PIVOTAL SYSTEMS

A DELAWARE CORPORATION

ARBN: 626 346 325

# ANNUAL FINANCIAL REPORT FOR THE YEAR ENDED 31 DECEMBER 2022

# Corporate Directory

# Corporate Directory

**Company**
Pivotal Systems Corporation
48389 Fremont Blvd, Suite 100
Fremont CA, 94538 USA
Phone: +1 (510) 770 9125
Fax: +1 (510) 770 9126

Website: www.pivotalsys.com

**Directors**

| | |
|---|---|
| John Hoffman | Executive Chairman |
| Kevin Hill | Executive Director and Chief Executive Officer |
| Ryan Benton | Independent Non-Executive Director |
| Kevin Landis | Non-Executive Director |
| Peter McGregor | Independent Non-Executive Director |
| David Michael | Non-Executive Director |
| Jason Korman | Non-Executive Director |

**Australian Securities Exchange Representative**
Danny Davies

**United States Registered Office**
c/o Incorporating Services Ltd
3500 South Dupont Highway
Dover, Delaware 19901 USA

**Australian Registered Office**
c/o Company Matters Pty Limited
Level 12, 680 George Street
Sydney, NSW 2000 Australia

**United States Legal Adviser**
DLA Piper LLP (US)
**555 Mission Street, Suite 2400**
**San Francisco, California**
**94105-2933, USA**

**Australian Legal Adviser**
Maddocks
Angel Place Level 27
123 Pitt Street
Sydney, NSW 2000 Australia

**Share Registry**

Australian CDI registry
Link Market Services
Level 12, 680 George Street
Sydney, NSW 2000 Australia
Telephone: +61 1300 554 474
Facsimile: +61 2 9287 0303

US share registry
American Stock Transfer and Trust Company, LLC
6201, 15th Avenue
Brooklyn, NY 11219 USA
Telephone: +1 (718) 921 8386

**Securities Exchange Listing**
Pivotal Systems Corporation (ASX code: PVS).
Chess Depository Interests (“CDIs”) over shares of the Company’s common stock are quoted on the Australian Securities Exchange. One CDI represents one fully paid share in the Company.

# Letter from the CEO

Dear Fellow Shareholders,

On behalf of the Board of Directors, I present the Pivotal Systems Annual Report for the year ended 31 December 2022, my first as the Company's CEO.

The 2022 financial year was undoubtedly a challenging one for the Company as we entered an industry cyclical correction and the Semi-Cap component industry slowed down. As a Board, we were disappointed by the performance of the business and the associated material decline in the share price. We are resolute in our focus to restore shareholder value in 2023 through a combination of more focused revenue opportunities, materially reducing the Company's operating costs without impacting our R&D innovation and new product development.

During the year, several changes to the Board and senior management team were made.

I was honored to assume the role of CEO of Pivotal Systems on 1 June 2022, where I previously held the role of COO of the Company since 2020. I have over 25 years of global high technology management experience including senior roles within Apple, Applied Materials, IBM, Flextronics and Collins Aerospace.

Dr. Joseph Monkowski, Pivotal's President and Chief Technology Officer (CTO) retired from the Board of Directors following the Company's 2022 Annual General Meeting. Dr Monkowski continues as President and CTO. We thank Joe for his years of dedicated service as a Board member.

On 31 December 2022, Mr John Hoffman, Pivotal's Executive Chairman and former CEO, retired from the Company. On behalf of the Board of Directors of Pivotal and our staff and customers, we express our sincere thanks and gratitude to John for his many years of dedicated service to the Company as CEO and Executive Chairman since joining the Company in 2010. We wish John all the very best in his retirement.

During the year, our installed base of gas flow controllers (GFCs) was 73,000 units across the globe. Revenues were down significantly during the year as the cyclical cycle went from a slowdown in chip manufacture by Integrated Device Manufacturers, and cascaded upstream to Pivotal. The Semi supply chain are still in a period of uncertainty as our Original Equipment Manufacturers (OEMs) rebalanced their inventory. The lower customer demand is expected to continue with the Company's revenue anticipated to be significantly impacted into the first half of 2023. However, we are anticipating a much improved second half of 2023. During industry downturns, it is important to qualify products with new customers to ensure any pick up in demand translates to product sales for the Company, and Pivotal remains keenly focused on new qualifications.

During 2022, the Company also experienced COVID-19 related supply shortages, particularly PCBA components. PCBA component shortages had to levels of impact, first was availability and second was mark-up contributing to increased pressure on our cost of goods and therefore gross profits. Our margins were also materially impacted by inflationary pressures throughout the supply chain, with cost increases affecting semi-grade metal as well as sub-systems such as pressure transducers and piezo assemblies.

Despite these short-term headwinds, longer term, the overall WFE sector is anticipated to benefit from billions of dollars in government initiatives progressively announced through 2021 and into 2022, to expand domestic chip manufacturing capacity in Europe, Japan, China, South Korea and the United States. Indeed, in August 2022 the US government signed into law the US$52 billion CHIPS Act, which will provide funding, certain tax relief and other incentives to companies looking to manufacture semiconductors in the US. Front end equipment typically comprises in the range of 45-55% of the total capital investment into a new production facility.

During the year, our production capacity remained at approximately 4,000 units per month with Pivotal using a completely outsourced contract manufacturing service for mass production.

## Letter from the CEO

As a technology leader in its segment, Pivotal is well-positioned to capitalize on market share gains at any point in the cycle as the GFC accuracy and reliability is an enabler for advanced technology, and the digital self-calibrating device design is an enabler for cost and productivity gains at the IDM.

We did continue to make solid progress with our customers in 2022. Our Atomic Layer Deposition product development with the leading Japanese OEM continued to progress well, with additional (and successful) qualifications for Pivotal products at a leading Korean and North American IDMs.

We are committed to the ASX for the foreseeable future. The delisting announced last February 14th is no longer being considered. The Company's parallel strategic review process, led by Needham & Co, reveals multiple indications of interest in the Company from strategic investors, but there is no certainty to any particular outcome, and the Company sees strong potential to continue its current independent path, as a result of our new growth strategy and the equity raising that is currently in progress.

Finally, on behalf of our Board of Directors, I would like to thank the Pivotal team for their commitment and diligence during a difficult year for the business with numerous operational challenges to overcome to ensure the Company was able to meet or exceed all of our customer requirements.

I would also like to thank our shareholders for their continued patience and support of the Company despite the very significant decline in our share price and market capitalization. As a Company, we are committed to preserving our cash, prudently managing our expenditures and delivering long term revenue growth and profitability. We are anticipating an improved business performance in the second half of 2023 as supply chain bottlenecks moderate and the wafer fabrication equipment market outlook improves.

Sincerely,

Kevin Hill

Executive Director and Chief Executive Officer
Pivotal Systems Corporation

30 March 2023 (PT) / 31 March 2023 (AEDT)

# Directors' Report

The directors present their report for Pivotal Systems Corporation ("Pivotal" 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 subsidiaries for the financial year ended 31 December 2022 and the auditor's report thereon.

**DIRECTORS**

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

| | |
|---|---|
| John Hoffman | Executive Chairman and Chief Executive Officer (retired as Chief Executive Officer on 31 May 2022, retired from Board on 31 December 2022) |
| Kevin Hill | Executive Director and Chief Executive Officer (appointed to the Board on 1 June 2022) |
| Ryan Benton | Independent Non-Executive Director |
| Kevin Landis | Non-Executive Director |
| Peter McGregor | Independent Non-Executive Director |
| David Michael | Non-Executive Director |
| Jason Korman | Non-Executive Director |
| Dr. Joseph Monkowski | Executive Director and Chief Technical Officer (retired from the Board on 19 May 2022) |

**PRINCIPAL ACTIVITIES**

Pivotal designs, develops, manufactures and sells high-performance gas flow control products. This includes the Gas Flow Controller ("GFC") family of products and Flow Ratio Controllers ("FRC") for both etch and deposition applications. The Company's proprietary hardware and software utilizes advanced flow intelligence and proprietary algorithms to enable preventative diagnostic capability resulting in the potential for an order of magnitude increase in fab productivity and capital efficiency for existing and future technology nodes.

Pivotal is incorporated in Delaware, United States and has offices in Fremont California, USA (headquarters) and third party contracted manufacturing ("CM") and assembling facilities in Shenzhen, China and Dongtan, South Korea.

**REVIEW OF OPERATIONS AND FINANCIAL RESULTS**

For the full year ending 31 December 2022, the Company recorded revenue of $18.2 million (2021: $29.2 million) which represents a 37.6% decrease driven by a lower demand as customers rebalance their inventory in part due to contraction in industry demand. As a result, gross profit decreased 82.5% (2021: $8.9 million).

Operating expenses for the period were $15.5 million (2021: $16.4 million). These expenses include a 12% decrease in R&D costs ($0.8 million). Selling, general and administrative expenses were relatively flat versus prior year. The Company maintained its focus on inventory management, and careful spending in R&D projects, improving working capital balances. The Company continued to direct manufacturing towards fulfillment of backlog shipments.

Loss from Operations was $14.0 million (2021: $7.5 million), substantially higher than the prior period due to the impact from lower revenues and lower gross profit.

During 2022, Pivotal continued product development and research in three key areas. First, Pivotal's focus on performance, creating an Ultra High Speed (UHS) GFC device capable of settling times 10x faster than any other device available in the industry. Second, Pivotal's R&D team concentrated on software enhancements for advanced digital profile control, with over 70 signals to monitor and custom control ECAT GFC performance. Third, Pivotal partnered with a Korean WFE OEM to develop prototypes for the fastest and most accurate Flow Ratio Control product platform on the market.

Atomic Layer Deposition product development with the leading Japanese OEM continues test and integration on OEM wafer processing equipment, as Pivotal continues to work with this OEM to qualify for volume production.

Standard GFCs are growing market share in deposition applications following successful silane qualification for a major North American Logic IDM, and qualification into critical deposition application with a major North American WFE OEM. These segments are part a deliberate initiative to expand beyond etch applications serving memory, into foundry/logic and deposition segments.

During 2022 the Company continued to experience supply shortages, such as PCBA component shortages which were heavily marked up by distributors, contributing to increased pressure on COGS.

**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 December 31, 2022, the Company had cash of $3.2 million and had an accumulated deficit of $125.9 million.

The Company believes that cash as of December 31, 2022, of $3.2 million, will not be sufficient to fund its planned operations for a period of at least 12 months from the date of the issuance of the accompanying consolidated financial statements. Management expects to incur additional losses in the future to fund its operations and will need to raise additional capital to fully implement its business plan. The Company may raise additional capital through the issuance of equity securities, debt financings or other sources in order to further implement its business plan. However, if such financing is not available when needed and at adequate levels, the Company will need to reevaluate its operating plan and may be required to curtail its business operations.

The Company believes that this raises substantial doubt about its ability to continue as a going concern. The accompanying financial statements have been prepared assuming that the Company will continue as a going concern, which contemplates the realization of assets and the settlement of liabilities and commitments in the normal course of business. The accompanying financial statements do not reflect any adjustments relating to the recoverability and reclassifications of assets and liabilities that might be necessary if the Company is unable to continue as a going concern.

**SIGNIFICANT CHANGES IN THE STATE OF AFFAIRS**

The pandemic kickstarted the supply chain shortage in SEMI, and its extended effects such as new virus outbreaks, labor challenges and geopolitical uncertainties, have fueled it. In 2022, each link of the global supply chain continued to be disrupted, and there are few signs of recovery in the near term. The pandemic also prompted a snap back in growth and demand that was remarkable and unpredictable, causing supply chains to struggle until demand declines to a manageable level and/or capacity and component supply issues are resolved. Commodities initially saw demand drop precipitously with the onset of COVID-19 and the shutdown of factories, but since then, consumer spending has created a V-shaped recovery of the global economy and triggered an unprecedented demand for semiconductors. Now, we face chip/components shortages, increased lead times from analog suppliers and huge price increases. Risk has been elevated all along the semiconductor supply chain.

As a result, the Company has experienced significant cost inflation, including higher material, transportation and energy costs, which negatively impacted its results of operations during the year ended December 31, 2022. We expect cost inflation to continue to have a negative impact on our results of operations in 2023 and possibly beyond. To the extent materials, transportation and energy prices continue to fluctuate, our business and financial results could continue to be materially adversely impacted. We continue to monitor these risks and rely on our increased pricing to our customers, and cost savings programs to help mitigate some of the inflationary pressures.

While the Company has been able to supply its customers on time, revenue was below expectations and receipts from customers dropped commensurately mainly as a result of downstream supply chain issues that negatively affected the customers' ability to produce and sell their product, constraining purchases of GFCs. These customers are forecasting improved demand by the end of 2023, which would result in higher revenues for the Company and better corresponding operating cash flows. In addition, in 2022, the Company has continued to negotiate with key suppliers to mitigate cost disruptions that have impacted the Company's profit margins. Further, the Company has taken steps to reduce operating expenses in both R&D and G&A.

There were no other significant changes in the state of affairs of the Group during the financial year.

**DIVIDENDS**

No dividends were paid or declared during the year ended 31 December 2022 and the Company does not intend to pay any dividends for the year ended 31 December 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.

**ROUNDING OF AMOUNTS**

Unless otherwise stated, amounts in this report have been rounded to the nearest thousand United States Dollars.

**JURISDICTION OF INCORPORATION**

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

**DELAWARE LAW, CERTIFICATE OF INCORPORATION AND BYLAWS**

As a foreign company registered in Australia, the Company is not subject to Chapters 6, 6A, 6B and 6C of the Corporations Act dealing with the acquisition of shares (including substantial shareholdings and takeovers). Under the provisions of Delaware General Corporation Law ("DGCL"), shares are freely transferable subject to restrictions imposed by US federal or state securities laws, by the Company's certificate of incorporation or bylaws, or by an agreement signed with the holders of the shares at issue. The Company's amended and restated certificate of incorporation and bylaws do not impose any specific restrictions on transfer. However, provisions of the DGCL, the Company's Certificate of Incorporation and the Company's Bylaws could make it more difficult to acquire the Company by means of a tender offer (takeover), a proxy contest or otherwise, or to remove incumbent officers and Directors of the Company. These provisions could discourage certain types of coercive takeover practices and takeover bids that the Board may consider inadequate and to encourage persons seeking to acquire control of the Company to first negotiate with the Board. The Company believes that the benefits of increased protection of its ability to negotiate with the proponent of an unfriendly or unsolicited proposal to acquire or restructure the Company outweigh the disadvantages of discouraging takeover or acquisition proposals because, among other things, negotiation of these proposals could result in an improvement of their terms.

