agreements

The employment contracts for senior management are summarised below.

Jack Wu – Executive Director and Chief Executive Officer

Jack Wu is employed by the Company in the position of President and Chief Executive Officer. Mr. Wu receives an annual base salary of USD$300,000. Mr Wu is also eligible to participate in various customary employee benefit programs maintained by the Company and is eligible for an annual discretionary bonus as determined by the Board or the Remuneration and Nomination Committee.

Pursuant to Mr. Wu's Employment Agreement, if Mr. Wu is terminated by the Company without cause or if he resigns for good reason (for example, a material decrease in salary or duties or a relocation of the corporate office by at least 30 miles) and Mr. Wu signs a general release of claims in favour of the Company and complies with certain other requirements, the Company must pay Mr. Wu severance in an amount equal to 100% of his base salary, 12 months of health insurance coverage and an amount equal to Mr. Wu's actual earned full-year bonus prorated based on the number of days Mr. Wu was employed for the year.

John Hsu – Chief Technology Officer

John Hsu is employed by the Company in the position of Chief Technology Officer. Mr Hsu receives an annual base salary of USD$300,000. Mr. Hsu is also eligible to participate in various customary employee benefit programs maintained by the Company and is eligible for an annual discretionary bonus as determined by the Board or the Remuneration and Nomination Committee.

Pursuant to Mr. Hsu's Employment Agreement, if Mr. Hsu is terminated by the Company without cause or if he resigns for good reason and Mr. Hsu signs a general release of claims in favour of the Company and complies with certain other requirements, the Company must pay Mr Hsu severance in an amount equal to 100% of his base salary, 12 months of health insurance coverage and an amount equal to Mr. Hsu's actual earned full-year bonus prorated based on the number of days Mr. Hsu was employed for the year.

The Agreements with Mr. Wu and Mr. Hsu (**Key Executives**) also provide for the following:

- In the event of a voluntary termination of employment by the Key Executive, such Key Executive must provide the Company with at least 14 days written notice, provided, however, that the Company may elect to waive such notice period; and

- The Key Executives may not, during their employment either directly or indirectly, have an interest in any business competitive with the Company or any of its business activities.

Note, however, that under California law, covenants not to compete are generally void as against public policy except when granted, on reasonable terms, in the context of a sale of goodwill associated with the acquisition of a company. If the extended notice provision referenced above or the restriction on having interests in other businesses provision above were deemed to constitute a de facto non-compete, it could be deemed unenforceable under California law.

Michael Tschiderer – Chief Financial Officer and Company Secretary

Michael Tschiderer is engaged by the Company as a consultant to provide the roles of Chief Financial Officer and Company Secretary under a Consulting Agreement dated 1 July 2021 (**Agreement**). It is anticipated shortly that Mr. Tschiderer will become an employee of the Company and will receive a fixed remuneration package of USD$150,000 per annum and become eligible for an annual bonus of up to 60% of his base salary. Currently, under the Agreement he receives a monthly fee of $12,500 as a consultant. Mr. Tschiderer is eligible to participate in the Company's 2014 Equity Plan.

Prior to the date of ASX-listing, Mr. Tschiderer received a monthly fee of US$8,000 under the Agreement. The 2022 fees were paid in January 2023.

This Remuneration Report is the Company’s first since listing on ASX on 18 November 2022.

Nightingale did not use any remuneration consultants during the reporting period.

The preceding Directors’ Report and Remuneration Report are made in accordance with a resolution of the directors.

On behalf of the directors

Jack Wu
Executive Director and Chief Executive Officer

31 March 2023

Nightingale Intelligent Systems, Inc.

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

Including:

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

	Year ended December 31, 2022	Year ended December 31, 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	84,132	318,972
Total current assets	1,953,042	2,438,444
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	$ 2,656,927	$ 2,794,726
Liabilities, Convertible Preferred Stock and Stockholders' Equity (Deficit)		
Current liabilities		
Accounts payable	$ 720,824	$ 132,315
Accrued expenses	73,624	75,662
Deferred revenue	573,566	893,074
Operating lease liability, current	164,626	—
Accrued interest	—	207,391
Total current liabilities	1,532,640	1,308,442
Loan payable	150,000	—
Operating lease liability, non-current	412,966	—
Convertible notes, non-current	—	1,926,297
Derivative liability	—	1,906,429
Total liabilities	2,095,606	5,141,168
Convertible preferred stock, $0.00001 par value; 0 and 50,036,091 shares authorized at December 31, 2022 and 2021, respectively; 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	17,418,009	173
Additional paid-in capital	14,432,183	10,259,243
Accumulated deficit	(31,288,871)	(25,315,077)
Total stockholders' equity (deficit)	561,321	(15,055,661)
Total liabilities, convertible preferred stock and stockholders' equity	$ 2,656,927	$ 2,794,726

See accompanying notes to financial statements.

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

	Years Ended December 31,	
	2022	**2021**
Revenue	$ 2,144,054	$ 1,939,090
Cost of revenue	1,626,110	1,235,983
Gross profit	517,944	703,107
Operating expenses:		
Research and development	2,299,710	2,368,182
Sales and marketing	235,203	130,800
General and administrative	2,062,519	1,613,316
Total operating expenses	4,597,432	4,112,298
Loss from operations	(4,079,488)	(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	$ (5,973,794)	$ (3,399,994)
Net loss per share - basic and diluted	$ (0.18)	$ (0.20)
Weighted average shares of common stock - basic and diluted	33,952,429	17,245,269

See accompanying notes to financial statements.

NIGHTINGALE INTELLIGENT SYSTEMS, INC.
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	Accumulated	Total Stockholders'
	Shares	Amount	Shares	Amount	Capital	Deficit	Equity (Deficit)
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	2,183,332	—	—	2,183,332
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	—	—	—	—	362,443	—	362,443
Net loss	—	—	—	—	—	(5,973,794)	(5,973,794)
Balances at December 31, 2022	—	$ —	133,222,854	$17,418,009	$ 14,432,183	$ (31,288,871)	$ 561,321

See accompanying notes to financial statements.

NIGHTINGALE INTELLIGENT SYSTEMS, INC.
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	$ (5,973,794)	$ (3,399,994)
Adjustments to reconcile net loss to net cash used in operating activities:		
Stock-based compensation expense	362,443	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	127,627	(283,576)
Other assets	22,596	(28,573)
Accounts payable	302,608	17,548
Accrued expenses	(2,038)	31,607
Accrued interest	213,346	158,785
Deferred revenues	(319,508)	688,111
Operating lease liability	(135,506)	—
Net cash used in operating activities	(2,945,267)	(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	(803,378)	(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	3,157,772	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**

See accompanying notes to consolidated financial statements.

	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	$ 285,902	$ —
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	$ —

See accompanying notes to consolidated financial statements.

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. The Company focuses on the business verticals of Enterprise, Defense, and Emergency Response linked to critical infrastructure locations (e.g. utilities, pharmaceutical facilities and laboratories, military facilities, data centers). Majority of the Company's business activities occur in the US but has also made sales in the EU, Australia, Saudi Arabia, and Brazil.

