Appendix 4D Half Year Report

31 August 2023

1. Reporting period

Name of Entity:	Nightingale Intelligent Systems, Inc. (the **Company**)
ARBN:	659 369 221
Reporting period:	For the half year ended 30 June 2023
Previous reporting period:	For the half year ended 30 June 2022

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

2. Results for announcement to the market

	30 June 2023	30 June 2022	Up / Down
Revenue from ordinary activities	$368,783	$1,141,604	Down 68%
Loss from ordinary activities after tax attributable to members	$(1,802,657)	$(1,840,474)	Down 2%
Net loss for the period attributable to members	$(1,841,445)	$(2,566,777)	Down 28%

Dividends

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

3. Net tangible assets

	30 June 2023 (cents)	30 June 2022 (cents)
Net tangible assets per security	$0.01	$0.08

Note: Net tangible assets exclude Right-of-Use Assets in accordance with ASU 2016-02 (Topic 842). The Company's securities include US shares of common stock and Australian CDIs representing underlying shares of common stock. US shares of common stock are convertible into CDIs on a 1:1 basis. Net tangible assets per security at 30 June 2023 reflects the significant increase in issued shares following the Company's November 2022 IPO.

4. Review of operations and financial results

Refer to the accompanying Half Year Report which includes the consolidated financial statements and the Directors' Report for details and commentary on the Company's operations and financial results.

5. Control gained or lost over entities

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

6. Associates and joint venture entities

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

7. Accounting standards

The Company's Half Year Report for the period ended 30 June 2023 has been prepared under US GAAP.

The Company's Half Year Report for the period ended 30 June 2023 has been subject to review by the Company's external auditors, Grant Thornton Audit Pty Limited, and includes a material uncertainty related to going concern. A copy of Grant Thornton's independent review report is included in the accompanying Half Year Report.

Signed by:

Jack Wu
Chief Executive Officer and Executive Director

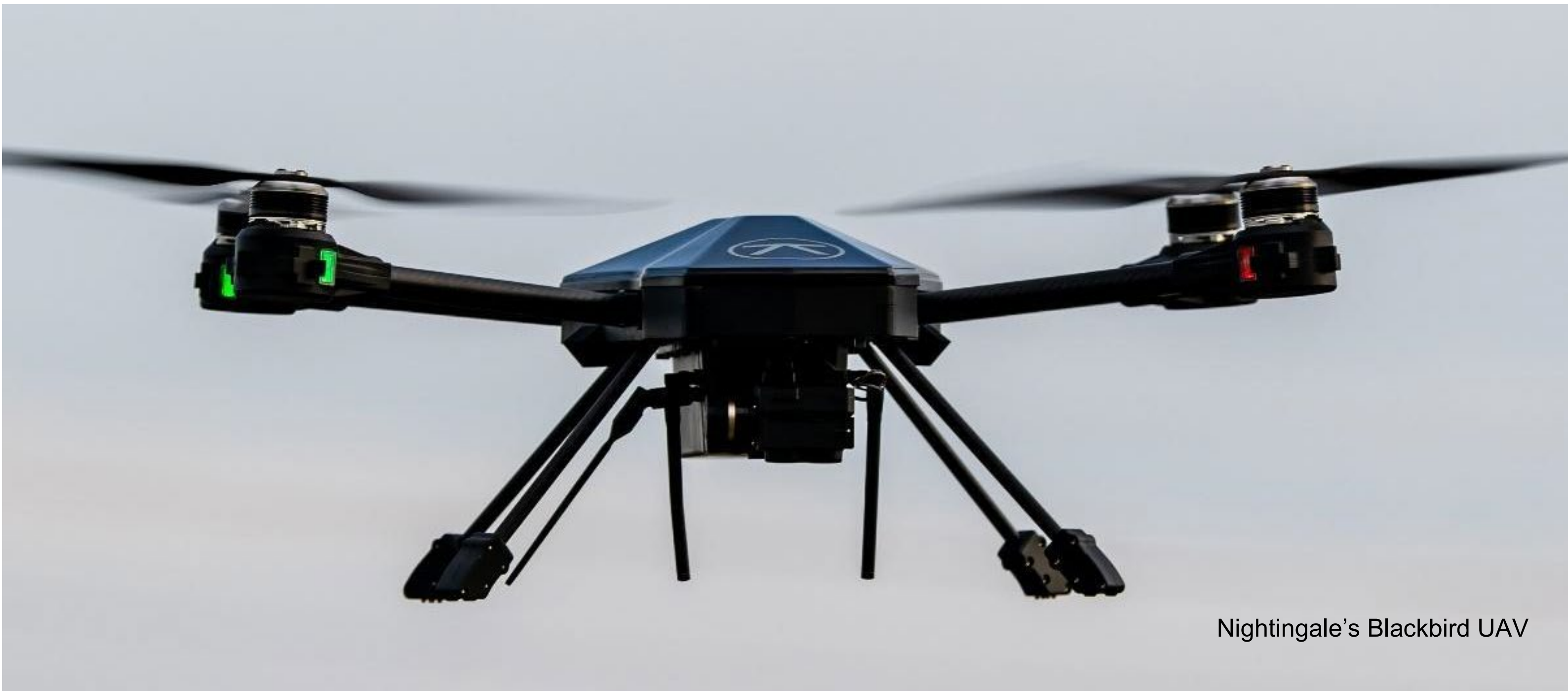
NIGHTINGALE SECURITY®

Nightingale Intelligent Systems, Inc.