Also refer to section 14 of the Additional Shareholder Information section of this Annual Report for further specific details on restrictions to registration of transfers in the Company's Bylaws.

**MATTERS SUBSEQUENT TO THE END OF THE FINANCIAL YEAR**

On 28 March 2023, Pivotal announced an equity raising of 5 for 1 pro-rata accelerated renounceable entitlement offer to raise up to A$7.9 million (US$5.25 million) at A$0.01 per new CDI. Each new CDI/Share issued under the Entitlement Offer will rank equally with existing fully paid ordinary CDIs/Shares on issue.
This equity raising will comprise an accelerated institutional entitlement offer, and a retail entitlement offer to eligible securityholders. Proceeds from the equity raising will be used to fund operations,

working capital and general corporate purposes bringing the company to EBITDA positive run rate by year end 2023 if the full US$5.25 million is raised.

Major shareholders Anzu Partners have committed to take up their full pro-rata entitlement of A$1.4m and major shareholder Viburnum have committed to take a minimum of A$0.5m. Directors and senior management have committed to subscribe for their pro-rata entitlements of A$0.1M and have asked if they can participate in any shortfall. Shareholders and new shortfall investors subscribing for more than US$500,000 each will be entitled to together nominate one new director to the Board on completion of the offer. New institutional US investor has committed to taking up a minimum of US$500k of the shortfall.

The Company has evaluated subsequent events through March 30, 2023, the date these financial statements were available to be issued, and determined that no additional subsequent events had occurred that would require disclosure or recognition in these financial statements.

**LIKELY DEVELOPMENTS AND EXPECTED RESULTS OF OPERATIONS**

The Group's new growth strategy involves focusing the portfolio on higher return on investment (ROI), developing a product roadmap fed by the market as well as technology, and reorganizing the team for disciplined execution to drive profits. This strategy will allow the Company to increase market share and the available market. The Group's growth strategy also includes:

1. Launching two new product platforms to attack competitor weak points;
2. Developing superior products with competitive pricing to penetrate and scale chemical vapor deposition (CVD) applications, doubling the served available market;
3. Enabling sales growth from memory focus to broadly serve all chip segments;
4. Promoting flow control software to accelerate chip manufacturers path to performance and efficiency;
5. Execute path to profit efficiently across sales, research and development, operations, and finance;
6. Obtaining positive operating cash flow by reducing cost of sales, improving vendor base and building optimized design.

**ENVIRONMENTAL REGULATION**

The Group is not subject to any significant environmental regulation under United States of America legislation. The Group is committed to the sustainable management of environmental, health, and safety (EHS) concerns as a core business principle. This includes ensuring compliance with all applicable government standards and regulations and providing a safe and healthy workplace, while reducing our environmental footprint. We integrate health, safety, and environmental considerations into all aspects of our business, including product design and services, to provide productive and responsible solutions by:

- Striving for zero accidents through the application of an EHS Management System.
- Implementing pollution prevention control strategies.
- Committing to continual improvement for our customers, Company, and Group's personnel.

The Board of Directors considers that adequate systems are in place to manage the Group's obligations and is not aware of any breach of environmental requirements as they relate to the Group.

## CORPORATE GOVERNANCE

During FY22, the Company, as a Delaware incorporated corporation listed on the ASX, sought to achieve substantive compliance with the governance recommendations set out in the 'Corporate Governance Principles and Recommendations 4th Edition', published by the ASX Corporate Governance Council (the ASX Principles). The Company's Corporate Governance Statement can be viewed at http://www.pivotalsys.com/investors. The Corporate Governance Statement sets out the extent to which Pivotal has followed the ASX Corporate Governance Council's Recommendations during the year ended 31 December 2022.

## SHARE OPTIONS

Options to acquire shares of Common Stock in the Company were granted during the financial year. The number of options outstanding as at the date of this report, and all other movements in share options, are disclosed in Note 15 to the financial statements.

## SECURITIES ON ISSUE

The Company had the following securities on issue as at 31 December 2022:

| | Common Stock | Preferred Stock |
|---|---|---|
| Shares of common stock[1] | 159,503,750 | - |
| Shares of preferred stock (i.e. RBI Preferred Stock) | - | 10,752 |
| Options over shares of common stock | 21,126,463 | - |

[1] Shares of Common Stock are equivalent to 159,503,750 CHESS Depositary Interests.

## INFORMATION ON DIRECTORS

**Kevin Hill** — **Executive Director and Chief Executive Officer (appointed to the Board on 1 June 2022)**

Kevin has over 25 years of global high technology management experience. Before joining Pivotal, Kevin held senior roles within Apple (NASDAQ:AAPL), Applied Materials (NASDAQ:AMAT), IBM (NYSE:IBM), Flextronics (NASDAQ:FLEX), and Collins Aerospace (NYSE:COL). Kevin has a B.S., United States Military Academy at West Point, MSBA Boston University, and is a Certified Product Manager.

*Special responsibilities:* None

*Other directorships:* None

**Ryan Benton** — **Independent Non-Executive Director**

Ryan joined the Board in 2015 bringing over 25 years of finance, operations, and transaction experience. Ryan is the CFO of Tempo Automation and previously served as CFO of Revasum, Inc. (ASX: RVS), BrainChip Holdings Ltd (ASX: BRN) and as CEO and Board Member at Exar Corporation (NYSE: EXAR), which was acquired by MaxLinear Corporation (NASDAQ: MXL) in May 2017. Previous roles included senior and consulting positions at ASM International NV (NASDAQ: ASMI), and eFunds Corporation (NASDAQ: EFDS).

*Special responsibilities:* Chairman of the Audit and Risk Management Committee
Member of the Remuneration and Nomination Committee

*Other directorships*: Non-executive director - Revasum, Inc. (ASX: RVS) and Tempo Automation Holdings, Inc. (NASDAQ: TMPO)

**Kevin Landis** **Non-Executive Director**

Kevin joined the Board in 2012 and is the CEO and CIO of Firsthand Capital Management, an investment management firm he founded in 1994. Firsthand Capital Management is the investment adviser to Firsthand Technology Value Fund, Inc. (NASDAQ: SVVC), a publicly traded venture capital fund. Kevin has over two decades of experience in engineering, market research, product management and investing in the technology sector. Kevin is Firsthand's nominee director to the board of Pivotal Systems Corporation.

*Special responsibilities:* Member of the Audit and Risk Management Committee
Member of the Remuneration and Nomination Committee

*Other directorships*: Non-executive director - Revasum, Inc. (ASX: RVS), Hera Systems, Inc., IntraOp Medical Corp., QMAT, Inc. and Silicon Genesis Corp. and Wrightspeed, Inc.

**David Michael** **Non-Executive Director**

David Michael is Managing Director at Anzu Partners, an investment partnership which invests in innovative industrial technology companies. In addition to his role at Pivotal Systems, he is also Board member of Nuburu (industrial lasers), and Terapore (nanofiltration membranes for ultrapure water and other applications.

Mr. Michael was formerly Senior Partner and Managing Director of The Boston Consulting Group (BCG), where his career spanned numerous leadership roles across the firm. He formerly led BCG's Greater China business and their Asia Technology Practice. He served a range of clients in semiconductors, components, hardware, software, and services. He was based for 7 years in Silicon Valley and for 16 years in Greater China. He remains a Senior Advisor to the firm.

*Special responsibilities:* Member of the Audit and Risk Management Committee
Member of the Remuneration and Nomination Committee

*Other directorships:* Non-executive director - Taiwan Cement Corporation (XTAI:1101), Nuburu, Axsun, and Terapore

**Peter McGregor** **Independent Non-Executive Director**

Peter McGregor was appointed a non-executive director on 23 August 2018 and has over 30 years' experience in senior finance and management roles, including having been Chief Executive Officer of technology company, Think Holdings, Chief Financial Officer of the ASX50 transport company, Asciano, and a partner in the Investment Banking firm of Goldman Sachs JBWere.

He also spent time as a Managing Director within the Institutional Banking & Markets division of Commonwealth Bank and was Chief Operating Officer of ASX-listed Australian Infrastructure Fund. Peter is an experienced company Director, having served as Chairman of the Port of Geelong and as a Director of Melbourne, Gold Coast and Darwin Airports.

*Special responsibilities:* Chairman of the Remuneration and Nomination Committee
Member of the Audit and Risk Management Committee

*Other directorships:* Non-executive Director - Imricor Medical Systems, Inc.

**Jason Korman** **Non-Executive Director**

Jason Korman was appointed a non-executive director on 6 December 2021. Jason is a Partner at Viburnum Funds, an Australian-based active ownership investment management firm and a major shareholder of Pivotal with a 16.4% stake in the Company.

Jason has over 10 years' experience in private equity and investment management across Australia, Singapore and the USA at BGH Capital, Argand Partners and CHAMP Private Equity. He has been involved in numerous investments, exits and financings across a range of sectors including technology, education, manufacturing, chemicals and general industrial. Prior to this, Jason worked in investment banking at Credit Suisse.

*Special responsibilities:* None

*Other directorships:* None

**John Hoffman** **Executive Chairman and Chief Executive Officer (retired as Chief Executive Officer on 31 May 2022, retired from Board on 31 December 2022)**

John Hoffman has over 30 years of global high technology management experience building growth organizations in both the semiconductor and information technology markets.

Prior to joining Pivotal Systems, John was a Senior VP with Spencer Trask Ventures, a New York based venture capital firm. While at Spencer Trask, John was primarily involved in the solar and integrated circuit efforts of the firm. Prior to Spencer Trask, John was the Chief Executive Officer of RagingWire Enterprise Solutions, an Inc 500 fastest growing private company. John reorganized the company and enabled record growth in revenue and profitability during his tenure. Prior to RagingWire, John worked in various general manager roles at Applied Materials for 18 years. He was the President of the billion dollar "Etch Product Business Group", VP and GM of the Process Control and Diagnostic Business Group and the General Manager of the Customer Service Division which grew by over 300% during his tenure.

*Special responsibilities:* None

*Other directorships:* None

**Dr. Joseph Monkowski** **Executive Director and Chief Technical Officer (retired from the Board on 31 May 2022)**

Joseph Monkowski has extensive experience in the semiconductor industry focused on providing process equipment and metrology solutions for next generation device manufacturing.

Prior to joining Pivotal, Joseph was the SVP of Business Development for Advanced Energy Industries, where he led the company's M&A strategy to expand its product portfolio and position the company as a market leader in the semiconductor subsystems space. Previously, he held senior executive positions at Pacific Scientific, Photon Dynamics and Lam Research, where he served as EVP and CTO. During his career, Monkowski led efforts to design and build a number of leading CVD and plasma etch systems, winning the R&D 100 award and multiple Semiconductor International Best Product awards. He has authored numerous patents and publications.

*Special responsibilities:* None

*Other directorships:* None

# Directors’ Report

**SECURITIES HELD BY DIRECTORS AND KEY MANAGEMENT PERSONNEL**

The directors and key management personnel of the Company are shown together with their holdings of shares of common stock and options, held directly or indirectly as at 31 December 2022:

| | Common Stock | Options | Common Stock | Options |
|---|---|---|---|---|
| | Direct | | Indirect | |
| John Hoffman (retired as a Director on 31 December 2022) | 1,853,568 | 4,584,083 | - | - |
| Dr. Joseph Monkowski (retired as a Director on 19 May 2022) | 1,786,646 | 4,382,490 | - | - |
| Kevin Hill | - | 1,440,000 | | |
| Ryan Benton | 195,000 | 301,000 | - | - |
| Kevin Landis | - | - | - | - |
| David Michael | - | - | - | - |
| Peter McGregor | 100,000- | 200,000 | - | - |
| Jason Korman | - | - | - | - |
| Ron Warrington | - | 1,500,000 | - | - |
| | **3,835,214** | **12,407,573** | **-** | **-** |

**REMUNERATION REPORT**

***EXECUTIVE COMPENSATION***

This section discusses the principles underlying our policies and decisions with respect to the compensation of our named executive officers, and all material factors relevant to an analysis of these policies and decisions. Our named executive officers for the year ended 31 December 2022 were:

| | |
|---|---|
| John Hoffman | Executive Chairman (retired as a Director on 31 December 2022) |
| Kevin Hill | Chief Executive Officer and Executive Director |
| Dr Joseph Monkowski | President, Executive Director and Chief Technical Officer (retired as a Director on 19 May 2022) |
| Ron Warrington | Chief Financial Officer |

***COMPONENTS OF EXECUTIVE COMPENSATION***

The principal components of our executive compensation are base salary, cash bonuses under the Senior Executive Remuneration Scheme, and long-term incentives. Our Remuneration and Nomination Committee considers that each component of executive compensation must be evaluated and determined with reference to competitive market data, individual and corporate performance, our recruiting and retention goals and other information we deem relevant.

Our executive officers are also eligible to participate in our 401(k)-retirement plan as well as medical and other benefit plans.

The terms of each named executive officer’s compensation are derived from the employment agreements the Company has entered into with them.

**Senior Executive Remuneration Scheme 2020 – 2022**

Mr. Hoffman and Dr. Monkowski each were eligible to receive cash bonuses pursuant to the Senior Executive Incentive Remuneration Scheme 2020-2022 (the “Bonus Plan”), which was adopted on June 23, 2020. The purpose of the Bonus Plan is to motivate and reward the eligible senior leadership team for their contributions toward the achievement of certain performance goals.