On November 16, 2022, the Company (trading under the ticker code "NGL") was successfully admitted to the Official List of Australian Securities Exchange via an Initial Public Offering "IPO". The Company raised, on a gross basis, AUD $5,000,000 or approximately USD $3.4 million through issuance of 22,727,273 shares at an issue price of AUD $0.22 per share.

<u>Basis of Presentation</u>

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. Unless otherwise noted, dollar amounts in these consolidated financial statements are shown in U.S. dollars.

<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 most 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 $6.0 million and $3.4 million for each of the years ended December 31, 2022 and 2021, had an accumulated deficit of $31.2 million at December 31, 2022 and working capital of $0.4 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 result, cash requirements for the upcoming year, terms of the Company's current debt arrangements, funding capacity, net working capital, total stockholders' equity (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, give rise to a material uncertainty that may cast significant doubt about the Company's ability to continue as a going concern for at least one year from the issue of the signed accounts (31 March 2023). 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, 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 any significant foreign currency translation adjustments as a component of other comprehensive loss through December 31, 2022.

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 expenses, promissory notes, loan payable, convertible notes and the derivative liability. The Company's cash and cash equivalents, accounts receivable, accounts payable, accrued expenses, 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. Subsequent to December 31, 2022, the Company's primary bank, Silicon Valley Bank ("SVB") declared bankruptcy. The United States government interceded and guaranteed all customer deposits held in SVB so the Company has not, and does not expect to, experience any losses. The Company is continuing to monitor the situation and has plans in place to ensure that no losses are incurred.

Inflation Reduction Act of 2022

On August 16, 2022, the Inflation Reduction Act of 2022 ("IRA") was signed into law. The IRA includes a 15% Corporate Alternative Minimum Tax ("Corporate AMT") for tax years beginning after December 31, 2022. The Company does not expect the Corporate AMT to have a material impact on its consolidated financial statements. Additionally, the IRA imposes a 1% excise tax on net repurchases of stock by certain publicly traded corporations. The excise tax is imposed on the value of the net stock repurchased or treated as repurchased. The new law will apply to stock repurchases occurring after December 31, 2022.

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. Generally, the Company does not perform evaluations of customers' financial condition and does not require collateral or other security to support accounts receivable. 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 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 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. All deferred offering costs related to the Company's IPO which closed in November 2023 have been recorded as a reduction of the IPO proceeds.

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 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.

At December 31, 2022, the Company had four customers whose accounts receivable balance each totaled 10% or more of the Company's total accounts receivable (39%, 20%, 14% and 13%) compared with three such customers (31%, 30% and 12%) at December 31, 2021.

For the year ended December 31, 2022, the Company had three customers (17%, 12% and 10%) who individually accounted for 10% or more of the Company's total customer revenue compared with three such customers (31%, 30% and 12%) for the year ended December 31, 2021.

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, the majority of which are purchased from third party suppliers. Only final assembly and testing is done by the Company. The Company has determined that presently labor and other direct and indirect costs of production are not material. The Company regularly assesses slow-moving, excess and obsolete inventory and will maintain 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 repairs and maintenance are expensed. See Note 5 - *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.

Intangible Assets

Intangible assets are stated at cost, net of accumulated amortization. Intangible assets are amortized using the straight-line method over the estimated useful life of 15 years.

Intangible assets include capitalized research and development costs and organization and start-up costs. Intangible assets are presented under other assets in the consolidated balance sheets.

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 $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 and 2021. None of the Company's drone units, base stations or property and equipment was determined to be impaired as of December 31, 2022.

Leases

The Company adopted ASU 2016-02, Leases (Topic 842), as of January 1, 2022, using the modified retrospective method. The Company had two leases as the lessee related to a building and vehicle lease. The lease terms for both leases expired prior to adoption of this new lease standard.

The Company determines if a contract is a lease or contains a lease at the inception of the contract and reassesses that conclusion if the contract is modified. All leases are assessed for classification as an operating lease or a finance lease. ROU assets represent the Company's right to use an underlying asset for the lease term and lease liabilities represent its obligation to make lease payments arising from the lease. The Company does not obtain and control its right to use the asset until the lease commencement date.

The Company's lease liabilities are recognized at the applicable lease commencement date based on the present value of the lease payments required to be paid over the lease term. As the Company's leases do not provide an implicit rate, the Company uses its incremental borrowing rate to discount the lease payments to present value. The estimated incremental borrowing rate is derived from information available at the lease commencement date. The Company's ROU assets also are recognized at the applicable lease commencement date. The ROU asset equals the carrying amount of the related lease liability, adjusted for any lease payments made prior to lease commencement and lease incentives provided by the lessor. Variable lease payments are expensed as incurred and do not factor into the measurement of the applicable ROU asset or lease liability.

The term of the Company's leases equals the non-cancellable period of the lease, including any rent-free periods provided by the lessor, and also includes options to renew or extend the lease (including by not terminating the lease) that the Company is reasonably certain to exercise. The Company establishes the term of each lease at lease commencement and reassesses that term in subsequent periods when one of the triggering events outlined in ASC Topic 842 occurs. Operating lease cost for lease payments is recognized on a straight-line basis over the lease term.

The Company's lease contracts often include lease and non-lease components. For all leases except telecommunications-related leases, the Company has elected the practical expedient offered by the standard to not separate the lease from non-lease components and accounts for them as a single lease component. The Company elected the package of practical expedients permitted under the transition guidance, which allows the Company to carry forward its historical lease classification, its assessment on whether a contract is or contains a lease, and its initial direct costs for any leases that existed prior to adoption of the new standard. The Company has elected, for all classes of underlying assets, not to recognize ROU assets and lease liabilities for leases with a term of twelve months or less. Lease cost for short-term leases is recognized on a straight-line basis over the lease term.

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:

<u>Lease Subscription Arrangements</u>: 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 16.6% or $355,109 and 9.3% or $180,751 of total sales revenue for the years ended December 31, 2022 and 2021, 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% over the past two years ended December 31, 2022 and 2021.

<u>Sales to Distributors and Resellers</u>: The Company utilizes distributors and resellers to sell 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. Total sales to distributors and resellers were $255,470 and $1,008,816 for the years ended December 31, 2022 and 2021, respectively.

<u>Service Arrangements</u>: 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 4 - *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.

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, 2022 and 2021.

Paycheck Protection Program ("PPP") Loan Forgiveness

The gain on the forgiveness of the PPP loans and accrued interest was recorded as a gain on loan extinguishment in other income (loss), net in the Company's consolidated statements of operations when it was realized in September 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 consolidated statements of convertible preferred stock and stockholders' equity (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 asset and liability method of accounting for income taxes as set forth in ASC 740, *Income Taxes*. Under this 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, 2022 and 2021.

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.