HALF YEARLY REPORT

for the period ended 30 June 2023

A Delaware Corporation
ARBN: 659 369 221



Nightingale's Blackbird UAV

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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 Limited
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

ASX 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.

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 half year ended 30 June 2023.

Directors

The following persons were directors of the Company during the reporting period and up to the date of this report:

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

Principal Activities

Nightingale designs, develops, builds, deploys, and supports autonomous robotic aerial security technologies that protect critical infrastructure for large Fortune 500-type 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.

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.

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

Results of Operations

The Company had revenues of $0.4M in the first half of 2023 compared to $1.1M in the first half of 2022. 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. The revenues for the first half of 2023 were lower than expected; however, based on recent sales activity and contract signings, the Company expects to sign and deploy new contracts in the second half of 2023 which will result in FY2023 revenues.

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. 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 $1.0M in the first half of 2023 compared to $1.1M in the first half of 2022. Sales and marketing expenses were $0.1M in the first half of 2023, and comparable to the first six months of 2022. General and administrative expenses were $1.0M in the first half of 2023, and comparable to the first six months of 2022. The Company has focused on cost containment in light of softer revenues to date in the first six months of 2023.

Net loss from operations was $(1.8M) in the first half of 2023 compared to $($1.8M) for the first half of 2022 which reflects the factors described above.

Net loss was $(1.8M) in the first half of 2023 compared to $(2.6M) for the first half of 2022. This improvement over 2022 is largely due to 2022 including the interest expense and other expense activity related to the November 2022 IPO and the accounting for the conversion of various debt and preferred shares in connection with the IPO.

In the Boards' view, earnings per share comparisons between the first half of 2023 versus the first half of 2022 provides little value to readers due to the number of shares issued and security conversions in connection with the Company's IPO.

Financial Position

Nightingale completed its ASX IPO on November 18, 2022. Gross proceeds were approximately $3.4M (approximately AUD$5.0M) before transaction costs. Most transaction costs were disbursed in 2022 although certain costs were, and will continue to be, disbursed in 2023. The Company has cash balances of $0.3M at June 30, 2023.

Accounts receivable, net, is $0.3M which is similar to December 31, 2022 and reflects the timing of customer billings and payments. The Company generally looks to have customers prepay for sales contracts, subscription lease agreements, and maintenance renewals.

Accounts payable is $0.7M at June 30, 2023 which is similar to December 31, 2022 and reflects the timing of payments to current suppliers and IPO-related costs in 2023.

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 June 30, 2023 is $0.7M and is expected to be recognized as revenue in the second half of 2023.

The Company has a $0.15M long-term loan agreement with the U.S. Small Business Administration. The loan is payable over 30 years with an interest rate of 3.50% on outstanding borrowings. Repayment has not commenced yet.

In the second quarter of 2023, the Company signed short-term promissory note payable agreements totaling $0.58M with certain of its officers and directors. Each note was due and payable with a 10% financing fee on August 31, 2023. In August, $0.55M of the notes were extended to November 30, 2023, and one note for $0.03M was repaid.

Business and Growth Strategies

An important piece of Nightingale's strategy is focusing on large corporate customers that have a tangible requirement for Robotic Aerial Security and securing small contracts with such corporates as an entry point.

As Nightingale's drones demonstrate their value to customers as an innovative, comprehensive, and cost-effective security approach, the Company works to deepen its relationships with customers by evolving small initial hardware and software contracts to a "robot as a service" relationship. This focus on "robot as a service" increases Nightingale's annual recurring revenue (ARR) which is the key to driving an improved valuation for the business over time.

Nightingale continues to expand its relationships with key large corporate customers. Notably, during the quarter the Company expanded consulting services and equipment purchases with Haliburton and Iron Mountain.

Whilst the revenue from these expansions is relatively small, the expansions represent a validation of Nightingale's "land and expand" strategy and a vote of confidence in the Company's flagship Blackbird drones and services. The Company believes that there is strong potential for further significant expansion across each customer's numerous sites, in the US and internationally, which could generate significant future revenue streams.

Nightingale will continue to grow its law enforcement and defense facility sector customers. Similar to its land and expand strategy (and success) for large corporate customers, the Company was awarded a follow-on contract with a municipal police department and a contract for a second U.S. military base. The contract awarded in August 2023 for a large municipal police department is expected to lead to follow-on orders after the initial units are deployed.

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 30 June 2023, the Company had cash of $0.3M and had an accumulated deficit of $33.1M.

Notwithstanding a strong customer pipeline that includes contracts awarded and sales opportunities, 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.

Significant Changes in the State of Affairs

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

Claims for Payroll Tax Refund

In July 2023, the Company received the proceeds of Earned Retention Credit (**ERC**) payroll tax refund claims it had filed with the U.S. Internal Revenue Service earlier in 2023. The ERC program was a COVID-19 cost relief program for companies who retained employees during the COVID-19 pandemic. Approximately $0.4 million was received in July 2023 and fees totaling 15% of the amounts received are expected to be paid in September 2023. The ERC refund claims were not previously recorded as a receivable when filed due to the uncertainty of collection.

Amendment of Notes Payables

In August 2023, the Company amended $0.55 million of the $0.58 million notes payable that had been due to repaid by August 31, 2023. The amendment provides for a repayment date of no later than November 30, 2023. No other terms or conditions of the notes payable were amended.

Contracts with Customers

In August 2023, the Company received a contract from the United States Air Force totaling approximately $0.8 million for the delivery of Company autonomous drone units and related services. Revenue from this contract is expected to be recorded in 2023 and 2024.