Administration

The Bonus Plan is administered by the Remuneration and Nomination Committee (the “Committee”), which has the discretionary authority to interpret the provisions of the Bonus Plan, including all decisions on eligibility to participate, the establishment of performance goals and the payment of awards.

Performance criteria

Cash bonus targets and corporate performance metrics for specific short-term and long-term performance periods pursuant to the Bonus Plan are established by the Committee. The Bonus Plan consists of the Short-Term Incentive Program and the Long-Term Incentive Program.

Short Term Incentive Program

Potential bonuses may be paid to Mr. Hoffman, Dr. Monkowski and other members of the senior leadership team selected by the Committee of up to 50% of base salary if key performance milestones are met by the end of the fiscal year. The key performance milestones include financial and business development goals. A portion of the short-term incentive bonus may also be based upon the discretion of our board of directors.

Long-Term Incentive Program

Potential bonuses may be paid to Mr. Hoffman, Dr. Monkowski and other members of the senior leadership team selected by the Committee subject to satisfaction of various performance hurdles, including: (i) our company achieving certain EBITDA targets for each of fiscal year 2020 to fiscal year 2022; (ii) our company achieving a market capitalization and share price target at the end of fiscal year 2022; and (iii) our company closing a change of control transaction at or above the target share price. Determination of the satisfaction of the performance hurdles will be made by the Committee in the first quarter of fiscal year 2023 unless a change of control event occurs on an earlier date. The maximum bonus pool payable under the Long Term Incentive Program is $10 million, with 60% of the actual bonus pool payable to Mr. Hoffman, Dr. Monkowski and other members of the senior leadership team selected by the Committee.

No Tax Gross-Ups

We do not make gross-up payments to cover our named executive officers’ personal income taxes that may pertain to any of the compensation paid or provided by us.

***EXECUTIVE COMPENSATION PACKAGES FOR 2022***

The components of the executive compensation packages for our named executive officers for the year ended 31 December 2022 are as follows:

*John Hoffman* *Executive Chairman*

Mr. Hoffman received a fixed remuneration of $225,000 and was eligible to participate in various customary employee benefit plans of Pivotal. Mr. Hoffman retired on 31 December 2022.

*Kevin Hill* *Chief Executive Officer* and Executive Director

Mr. Hill receives a fixed remuneration package of $360,000 and is eligible to participate in various customary employee benefit plans of Pivotal. Mr. Hill is entitled to the annual performance bonus at a target level of 50% of fixed remuneration at the end of the relevant calendar year. Payment is based on performance criteria determined by the Board. All of Mr. Hill’s unvested Options are subject to acceleration of vesting upon a change of control of the Company, and certain of his Options vest only subject to achievement of specified performance metrics and a time-based vesting schedule.

*Dr. Joseph Monkowski* *President, Chief Technical Officer*

Dr. Monkowski receives a fixed remuneration package of $325,000 and is eligible to participate in various customary employee benefit plans of Pivotal. Pursuant to Dr. Monkowski’s Retention Agreement, dated 11 May 2018, if Dr. Monkowski is terminated by the Company without cause or if he resigns for good reason and Mr. Hoffman signs a general release of claims in favor of the Company and complies with certain other requirements, the Company must pay Dr. Monkowski severance in an amount equal to twelve months of his base salary, twelve months of health insurance cover and 100% of his annual target bonus for the period in which termination occurs. All of Dr. Monkowski’s unvested Options are subject to acceleration of vesting upon a change of control of the Company, and certain of his Options vest only subject to achievement of specified performance metrics and a time-based vesting schedule.

Ron Warrington *Chief Financial Officer*

Mr. Warrington receives an annual base salary of $275,000 and is eligible to participate in various customary employee benefit plans of Pivotal. Under the terms of his offer of employment in August 2021, Mr. Warrington received an award of options to purchase up to 1,000,000 shares of our common stock and may receive a target bonus 45% of his base salary, subject to review and approval by the board of directors. In addition, all of his Options vest subject to a time-based vesting schedule, all of his unvested Options are subject to acceleration of vesting upon a change of control of the Company and certain of his Options vest only subject to achievement of specified performance metrics and a time-based vesting schedule.

***NON-EXECUTIVE COMPENSATION***

The Board is responsible for determining and reviewing compensation arrangements for each non-executive director. The non-executive directors for the year ended 31 December 2022 were as follows:

Ryan Benton
Kevin Landis
David Michael
Peter McGregor
Jason Korman

The Company has entered into a non-executive director agreement with Mr. Benton whereby he is entitled to receive $70,000 per annum for his role as a non-executive director, and a further $15,000 per annum as chair of the Audit and Risk Committee. The Company has also entered into a non-executive director agreement with Mr. McGregor whereby he is entitled to receive $70,000 per annum as a non-executive director, and a further $15,000 per annum as chair of the Remuneration and Nomination Committee. Mr. Landis, Mr. Michael and Mr. Korman do not receive compensation for their services as a non-executive director.

***REMUNERATION TABLE***

Remuneration earned by key management personnel during 2021 and 2022 is summarized as follows:

| **2021** | **Salary and Fees $** | **Bonus (1) $** | **401k & other Benefits $** | **Share based compensation $** | **Total $** |
|---|---|---|---|---|---|
| John Hoffman (retired as a Director on 31 December 2022) | 375,000 | 93,750 | 28,965 | 194,675 | 692,390 |
| Joseph Monkowski (retired as a Director on 19 May 2022) | 325,000 | 48,750 | 29,037 | 194,675 | 597,462 |
| Ryan Benton | 85,000 | - | - | 6,016 | 91,016 |
| Kevin Landis | - | - | - | - | - |
| David Michael | - | - | - | - | - |
| Peter McGregor | 85,000 | - | - | 22,222 | 107,222 |
| Jason Korman | - | - | - | - | - |
| Ron Warrington | 93,576 | 27,500 | 6,752 | 33,217 | 162,045 |
| Dennis Mahoney | 158,567 | - | 1,000 | 79,914 | 239,481 |
| Michael Bohn | 201,667 | 21,500 | 33,838 | 21,239 | 278,244 |
| | 1,323,810 | 191,500 | 99,592 | 551,958 | 2,166,860 |

| 2022 | Salary and Fees $ | Bonus (1) $ | 401k & other Benefits $ | Share based compensation $ | Total $ |
|---|---|---|---|---|---|
| John Hoffman (retired as a Director on 31 December 2022) | 225,000 | - | 29,736 | 90,159 | 344,895 |
| Joseph Monkowski (retired as a Director on 19 May 2022) | 325,000 | - | 31,670 | 74,307 | 430,977 |
| Kevin Hill | 360,000 | | 46,320 | 96,641 | 502,961 |
| Ryan Benton | 85,000 | - | - | 12,376 | 97,376 |
| Kevin Landis | - | - | - | - | - |
| David Michael | - | - | - | - | - |
| Peter McGregor | 77,500 | - | - | 17,036 | 94,536 |
| Jason Korman | - | - | - | - | - |
| Ron Warrington | 275,000 | - | 22,324 | 126,258 | 423,582 |
| | 1,347,500 | - | 130,050 | 416,777 | 1,894,327 |

(1) The 2021 Bonus was awarded and paid in March 2022. In 2022 there were no bonuses awarded.

END OF REMUNERATION REPORT

# Directors' Report

**MEETINGS ATTENDED BY BOARD**

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

| | Board of Directors | | Audit & Risk Management Committee | | Remuneration & Nomination Committee | |
|---|---|---|---|---|---|---|
| | **Eligible** | **Attendance** | **Eligible** | **Attendance** | **Eligible** | **Attendance** |
| John Hoffman | 28 | 28 | - | - | - | - |
| Joseph Monkowski | 16 | 16 | - | - | - | - |
| Kevin Hill | 12 | 12 | | | | |
| Ryan Benton | 28 | 25 | 6 | 6 | 2 | 2 |
| Kevin Landis | 28 | 22 | 6 | 6 | 2 | 2 |
| David Michael | 28 | 27 | 6 | 6 | 2 | 2 |
| Peter McGregor | 28 | 28 | 6 | 6 | 2 | 2 |
| Jason Korman | 28 | 24 | - | - | - | - |

**INDEMNITY AND INSURANCE OF DIRECTORS AND OFFICERS**

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

**INDEMNITY AND INSURANCE OF AUDITOR**

The Company has not, during or since the end of the financial year, indemnified or agreed to indemnify the auditor of the Company or any related entity against a liability incurred by the auditor.

During the financial year, the Company has not paid a premium in respect of a contract to insure the auditor of the Company or any related entity.

**NON-AUDIT SERVICES**

Details of amounts paid or payable to the auditor for non-audit services provided during the year are Nil.

**PROCEEDINGS ON BEHALF OF THE COMPANY**

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

On behalf of the directors

Kevin Hill
Director and Chief Executive Officer

30 March 2023 (Fremont PST), 31 March 2023 (Sydney AEDT)

## PIVOTAL SYSTEMS CORPORATION

## CONSOLIDATED BALANCE SHEETS
### (in thousands, except share and per share amounts)

| | December 31, 2021 | December 31, 2022 |
|---|---|---|
| **Assets** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 3,988 | $ 3,213 |
| Trade accounts receivable | 9,008 | 5,788 |
| Inventories | 6,857 | 7,410 |
| Prepaid expenses | 332 | 377 |
| Other current assets | 127 | 298 |
| Total current assets | 20,312 | 17,086 |
| Property, plant and equipment, net | 336 | 197 |
| Right of use assets, net | 697 | 420 |
| Other assets | 558 | 215 |
| Total assets | $ 21,903 | $ 17,918 |
| **Liabilities, Redeemable Preferred Stock and Stockholders' Equity** | | |
| Current liabilities: | | |
| Trade accounts payable | $ 3,770 | $ 4,020 |
| Accrued expenses | 880 | 1,143 |
| Current portion of long-term debt | 808 | 1,130 |
| Current portion of operating lease liabilities | 294 | 327 |
| Other current liabilities | 276 | 444 |
| Total current liabilities | 6,028 | 7,064 |
| Operating lease liabilities, less current portion | 473 | 146 |
| Other liabilities | 253 | 113 |
| Total liabilities | 6,754 | 7,323 |
| Redeemable preferred stock, par value $0.00001 per share, 13,000 shares authorized as of December 31, 2021 and 2022, 11,528 and 10,752 shares outstanding as of December 31, 2021 and December 31, 2022; aggregate liquidation preference of $14,260 and $15,378 as of December 31, 2021 and December 31, 2022 | 11,319 | 10,543 |
| Stockholders' equity: | | |
| Common stock, $0.00001 par value; 250,000,000 shares authorized as of December 31, 2021 and December 31, 2022; 128,546,316 and 159,503,750 shares issued and outstanding as of December 31, 2021 and December 31, 2022 | 1 | 1 |
| Common prime stock, $0.00001 par value; 120,000,000 shares authorized as of December 31, 2021 and December 31, 2022; no shares issued and outstanding as of December 31, 2021 and December 31, 2022 | — | — |
| Additional paid-in capital | 115,630 | 125,977 |
| Accumulated deficit | (111,801) | (125,926) |
| Total stockholders' equity | 3,830 | 52 |
| Total liabilities, redeemable preferred stock and stockholders' equity | $ 21,903 | $ 17,918 |

The accompanying notes are an integral part of these consolidated financial statements.

## PIVOTAL SYSTEMS CORPORATION

### CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except share and per share amounts)

| | Year Ended December 31, 2021 | Year Ended December 31, 2022 |
|---|---|---|
| Net product revenue | $ 27,652 | $ 17,029 |
| Service revenue | 1,593 | 1,214 |
| Total net revenue | 29,245 | 18,243 |
| Cost of goods sold | 19,405 | 15,992 |
| Cost of service revenue | 939 | 697 |
| Total costs of goods and service revenue | 20,344 | 16,689 |
| Gross profit | 8,901 | 1,554 |
| Operating expenses: | | |
| Research and development | 6,533 | 5,743 |
| Selling, general and administrative | 9,829 | 9,794 |
| Total operating expenses | 16,362 | 15,537 |
| Loss from operations | (7,461) | (13,983) |
| Other income (expense): | | |
| Interest expense | (120) | (71) |
| Foreign currency transaction loss | (12) | (35) |
| Gain on forgiveness of PPP loan | 906 | — |
| Other expense, net | (144) | (1) |
| Other income (expense) | 630 | (107) |
| Loss before provision for income taxes | (6,831) | (14,090) |
| Provision for income taxes | 48 | 35 |
| Net loss | $ (6,879) | $ (14,125) |
| Less deemed dividend to redeemable preferred stockholders | (368) | (388) |
| Net loss attributable to common stockholders, basic and diluted | $ (7,247) | $ (14,513) |
| Net loss per share attributable to common stockholders, basic and diluted | $ (0.06) | $ (0.09) |
| Weighted average common shares outstanding | 123,711,465 | 155,059,607 |

The accompanying notes are an integral part of these consolidated financial statements.