The table below presents a reconciliation of the numerator and denominator used to compute basic and diluted net loss per share for each class of common stock:

	December 31,	
	2022	2021
Basic and diluted net loss per share:		
Numerator:		
Net loss	5,973,794	3,399,994
Denominator:		
Weighted-average shares outstanding	33,952,429	17,245,269
Basic and diluted net loss per share	0.18	0.20

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):

`	December 31,	
	2022	2021
Restricted Stock Units	7,000,000	—
Common stock options	5,930,927	314,872
Common stock warrant - SVB	20,464	20,464
Common stock warrant – Series C	—	12,190,248
Convertible preferred stock	—	27,039,077
	12,951,391	39,564,661

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. The adoption of the standard resulted in the recognition of additional lease liabilities and right-of-use assets of $0.7 million.

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 and it did not have a material impact on the Company's financial position, results of operations or disclosures.

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 and it did not have a material impact on the Company's financial position, results of operations or disclosures.

Recent Accounting Pronouncements – Not Yet Adopted

The Company has reviewed all newly-issued accounting pronouncements that are not yet effective and concluded that they are either not applicable to its operations or their adoption will not have a material impact on its financial position, results of operations or disclosures.

NOTE 3: INITAL PUBLIC OFFERING

On November 16, 2022, the Company (trading under the ticker code "NGL") was successfully admitted to the Official List of Australian Securities Exchange via an Initial Public Offering "IPO". The Company's shares of common stock and quoted options will be settled in the form of CHESS Depositary Interests ("CDI's") at a ratio of 1:1. The Company raised, on a gross basis, AUD $5,000,000 or approximately USD $3.4 million through issuance of 22,727,273 shares at an issue price of AUD $0.22 per share and 11,363,610 options with an exercise price of AUD $0.35 and expiring on or before September 16, 2025.

As part of the IPO, the Company converted all their 2020 and 2021 Convertible Notes into Common Shares. The Company converted a portion of their 2022 Convertible Notes into Common Shares. See Note 11 – *Debt Obligations.*

The Company incurred IPO related expenses consisting of underwriters' commissions, discounts and issuance costs totaling approximately USD $1.1 million.

NOTE 4: REVENUE RECOGNITION

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

	December 31, 2022	December 31, 2021
Major product and services lines		
Drone and Base Equipment	$ 1,407,285	$ 1,319,507
Maintenance Agreements (1)	171,836	50,649
Deployment (2)	90,000	65,083
Other (3)	119,824	323,100
Lease subscription arrangements (4)	355,109	180,751
Total Revenues	$ 2,144,054	$ 1,939,090
Sales channels:		
Customer direct sales	$ 1,533,475	$ 749,523
Direct equipment lease (4)	355,109	180,751
Distributors & resellers (5)	255,470	1,008,816
Total Revenues	$ 2,144,054	$ 1,939,090

(1) Includes revenues from MRU agreements on sold equipment as well as revenues associated with maintenance service agreements sold through resellers.
(2) Primarily includes revenues from deployment of drone systems.
(3) Primarily includes revenues from training, consulting services, and miscellaneous hardware sales.
(4) Primarily reflects sales through bundled lease subscription arrangements.
(5) Primarily reflects sales through two-tier distribution channels.

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

	December 31, 2022	December 31, 2021
Recognition:		
Point-in-time	$ 1,617,109	$ 1,707,690
Over-time	526,945	231,400
Total Revenues	$ 2,144,054	$ 1,939,090

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 $573,566 and $893,074 at December 31, 2022 and 2021, respectively. The majority of the balance at December 31, 2022 will be amortized to revenue over approximately the next 12 months. See below for the rollforward of contract liabilities.

	December 31,			
Year Ended December 31,		2022		2021
Beginning of the year	$	893,074	$	204,963
Payments in advance		895,142		2,235,974
Revenue recognized on contract		(1,214,650)		(1,547,863)
End of the year	$	573,566	$	893,074

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 5: INVENTORY & EQUIPMENT ON OPERATING LEASES

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

	December 31,			
		2022		2021
Raw material components	$	105,885	$	83,719
Finished drones		61,911		20,800
Finished base stations		35,505		—
Inventory	$	203,301	$	104,519

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:

	December 31,			
		2022		2021
Equipment on lease	$	695,537	$	695,538
Accumulated depreciation		586,607		470,152
Drones and base stations, net	$	108,930	$	225,386

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,			
		2022		2021
12 months	$	314,000	$	120,000
24 months		94,000		—
36 months		47,000		—
Total	$	455,000	$	120,000

NOTE 6: ACCRUED EXPENSES

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

	December 31, 2022	December 31, 2021
Accrued payroll	$ 51,897	$ 35,901
Accrued rent	—	11,044
Other accrued liabilities	21,727	28,717
	$ 73,624	$ 75,662

NOTE 7: 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, 2022 and 2021:

	Carrying	Fair Value Measurements at December 31, 2022 using:		
Assets:	Amount	Level 1	Level 2	Level 3
Money market funds	$ 24,042	$ 24,042	$ —	$ —
	$ 24,042	$ 24,042	$ —	$ —
Liabilities:				
2020 Convertible Notes	$ —	$ —	$ —	$ —
2021 Convertible Notes	—	—	—	—
2022 Convertible Notes	—	—	—	—
	$ —	$ —	$ —	$ —

	Carrying	Fair Value Measurements at December 31, 2021 using:		
Assets:	Amount	Level 1	Level 2	Level 3
Money market funds	$ 1,158,879	$ 1,158,879	$ —	$ —
	$ 1,158,879	$ 1,158,879	$ —	$ —
Liabilities:				
2020 Convertible Notes	$ 1,084,982	$ —	$ —	$ 1,084,982
2021 Convertible Notes	821,447	—	—	821,447
	$ 1,906,429	$ —	$ —	$ 1,906,429

The change in the fair value of the derivative liabilities for the years ended December 31, 2022 and 2021 are summarized below:

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	1,906,429
Derivative liability upon issuance of 2022 Convertible Notes	50,128
Change in fair value on 2020 Notes	357,226
Change in fair value on 2021 Notes	(232,920)
Change in fair value on 2022 Notes	14,656
Conversion of derivative liability	(2,094,520)
Release of remaining derivative liability	(999)
Fair value as of December 31, 2022	$ —

For the years ended December 31, 2022 and 2021, the recorded gain/(loss) on change in fair value of derivative warrants amounted to ($0.1) million and $0.1 million, respectively, in the consolidated statements of operations.

The derivative liabilities in the table above related to the 2020, 2021 and 2022 Convertible Notes 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 (see Note 11 – *Debt Obligations*).