In August 2023, the Company received approximately $0.3 million as a prepayment from a contract with a municipal law enforcement agency for the delivery of Company autonomous drone units and related services for the next three years.

In August 2023, the Company received a contract totaling approximately $0.9 million from a large municipal law enforcement agency for the delivery of Company autonomous drone units and related services. Revenue from this contract is expected to be recorded in 2023 through 2025.

Dividends

No dividends were paid or declared during the half year to 30 June 2023 and the Company does not intend to pay any dividends for the half year ended 30 June 2023 (2022: $Nil).

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 holdings 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 on issue. The Company's amended and restated certificate of incorporation (**Certificate of Incorporation**) and bylaws (**Bylaws**) do not impose any specific restrictions on transfer.

However, provisions of the DGCL, the Certificate of Incorporation and the Bylaws could make it more difficult to acquire the Company by means of a tender (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.

The preceding Directors' Report is made in accordance with a resolution of the directors.

On behalf of the directors

Jack Wu
Chief Executive Officer and Executive Director

31 August 2023

Nightingale Intelligent Systems, Inc.

Condensed Consolidated Financial Statements

For the Six Months Ended June 30, 2023 and 2022

Including:

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NIGHTINGALE INTELLIGENT SYSTEMS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
AS OF JUNE 30, 2023 AND DECEMBER 31, 2022

	June 30, 2023	December 31, 2022
Assets		
Current assets		
Cash and cash equivalents	$ 274,303	$ 1,441,248
Accounts receivable, net of allowance for doubtful accounts ($158,150 at June 30, 2023 and December 31, 2022)	258,221	224,361
Inventory, net	406,696	203,301
Prepaid expenses and other current assets	138,000	84,132
Total current assets	1,077,220	1,953,042
Operating lease right-of-use asset	471,020	538,462
Leased assets, net	99,815	108,930
Property and equipment, net	6,224	33,086
Other assets	23,035	23,407
Total assets	$ 1,677,314	$ 2,656,927
Liabilities, and Stockholders' Equity (Deficit)		
Current liabilities		
Accounts payable	$ 738,327	$ 720,824
Accrued expenses	65,675	73,624
Deferred revenue	645,409	573,566
Operating lease liability, current	156,790	164,626
Loans from officers and directors	580,000	—
Total current liabilities	2,186,201	1,532,640
Loan payable	150,000	150,000
Operating lease liability, non-current	309,859	412,966
Total liabilities	2,646,060	2,095,606
Stockholders' Equity (Deficit):		
Common stock, $0.00001 par value; 250,000,000 and 90,433,860 shares authorized at June 30, 2023 and December 31, 2022, respectively; 133,222,854 shares issued and outstanding at June 30, 2023 and December 31, 2022	17,418,009	17,418,009
Additional paid-in capital	14,743,561	14,432,183
Accumulated deficit	(33,130,316)	(31,288,871)
Total stockholders' equity (deficit)	(968,746)	561,321
Total liabilities and stockholders' equity (deficit)	$ 1,677,314	$ 2,656,927

See accompanying notes to condensed consolidated financial statements.

NIGHTINGALE INTELLIGENT SYSTEMS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE SIX MONTHS ENDED JUNE 30, 2023 AND 2022

	Six Months Ended June 30, 2023	Six Months Ended June 30, 2022
Revenue	$ 368,783	$ 1,141,604
Cost of revenue	111,553	735,924
Gross profit	257,230	405,680
Operating expenses:		
Research and development	992,449	1,120,911
Sales and marketing	88,663	92,389
General and administrative	978,775	1,032,854
Total operating expenses	2,059,887	2,246,154
Loss from operations	(1,802,657)	(1,840,474)
Other expense, net		
Interest expense, net	19,938	648,229
Other expense	18,850	78,074
Total other expense, net	38,788	726,303
Net loss	$ (1,841,445)	$ (2,566,777)
Net loss per share - basic and diluted	$ (0.01)	$ (0.14)
Weighted average shares of common stock - basic and diluted	133,222,854	17,722,655

See accompanying notes to condensed consolidated financial statements.

NIGHTINGALE INTELLIGENT SYSTEMS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CONVERTIBLE PREFERRED STOCK AND CHANGES IN STOCKHOLDERS' EQUITY (DEFICIT)
FOR THE SIX MONTHS ENDED JUNE 30, 2023 AND 2022

	Convertible Preferred Stock		Common Stock		Additional Paid-In Capital	Accumulated Deficit	Total Stockholders' Equity (Deficit)
	Shares	Amount	Shares	Amount			
Balances at December 31, 2022	—	—	133,222,854	$ 17,418,009	$ 14,432,183	$ (31,288,871)	$ 561,321
Stock-based compensation	—	—	—	—	311,378	—	311,378
Net loss	—	—	—	—	—	(1,841,445)	(1,841,445)
Balances at June 30, 2023	—	—	133,222,854	$ 17,418,009	$ 14,743,561	$ (33,130,316)	$ (968,746)

	Convertible Preferred Stock		Common Stock		Additional Paid-In Capital	Accumulated Deficit	Total Stockholders' Equity (Deficit)
	Shares	Amount	Shares	Amount			
Balances at December 31, 2021	27,039,077	$ 12,709,219	17,245,269	$ 173	$ 10,259,243	$ (25,315,077)	$ (15,055,661)
Stock-based compensation	—	—	—	—	4,921	—	4,921
Proceeds from exercise of warrants	—	—	5,626,266	56	56,207	—	56,263
Net loss	—	—	—	—	—	(2,566,777)	(2,566,777)
Balances at June 30, 2022	27,039,077	$ 12,709,219	22,871,535	$ 229	$ 10,320,371	$ (27,881,854)	$ (17,561,254)

See accompanying notes to condensed consolidated financial statements.