**PIVOTAL SYSTEMS CORPORATION**

**CONSOLIDATED STATEMENTS OF REDEEMABLE PREFERRED STOCK AND STOCKHOLDERS' EQUITY**
**(in thousands, except share amounts)**

| | Redeemable Preferred Stock | | Common Stock | | Additional Paid-In Capital | Accumulated Deficit | Total Stockholders' Equity |
|---|---|---|---|---|---|---|---|
| | Shares | Amount | Shares | Par Value | | | |
| Balance at December 31, 2020 .. | 10,000 | $ 9,795 | 120,240,769 | $ 1 | $ 108,241 | $ (104,922) | $ 3,320 |
| Proceeds from the sale of redeemable preferred stock, net of issuance costs of $4 ........ | 3,000 | 2,996 | — | — | — | — | — |
| Issuance of shares upon institutional placement, net of issuance costs of $184 ... | — | — | 7,137,795 | — | 6,502 | — | 6,502 |
| Issuance of common stock upon stock options exercise | — | — | 1,167,752 | — | 293 | — | 293 |
| Redeemable preferred stock redemptions ................. | (1,472) | (1,472) | — | — | (368) | — | (368) |
| Stock-based compensation .... | — | — | — | — | 962 | — | 962 |
| Net loss ......................... | — | — | — | — | — | (6,879) | (6,879) |
| Balance at December 31, 2021 . | 11,528 | 11,319 | 128,546,316 | 1 | 115,630 | (111,801)) | 3,830 |
| Issuance of shares upon funding-rights offering, net of issuance costs of $703 .... | — | — | 30,317,527 | — | 9,911 | — | 9,911 |
| Issuance of common stock upon stock options exercise | — | — | 639,907 | — | 117 | — | 117 |
| Redeemable preferred stock redemptions ................. | (776) | (776) | — | — | (388) | — | (388) |
| Stock-based compensation ... | — | — | — | — | 707 | — | 707 |
| Net loss ......................... | — | — | — | — | — | (14,125) | (14,125) |
| Balance at December 31, 2022 . | 10,752 | $ 10,543 | 159,503,750 | $ 1 | $ 125,977 | $ (125,926) | $ 52 |

The accompanying notes are an integral part of these consolidated financial statements

**PIVOTAL SYSTEMS CORPORATION**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**
**(in thousands)**

| | Year Ended December 31, | |
|---|---|---|
| | **2021** | **2022** |
| **Cash Flows from Operating Activities** | | |
| Net loss | $ (6,879) | $ (14,125) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation and amortization | 366 | 228 |
| Non-cash lease expense | 257 | 276 |
| Stock-based compensation | 962 | 707 |
| Gain on forgiveness of PPP loan | (906) | — |
| Gain on sale of property, plant and equipment | (56) | — |
| Write off of deferred offering costs | 2,190 | — |
| Changes in operating assets and liabilities: | | |
| Trade accounts receivable | (2,246) | 3,220 |
| Inventories | (40) | (553) |
| Prepaid expenses | (18) | (45) |
| Other current assets | 34 | (171) |
| Other assets | 56 | 343 |
| Trade accounts payable | 505 | 417 |
| Accrued expenses | (1,717) | 263 |
| Other liabilities | (538) | 28 |
| Operating lease liabilities | (264) | (294) |
| **Net cash used in operating activities** | (8,294) | (9,706) |
| **Cash Flows from Investing Activities** | | |
| Purchase of property, plant and equipment | (185) | (72) |
| **Net cash used in investing activities** | (185) | (72) |
| **Cash Flows from Financing Activities** | | |
| Proceeds from borrowings on long-term-debt | — | 1,500 |
| Payments on borrowings of long-term-debt | (1,000) | (1,195) |
| Proceeds from the exercise of stock options | 293 | 117 |
| Proceeds from the issuance of common stock, net of issuance costs | 6,502 | 9,911 |
| Proceeds from issuance of redeemable preferred stock, net of issuance costs | 2,996 | — |
| Payments on redemption of preferred stock | (1,840) | (1,164) |

| | | | | |
|---|---|---|---|---|
| Payment of deferred offering costs | | (2,023) | | (167) |
| **Net cash provided by financing activities** | | 4,928 | | 9,002 |
| Net decrease in cash and cash equivalents | | (3,551) | | (776) |
| Cash and cash equivalents at beginning of year | | 7,539 | | 3,988 |
| Cash and cash equivalents at end of year | $ | 3,988 | $ | 3,213 |
| **Supplemental disclosures of cash flow information:** | | | | |
| Cash paid for income taxes | $ | 49 | $ | 35 |
| Cash paid for interest | $ | 96 | $ | 53 |
| **Non-cash investing and financing activities:** | | | | |
| Purchases of property, plant, and equipment in accounts payable | $ | 9 | $ | — |
| Deferred issuance costs in accounts payable | $ | 167 | $ | — |
| Gain of forgiveness of PPP loan | $ | 906 | $ | — |
| Disposal of property, plant and equipment in exchange for note receivable | $ | 278 | $ | — |

The accompanying notes are an integral part of these consolidated financial statements.

## PIVOTAL SYSTEMS CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 1. Nature of the Business and Basis of Presentation

Pivotal Systems Corporation, together with its consolidated subsidiary (the Company), designs, develops and manufactures flow monitoring and control technology products for the global semiconductor industry. The Company's proprietary hardware and software utilizes advanced machine learning to enable preventative diagnostic capability resulting in an order of magnitude increase in fab productivity and capital efficiency technology nodes. The Company is incorporated in Delaware, United States and has offices in Fremont, California, USA (headquarters) and third party contracted manufacturing and assembling facilities in Shenzhen, China and Dongtan, South Korea.

The Company's securities have been listed for quotation in the form of CHESS Depositary Interests, or CDIs, on the Australian Securities Exchange (the ASX) and trade under the symbol PVS since July 2, 2018. Legal title to the shares of common stock underlying the CDIs is held by CHESS Depositary Nominees Pty Ltd (CDN), a wholly owned subsidiary of the ASX. One CDI represents the beneficial interest in one share of common stock.

#### *Liquidity and 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 December 31, 2022, the Company had cash of $3.2 million and had an accumulated deficit of $125.9 million.

The Company believes that cash as of December 31, 2022, of $3.2 million, will not be sufficient to fund its planned operations for a period of at least 12 months from the date of the issuance of the accompanying consolidated financial statements. Management expects to incur additional losses in the future to fund its operations and will need to raise additional capital to fully implement its business plan. The Company may raise additional capital through the issuance of equity securities, debt financings or other sources in order to further implement its business plan. However, if such financing is not available when needed and at adequate levels, the Company will need to reevaluate its operating plan and may be required to curtail its business operations.

The Company believes that this raises substantial doubt about its ability to continue as a going concern. The accompanying financial statements have been prepared assuming that the Company will continue as a going concern, which contemplates the realization of assets and the settlement of liabilities and commitments in the normal course of business. The accompanying financial statements do not reflect any adjustments relating to the recoverability and reclassifications of assets and liabilities that might be necessary if the Company is unable to continue as a going concern.

### 2. Summary of Significant Accounting Policies

#### *Basis of presentation and consolidation*

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (U.S. GAAP) and include the accounts and results of operations of the Company and its wholly owned subsidiary. All intercompany balances and transactions have been eliminated in consolidation.

#### *Use of Estimates*

The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, and disclosures of contingencies at the date of the consolidated financial statements and the reported amounts of net revenue and expenses during the reporting period. Such estimates relate to revenue recognition, the useful lives of fixed assets, leases, allowances for doubtful accounts. Such estimates also relate to the net realizable value of inventory, accrued liabilities, the valuation of stock-based awards, deferred tax valuation allowances, and other reserves. On an ongoing basis, the Company evaluates its estimates. Actual results could differ from those estimates, and such differences may be material to the consolidated financial statements.

***Business Segment Information***

The Company operates in one segment which involves the technological design, development, manufacture, and sale of high-performance flow controllers. All the activities of the Company are interrelated, and each activity is dependent on the others. Accordingly, all significant operating disclosures are based upon analysis of the Company as one segment. The financial results of this segment are equivalent to the financial statements of the Company as a whole.

The chief operating decision maker, who is the Company's chief executive officer, measures financial performance as a single enterprise and not on legal entity or end market basis. Throughout the year, the chief operating decision maker allocates capital resources on a project-by-project basis across the Company's entire asset base to maximize profitability without regard to legal entity or end market basis.

***Foreign Currency***

Transactions in foreign currencies are initially recorded by the Company's entities at their respective functional currency spot rates at the date the transaction first qualifies for recognition. Monetary assets and liabilities denominated in foreign currencies are translated at the functional currency spot rates of exchange at the reporting date. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates at the dates of the initial transactions. Exchange differences arising on the remeasurement of monetary items are recognized in the consolidated statements of operations.

***Credit Risk and Concentrations***

Financial instruments that potentially subject the Company to a concentration of credit risk consist principally of cash and accounts receivable.

The Company places its cash in high credit quality financial institutions. Substantially all of the Company's cash is held at one financial institution that management believes is of high credit quality. Such deposits may, at times, exceed federally insured limits. In general, the Company's customers are not required to provide collateral or any other security to support accounts receivable. The Company performs ongoing credit evaluations of its customers and maintain an allowance for estimated credit losses. Bad debt expense was immaterial for the year ended December 31, 2021. For the year ended December 31, 2022, bad debt expense was $400,000.

***Deferred offering costs***

The Company capitalizes certain legal, professional accounting and other third-party fees that are directly associated with in-process equity financings as deferred offering costs, until such financings are consummated. After consummation of an equity financing, these costs are recorded as a reduction of the proceeds from the offering, either as a reduction to the carrying value of the preferred stock or in stockholder's deficit as a reduction of additional paid-in capital generated as a result of the offering. In December 2021 the Company wrote off $2,190,000 in deferred offering costs, due to delays and uncertainties around the Company's public listing in the United States. These expenditures were included in selling, general and administrative expenses in the statement of operations. No such costs were incurred in 2022.

***Fair Value of Financial Instruments***

Certain assets and liabilities are carried at fair value under U.S. GAAP. Fair value is the exchange price that would be received for an asset or paid to transfer a liability (at exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The Company establishes a fair value hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value, which are provided below:

*Level 1 – Quoted* prices in active markets for identical assets or liabilities.

*Level 2 — Observable* inputs (other than Level 1 prices) such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

*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. Assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or examination.

The categorization of a financial instrument within the valuation hierarchy is based on the lowest level of input that is significant to the fair value measurement.

The carrying value of accounts receivable, accounts payable and accrued expenses approximate their respective fair value due to the short-term nature of these assets and liabilities. The carrying value of the term loan and outstanding borrowings under the line of credit agreement approximate fair value as they bear interest at a rate approximating a market interest rate.

***Cash and cash equivalents***

The Company considers all highly liquid investments with an original maturity date of three months or less at the date of purchase to be cash equivalents. Cash is maintained at financial institutions. The Company maintains all cash in a highly liquid form to meet current obligations.

***Trade accounts receivable, net***

A receivable is a right to consideration that is unconditional (i.e., only the passage of time is required before payment is due). Accounts receivables are presented net of an allowance for doubtful accounts, which is an estimate of amounts that may not be collectible.

The Company manages the collectability of accounts receivable primarily through its review of the accounts receivable aging. When facts and circumstances dictate the collection of a specific invoice amount or the balance relating to a customer is in doubt, the Company assesses the impact on amounts recorded for doubtful accounts and, if necessary, records a charge in the fiscal period that such assessment is determined. Adjustments to the allowance for doubtful accounts are recorded as selling, general and administrative expenses in the consolidated statements of operations. Account balances are written off after all means of collection are exhausted and the potential for non-recovery is determined to be probable.

***Inventories***

Inventories are stated at the lower of cost or net realizable value, with cost being determined on a first-in, first-out basis. The Company records inventory valuation adjustments when conditions exist that suggest that inventory may be more than anticipated demand, is obsolete based upon expected future demand for products and market conditions, or quality related rejections. These valuation adjustments are reported as a reduction to raw materials, work in process and finished goods. The Company regularly evaluates the ability to realize the value of inventory based on a combination of factors, including historical usage rates, forecasted sales or usage, and product end of life dates. Assumptions used in determining management's estimates of future product demand may prove to be incorrect, in which case the Company may need to record additional write offs of inventory. Although the Company performs a detailed review of its forecasts of future product demand, any significant unanticipated changes in demand could have a significant impact on the value of the Company's inventory and reported operating results.

### *Property, Plant and Equipment, Net*

Property, plant and equipment, net, including improvements that significantly add to productive capacity or extend useful life, are stated at historical cost less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets. Maintenance and repairs expenditures are charged to expense as incurred. Estimated useful lives of the respective property, plant and equipment assets are as follows:

| Asset | Useful Life |
|---|---|
| Plant and equipment | 2 – 5 years |
| Furniture and fixtures | 2 – 5 years |
| Computers and equipment | 3 years |
| Software | 2 years |
| Leasehold improvements | The shorter of the remaining term of the lease or estimated useful life |

### *Leases*

The Company accounts for leases in accordance with Accounting Standards Codification (ASC) ASC 842, which requires lessees to recognize leases on-balance sheet and disclose key information about leasing arrangements. ASC 842, *Leases* was adopted as of January 1, 2019. The Company determines if a contract contains a lease based on whether it has the right to obtain substantially all the economic benefits from the use of an identified asset and whether we have the right to direct the use of an identified asset in exchange for consideration, which relates to an asset which the Company does not own. Right-of-use (ROU) assets represent the Company's right to use an underlying asset for the lease term and lease liabilities represent the Company's obligation to make lease payments arising from the lease. ROU assets are recognized as the lease liability, adjusted for lease incentives received and prepayments made. Lease liabilities are recognized at the present value of the future lease payments at the lease commencement date. The interest rate used to determine the present value of the future lease payments is our incremental borrowing rate (IBR) because the interest rate implicit in most of our leases is not readily determinable.

The IBR is a hypothetical rate based on the Company's understanding of what its credit rating would be. Lease payments may be fixed or variable; however, only fixed payments or in-substance fixed payments are included in the Company's lease liability calculation. Variable lease payments are recognized in operating expenses in the period in which the obligation for those payments is incurred.

The ROU asset also includes any initial direct costs and any lease payments made prior to the lease commencement date and is reduced by any lease incentives received. The ROU asset is amortized on a straight-line basis as the operating lease cost over the lease term on the consolidated statements of operations. ROU asset amortization, referred to as non-cash lease expense, along with the change in the operating lease liabilities are separately presented within the cash flows from operating activities on the consolidated statements of cash flows.