NOTE 8: PROPERTY AND EQUIPMENT

Property and equipment, net as of December 31, 2022 and 2021 is as follows:

	December 31, 2022	December 31, 2021
Computer equipment	$ 20,337	$ 20,337
Machinery and equipment	6,493	6,493
Automobiles	49,723	49,722
Leasehold improvements	69,432	69,432
	145,985	145,984
Accumulated depreciation	(112,899)	(80,433)
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 $32,466 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 9: OTHER ASSETS

Other assets consisted of the following at December 31:

	December 31, 2022	December 31, 2021
Intangible assets, net	$ 5,944	$ 7,059
Rent deposits	17,463	10,000
Investment in subsidiary	—	28,944
	$ 23,407	$ 46,003

Intangible assets, net consisted of the following at December 31:

	December 31, 2022	December 31, 2021
Capitalized research and development costs	$ 614,408	$ 614,408
Organization and start-up costs	11,145	11,145
	625,553	625,553
Accumulated amortization	(619,609)	(618,494)
Intangible assets, net	$ 5,944	$ 7,059

Amortization expense amounted to $1,115 and $372 for the years ended December 31, 2022 and 2021, respectively.

The Company's estimated future intangible assets amortization expense is as follows:

		Amounts
Years Ending December 31:		
2023	$	743
2024		743
2025		743
2026		743
2027		743
Thereafter		2,229
	$	5,944

NOTE 10: 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 consolidated statements of operations for the year ended December 31, 2021.

NOTE 11: 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 over thirty years from the date of the promissory note. The proceeds from the promissory note were received in March 2022.

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 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' equity (deficit).

<u>Convertible Notes</u>

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 were 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. On July 2021, the Company amended the 2020 Convertible Notes to extend the due date of principal and interest to twelve months from August, 1, 2022.

Upon the completion of the Initial Public Offering ("IPO"– see Note 3 – *Initial Public Offering*), on the Australian Securities Exchange ("ASX") in November 2022, the 2020 Convertible Notes were then automatically converted into 19,851,471 fully paid CHESS Depository Interests (CDIs) of the Company at 50% of the IPO offer price or the Trade Sales price, as applicable.

The Company determined that the 2020 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 2020 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 2020 Convertible Notes was approximately $730,000, with the offsetting amount being recorded as a debt discount. Debt issuance costs were approximately $85,000. The debt discount and debt issuance costs are being amortized to interest expense using the effective interest method over the expected term of the 2020 Convertible Notes.

The Company recognized approximately $206,000 and $24,000 in interest expense relating to amortization of the debt discount and debt issuance costs for the twelve months ended December 31, 2022, respectively. The Company also recognized approximately $354,000 and $42,000 in interest expense relating to amortization of the debt discount and debt issuance costs for the twelve months ended December 31, 2021, respectively. The Company also recognized the stated interest expense of approximately $80,000 and $97,000 for the twelve months ended December 31, 2022 and 2021, respectively.

The effective interest rate of the 2020 Convertible Notes was 40.4% at November 17, 2022 compared to the stated rate of 8%. Upon IPO, the final valuation of the conversion feature was calculated as of the date of IPO and was reclassified from a derivative liability to additional paid-in capital. The fair value of the embedded derivatives with the notes was approximately $1.4 million upon reclassification.

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.

Upon the completion of the Initial Public Offering ("IPO"– see Note 3 Initial Public Offering) on the Australian Securities Exchange ("ASX") in November 2022, the 2021 Convertible Notes were then automatically converted into 21,908,986 fully paid CHESS Depository Interests (CDIs) of the Company 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. The fair value of the derivative liability at the inception of the 2021 Convertible Notes was approximately $1.1 million, with the offsetting amount being recorded as a debt discount. Debt issuance costs were approximately $131,000. The debt discount and debt issuance costs are being amortized to interest expense using the effective interest method over the expected term of the 2021 Convertible Notes.

The Company recognized approximately $419,000 and $52,000 in interest expense relating to amortization of the debt discount and debt issuance costs for the twelve months ended December 31, 2022, respectively. The Company also recognized approximately $190,000 and $23,000 in interest expense relating to amortization of the debt discount and debt issuance costs for the twelve months ended December 31, 2021, respectively. The Company also recognized the stated interest expense of approximately $135,000 and $61,000 for the twelve months ended December 31, 2022 and 2021, respectively.

The effective interest rate of the 2021 Convertible Notes was 35.8% at November 17, 2022 compared to the stated rate of 8%. Upon IPO, the final valuation of the conversion feature was calculated as of the date of IPO and was reclassified from a derivative liability to additional paid-in capital. The fair value of the embedded derivatives with the notes was approximately $587,000 upon reclassification.

2022 Convertible Notes

In June 2022, the Company entered into a convertible loan agreement (the "2022 Convertible Notes") with investors for aggregate gross borrowings of approximately AUD $1.0 million or USD $0.7 million; net proceeds received in USD totaled approximately $0.7 million.

Upon the completion of the Initial Public Offering ("IPO"– see Note 3 – *Initial Public Offering*), on the Australian Securities Exchange ("ASX") in November 2022, approximately 50% the 2022 Convertible Notes were converted into 4,222,219 fully paid CHESS Depository Interests (CDIs) of the Company. The formal decision by holders of the 2022 Convertible Notes to convert or redeem their notes was made in 2022 with the 4,222,219 CDIs being physically converted in January 2023 which results in ASX capital tables reflecting 129,000,625 CDIs at December 31, 2022.

The remaining 2022 Convertible Notes were redeemed at the holders' election with AUD $510,000 of principal repaid with 10% interest of $51,000 with a total payment of $561,000

The Company determined that the 2022 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 2022 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 2022 Convertible Notes was $50,128, with the offsetting amount being recorded as a debt discount. Debt issuance costs were $59,519.

The Company recognized approximately $36,000 and $0 in interest expense relating to amortization of the debt discount and debt issuance costs for the twelve months ended December 31, 2022, respectively. The Company did not incur interest expense relating to amortization of the debt discount and debt issuance costs for the twelve months ended December 31, 2021, respectively. The Company did not incur interest expense for the twelve months ended December 31, 2022 and 2021, respectively.

The effective interest rate of the 2022 Convertible Notes was 44.3% at November 17, 2022 compared to the stated rate of 10%. Upon IPO, the final valuation of the conversion feature was calculated as of the date of IPO and was reclassified from a derivative liability to additional paid-in capital. The fair value of the embedded derivatives with the notes was approximately $65,000 upon reclassification.

NOTE 12: STOCKHOLDERS' EQUITY

As of December 31, 2022, the Company was authorized to issue one class of stock with a $0.00001 par value consisting of common stock totaling 250,000,000 shares. See Note 13 for further information on the Preferred Stock, all of which was converted to common shares in connection with the Company's IPO in 2022.

As of December 31, 2022 and 2021, 133,222,854 and 21,570,999 shares of Common Stock were issued and outstanding, respectively. The Company has reserved 25,000,000 shares of its common stock pursuant to the 2014 Stock Plan ("2014 Plan") as of December 31,

2022. A total of 5,930,927and 314,872 stock options are outstanding under the 2014 Plan as of December 31, 2022 and 2021, respectively.