NIGHTINGALE INTELLIGENT SYSTEMS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE SIX MONTHS ENDED JUNE 30, 2023 AND 2022

	Six Months Ended June 30, 2023	Six Months Ended June 30, 2022
Cash flows from operating activities:		
Net loss	$ (1,841,445)	$ (2,566,777)
Adjustments to reconcile net loss to net cash used in operating activities:		
Stock-based compensation expense	311,378	4,921
Depreciation and amortization	15,818	153,596
Loss on sale of fixed assets	5,159	—
Loss on change in fair value of derivative liability	—	73,192
Reduction of operating lease ROU asset	67,442	—
Amortization of debt discount	—	449,602
Amortization of debt issuance costs	—	64,907
Foreign exchange gain	14,797	—
Changes in operating assets and liabilities:		
Accounts receivable	(33,860)	(9,373)
Inventories	(203,395)	(265,479)
Prepaid expenses and other current assets	(53,868)	228,532
Other assets	372	25,585
Accounts payable	17,503	281,633
Accrued expenses	(7,949)	135,897
Deferred revenues	71,843	(243,436)
Operating lease liability	(110,943)	74,053
Net cash used in operating activities	(1,747,148)	(1,743,323)
Cash flows from investing activity:		
Proceeds on sale of fixed assets	15,000	—
Net cash provided by investing activity	15,000	—
Cash flows from financing activities:		
Proceeds from convertible notes	—	578,164
Proceeds from bank loan	—	149,900
Proceeds from loans from officers and directors	580,000	—
Proceeds from exercise of warrants	—	56,263
Offering costs paid	—	(81,920)
Net cash provided by financing activities	580,000	702,406
Effects of foreign exchange rate on cash and cash equivalents	(14,797)	—
Decrease in cash and cash equivalents	**(1,166,945)**	**(1,040,916)**
Cash and cash equivalents, beginning of period	**1,441,248**	**1,253,277**
Cash and cash equivalents, end of period	**$ 274,303**	**$ 212,361**

See accompanying notes to condensed 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-type 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 Enterprise, Defense, and Emergency Response market segments linked to critical infrastructure locations (e.g. utilities, pharmaceutical facilities and laboratories, military facilities, data centers). The majority of the Company's business activities occur in the US but the Company 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 ("ASX") via an Initial Public Offering and listing on the ASX ("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. The Company's shares of common stock trade on the ASX by way of CHESS Depositary Interests.

Basis of Presentation

The accompanying unaudited interim condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("U.S. GAAP") for interim financial information. Accordingly, they do not include all of the information and disclosures required by U.S. GAAP for complete financial statements. In the opinion of the Company's management, the accompanying interim condensed consolidated financial statements reflect all adjustments, which include normal recurring adjustments, necessary to present fairly the Company's interim financial information. Any reference in these notes to applicable guidance is meant to refer to the authoritative U.S. GAAP as found in the Accounting Standards Codification ("ASC") and Accounting Standard Updates ("ASUs") of the Financial Accounting Standards Board ("FASB"). Unless otherwise noted, amounts in these condensed consolidated financial statements are presented in U.S. dollars.

The accompanying unaudited interim condensed consolidated financial statements and related notes should be read in conjunction with the Company's audited consolidated financial statements for the year ended December 31, 2022. The financial results of any interim period are not necessarily indicative of the expected financial results for the full year.

Liquidity

The financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. In order to continue its operations, the Company must be awarded contracts from customers, 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 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 achieve additional liquidity from operations, and through funding from 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. Although the Company has generated revenue from product sales to date, the Company has 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 $0.2 million and $1.4 million at June 30, 2023 and December 31, 2022, respectively. The Company has incurred net losses of $1.8 million and $2.6 million for the period ended June 30, 2023 and 2022, had an accumulated deficit of $33.1 million as of June 30, 2023 and working capital deficit of $1.1 million. The Company has reviewed the relevant conditions and events surrounding its ability to continue as a going concern including among others: historical losses, projected future results, 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 date the interim condensed consolidated financial statements are issued. The financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result from the outcome of this uncertainty. If future financing is not achieved, the Company may be required to curtail spending to reduce cash outflows.

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The interim condensed 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 June 30, 2023, 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 June 30, 2023.

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 interim condensed consolidated financial statements and the accompanying notes. The most significant estimates in the Company's interim condensed consolidated financial statements relate to revenue recognition, determination of the cost and deriving the useful lives of the Company's drone units and base stations, assessing assets for impairment, ability to realize deferred tax assets, fair value measurements, valuation of financial instruments, valuation of stock options and warrants, and contingencies.

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

Financial Instruments – Recognition and Derecognition

The Company's financial instruments include cash and cash equivalents, accounts receivable, accounts payable, accrued liabilities, and loans payable. The Company's cash and cash equivalents, accounts receivable, accounts payable, accrued liabilities, and loans 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, canceled or expires.

Fair Value Measurements

The Company accounts for fair value measurements under ASC Topic 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 interim condensed 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.

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 interim condensed 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. No shares have been repurchased in 2023 to date.

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 interim condensed 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 interim condensed consolidated statements of operations. All deferred offering costs related to the Company's IPO which closed in November 2022 have been recorded as a reduction of the IPO proceeds.