### *Impairment of Long-Lived Assets*

Long-lived assets are tested for impairment whenever events or changes in business circumstances indicate that the carrying amount of the assets may not be fully recoverable. Factors that the Company considers in deciding when to perform an impairment review include significant underperformance of the business in relation to expectations, significant negative industry or economic trends and significant changes or planned changes in the use of the assets. If an impairment review is performed to evaluate a long-lived asset for recoverability, the Company compares forecasts of undiscounted cash flows expected to result from the use and eventual disposition of the long-lived asset to its carrying value. If such assets are considered to be impaired, the impairment to be recognized is measured as the amount by which the carrying amount of the assets exceeds the fair value of the assets. To date, the Company has not recorded any impairment losses on long-lived assets. If such assets are not impaired, but their useful lives have decreased, the remaining net book value is amortized over the revised useful life.

***Product Warranties***

The Company provides warranties on its products to its customers, generally for one to three years from the date of shipment. In the event of a failure of a product covered by these warranties, the Company must repair or replace the product or, if those remedies are insufficient, and at the discretion of the Company, provide a refund. The Company periodically assesses the adequacy of the warranty reserve and adjusts the amount as necessary. If there is a material increase in the rate of customer claims, or the Company's estimates of probable losses relating to specifically identified warranty exposures are inaccurate, the Company may need to record a charge against future cost of goods sold. As of December 31, 2021 and 2022, the Company had accrued warranty reserves of $115,000 and $267,000, respectively.

***Redeemable Preferred Stock***

The Company classifies redeemable preferred stock outside of stockholders' equity because, upon the occurrence of certain change in control events that are outside the Company's control, including liquidation, sale or transfer of the Company's assets, or events of default, holders of the redeemable preferred stock can cause redemption for cash. If it becomes probable that the shares will become redeemable, the Company will re-measure the carrying value of the shares to the redemption value through the redemption date. As of December 31, 2021 and 2022, no remeasurements were required, as the Company determined that the shares were not probable of becoming redeemable. The Company analyzed all embedded derivatives and beneficial conversion features for its redeemable preferred stock and concluded that none requires bifurcation.

***Revenue Recognition***

The Company earns revenue from contracts with customers, primarily through the design, development, manufacture and sale of flow controllers. Contracts are priced based on specific negotiations with each customer. The Company records revenue under ASC 606, *Revenue from Contracts with Customers (ASC 606)*.

Under the guidance of ASC 606, revenue is recognized when transfer of control to the customer occurs in an amount reflecting the consideration that the Company expects to be entitled. To achieve this core principle, the Company applies the following five step approach:

(1) *Identify the contract with a customer* — The Company considers distributor or sales representative agreements, together with purchase orders, as well as individual customer purchase orders to be customer contracts. A contract exists when it is approved by both parties, each party's rights and obligations are identified, payment terms are known, customer has the ability and intent to pay and the contract has commercial substance. The Company uses judgement in determining the customer's ability and intent to pay, which is based on factors such as the customer's historical payment experience.

(2) *Identify the performance obligations in the contract* — Performance obligations are identified as products and services that will be transferred to the customer that are both capable of being distinct, whereby the customer can benefit from the product or service either on its own or together with other resources that are readily available from third parties or from the Company, and are distinct in the context of the contract, whereby the transfer of the products or services is separately identifiable from other promises in the contract. Substantially, all the Company's contracts with customers contain single performance obligation, such as the sale of flow controllers.

(3) *Determine the transaction price* — The transaction price is determined based on the consideration to which the Company expects to be entitled in exchange for transferring products to the

customer. The transaction price may include variable consideration. Variable consideration is included in the transaction price if, in the Company's judgment, it is probable that no significant future reversal of cumulative revenue under the contract will occur.

(4) *Allocate the transaction price to the performance obligations in the contract* — If the contract contains a single performance obligation, the entire transaction price is allocated to that performance obligation. Contracts that contain multiple performance obligations require an allocation of the transaction price to each performance obligations based on a relative standalone selling price (SSP). For the periods ended December 31, 2021 and 2022, contracts including multiple performance obligations are infrequent.

(5) *Recognize revenue when a performance obligation is satisfied* — Revenue is recognized when control of the product is transferred to the customer (i.e., when the Company's performance obligation is satisfied), which typically occurs point in time at shipment or when control of a service is transferred. The Company records product sales net of discounts, sales returns and allowances.

*Service revenue*

Service revenue is recognized upon transfer of control of promised services to customers in an amount that reflects the consideration that the Company expects to receive in exchange for those products or services. These services are regularly sold on a stand-alone basis. Contracts that include the provision of services are typically related with repair services, which are generally capable of being distinct and accounted for as separate performance obligations. Repair services are typically sold on a time and materials basis and related revenue is recognized once the repaired product is shipped or delivered to the customer. These services are provided at a point in time.

ASC 606 defines "control" as "the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset." The Company first determines whether control of a service is transferred over time when at least one of the following criteria is met:

- The customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs.
- The entity's performance creates or enhances an asset that the customer controls as the asset is created or enhanced.
- The entity's performance does not create an asset with an alternative use to the entity and the entity has an enforceable right to payment for performance completed to date.

If a performance obligation is satisfied over time, the Company recognizes revenue by measuring progress toward satisfying the performance obligation in a manner that faithfully depicts the transfer of goods or services to the customer. Considering that repair services are generally satisfied when the Company has transferred physical possession of the repaired product, the related revenue is recognized at a point in time.

*Sales channels*

The Company sells products and services primarily in the United States and Asia through its direct sales force, third party distributors and independent sales representatives. When the Company transacts with a distributor, its contractual arrangement is with the distributor and not with the end user. Whether the Company transacts business with and receives the order from a distributor or directly from an end user, its revenue recognition policy and resulting pattern of revenue recognition for the order are the same.

The Company also uses independent sales representatives to assist in the sales process with certain customers. Sales representatives are not distributors. If a sales representative is engaged in the sales process, the Company receives the order directly from and sells the products directly to the end customer. The Company pays a commission to the sales representative, calculated as a percentage of the related customer payment. Sales representatives commissions are recorded as expenses when incurred and are classified as sales and marketing expenses in the Company's consolidated statements of operations.

*Variable consideration*

Variable consideration includes returns for which reserves are established. When applicable, these reserves are based on the amounts earned or claimed on the related sales and are classified as reductions of accounts receivable. Where appropriate, these estimates take into consideration the Company's historical experience, current contractual and statutory requirements, industry data and forecasted customer buying and payment patterns.

*Practical expedients elected*

The Company elected certain practical expedients with the adoption of the new revenue recognition standard. The length of time between revenue recognition and payment is not significant under any of the Company's payment terms. However, if the period between revenue recognition and when the customer pays is one year or less, the Company elected to not account for the significant financing component. In addition, the Company expenses incremental costs of obtaining a contract as and when incurred because the expected amortization period of the asset that the Company would have recognized is one year or less.

*Other Revenue Recognition Policies*

Shipping and handling activities are not considered a fulfillment cost. The Company records shipping and handling costs as a cost of goods sold.

*Contract Assets and Contract Liabilities*

Contract liabilities (deferred revenue) consist of advance consideration received from customers and billings more than revenue recognized as deferred revenue, which precede the Company's satisfaction of the associated performance obligations. The Company's contract liabilities primarily result from customer payments received upfront for performance obligations that are satisfied at a point in time. Contract liabilities are recognized as revenue when the goods are delivered to the customer. As of December 31, 2021, and 2022, the Company had contract liabilities of $37,000, and $0, respectively. Revenue recognized from contract liabilities were $538,000 and $37,000 for the periods ended December 31, 2021, and 2022, respectively. Deferred cost of goods sold was immaterial for the Company as of December 31, 2021 and 2022.

Due to the relationship between the Company's performance and the customer's payment, the Company typically does not have conditional rights to consideration in exchange for goods or services transferred to a customer. Generally, the Company has the right to bill the customer as goods are delivered and services are provided, which results in the Company's right to payment being unconditional. Therefore, the Company does not have contract assets as of December 31, 2021, or 2022.

Due to the nature of the product, each contract with a customer has distinct performance obligations that are capable of being distinct on their own and within the context of the contract. In addition, based on the contract terms, which generally include performance obligations subject to cancellation terms, the Company does not have material unsatisfied performance obligations.

***Research and Development Expenses***

Research and development costs consist primarily of salaries, employee benefits, depreciation, amortization, overhead, outside contractors, facility expenses, and non-recurring engineering fees. Expenditures for research and development are charged to expense as incurred.

### *Stock-Based Compensation*

The Company recognizes compensation costs for all stock-based compensation awards made to employees based upon the awards' grant-date fair value. The fair value of the equity-settled share options granted throughout the year is estimated as at the date of grant using a Black Scholes Merton Option Pricing Model. Stock-based compensation expense is recognized evenly over the requisite service period, which is generally the vesting period. The Company accounts for forfeitures as they occur. Determining the fair value of the stock-based compensation awards at the grant date requires judgment, including estimated the expected term of the stock awards and the volatility of the underlying market-based and projected future cash flow assumptions. Any changes to those estimates that the Company makes from time to time may have a significant impact on the stock-based compensation expense recorded and could materially impact the Company's results of operations.

### *Income Taxes*

The Company accounts for income taxes using the asset and liability method, which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the financial statement and tax basis of assets and liabilities, as measured by enacted tax rates anticipated to be in effect when these differences are expected to reverse. This method also requires the recognition of future tax benefits to the extent that realization of such benefits is more likely than not. Deferred tax expense or benefit is the result of changes in the deferred tax assets and liabilities. The Company assesses the likelihood that its deferred tax assets will be recovered from future taxable income and, to the extent it believes, based upon the weight of available evidence, it is more likely than not that some or all the deferred tax assets will not be realized, a valuation allowance is established.

The Company recognizes a liability for potential payments of taxes to various tax authorities related to uncertain tax positions and other tax matters. The recorded liability is based on a determination of whether and how much of a tax benefit taken by the Company in its tax filings or positions is "more likely than not" to be realized. The amount of the benefit that may be recognized in the consolidated financial statements is the largest amount that has a greater than 50% likelihood of being realized upon ultimate settlement. To the extent that the assessment of such tax positions changes, the change in estimate is recorded in the period in which the determination is made. The Company establishes a liability, which is included in other long-term liabilities in the consolidated balance sheets, for tax-related uncertainties based on estimates of whether, and the extent to which, additional taxes will be due. These liabilities are established when the Company believes that certain positions might be challenged despite the Company's belief that the tax return positions are fully supportable. The recorded liability is adjusted considering changing facts and circumstances. The provision for income taxes includes the impact of the recorded liability and the related changes.

When incurred, the Company recognizes interest and penalties related to uncertain tax positions as a component of income tax provision in the consolidated statements of operations. Accrued interest and penalties are included in accrued income taxes in the consolidated balance sheets.

### *Net Loss Per Share*

The Company computes net loss per share in accordance with ASC 260, *Earnings Per Share* (ASC 260). Basic net loss per share is computed by dividing net loss attributable to shareholders of the Company by the weighted-average number of common shares outstanding during the reporting period. Diluted loss per share is computed similarly to basic net loss per share, except that it includes the potential dilution that could occur if dilutive securities were exercised. Information about potentially dilutive and antidilutive shares for the reporting period is provided in Note 14 - Net Loss per Share.

### *Concentrations of Credit Risk and Significant Customers*

Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of cash and accounts receivable. To manage credit risk related to accounts receivables, the Company evaluates its creditworthiness of its customers and maintains allowances, to the extend necessary, for potential credit losses based upon the aging of its accounts receivable balances and known collection issues. There were no expected credit losses as of December 31, 2021 and 2022.

Geographically, the Company has the following revenue information based on the location of its customers during the years ended December 31, 2021 and 2022 (in thousands):

| | 2021 | 2022 |
|---|---|---|
| Asia | $ 7,673 | $ 4,005 |
| North America | 21,572 | 14,238 |
| | $ 29,245 | $ 18,243 |

The categorization of net sales by geography is determined based on the location the products are being shipped to.

The following customers accounted for more than 10% of revenues during the years ended December 31, 2021 and 2022:

| | 2021 | 2022 |
|---|---|---|
| Customer A. | 38% | 51% |
| Customer B | 17% | 18% |
| Customer C | 17% | 17% |
| Customer D | 17% | 7% |
| | 89% | 93% |

The following customers accounted for more than 10% of trade accounts receivable during the years ended December 31, 2021 and 2022:

| | 2021 | 2022 |
|---|---|---|
| Customer A. | 31% | 46% |
| Customer B | 28% | 19% |
| Customer C | 4% | 5% |
| Customer D | 0% | 0% |
| Customer E | 14% | 9% |
| Customer F | 0% | 15% |
| | 77% | 94% |

### *Impact of Recently Issued Accounting Standards*

In June 2016, the Financial Accounting Standards Board (FASB) FASB issued ASU No. 2016-13, "Measurement of Credit Losses on Financial Instruments" (ASU 2016-13), which adds an impairment model (known as the current expected credit loss (CECL) model) that is based on expected losses rather than incurred losses. Under the new guidance, an entity recognizes as an allowance its estimate of expected credit losses, which the FASB believes will result in more timely recognition of such losses. The ASU is also intended to reduce complexity by decreasing the number of credit impairment models that entities use to account for debt instruments. The FASB subsequently issued ASU 2018-19, ASU 2019-04, and ASU 2019-10, which clarified the implementation guidance and effective date of Topic 326. Topic 326 is effective for the Company beginning fiscal year 2023. The Company is currently evaluating the impact of the adoption of this standard on the Company's consolidated financial statements.

There are no recently issued accounting standards which have not been previously adopted which are expected to have a material impact on the Company's financial statements.

### 3. Revenue from Customers

The Company earns revenue from customers, primarily through the design, development, manufacture, and sale of flow controllers. The following table summarizes net revenues disaggregated by type of customer for the years ended December 31, 2021 and 2022. The categorization of net revenues by customer type is determined using various characteristics of the product and the application into which the Company's product will be incorporated.

Net revenues by core end market and application were as follows for the years ended December 31, 2021 and 2022 (in thousands):

| | 2021 | 2022 |
|---|---|---|
| Customer type: | | |
| Integrated device manufacturer (IDM) | $ 5,994 | $ 3,670 |
| Original equipment manufacturer (OEM) | 23,251 | 14,573 |
| Total net revenue | $ 29,245 | $ 18,243 |

The Company recognizes revenues net of discounts.