Common Stock Reserved for Future Issuance

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

	December 31,	
	2022	**2021**
Stock options available for future issuance	15,536,563	238,244
Stock options to purchase common stock	5,930,927	314,872
Restricted stock units of common stock	7,000,000	—
Common stock warrants – SVB	20,464	20,464
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
Total shares of common stock reserved	28,487,954	39,691,332

NOTE 13: PREFERRED STOCK

The following table summarizes shares of Preferred Stock that were issued and outstanding as of December 31, 2022 and 2021:

	December 31,	
	2022	**2021**
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
	—	27,039,077

All of the Company's preferred stock were converted into 27,039,068 shares of common stock upon completion of the IPO in November 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 certain liquidation preference features, 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 had 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 12,002,838 shares of the Company's common stock at an exercise price of $0.01 per share. The warrants were exercised in 2022 prior to the Company's November 2022 IPO. Prior to exercise, the Company had 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, 2022 and 2021:

December 31, 2022	Shares Authorized	Shares Outstanding	Proceeds, Net of Issuance Costs	Aggregate Liquidation Preference
Series A Preferred Stock	—	—	$ —	$ —
Series B Preferred Stock	—	—	—	—
Series B-1 Preferred Stock	—	—	—	—
Series C Preferred Stock	—	—	—	—
Series Seed Preferred Stock	—	—	—	—
	—	—	$ —	$ —

December 31, 2021	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

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

NOTE 14: 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 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, non-statutory stock options, and restricted share unit awards to employees, directors and outside consultants as determined by the Board of Directors. The Plan, as last amended in June 2022, allows for the issuance of 25,000,000 shares of Company common stock.

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 non-employees 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 15,536,536 and 238,244 as of December 31, 2022 and 2021, respectively.

A summary of the option activity under the 2014 Plan as of December 31, 2022 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, 2020	283,244	269,872	$ 0.47	8.34
Granted	(120,000)	120,000		
Exercised	—	—		
Cancelled	75,000	(75,000)	0.47	
Outstanding at December 31, 2021	238,244	314,872	0.47	7.10
Granted	(5,723,055)	5,723,055		
Exercised	—	—		
Cancelled	107,000	(107,000)	0.09	
Increase in authorized Plan shares	20,914,374	—		
Outstanding at December 31, 2022	15,536,563	5,930,927	0.05	8.26
Vested and exercisable at December 31, 2022		3,291,680		
Vested and expected to vest at December 31, 2022		5,930,927		

The weighted average grant date fair value of options granted during the year ended December 31, 2022 and 2021 were $0.05 and $0.47 per share, respectively. There were 5,723,055 and 120,000 option grants during the years ended December 31, 2022 and 2021, respectively. The fair value of the shares subject to stock options that were vested at December 31, 2022 and 2021 was $435,338 and $72,895, 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, 2022 and 2021, 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 $362,443 and $47,415 was recognized for the years ended December 31, 2022 and 2021, respectively. Total unrecognized compensation cost related to non-vested stock option awards amounted to $76,195 and $17,854 for the years December 31, 2022 and 2021, respectively, which will be recognized over a weighted average period of 2.5 and 2.7 years as of December 31, 2022 and 2021, 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:

	Years ended December 31, 2022	Years ended December 31, 2021
Cost of revenue	$ 4,104	$ 12,557
General and administrative	194,878	—
Research and development	163,461	34,858
	$ 362,443	$ 47,415

The fair value of options granted during the years ended December 31, 2022 and 2021, respectively, were calculated using the range of assumptions set forth below:

	Years ended December 31, 2022	Years ended December 31, 2021
Volatility	70% - 80%	65% - 70%
Expected term (years)	7 - 10	7 - 10
Risk-free interest rate	1.00%	1.00%
Expected dividend yield	—	—

Restricted Stock Units

In 2022, the Company's Board of Directors approved the creation of Restricted Stock Units ("RSU's") to be awarded to its CEO and its CTO. A total of 7,000,000 RSU's were issued with the CEO and CTO each receiving 3,500,000 RSUs. Each RSU has the right to convert to one share of the Company's common stock. The RSU's were issued subject to, and in conjunction with, the Company's IPO on November 18, 2022. The RSU's were issued as Class A and Class B RSU's – a total of 3,500,000 RSU's of each class. The Class A RSU's vest in two tranches upon the Company achieving certain revenue target thresholds for the period from January 1, 2022 to June 1, 2023. The Class A RSU's expire on June 1, 2023. The Class B RSU's vest upon the Company achieving Beyond Visual Line of Sight ("BVLOS") certification from the FAA, and the Company achieving a certain revenue threshold within 18 months of receiving the BVLOS certification. The Class B RSU's expire 18 months after BVLOS certification is received. The Class A RSU's are not transferable and do not entitle the holder to any voting rights until such time as the Class B RSU's vest and the holder is issued common shares in exchange for the RSU's.

Similar to its accounting for stock options, the Company measures restricted stock unit 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 Class A RSU's were valued at fair value as of the grant date and will be recognized as stock-based compensation expense over the life of the Class A RSU's. This treatment resulted in stock-based compensation expense of approximately $0.3 million being recognized in the consolidated statement of operations for 2022. As the conditions and expected life of the Class B RSU's are highly uncertain at December 31, 2022, no stock-based compensation has been recognized at December 31, 2022 for the Class B RSU's.

NOTE 15: 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 16: 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	$ (5,973,794)	$ (3,399,194)
Income (loss) before income taxes	$ (5,973,794)	$ (3,399,194)

The Company's effective tax during the years ended December 31, 2022 and 2021, differed from the federal statutory rate as follows:

	December 31, 2022	December 31, 2021
Statutory federal income tax rate	21.00%	21.00%
State income tax rate	0.48%	10.08%
Change in valuation allowance	-13.95%	-37.32%
Permanent items	-0.78%	3.73%
Deferred true up	0.49%	0.00%
Tax credits	1.59%	2.69%
Other	-8.84%	0.29%
Effective tax rate	0.01%	-0.02%

The provision for income taxes consisted of the following:

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

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

	December 31,	
	2022	2021
Deferred tax assets:		
Net operating loss carryforwards	$ 6,585,160	$ 6,230,342
Research and development credit carryforwards	684,391	536,301
Fixed Assets	2,303	—
Sec. 174 R&E	501,221	—
Lease Liability	127,205	
Accruals and other	39,403	286,291
	7,939,683	7,052,934
Valuation allowance	(7,821,095)	(6,995,925)
Total deferred tax assets	118,588	57,009
Deferred tax liability:		
ROU Assets	(118,588)	(57,009)
Total deferred tax liability	(118,588)	57,009
Net deferred tax asset (liability)	$ —	$ —

Realization of deferred tax assets is dependent upon future earnings, if any, the timing and amount of which are uncertain. Because of our lack of earnings history, the net deferred tax assets have been fully offset by a valuation allowance. The valuation allowance increased by $825,171 and $1,285,616 during the years ended December 31, 2022 and 2021, respectively.