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 adjusted for existing conditions and further adjusted for the period of time that can reasonably be forecasted, 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 June 30, 2023 and December 31, 2022.

At June 30, 2023, the Company had three customers whose accounts receivable balance each totaled 10% or more of the Company's total accounts receivable (28%, 21% and 12%) compared with four such customers (39%, 20%, 14% and 13%) at December 31, 2022.

For the six months ended June 30, 2023, the Company had three customers (20%, 16% and 16%) who individually accounted for 10% or more of the Company's total customer revenue compared with three such customers (17%, 12%, and 10%) for the period ended December 31, 2022.

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 are stated at cost and include 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 interim condensed 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 interim condensed consolidated balance sheets.

Product Development Assets

Depreciation expense on product development assets is included in research and development expenses on the Company's interim condensed consolidated statements of operations.

Impairment of Long-Lived Assets

The Company assesses the impairment of long-lived assets whenever events or changes in circumstances indicate that their carrying value may not be recoverable from the estimated future cash flows expected to result from their use or eventual disposition. If estimates of future undiscounted net cash flows are insufficient to recover the carrying value of the assets, the Company will record an impairment loss in the amount by which the carrying value exceeds the fair value. If the assets are determined to be recoverable, but the useful lives are shorter than originally estimated, the Company will depreciate or amortize the net book value of the assets over the newly determined remaining useful lives. The Company had a $140,000 reserve recorded against certain early-generation drone units determined to be obsolete as of both June 30, 2023 and December 31, 2022. None of the Company's drone units, base stations or property and equipment was determined to be impaired as of June 30, 2023 and December 31, 2022.

Leases

The Company adopted ASU 2016-02, *Leases* (Topic 842) ("ASU 2016-02"), 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, *Leases* ("ASC 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 interim condensed 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 606 and ASC 842. Complex arrangements with nonstandard terms and conditions may require significant contract interpretation to determine the appropriate accounting. Specifically, the revenue related to the following areas involves significant judgments and estimates:

Lease Subscription Arrangements: The Company also leases its equipment direct to end customers under bundled lease subscription arrangements, which typically include the equipment, software, maintenance services, and training for which the customer pays a single negotiated fixed minimum monthly payment for all elements over the contractual lease term. Lease deliverables include the drone and base equipment and software as well as the deployment fee associated with the drone system, while the non-lease deliverables generally consist of the services, which include maintenance, repair, upgrades, and training. Sales made under bundled lease subscription arrangements comprise 46% or $168,000 and 12% or $132,000 of total sales revenue for the six months ended June 30, 2023 and 2022, 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 20% and 80%, respectively, over the six months ended June 30, 2023 and 2022.

Sales to Distributors and Resellers: 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 six months ended June 30, 2023 and 2022 as none was deemed needed as a result of the measurement of constraint of revenues. Total sales to distributors and resellers were $0 and $254,000 for the six months ended June 30, 2023 and 2022, respectively.

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

Significant management judgments and estimates must be made and used in connection with the recognition of revenue in any accounting period. Material differences in the amount of revenue in any given period may result if these judgments or estimates prove to be incorrect or if management's estimates change on the basis of development of the business or market conditions. Management judgments and estimates have been applied consistently and have been reliable historically. The Company believes that there are two key factors which impact the reliability of management's estimates. The first of those key factors is that the terms of its contracts are typically for one year. The short-term nature of such contracts reduces the risk that material changes in accounting estimates will occur on the basis of market conditions or other factors. The second key factor is that it has numerous contracts in any given accounting period, which reduces the risk that any one change in an accounting estimate on one or several contracts would have a material impact on the Company's interim condensed 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 606. The only change of significance identified in adoption involves a change in the classification of certain revenues that were previously reported in service 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 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 interim condensed 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 interim condensed 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 interim condensed consolidated statements of operations. Derivative instrument liabilities are classified in the interim condensed 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 Topic 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 interim condensed consolidated statements of operations as incurred. Advertising expense was immaterial for the six-month period ended June 30, 2023 and 2022.

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 interim condensed consolidated statements of convertible preferred stock and stockholders' equity (deficit). Exchange differences are included in general and administrative expenses in the interim condensed 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 Topic 740, *Income Taxes* ("ASC 740"). 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 records 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 six months ended June 30, 2023 and 2022.

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:

	June 30,	
	2023	**2022**
Basic and diluted net loss per share:		
Numerator:		
Net loss	1,839,130	2,566,776
Denominator:		
Weighted-average shares outstanding	133,222,854	17,722,655
Basic and diluted net loss per share	0.01	0.15

Recent Accounting Pronouncements - Adopted

In February 2016, the FASB issued ASU 2016-02 that 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* ("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* 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* ("ASU 2020-06"). 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 18, 2022, the Company (trading under the ticker code "NGL") was successfully admitted to the Official List of Australian Securities Exchange ("ASX") via an initial public offering and listing on the ASX ("IPO"). The Company's shares of common stock and quoted options will be settled and traded on the ASX in the form of CHESS Depositary Interests ("CDIs") 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 its 2020 and 2021 Convertible Notes into shares of common stock. The Company converted a portion of its 2022 Convertible Notes into shares of common stock. See Note 11 – *Debt Obligations.*

The Company incurred IPO related expenses consisting of lead manager's 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:

	Six Months Ended June 30	
	2023	2022
Major product and services lines		
Drone and Base Equipment	$ 38,886	$ 486,057
Maintenance Agreements (1)	93,517	74,355
Deployment (2)	39,900	87,895
Other (3)	28,519	361,465
Lease subscription arrangements (4)	167,961	131,832
Total Revenues	$ 368,783	$ 1,141,604
Sales channels:		
Customer direct sales	$ 200,822	$ 756,057
Direct equipment lease (4)	167,961	131,832
Distributors & resellers (5)	-	253,715
Total Revenues	$ 368,783	$ 1,141,604

(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:

	Six Months Ended June 30	
	2023	2022
Recognition:		
Point-in-time	$ 107,305	$ 935,417
Over-time	261,478	206,187
Total Revenues	$ 368,783	$ 1,141,604

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 $645,409 and $573,566 at June 30, 2023 and December 31, 2022, respectively. The majority of the balance at June 30, 2023 will be amortized to revenue over approximately the next 12 months. See below for the rollforward of contract liabilities.