Unsatisfied performance obligations primarily represent contracts for products with future delivery dates. The Company elected to not disclose the amount of unsatisfied performance obligations as these contracts have original expected durations of less than one year.

### 4. Trade Accounts Receivable

Trade accounts receivable, net consists of the following (in thousands):

| | December 31, 2021 | December 31, 2022 |
|---|---|---|
| Trade accounts receivable | $ 9,008 | $ 5,243 |
| Other receivables | | 545 |
| Total trade accounts receivable | $ 9,008 | $ 5,788 |

## 5. Inventories

Inventories include material, labor and overhead and consists of the following (in thousands):

| | December 31, 2021 | December 31, 2022 |
|---|---|---|
| Raw materials | $ 4,276 | $ 4,525 |
| Work in process | 1,357 | 628 |
| Finished goods | 1,224 | 2,257 |
| Total inventories | $ 6,857 | $ 7,410 |

As of December 31, 2021 and 2022, the Company recorded inventory provisions totaling $994,000 and $775,000, respectively.

## 6. Property, Plant and Equipment, net

Property, plant and equipment, net is stated at cost, and consists of the following (in thousands):

| | December 31, 2021 | December 31, 2022 |
|---|---|---|
| Furniture and fixtures | $ 121 | $ 121 |
| Computers and equipment | 1,937 | 2,009 |
| Software | 125 | 125 |
| Leasehold improvements | 130 | 130 |
| Total property, plant and equipment, gross | 2,313 | 2,385 |
| Less: accumulated depreciation | (1,976) | (2,188) |
| Total property, plant and equipment, net | $ 336 | $ 197 |

| The Company recorded depreciation expense in the following categories of its consolidated statements of operations during the years ended December 31, 2021 and 2022 (in thousands): | 2021 | 2022 |
|---|---|---|
| Cost of goods sold | $ — | $ — |
| Selling, general and administrative | 59 | 63 |
| Research and development | 284 | 149 |
| Total depreciation expense | $ 343 | $ 212 |

The geographic locations of the Company's long-lived assets, net, based on physical location of the assets, as of December 31, 2021 and December 31, 2022 were as follows (in thousands):

| | December 31, 2021 | December 31, 2022 |
|---|---|---|
| United States | $ 293 | $ 188 |
| South Korea | 43 | 9 |
| Total property, plant and equipment, net | $ 336 | $ 197 |

## 7. Prepaid Expenses

The composition of prepaid expenses is as follows (in thousands):

| | December 31, 2021 | December 31, 2022 |
|---|---|---|
| Prepaid insurance | $ 215 | $ 262 |
| Prepaid expenses | 117 | 115 |
| Total | $ 332 | $ 377 |

## 8. Accrued Expenses

The composition of accrued expenses is as follows (in thousands):

| | December 31, 2021 | December 31, 2022 |
|---|---|---|
| Accrued other | $ 91 | $ — |
| Accrued expenses | 254 | 587 |
| Accrued salaries and wages | 5 | 7 |
| Accrued vacation | 530 | 549 |
| Total | $ 880 | $ 1,143 |

## 9. Other Current Liabilities

The composition of other current liabilities is as follows (in thousands):

| | December 31, 2021 | December 31, 2022 |
|---|---|---|
| Contract liabilities | $ 37 | $ — |
| Accrued warranties | 115 | 267 |
| Deferred product refunds | 11 | — |
| Deferred gain on sale of property, plant and equipment | 113 | 177 |
| Total | $ 276 | $ 444 |

Changes in the Company’s accrued warranties account were as follows (in thousands):

| | Accrued Warranties |
|---|---|
| Balance at December 31, 2020 | $ 115 |
| Warranty expense | 204 |
| Settled and expired warranties | (204) |
| Balance at December 31, 2021 | 115 |
| Warranty expense | 466 |
| Settled and expired warranties | (314) |
| Balance at December 31, 2022 | $ 267 |

## 10. Notes Payable

On August 27, 2019, the Company entered into a financing agreement with Bridge Bank, a division of Western Alliance Bank. The financing agreement includes a revolving line of credit with a maximum borrowing capacity of $7.0 million (revolving credit line), and a term loan line of credit with a maximum borrowing capacity of $3.0 million (term loan).

The amount of liquidity available under the revolving credit line is based on the Company's balances and composition of eligible customer receivables and inventory, as well as other factors. As of December 31, 2022, the amount available under the revolving credit line is $2.2 million. Amounts borrowed under the revolving credit line mature and become due and payable in 24 months from the date of borrowing, unless extended by the parties. The agreement was amended on September 27, 2021, extending the maturity date of the revolving credit line to September 27, 2023. The revolving credit line bears interest at a rate equal to 1% above the prime rate, floating on the average outstanding balance. As of December 31, 2021 and 2022, the outstanding balance of the revolving credit line was $0 and $1.13 million, respectively. As of December 31, 2022, the interest rate for the revolving credit line was 9%.

On September 3, 2019, the Company drew $3.0 million on the term loan. As of December 31, 2021 and 2022, the outstanding balance of the term loan plus accrued interest was $808,000 and $0, respectively.

The financial covenants of the revolving credit line require an adjusted current ratio of at least 1.25:1.00, including liquidity, for which the Company must maintain unrestricted cash and cash equivalents with the lender of not less than $2.0 million at any time. The Company was in compliance with the financial covenants of its borrowing facilities outstanding as of December 31, 2021 and December 31, 2022.

The term loan is secured by all tangible and intangible assets of the Company.

The agreement was amended on August 20, 2021 (2nd amendment) and September 27, 2021 (3rd amendment). These amendments extended only to the revolving line of credit. The 2nd amendment extended the term of the agreement by 30 days to September 26, 2021. The 3rd amendment extended the revolving line of credit maturity date to September 27, 2023, and reduced the liquidity requirement to $500,000 from $2,000,000, for the remaining 2 year term. These amendments were accounted for as modifications.

On April 20, 2020, the Company entered a Promissory Note with Western Alliance Bank as the lender (Lender), pursuant to which the Lender agreed to make a loan to the Company under the Payroll Protection Program (PPP Loan) offered by the U.S. Small Business Administration (SBA) in a principal amount of $0.9 million pursuant to Title 1 of the Coronavirus Aid, Relief and Economic Security Act (CARES). The loan was forgiven in January 2021, resulting in a gain on loan forgiveness of $0.9 million, which has been recorded within gain on forgiveness of PPP loan on the consolidated statement of operations.

Maturities of long-term debt, net of debt costs, are as follows (in thousands):

| Year Ending December 31, | Future Maturities of Notes Payable |
|---|---|
| 2023 | $ 1,130 |
| Total | $ 1,130 |

## 11. Leases

The Company's operating lease liabilities as of December 31, 2021 and 2022 are comprised of future payments related to the Company's operating lease agreement for office space, and operating lease for office equipment. Total lease costs for the years ended December 31, 2021 and 2022 were as follows (in thousands):

| | 2021 | 2022 |
|---|---|---|
| Operating lease costs | $ 319 | $ 303 |

The following table presents the weighted average remaining lease term, and weighted-average discount rates related to the Company's operating leases:

| | December 31, 2021 | December 31, 2022 |
|---|---|---|
| Weighted average remaining lease term (in months) | 28 | 16 |
| Weighted average discount rate | 7.5% | 7.5% |

Future minimum payments on operating lease liabilities as of December 31, 2022, are as follows (in thousands):

| Year Ending December 31, | |
|---|---|
| 2023 | $ 350 |
| 2024 | 148 |
| Total minimum lease payments | 498 |
| Less: Imputed interest | (24) |
| Total | $ 473 |

## 12. Commitments and Contingencies

### *Legal proceedings*

From time to time, the Company becomes subject to various legal proceedings and claims, the outcomes of which are subject to significant uncertainty. The Company records an accrual for legal contingencies when it is determined that it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. In making such determinations, the Company evaluates, among other things, the degree of probability of an unfavorable outcome and, when it is probable that a liability has been incurred, the ability to make a reasonable estimate of the loss. If the occurrence of liability is probable but not estimable, the Company will disclose the nature of the contingency, or if reasonably possible and estimable, will also provide the likely amount of such loss or range of loss. Furthermore, the Company does not believe there are any matters that could have a material adverse effect on financial position, results of operations or cash flows.

Flow Device and Systems, Inc. ("Flow Device") has filed a lawsuit against the Company in the United States District Court Central District of California Southern Division (Case No. 8:21-cv-02089) claiming that certain of the Company's products infringe U.S. Patent No. 7,204,158, of which Flow Device purports to be the exclusive licensee.  The Company believes this lawsuit is without merit and will defend itself vigorously. As of the reporting date, the outcome is not determinable, and no liabilities are accrued as a result.

### *Indemnification*

From time to time, the Company has agreed to indemnify and hold harmless certain customers for potential allegations of infringement of intellectual property rights and patents arising from the use of its products. To date, the Company has not incurred any costs in connection with such indemnification arrangements; therefore, there was no accrual of such amounts as of December 31, 2021, or December 31, 2022.

### *Purchase Commitments*

The Company has current third-party purchase obligations for supplies and manufacturing services with two vendors. The minimum purchase obligations expire by February 2025. The Company made third-party purchases under the commitments totaling $3.2 million and $3.4 million during the years ended December 31, 2021 and December 31, 2022, respectively.

The estimated annual minimum purchase commitments with the suppliers were as follows (in thousands):

| Year Ending December 31, | |
|---|---|
| 2023 | 2,117 |
| 2024 | 2,000 |
| 2025 | 250 |
| Total | $ 4,367 |

## 13. Common and Redeemable Preferred Stock

*Common Stock*

The holders of common stock participate in dividends and the proceeds on the winding up of the Company in proportion to the number of and amounts paid on the shares held. The fully paid common stock has a par value of $0.00001 and the Company has designated authorized capital of 250,000,000 shares of common stock.

Holders of common stock are entitled to one vote for each share of common stock held. There shall be no cumulative voting. Holders are also entitled to receive, when, as and if declared by our board, out of any assets of the Company legally available therefore, any dividends as may be declared from time to time by our board.

On February 3, 2022, the Company entered into an underwritten rights offering of 30,317,527 CDIs to raise maximum gross proceeds of approximately $10.5 million. (Refer to note 17).

*Common Prime Stock*

The holders of Common Prime Stock are not entitled to any voting rights or powers, except as otherwise required by law. They are also not entitled to share in any dividends or other distributions of cash, property or shares of the Company as may be declared by our board on the Common Prime Stock. The fully paid Common Prime Stock has a par value of $0.00001 and the Company has designated authorized capital of 120,000,000 shares of Common Prime Stock. At December 31, 2021 and 2022 there was no common prime stock issued and outstanding.

*Redeemable Preferred Shares*

The authorized capital of the Company includes 13,000 shares of redeemable preferred stock, $0.00001 par value per share, 13,000 of which have been designated redeemable preferred stock. On June 2, 2021, the Company received $3.0 million funding from the issuance of 3,000 shares of redeemable preferred stock to Anzu RBI Mezzanine Preferred LLC (Anzu RBI). The issue costs related with this financing were $4,000. Anzu RBI is entitled to a non-cumulative priority preference dividend of 2%, payable at the Company's discretion. There was no dividend payable during 2021 and 2022.

At any time prior to or on the first anniversary of the original issue date, the redemption price is 120% of the original issue price, plus any unpaid dividends. On the day after the first anniversary of the issuance date, and on each anniversary thereafter, the redemption price increases to the original issue price plus the product of $250 dollars multiplied by the number of years from original issuance. The calculation does not include fractional year increases.

As per the Investment Agreement, the "First Redemption" of redeemable preferred stock will be redeemable based on the aggregate amounts attributed to the prior 10 months (4.0% of net revenues/month). After the First Redemption, subsequent redemptions of shares of redeemable preferred stock will occur on a quarterly basis and will be based on an amount equal to 4.0% of the Company's previous financial quarter revenues. The number of redeemable preferred shares to be redeemed during the quarter is based on the established share price, as defined in the Investment Agreement. If the Company fails to make an anticipated redemption, Anzu RBI may send notice to state that the anticipated redemption has not been made. The Company would have a 30-day period to make the anticipated redemption. If the anticipated redemption is not made at the end of the period, the redeemable preferred stock redemption price would increase to the greater of the current share price plus $1,000, or $3,000. If the Company fails to make a demanded redemption, the outstanding amount accrues interest at the lower of 17% or the maximum permissible interest rate which is secured on the assets of the Company.

The Company is required to deposit an amount equal to 4.0% of the financial quarter revenues into a bank account to be used for no other purpose than to redeem shares of redeemable preferred stock pursuant to the Investment Agreement. After the first redemption is made, the Company is no longer required to make these deposits or maintain the related bank account. While the total value payable is fixed based on quarterly revenue, the number of shares of redeemable preferred stock to be redeemed decreases if an anticipated redemption is not made. The Company has no contractual obligation to redeem shares of redeemable preferred stock. In the event of a failure to make an anticipated redemption, the Company may indefinitely delay or defer cash settlement at the increased settlement price.

During the year ended December 31, 2021, the First Redemption occurred, and during 2021 the Company redeemed 1,472 redeemable preferred shares at $1,250 per share for a total of $1.84 million. During the year ended December 31, 2022, the Company redeemed 776 redeemable preferred shares at $1,500 per share for a total of $1.16 million. The amount of consideration paid by the Company to redeemable preferred stockholders' in excess of the amount originally contributed by such shareholders was treated a deemed dividend to the preferred shareholder. The Company recorded deemed dividends in the amounts of $368,000 and $388,000 for the years ended December 31, 2021 and 2022 respectively. The Company has adjusted its net loss per share computation to reflect the value given to redeemable preferred stockholders by the Company (refer to Note 14).

There is no fixed term to the redemption period on the redeemable preferred stock. The Company will redeem shares of redeemable preferred stock upon the occurrence of insolvency, liquidation or similar bankruptcy; an event of default; a change of control or if the Company disposes all or substantially all its assets, property or business.