Net operating loss and tax credit carryforwards

As of December 31, 2022, the Company had U.S. federal and state net operating loss ("NOL") carryforwards of $23,836,717. 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 $19,007,183 generated after December 31, 2017 that will carry forward indefinitely but will be subject to 80% of taxable income limitation.

As of December 31, 2022, the Company had federal research and development tax credit carryforwards of $376,334 which will begin to expire in 2036. As of December 31, 2022, the Company had state net operating loss carryforwards of $22,580,961 which will begin to expire in 2036 and state research and development tax credit carryforwards of $678,718, which do not expire.

The utilization of NOLs and tax credit carryforwards to offset future taxable income may be subject to an annual limitation as a result of ownership changes that have occurred previously or may occur in the future. Under Sections 382 and 383 of the Internal Revenue Code ("IRC") a corporation that undergoes an ownership change may be subject to limitations on its ability to utilize its pre-change NOLs and other tax attributes otherwise available to offset future taxable income and/or tax liability. An ownership change is defined as a cumulative change of 50% or more in the ownership positions of certain stockholders during a rolling three-year period. The Company has not completed a formal study to determine if any ownership changes within the meaning of IRC Section 382 and 383 have occurred. If an ownership change has occurred, the Company's ability to use its NOLs or tax credit carryforwards may be restricted, which could require the Company to pay federal or state income taxes earlier than would be required if such limitations were not in effect.

Effective for tax years beginning after December 31, 2021, taxpayers are required to capitalize any expenses incurred that are considered incidental to research and experimentation (R&E) activities under IRC Section 174. While taxpayers historically had the option of deducting these expenses under IRC Section 174, the December 2017 Tax Cuts and Jobs Act mandates capitalization and amortization of R&E expenses for tax years beginning after December 31, 2021. Expenses incurred in connection with R&E activities in the US must be amortized over a 5-year period if incurred, and R&E expenses incurred outside the US must be amortized over a 15-year period. R&E activities are broader in scope than qualified research activities considered under IRC Section 41 (relating to the research tax credit). For the year ended December 31, 2022, the Company performed an analysis based on available guidance and determined that it will continue to be in a loss position even after the required capitalization and amortization of its R&E expenses. The Company will continue to monitor this issue for future developments, but it does not expect R&E capitalization and amortization to require it to pay cash taxes now or in the near future.

Unrecognized tax benefits

As of December 31, 2022, the Company had unrecognized tax benefits of $263,273. 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, 2022. 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 2022 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 2022 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.

The Company has the following activity relating to unrecognized tax benefits:

	December 31,	
	2022	**2021**
Beginning balance	$ 209,703	$ 150,185
Gross increases – tax positions in prior periods	—	—
Gross decreases – tax positions in prior periods	—	—
Gross increases – tax positions in current periods	54,060	59,518
Ending balance	$ 263,763	$ 209,703

NOTE 17: 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.

Operating lease cost totaled $214,078 for the year ended December 31, 2022. Rent expense totaled $166,000 for the year ended December 31, 2021. Both amounts are included in the Company's consolidated statements of operations.

As of December 31, 2022, operating lease ROU asset amounted to $538,462. Weighted average remaining lease term is 3.12 years. Weighted average discount rate is 6.25%.

Operating cash flow used from operating activities amounted to $174,016 for the year ended December 31, 2022. ROU assets obtained in exchange for operating lease liabilities amounted to $713,098.

To calculate the ROU assets and lease liabilities, the Company uses the discount rate implicit in lease agreements when available. When the implicit discount rates are not readily determinable, the Company uses its incremental borrowing rate. The Company determines the incremental borrowing rate using the interest rates from the Company's secured borrowings after taking into consideration the nature of the debt, such as borrowings collateralized by the exact building in the lease, and payment structure, including frequency and number of payments in the agreement.

Maturities of operating lease liabilities as of December 31, 2022 are as follows:

For the year ending:		
2023	$	209,298
2024		199,983
2025		205,993
2026		17,463
Total lease payments		632,737
Less: imputed interest		(55,145)
Less: lease liabilities, current		(164,626)
Lease liabilities, non-current	$	412,966

NOTE 18: 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 19: SUBSEQUENT EVENTS

Other than as set out below, management has evaluated subsequent events through March 31, 2023, 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.

On 28 March 2023, Nightingale announced a significant distribution agreement with Arvensys Group for Australia and New Zealand. The five-year agreement includes annual minimum purchase obligations on Arvensys for seven complete product systems (with a yearly aggregate value of AUD$1.10 million) each year. Importantly, Nightingale will generate additional recurring revenue from each system deployed at customer locations in the form of continuing maintenance, repair, and upgrade services. The agreement also requires an upfront payment for the first year of the term.

The Company keeps its cash funds on deposit with Silicon Valley Bank (SVB) in the US, similar to many US start-ups. On 10 March 2023, SVB was closed by California banking regulators and the US Federal Deposit Insurance Corporation (FIDC) was appointed as receiver. On 13 March 2023, the US Federal Government and the FIDC announced that the FIDC's deposit guarantee scheme would be extended to cover all deposits at SVB. As a result, although there may be operational inefficiencies in the short-term, the Company has not, and does not expect to, experience any losses.

On 30 January 2023, the Company issued to holders of redeemable convertible notes (Bridge Loan Notes) who had in December 2022 elected to convert their Bridge Loan Notes into CHESS Depositary Interests (CDIs) over common stock in the Company (Shares) a total of 4,229,129 CDIs. The conversion price was a 10% discount to the lower of the IPO price under the Company's recent IPO (i.e., AUD$0.22) and the 15-day volume weighted average price of the Company's CDIs prior to conversion. Based on this formula, the conversion price was AUD$0.126.

On 20 March 2023, the Company announced a partnership with Amazon Web Services (AWS) to integrate the sensor data from its Artificially Intelligent Blackbird Security Drone with AWS systems to provide Enterprise and Public Sector clients with a highly advanced data analytics platform for intrusion detection, navigation, and life-safety use-cases.

Directors' Declaration

In accordance with a resolution of the directors of Nightingale Intelligent Systems, Inc., the directors of the Company declare that:

1. the financial statements and notes thereto, comply with accounting principles generally accepted in the United States (U.S. GAAP);

2. the financial statements and notes thereto, give a true and fair view of the Company's financial position as at 31 December 2022 and of the performance for the year ended on that date; and

3. in the directors' opinion there are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable.

On behalf of the directors

Jack Wu
Executive Director and Chief Executive Officer

31 March 2023

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Independent Auditor's Report

To the Members of Nightingale Intelligent Systems, Inc.

Report on the audit of the financial report

Opinion

We have audited the financial report of Nightingale Intelligent Systems, Inc. (the Company) and its subsidiaries (the Group), which comprises the consolidated balance sheet as at 31 December 2022, the consolidated statement of operations, consolidated statement of convertible preferred stock and changes in stockholders' equity, and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial report of Nightingale Intelligent Systems, Inc. presents fairly, in all material respects, the Group's financial position as at 31 December 2022 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 opinion

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 opinion.