	Six Months Ended June 30	
	2023	2022
Beginning of the period – December 31	$ 573,566	$ 893,074
Payments in advance	331,022	412,654
Revenue recognized on contract	(259,179)	(656,089)
End of the period – June 30	$ 645,409	$ 649,639

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 AND EQUIPMENT ON OPERATING LEASES

Inventory, net, consisted of the following at June 30, 2023 and December 31, 2022:

	June 30, 2023	December 31, 2022
Raw material components	$ 159,208	$ 105,885
Finished drones	26,533	61,911
Finished base stations	220,955	35,505
Inventory	$ 406,696	$ 203,301

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 June 30, 2023 and December 31, 2022 were as follows:

	June 30, 2023	December 31, 2022
Equipment on lease	$ 695,537	$ 695,537
Accumulated depreciation	(595,722)	(586,607)
Drones and base stations, net	$ 99,815	$ 108,930

Depreciable lives generally vary from two to five years consistent with the planned and historical usage of the equipment subject to operating leases.

NOTE 6: ACCRUED EXPENSES

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

	June 30, 2023	December 31, 2022
Accrued payroll	$ 45,736	$ 51,897
Other accrued liabilities	19,939	21,727
	$ 65,675	$ 73,624

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 June 30, 2023 and December 31, 2022:

Assets:	Carrying Amount	Fair Value Measurements at June 30, 2023 using: Level 1	Level 2	Level 3
Money market funds	$ 43	$ 43	$ —	$ —
	$ 43	$ 43	$ —	$ —

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

The change in the fair value of derivative liabilities for the six months ended June 30, 2023 and 2022 are summarized below:

	Six Months Ended June 30 2023	2022
Fair value as of beginning of the period – December 31	$ —	$ 1,906,429
Change in fair value on 2020 Convertible Notes	—	40,745
Change in fair value on 2021 Convertible Notes	—	32,448
Derivative liability upon issuance of 2022 Notes	—	50,128
Change in fair value on 2022 Convertible Notes	—	—
Fair value as of end of the period – June 30	$ —	$ 2,029,750

For the six-month period ended June 30, 2023 and 2022, the recorded gain/(loss) on change in fair value of derivative warrants amounted to $nil and $73,000, respectively, in the interim condensed 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, leasehold improvements and software, as of June 30, 2023 and December 31, 2022 are as follows:

	June 30, 2023	December 31, 2022
Computer equipment	$ 20,337	$ 20,337
Machinery and equipment	6,493	6,493
Automobiles	16,124	49,723
Leasehold improvements	69,431	69,432
	112,385	145,985
Accumulated depreciation	(106,161)	(112,899)
Property and equipment, net	$ 6,224	$ 33,086

Depreciation and amortization expense on property and equipment included in general and administrative expenses amounted to approximately $6,700 and $5,000 in June 30, 2023 and 2022, 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 June 30, 2023 and December 31, 2022:

	June 30, 2023	December 31, 2022
Intangible assets, net	$ 5,573	$ 5,944
Rent deposits	17,462	17,463
	$ 23,035	$ 23,407

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

	June 30, 2023	December 31, 2022
Capitalized research and development costs	$ 614,408	$ 614,408
Organization and start-up costs	11,145	11,145
	625,553	625,553
Accumulated amortization	(619,980)	(619,609)
Intangible assets, net	$ 5,573	$ 5,944

Amortization expense amounted to $372 for both periods ended June 30, 2023 and 2022, respectively.

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

	Amounts
Six Month Period Ending June 30:	
2024	$ 372
2025	372
2026	372
2027	372
2028	372
Thereafter	743

NOTE 10: LOANS FROM OFFICERS AND DIRECTORS

The Company entered into note agreements with certain of its officers on May 24, 2023 amounting to $30,000 and $150,000, and with certain of its Board of Director members on June 19, 2023 amounting to $250,000 and $150,000. The loans are payable in full including accrued fees on or before August 30, 2023. The financing fees will vary depending on the principal repayment date: 5% of the loan amounts if repayment is made within 30 days of the agreement date, and 10% thereafter. The loans are secured by the Earned Retention Credit refund claim filed by the Company with the Internal Revenue Service (IRS) and the Company's accounts receivables. The Company reserves the right to fully or partially prepay the loans prior to maturity with no penalty.

Subsequent to June 30, 2023, $550,000 of the loans were amended to change the repayment date to November 30, 2023. No other provisions of the note agreements were amended. One note for $30,000 was repaid prior to August 30, 2023.

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 or (ii) 6.25%. Interest expense on the Loan Agreement during the six months ended June 30, 2023 and 2022 was $0 and $0, respectively. 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 June 30, 2023, 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).