The redeemable preferred stock carries voting rights of one vote per share during a period in which a dividend or part of a dividend in respect to redeemable preferred stock is in arrears (declared but not paid), or during the winding up of the Company.

The redeemable preferred stock also carry voting rights of one vote per share, on a proposal:

- that affects rights attached to redeemable preferred stock;
- to wind up the Company; or
- for the disposal of the property, business and undertaking of the Company.

The redeemable preferred stock carries voting rights of one vote per share, on a resolution to approve:

- the terms of a share buy-back arrangement, other than the buy-back of redeemable preferred stock; or
- a reduction in share capital of the Company, other than a reduction with respect to redeemable preferred stock.

**14. Net Loss per Share**

The following table sets forth the computation of basic and diluted net loss per share attributable to common stockholders (in thousands, except share and per share amounts):

| | 2021 | 2022 |
|---|---|---|
| Net loss | $ (6,879) | $ (14,125) |
| Less: Deemed dividend to redeemable preferred stockholders | (368) | (388) |
| Net loss attributable to common stockholders | (7,247) | (14,513) |
| Weighted average basic and diluted common share | 123,711,465 | 155,059,607 |
| Net loss per share attributable to common stockholders – basic and diluted | $ (0.06) | $ (0.09) |

Basic net loss per share has been computed by dividing the net loss by the weighted-average number of shares of common stock outstanding during the period. Diluted net loss per share is calculated by dividing net loss by the weighted average number of shares of common stock and potentially dilutive securities outstanding during the period. Because the Company is in a net loss position, diluted net loss per share excludes the effects of common stock equivalents consisting of issued and outstanding stock options which are antidilutive. It also excludes the impact of redeemable preferred stock, as they are not convertible into common stock.

The following outstanding potentially dilutive shares were excluded from the computation of diluted net loss per share attributable to common stockholders for the periods presented, because including them would have been anti-dilutive (on an as-converted basis):

| | As of December 31, | |
|---|---|---|
| | 2021 | 2022 |
| Common stock options issued and outstanding | 16,548,497 | 21,126,463 |
| | 16,548,497 | 21,126,463 |

## 15. Stock-Based Compensation

The Company grants stock options to its employees, directors, and consultants for a fixed number of shares with an exercise price equal to or greater than the fair value of the common stock at the date of grant. Granted options expire no later than 10 years from the date of grant and generally vest over a four-year period, with 25% vesting on the first anniversary of the grant date and monthly thereafter.

The 2012 Equity Incentive Plan (the Plan) adopted on June 29, 2012, as amended on June 20, 2019, authorizes the Company to grant incentive stock options and non-statutory stock options to employees, directors, and consultants for up to 26,965,000 shares of common stock as of December 31, 2021. The 2012 Plan expired on May 18, 2022. There are 14,517,297 unexercised options under the 2012 Plan as of December 31, 2022 which are outstanding.

The 2022 Equity Incentive Plan (the "2022 Plan") adopted on April 26, 2022, authorizes the Company to grant incentive stock options and non-statutory stock options to employees, directors, and consultants for up to 12,000,000 shares of common stock as of December 31, 2022. Incentive Stock Options (ISOs) may be granted only to employees. Nonqualified stock options may be granted to employees, directors and consultants. The Company issues new shares of common stock upon the exercise of stock options.

The Company granted awards with service conditions. Awards generally vest 25% on the first anniversary of the grant date and one forty-eighth each month thereafter. The service condition requires continuous employment for a duration of time that once achieved will vest a portion, or tranche, of the grant. The awards have contract term of 10 years.

The Company used Black-Scholes option pricing model to estimate the fair value of option awards using the following assumptions during the years ended December 31, 2021 and 2022:

| | 2021 | 2022 |
|---|---|---|
| Expected volatility | 59.3% – 67.3% | 59.1% - 70.4% |
| Risk-free interest rate | 0.59% – 1.06% | 1.17% – 4.36% |
| Expected dividend | —% | —% |
| Expected term (in years) | 4 years | 1 - 4 years |
| ASX market price | $0.63 – $1.21 | $0.05 – $0.63 |

The expected term of options granted to employees is based on the expected life of the stock options, giving consideration to the contractual terms and vesting schedules. The expected volatility reflects the assumption that the historical volatility over a period similar to the life of the options is indicative of future trends, which may not be the actual outcome. The dividend yield was based on the Company's dividend history and the anticipated dividend payout over its expected term. The risk-free interest rate was based on the U.S. Treasury yield curve in effect at the time of grant and with a maturity that approximated the Company's expected term.

The following table summarizes the stock awards activity for the fiscal years ended as follows:

| | Number of Shares | Weighted-Average Exercise Price Per Share | Weighted-Average Grant Date Fair Value | Weighted-Average Remaining Contractual Life (In years) |
|---|---|---|---|---|
| Outstanding – December 31, 2020 | 16,734,199 | $ 0.57 | $ 0.96 | 5.92 |
| Granted | 2,475,000 | 1.02 | 0.47 | |
| Exercised | (1,167,752) | 0.25 | | |
| Forfeited | (1,488,542) | 1.17 | | |
| Expired | (4,408) | 17.70 | | |
| Outstanding – December 31, 2021 | 16,548,497 | $ 0.60 | $ 0.24 | 6.09 |
| Granted | 6,873,500 | 0.10 | 0.0404 | |
| Exercised | (639,907) | 0.18 | | |
| Forfeited | (567,399) | 0.79 | | |
| Expired | (1,088,228) | 0.77 | | |
| Outstanding – December 31, 2022 | 21,126,463 | $ 0.43 | $ 0.17 | 6.03 |
| Vested and expected to vest as of December 31, 2022 | 19,819,294 | $ 0.45 | | 6.36 |
| Options exercisable as of December 31, 2022 | 13,066,312 | $ 0.52 | | 4.80 |

As of December 31, 2022, 13,062,098 options had vested. The Company recognizes forfeitures as they occur. As of December 31, 2021 and December 31, 2022, the intrinsic value of options outstanding was $3.5 million and $0, respectively. During the years ended December 31, 2021 and December 31, 2022, the intrinsic value of options exercised was $0.9 million and $0.1 million, respectively. As of December 31, 2021 and 2022, the aggregate intrinsic value of options vested and expected to vest was $3.5 million and $0, respectively. As of December 31, 2021 and 2022, the aggregate intrinsic value of options exercisable was $3.5 million and $0, respectively. During the years ended December 31, 2021 and December 31, 2022, the grant date fair value of shares vested was $2.0 million and $2.6 million, respectively.

As of December 31, 2022, there was $0.9 million of compensation costs related to non-vested awards granted under the Company's equity incentive plans not yet recognized in the financial statements. The unrecognized compensation cost is expected to be recognized over a weighted average period of 2.5 years.

The Company recorded stock-based compensation expense in the following expense categories of its consolidated statements of operations during the years ended December 31, 2021 and 2022 (in thousands):

| | 2021 | 2022 |
|---|---|---|
| Cost of goods sold | $ 59 | $ 50 |
| Research and development | 323 | 141 |
| Selling, general and administrative | 580 | 516 |
| Total stock-based compensation | $ 962 | $ 707 |

## 16. Income Taxes

The following table presents a reconciliation of the federal statutory rate of 21% to our effective tax rate for the years ended December 31 2021, and 2022:

| | 2021 | 2022 |
|---|---|---|
| U.S. federal tax benefit at statutory rate | 21.00% | 21.00% |
| State (tax benefit) income taxes, net of federal benefit | 3.03% | 5.71% |
| Change in valuation allowance | (22.74)% | (26.78)% |
| Research and development credit (net of reserve) | 3.02% | 1.30% |
| Other | (4.72)% | (1.38)% |
| Effective tax rate | (0.41)% | (0.15)% |

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The following table presents the significant components of the Company's deferred tax assets and liabilities (in thousands):

| | December 31, 2021 | December 31, 2022 |
|---|---|---|
| Deferred tax assets: | | |
| Net operating loss carryforward | $ 12,312 | $ 15,647 |
| Research and development credits | 1,437 | 1,738 |
| Depreciation and amortization | 151 | 190 |
| Section 174 Capitalization | — | 1,058 |
| Reserves and accruals | 808 | 787 |
| Gross deferred tax assets | 14,708 | 19,420 |
| Valuation allowance | (14,485) | (19,237) |
| Net deferred tax assets | 223 | 183 |
| Deferred tax liabilities: | | |
| Right of use asset | (170) | (113) |
| Prepaid expenses | (53) | (70) |
| Total deferred tax liabilities | (223) | (183) |
| Total net deferred tax asset (liabilities) | $ — | $ — |

Based on historical losses and the expectation of future losses, management cannot conclude that it is more likely than not that the net deferred tax assets will be realizable. Accordingly, the Company has provided a full valuation allowance against its net deferred tax assets at December 31, 2021 and 2022. The Company's deferred tax assets are primarily related to net operating loss carryforwards. The Company's valuation allowance increased by $1.6 million and increased by $4.8 million for the years ended December 31, 2021, and 2022, respectively. The change in the valuation allowance for both years is primarily due to the addition of net operating losses carryforward.

As of December 31, 2022, the Company had federal and state net operating loss carry-forwards of approximately $107.8 million and $47.1 million, respectively, available to reduce future taxable income, if any. The net operating loss carry-forwards will expire beginning 2032 for both federal and California income tax purposes. The federal net operating losses generated on and after 2018 are carried forward indefinitely.

As of December 31, 2022, the Company had federal and state research credit carry-forwards of $1.9 and $1.8 million, respectively. Federal tax credits begin to expire in 2037. The state tax credits have no expiration date.

The Company has not performed a Section 382 study to determine whether it had experienced a change in ownership and, if so, whether the tax attributes (net operating losses or credits) were impaired. Under Section 382 of the Internal Revenue Code of 1986, as amended, the Company's ability to utilize net operating loss or other tax attributes, such as research tax credits, in any taxable year may be limited if the Company has experienced an "ownership change." Generally, a Section 382 ownership change occurs if there is a cumulative increase of more than 50 percentage points in the stock ownership of one or more stockholders or groups of stockholders who owns at least 5% of a corporation's stock within a specified testing period. Similar rules may apply under state tax laws.

A reconciliation of the unrecognized tax benefit for the years ended December 31, 2021 and 2022 is as follows (in thousands):

| | 2021 | 2022 |
|---|---|---|
| Unrecognized tax benefits as of the beginning of the year | $ 576 | $ 717 |
| Increase related to prior year tax provisions | 40 | 55 |
| Increase related to current year tax provisions | 101 | 88 |
| Unrecognized tax benefits as of the end of the year | $ 717 | $ 860 |

The Company does not expect the unrecognized tax benefits to change significantly over the next 12 months. Interest and penalties are not applicable to those uncertain tax benefits as the Company has experienced taxable losses since inception and has not utilized any of the tax credits in the prior year or current year tax returns.

The Company has not been audited by the Internal Revenue Service or any state income or franchise tax agency. The federal and state income tax returns are open under the statute of limitations subject to tax examinations for the tax years ended December 31, 2019 through December 31, 2021 and December 31, 2018 through December 31, 2021, respectively. All the net operating losses and research and development credit carryforwards that may be used in future years are still subject to inquiry given the statute of limitation for these items would begin in the year of utilization.

**17. Related Party Transactions**

On February 3, 2022, the Company entered into an underwritten rights offering of 30,317,527 CDIs to raise maximum gross proceeds of approximately $10.5 million. One CDI represents one share of common stock. As a result of this offering, on February 15, 2022, the Company issued 16,410,646 CDIs, and on February 28, 2022 the Company issued 13,906,881 CDIs and raised $10.1 million, net of $0.6 million issuance costs. $3.9 million of the proceeds were received from Viburnum Funds and $3.7 million from Anzu Partners, LLC, both related parties of the Company. Mr. John Hoffman and Mr. Joseph Monkoswki, both Directors of the Company also participated in these rights offering by subscribing CDI's for $0.1 million each.

During 2022, the Company made redemption payments to redeemable preferred stockholders for $1,164,000. The Company recorded $388,000 as deemed dividends in connection with the redemption premium paid to Anzu RBI during the periods ended December 31, 2022.

Potential bonuses may be paid to members of the senior leadership team selected by the Remuneration and Nomination Committee ("Committee") subject to satisfaction of various performance hurdles, including: (i) the Company achieving certain EBITDA targets for each of fiscal year 2021 to fiscal year 2022; (ii) the Company achieving a market capitalization and share price target at the end of fiscal year 2022; and (iii) the Company closing a change of control transaction at or above the target share price. Determination of the satisfaction of the fiscal year 2022 performance hurdles will be made by the Committee in the first quarter of fiscal year 2023 unless a change of control event occurs on an earlier date. The maximum bonus pool payable under the Long Term Incentive Program (LTIP) is $10 million, with 60% of the actual bonus pool payable to the Chief Executive Officer, the Chief Technical Officer, and other members of the senior leadership team selected by the Committee. LTIP Bonuses earned as of December 31, 2022 were Nil.

**18. Subsequent Events**

On 28 March 2023, Pivotal announced an equity raising of 5 for 1 pro-rata accelerated renounceable entitlement offer to raise up to A$7.9 million (US$5.25 million) at A$0.01 per new CDI. Each new CDI/Share issued under the Entitlement Offer will rank equally with existing fully paid ordinary CDIs/Shares on issue.

This equity raising will comprise an accelerated institutional entitlement offer, and a retail entitlement offer to eligible securityholders. Proceeds from the equity raising will be used to fund operations, working capital and general corporate purposes bringing the company to EBITDA positive run rate by year end 2023 if the full US$5.25 million is raised.

Major shareholders Anzu Partners have committed to take up their full pro-rata entitlement of A$1.4m and major shareholder Viburnum have committed to take a minimum of A$0.5m. Directors and senior management have committed to subscribe for their pro-rata entitlements of A$0.1M and have asked if they can participate in any shortfall. Shareholders and new shortfall investors subscribing for more than US$500,000 each will be entitled to together nominate one new director to the Board on completion of the offer. New institutional US investor has committed to taking up a minimum of US$500k of the shortfall.