Material uncertainty related to going concern

We draw attention to Note 1 in the financial statements, which indicates that the Group incurred a net loss of US$5.9 million and had an accumulated deficit of US$31.2 million at 31 December 2022. 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 doubt on the Group's ability to continue as a going concern. Our opinion is not modified in respect of this matter.

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial report of the current period. These matters were addressed in the context of our audit of the financial report as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

In addition to the matter described in the Material uncertainty related to going concern section, we have determined the matters described below to be the key audit matters to be communicated in our report.

Key audit matter	How our audit addressed the key audit matter
Initial Public Offering (IPO) – Notes 3, 11, 12 and 13	

On 16 November 2022, the Group listed on the Australian Securities Exchange ('ASX'). As part of the IPO:
• The Group raised A$5,000,000 (US$3,379,464) through the issuance of 22,727,273 shares at an issue price of A$0.22 per share;
• Transaction costs of US$1,102,572 were incurred and were capitalised in the Group's balance sheet as an offset to equity;
• Convertible preferred stock with a value of US$12,709,219 was converted into 27,039,068 shares; and
• Convertible notes with a value of US$4,121,229 (comprising face value of convertible notes, accrued interest and embedded derivative) were converted into 49,882,676 shares;
 	
This area is a key audit matter due to the significance and complexity of the transactions and the judgement applied in allocating costs between share capital and the statement of profit or loss and other comprehensive income.
	Our procedures included, amongst others:
	• Agreeing the recorded proceeds from the issuance of shares to supporting documentation such as the prospectus document, ASX announcement, share registry records and bank statements;
	• Testing a sample of transaction costs to supporting documentation;
	• Assessing the accounting for the conversion of convertible preferred stock into shares, including:
	  – Performing tests on the mathematical accuracy of the underlying conversion calculations;
	• Assessing the accounting for the conversion of convertible notes into shares, including:
	  – Performing tests on the mathematical accuracy of the underlying conversion calculations;
	  – Assessing the fair value adjustments recognised associated with the conversion of convertible notes; and
	• Assessing the adequacy of related disclosures in the financial statements.

Revenue recognition – Notes 2 and 4	
The Group recognised revenue of US$2,144,054 during the year ended 31 December 2022. The Group recognises revenue across five separate revenue streams: drone and base equipment, maintenance agreements, deployment, lease subscription arrangements and others (comprising training, consulting services and miscellaneous hardware sales). The revenue recognition process and policies differ for each stream depending on the nature of the products and services provided to the customer in accordance with ASC Topic 606: *Revenue from Contracts with Customers*. The Group applies significant estimation and judgement to determine the timing and amount of revenue to be recognised. This area is a key audit matter due to the estimation uncertainty, the material nature of the balance, the volume of transactions and the importance of the revenue balance to the current stakeholders.	Our procedures included, amongst others: • Assessing the revenue recognition policies for appropriateness and compliance with ASC 606, including reviewing consistency with the prior period; • Testing the design and implementation of relevant controls relating to the occurrence of revenue; • Testing a sample of revenue transactions for each revenue stream by tracing through to sales contracts, assessing the identification of performance obligations, and evaluating the timing of revenue recognition; • Assessing whether revenue has been recognised in accordance with revenue recognition policies; and • Assessing the adequacy of related disclosures in the financial statements.

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

The Directors are responsible for the other information. The other information comprises the information included in the Group's annual report for the year ended 31 December 2022, 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 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 the Directors' for the financial report

The Directors of the Company are responsible for the preparation of the financial report that gives a true and fair view 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, the Directors are 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 the Directors either intend to liquidate the Group or to cease operations, or have no realistic alternative but to do so.

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: https://www.auasb.gov.au/admin/file/content102/c3/ar1_2020.pdf.This description forms part of our auditor's report.

Grant Thornton

Grant Thornton Audit Pty Ltd
Chartered Accountants

C F Farley
Partner – Audit & Assurance

Sydney, 31 March 2023

Additional Shareholder Information

The information in this section is applicable as at 28 March 2023.

Corporate governance

In accordance with the ASX Corporate Governance Council's, Corporate Governance Principles and Recommendations (4th edition), the 2022 Corporate Governance Statement, as approved by the Board, is available on the Company's website at: https://www.nightingalesecurity.com/investors/.

The Corporate Governance Statement sets out the extent to which Nightingale has followed the ASX Corporate Governance Council's 35 specific Recommendations of general application and three additional Recommendations applicable in certain cases, to the extent applicable to Nightingale during the 2022 financial year.

Nightingale's issued securities and voting rights

The Company has the following securities on issue:

Security	Quoted	Number	Number of holders
Shares of common stock (**Shares**)	No	39,767,332	39
CHESS Depositary Interests (**CDIs**)	Yes	93,455,522	416
CDIs assuming all Shares held as CDIs		133,222,854	454
Listed Options	Yes	11,363,610	207
Unlisted Options	No	5,930,927	19
Restricted Stock Units	No	7,000,000	2
Silicon Valley Bank Warrants	No	20,464	1

Shares and CDIs

Nightingale's CHESS Depositary Interests (**CDIs**) are listed for quotation on the ASX under the ticker symbol "ASX: NGL". Each CDI is equivalent to one (1) Share. Legal title to the shares of common stock (**Shares**) underlying the CDIs is held by CHESS Depositary Nominees Pty Limited (**CDN**), a wholly owned subsidiary of the ASX. Holders of Shares may elect to convert their shares into CDIs at any time.

Shares and CDIs carry one vote per Share or CDI at a meeting of Nightingale's stockholders. To vote, holders of CDIs must instruct CDN, as the legal owner of the CDIs, to vote the Shares underlying their CDIs in a particular manner.

Options

Nightingale's listed options are listed for quotation on the ASX under the ticker symbol "ASX: NGLO". They have an exercise price of A$0.35 and an expiry date of 16 September 2025. Each option entitles the holder to be issued one CDI on exercise.

Nightingale's unlisted options issued under its 2014 Equity Plan have exercise prices of USD$0.03 to USD$0.47 with ten-year terms and expiry dates of 2 February 2028 to 3 October 2031l. Each option entitles the holder to be issued one Share on vesting and exercise.

Option holders do not have any voting rights. Shares or CDIs issued to option holders on exercise of their options will have the same voting rights as a holder of Shares or CDIs.

Restricted Stock Units

Nightingale's Restricted Stock Units (**RSUs**) were issued to Nightingale's two founders. Details of the RSUs are set out in the Remuneration Report.

RSU holders do not have any voting rights.

Silicon Valley Bank Warrants

Nightingale's Silicon Valley Bank Warrants (**SVBWs**) have an exercise price of US$0.47 and an expiry date of 4 April 2028. Each warrant entitles the holder to be issued one Share on exercise.

The SVBWs do not have any voting rights. Silicon Valley Bank holds 100% of the SVBWs.

Top 20 Holders

Top 20 holders of CDIs

The table assumes that all Shares are held as CDIs.