Convertible Notes

2020 Convertible Notes

In July 2020, the Company entered into a series of convertible note subscription agreements (the "2020 Convertible Notes") with various investors for aggregate gross borrowings of approximately AUD $1.8 million or USD $1.2 million; net proceeds received in USD 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 IPO (see Note 3 – *Initial Public Offering*) and listing, on the Australian Securities Exchange ("ASX") in November 2022, the 2020 Convertible Notes were then automatically converted into 19,851,471 fully paid CDIs of the Company at 50% of the IPO offer price.

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 2020 Convertible Notes have been fully converted as of December 31, 2022. Hence, no interest expense is recognized relating to amortization of the debt discount and debt issuance costs for the six months period ended June 30, 2023, respectively. The Company recognized approximately $175,000 and $20,000 in interest expense relating to amortization of the debt discount and debt issuance costs for the six months period ended June 30, 2022, respectively. The Company also recognized the stated interest expense of $48,000 for the six months period ended June 30, 2022.

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 IPO (see Note 3- *Initial Public Offering*) and listing on the Australian Securities Exchange ("ASX") in November 2022, the 2021 Convertible Notes were then automatically converted into 21,908,986 fully paid CDIs of the Company at 70% of the IPO offer price.

The Company determined that the 2021 Convertible Notes contained rights and obligations for conversion contingent upon 1) the Company's receipt of a listing approval to be admitted to an Approved Securities 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 2021 Convertible Notes have been fully converted as of December 31, 2022. Hence, no interest expense is recognized relating to amortization of the debt discount and debt issuance costs for the six months period ended June 30, 2023. The Company recognized approximately $297,000 and $0 in interest expense relating to amortization of the debt discount and debt issuance costs for the six months ended June 30, 2022 respectively. The Company also recognized the stated interest expense of $85,000 for the six months period ended June 30, 2022.

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 $0.6 million.

Upon the completion of the IPO (see Note 3 – *Initial Public Offering*) and listing, on the Australian Securities Exchange ("ASX") in November 2022, approximately 50% the 2022 Convertible Notes were converted into 4,222,219 fully paid CDIs of the Company. The remaining 2022 Convertible Notes were redeemed at the holders' election with AUD $510,000 in 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 2022 Convertible Notes have been fully converted as of December 31, 2022. Hence, no interest expense is recognized relating to amortization of the debt discount and debt issuance costs for the six months period ended June 30, 2023. The Company did not incur interest expense relating to amortization of the debt discount and debt issuance costs for the six months ended June 30, 2022, respectively. The Company did not incur any stated interest expense for the six months period ended June 30, 2022.

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 (DEFICIT)

As of June 30, 2023, 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. All Preferred Stock was converted to common shares in connection with the Company's IPO in 2022.

As of both June 30, 2023 and December 31, 2022 respectively, 133,222,854 shares of Common Stock were issued and outstanding. The Company has reserved 25,000,000 shares of its common stock pursuant to the 2014 Stock Plan ("2014 Plan") as of June 30, 2023. A total of 5,930,927 stock options are outstanding under the 2014 Plan as of June 30, 2023 and December 31, 2022, respectively.

NOTE 13: 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 nonemployees for advisory and consulting services. At each measurement date, the Company will remeasure the fair value of these stock options using the Black-Scholes option pricing model and recognize the expense ratably over the vesting period of each stock option award. Stock options comprise all of the awards granted since the Plan's inception. Shares available for grant under the 2014 Plan amounted to 15,536,536 and 15,536,536 as of June 30, 2023 and December 31, 2022, respectively.

The weighted average grant date fair value of options granted during the period ended June 30, 2023 and December 31, 2022 were $0.05 and $0.05 per share, respectively. There were 5,723,055 and 5,723,055 option grants during the period ended June 30, 2023 and December 31, 2022, respectively. The fair value of the shares subject to stock options that were vested at June 30, 2023 and December 31, 2022 were $746,716 and $435,338 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 period ended June 30, 2023 and 2022, respectively, 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 $311,378 and $4,922 was recognized for the period ended June 30, 2023 and 2022, respectively.

Stock-based compensation is included in the interim condensed 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:

	Six months ended June 30,	
	2023	**2022**
Cost of revenue	$ (8,297)	$ —
General and administrative	181,939	—
Research and development	137,736	5,145
Sales and marketing	—	(223)
	$ 311,378	$ 4,922

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 vested in two tranches upon the Company achieving certain revenue target thresholds for the period from January 1, 2022 to 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. As the conditions and expected life of the Class B RSU's are highly uncertain at June 30, 2023, no stock-based compensation has been recognized at June 30, 2023 for the Class B RSU's.

NOTE 14: 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 15: INCOME TAXES

The Company recorded zero provision for income taxes during the six months ended June 30, 2023 and 2022. The effective tax rate for the six months ended June 30, 2023 and 2022 was zero as the Company has incurred continuous operating losses.

Deferred tax assets and deferred tax liabilities are recognized based on temporary differences between the financial reporting and tax basis of assets and liabilities using statutory rates. A valuation allowance is recorded against deferred tax assets if it is more likely than not that some or all of the deferred tax assets will not be realized. Due to the uncertainty surrounding the realization of the favorable tax attributes in future tax returns, we have recorded fall valuation allowance against our otherwise recognizable net deferred tax assets.

NOTE 16: 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 included in the Company's interim condensed consolidated statements of operations totaled $98,730 for the period ended June 30, 2023. Rent expense amounted to $108,000 for the six months period ended June 30,2022.

As of June 30, 2023 and December 31, 2022, operating lease ROU asset amounted to $471,020 and $538,462, respectively. Weighted average remaining lease term is 2.62 years. Weighted average discount rate is 6.25%.

Operating cash flow used from operating activities amounted to $111,860 and $92,819 for the period ended June 30, 2023 and December 31, 2022, respectively. ROU assets obtained in exchange for operating lease liabilities amounted to nil and $713,098 for the period ended June 30, 2023 and June 30, 2022 respectively.

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 June 30, 2023 are as follows:

For the period ending:		
2023 (remaining six months)	$	82,294
2024		199,983
2025		205,993
2026		17,463
Thereafter		—
Total lease payments		505,733
Less: imputed interest		(39,084)
Less: lease liabilities, current		(156,790)
Lease liabilities, non-current	$	309,859

NOTE 17: COMMITMENTS AND CONTINGENCIES

In the normal course of business, the Company enters into contracts that contain various representations 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 18: SUBSEQUENT EVENTS

Claims for Payroll Tax Refund

In July 2023, the Company received the proceeds of Earned Retention Credit (“ERC”) payroll tax refund claims it had filed with the U.S. Internal Revenue Service earlier in 2023. The ERC program was a COVID-19 cost relief program for companies who retained employees during the COVID-19 pandemic. Approximately \$0.4 million was received in July 2023 and fees totaling 15% of the amounts received are expected to be paid in September 2023. The ERC refund claims were not previously recorded as a receivable when filed due to the uncertainty of collection.

Amendment of Notes Payables

In August 2023, the Company amended \$0.55 million of the \$0.58 million notes payable that had been due to repaid by August 31, 2023. The amendment provides for a repayment date of no later than November 30, 2023. No other terms or conditions of the notes payable were amended.

Contracts with Customers

In August 2023, the Company received a contract from the United States Air Force totaling approximately \$0.8 million for the delivery of Company autonomous drone units and related services. Revenue from this contract is expected to be recorded in 2023 and 2024.

In August 2023, the Company also received approximately \$0.3 million as a prepayment from a contract with a municipal law enforcement agency for the delivery of Company autonomous drone units and related services for the next three years.

In August 2023, the Company received a contract totaling approximately \$0.9 million from a large municipal law enforcement agency for the delivery of Company autonomous drone units and related services. Payment is expected in September 2023 with installation in the fourth quarter of 2023. Revenue from this contract is expected to be recorded in 2023 through 2025.

Management has evaluated subsequent events through August 31, 2023, the date the interim condensed consolidated financial statements were issued. Based on this evaluation, no additional material events were identified which require adjustment or disclosure in these interim condensed consolidated financial statements.

Directors' Declaration

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

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

2. the interim financial statements and notes thereto, give a true and fair view of the Company's financial position as at 30 June 2023 and of the performance for the half 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
Chief Executive Officer and Executive Director

31 August 2023

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Independent Auditor's Review Report

To the Members of Nightingale Intelligent Systems, Inc.

Report on the half year financial report

Conclusion

We have reviewed the accompanying half year financial report of Nightingale Intelligent Systems, Inc. (the Company) and its subsidiaries (the Group), which comprises the condensed consolidated balance sheet as at 30 June 2023, and the condensed consolidated statement of operations, condensed consolidated statement of convertible preferred stock and changes in stockholders' equity and condensed consolidated statement of cash flows for the half year ended on that date, a description of accounting policies, and other selected explanatory notes.

Based on our review, which is not an audit, we have not become aware of any matter that makes us believe that the accompanying half-year financial report of Nightingale Intelligent Systems, Inc. does not comply with accounting principles generally accepted in the United States of America including:

a giving a true and fair view of Nightingale Intelligent Systems, Inc's financial position as at 30 June 2023 and of its performance for the half year ended on that date; and

b complying with accounting principles generally accepted in the United States of America.

Basis for conclusion

We conducted our review in accordance with ASRE 2410 *Review of a Financial Report Performed by the Independent Auditor of the Entity*. Our responsibilities are further described in the Auditor's Responsibilities for the Review of the Financial Report section of our report. We are independent of the Company 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 annual financial report in Australia. We have also fulfilled our other ethical responsibilities in accordance with the Code.

Material uncertainty related to going concern

We draw attention to Note 1 in the financial report, which indicates that the Group incurred a net loss of US$1.8 million during the half year ended 30 June 2023 and, as of that date, the Group had an accumulated deficit of US$33.1 million. As stated in Note 1, these events or conditions, along with other matters as set forth in Note 1, indicate that a material uncertainty exists that may cast significant doubt on the Group's ability to continue as a going concern. Our conclusion is not modified in respect of this matter.

Directors' responsibility for the half-year financial report

The Directors of the Company are responsible for the preparation of the half-year financial report that gives a true and fair view in accordance with accounting principles generally accepted in the United States of America and for such internal control as the Directors determine is necessary to enable the preparation of the half-year financial report that gives a true and fair view and is free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express a conclusion on the half-year financial report based on our review. We conducted our review in accordance with Auditing Standard on Review Engagements ASRE 2410 *Review of a Financial Report Performed by the Independent Auditor of the Entity*, in order to state whether, on the basis of the procedures described, we have become aware of any matter that makes us believe that the half year financial report is not in accordance with accounting principles generally accepted in the United States of America including giving a true and fair view of the Group's financial position as at 30 June 2023 and its performance for the half-year ended on that date.

A review of a half-year financial report consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with Australian Auditing Standards and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Grant Thornton

Grant Thornton Audit Pty Ltd
Chartered Accountants

C F Farley
Partner – Audit & Assurance

Sydney, 31 August 2023