Holders	Holding	%
BVM Fund LLC	16,528,034	12.41%
Motasim Faleh H. Hajaj	13,792,660	10.35%
Mark Iv Capital Inc	6,653,703	4.99%
Jack Wu	4,250,000	3.19%
John Hsu	4,250,000	3.19%
BNP Paribas Noms Pty Ltd <DRP>	3,725,012	2.80%
Triple AB LP	3,447,122	2.59%
Impact Venture Capital I LP	2,819,655	2.12%
Eric C Schachenmann	2,598,390	1.95%
Rusad Holdings Pty Limited <The Rusad A/C>	2,247,265	1.69%
Saxby Capital Investments Pty Ltd	2,020,979	1.52%
Yea-Sayer Pty Limited	2,017,798	1.51%
Mr Paul Dolan	1,889,890	1.42%
Willec Holdings Pty Ltd <The Lechner Family A/C>	1,820,000	1.37%
McElnea Holdings Pty Ltd <McElnea Family A/C>	1,804,431	1.35%
The Hebert Trust	1,606,573	1.21%
Nikola Krkovski	1,590,910	1.19%
Capp SMSF Pty Ltd <Capp SMSF Pty Limited A/C>	1,558,441	1.17%
Bearay Pty Ltd <Brian Clayton S/F A/C>	1,449,418	1.09%
Toby Lei	1,433,578	1.08%
Total	**77,503,859**	58.18%

Top 20 holders of Listed Options

Listed Options are quoted on ASX under the ticker ASX: NGLO.

Holders	Holding	%
Mark IV Capital Inc	1,734,906	15.27%
BVM Fund LLC	1,023,563	9.01%
Willec Holdings Pty Ltd <The Lechner Family A/C>	910,000	8.01%
Nikola Krkovski	795,455	7.00%
Mr Antanas Guoga	454,545	4.00%
Novus Capital Nominees Pty Limited <Nominee A/C>	420,203	3.70%
John Hsu	341,506	3.01%
Netwealth Investments Limited <Wrap Services A/C>	306,816	2.70%
Netwealth Investments Limited <Super Services A/C>	261,364	2.30%
Publisher's Internationale Pty Ltd	227,500	2.00%
Mr Bradley Saxby	227,273	2.00%
VES Operations and Management LLC	223,122	1.96%
Mr Charles Philip Peake & Mr Simon Gilber Peake & Mrs Annmaree Peake <Seymour Retirement Fund A/C>	119,318	1.05%
FTM Share Investments Pty Ltd	113,750	1.00%
Berrygrats Australia Pty Ltd <Berrygrats Superfund A/C>	113,750	1.00%
Estate Planners Australia Pty Ltd <Jedriver Estate A/C>	113,750	1.00%
Arcturus Retirement Pty Ltd <Arcturus Retirement Fund A/C>	113,637	1.00%
Mrs Jennifer Ann Fletcher <Jennifer Fletcher A/C>	113,636	1.00%
BNP Paribas Noms Pty Ltd <DRP>	113,636	1.00%
Mrs Elisa Eliana Cativo Palomo	113,500	1.00%
Total	**7,841,230**	**69.00%**

Substantial shareholders

Nightingale's substantial shareholders, as disclosed in substantial shareholder notices given to the Company, are:

Name	Class	Number	Voting Power
BVM Fund LLC	CDIs	16,528,034	12.41%
Motasim Faleh H. Hajaj	Shares	13,792,660	10.35%

Distribution schedules of security holders

CDIs

The table assumes that all Shares are held as CDIs.

Range	Holders	Securities	%
1-1,000	3	182	0
1,001-5,000	19	94,461	0.07
5,001-10,000	85	918,647	0.69
10,001-100,000	212	10,802,213	8.11
100,001 and over	135	121,407,351	91.13
Totals	**454**	**133,222,854**	**100.00**

Listed options

Range	Holders	Securities	%
1-1,000	-	-	-
1,001-5,000	65	323,176	2.84
5,001-10,000	27	195,313	1.72
10,001-100,000	94	2,776,891	24.44
100,001 and over	22	8,068,230	71.00
Totals	**208**	**11,363,610**	**100.00**

Unlisted options

Range	Holders	Securities	%
1-1,000	-	-	-
1,001-5,000	-	-	-
5,001-10,000	-	-	-
10,001-100,000	12	425,000	7.20
100,001 and over	7	5,505,927	92.80
Totals	**19**	**5,930,927**	**100.00**

Restricted Stock Units

Range	Holders	Securities	%
1-1,000	-	-	-
1,001-5,000	-	-	-
5,001-10,000	-	-	-
10,001-100,000	-	-	-
100,001 and over	2	7,000,000	100.00
Totals	**2**	**7,000,000**	**100.00**

Silicon Valley Bank Warrants

Range	Holders	Securities	%
1-1000	-	-	-
1,001-5000	-	-	-
5,001-10,000	-	-	-
10,001-100,000	1	20,464	100.00
100,001 and over	-	-	-
Totals	**1**	**20,464**	**100.00**

Restricted securities

Class	Number	End of escrow period
Shares (ASX: NGLAA)	1,158,089	27 June 2023
CDIs (ASX: NGLAH)	1,803,406	5 July 2023
Shares (ASX: NGLAB)	5,304,808	7 November 2023
Shares (ASX: NGLAC)	25,789,028	18 November 2024
Restricted Share Units (ASX: NGLAF)	7,000,000	18 November 2024
Unlisted Options (ASX: NGLAD)	255,927	18 November 2024
Unlisted Options (ASX: NGLAE)	4,400,000	18 November 2024

Unmarketable parcels of securities

The table assumes that all Shares are held as CDIs.

Range	Holders	CDIs
Unmarketable parcels of CDIs (being less than A$500)	32	102,425

Company Secretary

Mr. Mike Tschiderer is the Company’s Chief Financial Officer and Company Secretary

Registered offices

Principal and US Registered Office

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Tel: +1 (408) 909-7227

Australian Registered Office

Maddocks Lawyers
Level 27, 123 Pitt Street
Sydney, NSW, Australia
Tel: +61 2 9291 6000

Registers of securities

United States

Securities Transfer Corporation
2901 N Dallas Parkway Suite 380
Texas, 75093 USA
Tel: +1 (469) 633 0101

Australia

Automic Group Pty Ltd
Level 5/126 Phillip Street
Sydney, NSW 2000 Australia
Tel: 1300 288 664

Stock exchange listings

The Company's securities are not traded on any other exchange other than the ASX.

Review of operations and activities

A detailed review of operations and activities is reported in Directors' Report.

On-market share buy-back

There is no current on-market share buy-back.

Use of funds

During the period between the Company's admission to ASX on 18 November 2022 to 31 December 2022, the Company has used its cash and assets readily convertible to cash that it had at the time of ASX admission in a way consistent with its business objectives set out in the in its Second Supplementary Prospectus dated 16 November 2022.

END.