The Company has evaluated subsequent events through March 30, 2023, the date these financial statements were available to be issued, and determined that no additional subsequent events had occurred that would require disclosure or recognition in these financial statements.

# DIRECTORS' DECLARATION

In accordance with a resolution of the directors of Pivotal Systems Corporation, the directors of the Company declare that:

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

2. The financial statements and notes thereto, give a true and fair view of the Company's financial position as at 31 December 2021 and of the performance for the year ended on that date; and

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

On behalf of the directors,

Kevin Hill
Chief Executive Officer

30 March 2023 (Fremont PST), 31 March 2023 (Sydney AEDT)

armanino

INDEPENDENT AUDITOR'S REPORT

Board of Directors
Pivotal Systems Corporation
Fremont, California

**Opinion**

We have audited the accompanying consolidated financial statements of Pivotal Systems Corporation (a California corporation), which comprise the consolidated balance sheet as of December 31, 2022, and the related consolidated statements of operations, redeemable preferred stock and stockholders' equity, and cash flows for the year then ended, and the related notes to the consolidated financial statements.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Pivotal Systems Corporation as of December 31, 2022, and the results of their operations and their cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

**Basis for Opinion**

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of Pivotal Systems Corporation and to meet our other ethical responsibilities in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

**Prior Period Financial Statements**

The consolidated financial statements of Pivotal Systems Corporation as of December 31, 2021, were audited by other accountants whose report dated March 30, 2022, expressed an unmodified opinion on those statements.

**Emphasis of Matter**

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 2 to the consolidated financial statements, the Company has suffered recurring losses from operations, has a net capital deficiency, and has stated that substantial doubt exists about the Company's ability to continue as a going concern. Management's evaluation of the events and conditions and managements plans regarding these matters are also described in Note 2. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not modified with respect to this matter.

**Responsibilities of Management for the Financial Statements**

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

MOORE

An independent firm associated with Moore Global Network Limited

# Independent Auditor’s Report

In preparing the consolidated financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about Pivotal Systems Corporation's ability to continue as a going concern within one year after the date that the financial statements are available to be issued.

**Auditor's Responsibilities for the Audit of the Financial Statements**

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with auditing standards generally accepted in the United States of America will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the consolidated financial statements.

In performing an audit in accordance with auditing standards generally accepted in the United States of America, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of Pivotal Systems Corporation's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about Pivotal Systems Corporation's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control related matters that we identified during the audit.

Armanino LLP

Armanino LLP
San Francisco, California

March 30, 2023

# Additional Shareholder's Information
**SHAREHOLDER INFORMATION AS AT 15 MARCH 2023**

Additional Shareholder Information required by the Australian Securities Exchange (ASX) Listing Rules is set out below.

In accordance with the ASX Corporate Governance Council's, Corporate Governance Principles and Recommendations (4th edition), the 2021 Corporate Governance Statement, as approved by the Board, is available on the Company's website at: https://www.pivotalsys.com/investors. The Corporate Governance Statement sets out the extent to which Pivotal has followed the ASX Corporate Governance Council's 35 specific Recommendations of general application and three additional Recommendations applicable in certain cases, to the extent applicable to Pivotal during the financial year ended 31 December 2022.

The Company's securities have been listed for quotation in the form of CHESS Depositary Interests, or CDIs, on the ASX and trade under the symbol "PVS" since 2 July 2018. Legal title to the shares of common stock (Shares) underlying the CDIs is held by CHESS Depositary Nominees Pty Ltd (CDN), a wholly owned subsidiary of the ASX. Each Share is equivalent to 1 CDI.

As at the date of currency indicated above, 153,998,333 CDIs are issued and held by 515 CDI holders which represents 153,998,333 underlying Shares. 5,505,417 Shares are held by 41 shareholders who have not elected to hold Company securities in the form of CDIs.

Assuming all Shares were held as CDIs, the Company would have 159,503,750 CDIs on issue.

**1. Substantial shareholders**

The number of CDIs (assuming all Shares are held as CDIs) held by substantial shareholders and their associates as advised to the ASX are set out below:

| Name | Number CDIs | % of total CDIs |
|---|---|---|
| Firsthand Capital Mgt | 42,239,506 | 27.43 |
| Viburnum Funds | 32,141,394 | 20.87 |
| Anzu Partners | 28,194,189 | 17.75 |

**2. Number of security holders and securities on issue**

Pivotal has issued the following securities:

(a) 5,509,584 fully paid ordinary shares held by 42 shareholders;
(b) 153,998,333 CDIs held by 515 CDI holders;
(c) 10,591 Redeemable RBI Preferred Stock held by 1 holder; being Anzu Industrial USA LLC (now known as Anzu RBI Mezzanine Preferred LLC);
(d) 20,309,483 unlisted options exercisable at various prices held by 49 option holders.

Details of the Top 20 Shareholders are set out in section 6 below.

**3. Voting rights**

Shares of common stock

At a meeting of the Company's stockholders, every stockholder present, in person or by proxy is entitled to one vote for each share of common stock held on the record date for the meeting on all matters submitted to a vote of stockholders.

CDIs

CDI holders are entitled to one vote for every one CDI they hold. To vote, holders of CDIs must instruct CDN, as the legal owner of the CDIs, to vote the shares of common stock underlying their CDIs in a particular manner.

Options

Option holders do not have any voting rights on the options held by them. Shares of common stock issued to option holders on exercise of their options will have the same voting rights as the holder of shares of common stock.

Redeemable RBI Preferred Stock

RBI Preferred Stockholders will not be entitled to vote at any general meeting of the Company except in the following circumstances:

- On a proposal:
    - that affects rights attached to RBI Preferred Stock;
    - to wind up the Company; or
    - for the disposal of the whole of the property, business and undertaking of the Company;
- On a resolution to approve:
    - the terms of a share buy-back agreement;
    - a reduction of the share capital of the Company,

  other than a resolution to approve a buy-back or reduction of capital with respect to RBI Preferred Stock;
- During a period in which a dividend or part of a dividend in respect of an RBI Preferred Stock is in arrears; or
- During the winding-up of the Company.

At a general meeting of the Company at which RBI Preferred Stockholders may vote, they are entitled:

- to one vote on a show of hands; and
- to one vote for each RBI Preferred Stock on a poll.

RBI Preferred Stockholders will have the same rights as holders of shares of Common Stock/CDIs in the Company to receive notices, reports and audited accounts from the Company and to attend general meetings.

**4. Distribution schedules of security holders**

| **Category** | **Chess Depositary Interests (CDIs)*** | | |
|---|---|---|---|
| | Total Shareholders | Number of Shares | % |
| 1 - 1,000 | 146 | 66,903 | 0.04 |
| 1,001 - 5,000 | 139 | 386,268 | 0.24 |
| 5,001 - 10,000 | 79 | 607,264 | 0.38 |
| 10,001 - 100,000 | 136 | 4,955,126 | 3.11 |
| 100,001 and over | 57 | 153,492,356 | 96.23 |
| **Total** | **557** | **159,507,917** | **100.00** |

*Total shareholders and number of CDIs assuming all common shares held are CDIs.

| Category | Fully Paid Shares of Common Stock | | |
|---|---|---|---|
| | Total Shareholders | Number of Shares | % |
| 1 - 1,000 | 16 | 1,043 | 0.02 |
| 1,001 - 5,000 | 5 | 16,814 | 0.31 |
| 5,001 - 10,000 | 3 | 20,936 | 0.38 |
| 10,001 - 100,000 | 9 | 488,259 | 8.86 |
| 100,001 and over | 9 | 4,982,532 | 90.43 |
| **Total** | **42** | **5,509,584** | **100.00** |

| Category | Chess Depositary Interests (CDIs) | | |
|---|---|---|---|
| | **Total CDI Holders** | **Number of CDIs** | **%** |
| 1 - 1,000 | 130 | 65,860 | 0.04 |
| 1,001 - 5,000 | 134 | 369,454 | 0.24 |
| 5,001 - 10,000 | 76 | 586,328 | 0.38 |
| 10,001 - 100,000 | 127 | 4,466,867 | 2.90 |
| 100,001 and over | 48 | 148,509,824 | 96.44 |
| **Total** | **515** | **153,998,333** | **100.00** |

| Category | Unquoted Options | | |
|---|---|---|---|
| | **Total Option Holders** | **Number of Options** | **%** |
| 1 - 1,000 | - | - | 0.00 |
| 1,001 - 5,000 | - | - | 0.00 |
| 5,001 - 10,000 | 2 | 16,563 | 0.08 |
| 10,001 - 100,000 | 18 | 1,068,957 | 5.26 |
| 100,001 and over | 29 | 19,223,963 | 94.66 |
| **Total** | **49** | **20,309,483** | **100.00** |

*Note that the Unquoted Options as stated above have various exercise prices and expiry dates.*

**5. Unmarketable parcel of shares**

The number of CDI Holders holding less than a marketable parcel of CDIs (being A$500) is 364 (representing 1,313,000 CDIs).

## 6. Twenty largest shareholders of quoted equity securities

**Chess Depositary Interests only**

Details of the 20 largest CDI Holders by registered CDI holding are as follows.

| | Name | No. of CDIs | % |
|---|---|---|---|
| 1 | HSBC CUSTODY NOMINEES (AUSTRALIA) LIMITED | 59,537,142 | 38.66 |
| 2 | CITICORP NOMINEES PTY LIMITED | 28,210,544 | 18.32 |
| 3 | J P MORGAN NOMINEES AUSTRALIA PTY LIMITED | 14,583,300 | 9.47 |
| 4 | CRANPORT PTY LTD | 7,945,610 | 5.16 |
| 5 | ENTERPRISE PARTNERS MANAGEMENT LLC | 7,677,125 | 4.99 |
| 6 | ALTOR CAPITAL MANAGEMENT PTY LTD | 7,676,808 | 4.98 |
| 7 | MR DIMITAR STRAHILOV BELYOVSKI & MRS MAYA EFTIMOVA BELYOVSKA | 3,234,165 | 2.10 |
| 8 | MS PHILIPPA CAMERON CUMMINS | 2,750,000 | 1.79 |
| 9 | ANNBROOK CAPITAL PTY LTD | 2,715,000 | 1.76 |
| 10 | BNP PARIBAS NOMINEES PTY LTD | 2,693,174 | 1.75 |
| 11 | SALTINI PTY LTD | 1,500,000 | 0.97 |
| 12 | SCRATCHING AROUND 4 RETURNS PTY LTD | 1,000,000 | 0.65 |
| 12 | MICROGOLD CORPORATION PTY LTD | 1,000,000 | 0.65 |
| 13 | RXC PTY LTD | 525,000 | 0.34 |
| 14 | MR DAVID GRUNDMANN & MRS MICHELLE GRUNDMANN | 400,000 | 0.26 |
| 15 | MR DARSHIL PRAVINBHAI DOSHI | 392,338 | 0.25 |
| 16 | NATIONAL NOMINEES LIMITED | 375,000 | 0.24 |
| 17 | MR JOHN ANASSIS | 360,576 | 0.23 |
| 18 | MR HUGH JAMES PILGRIM | 349,351 | 0.23 |
| 19 | MR RAKESH MULSHANKAR PANDYA | 322,520 | 0.21 |
| 20 | MR DIMITAR BELYOVSKI | 304,110 | 0.20 |
| | **Total** | **143,551,763** | **93.22** |
| | Balance of register | 10,446,570 | 6.78 |
| | **Grand total** | **153,998,333** | **100.00** |

**Fully Paid Ordinary Shares of Common Stock and CDIs combined**

Details of the 20 largest Shareholders by registered shareholding on the basis that all shares of common stock on issue are held as CDIs are as follows.

| | Name | No. of Shares | % |
|---|---|---|---|
| 1 | CHESS DEPOSITORY NOMINEES PTY LIMITED | 153,998,333 | 96.55 |
| 2 | JOSEPH MONKOWSKI | 1,616,164 | 1.01 |
| 3 | JOHN HOFFMAN | 1,611,771 | 1.01 |
| 4 | NORITAKA KOBAYAKAWA | 450,000 | 0.28 |
| 5 | HOSEUNG CHANG | 388,670 | 0.24 |
| 6 | JIUYI CHENG | 250,000 | 0.16 |
| 7 | RYAN BENTON | 195,000 | 0.12 |

| | Name | No. of Shares | % |
|---|---|---|---|
| 8 | ADAM MONKOWSKI & MELANIE A GOSSHEIDER | 170,972 | 0.11 |
| 9 | SOPHIA L SHTILMAN | 165,000 | 0.10 |
| 10 | CARTER CRUM | 134,955 | 0.08 |
| 11 | TRAVIS OWENS | 100,000 | 0.06 |
| 12 | JAMES T FRANKLIN | 97,065 | 0.06 |
| 13 | JOSEPH BRONSON | 83,146 | 0.05 |
| 14 | WILLIAM E BRISKO | 75,000 | 0.05 |
| 15 | WILLIAM ROTHROCK | 37,083 | 0.02 |
| 16 | MUKUND VENKATESH | 36,590 | 0.02 |
| 17 | GABRIEL SEGOVIA | 25,000 | 0.02 |
| 18 | ANNE R REYNOLDS | 20,000 | 0.01 |
| 19 | JIALING CHEN | 14,375 | 0.01 |
| 20 | RAYMOND & HILLARY KARNO | 10,000 | 0.01 |
| | **Total** | **158,850,153** | **99.59** |
| | Balance Of Register | 657,764 | 0.41 |
| | **Grand Total** | **159,507,917** | **100.00** |

*Subject to rounding*

**7.** The name of the entity's secretary

The Company has not formally appointed a Company Secretary but has appointed Company Matters Pty Ltd to provide it with general company secretarial services. Mr Danny Davies has been appointed as the Company's ASX Representative pursuant to ASX Listing Rule 12.6.

**8.** The address and telephone number of the Company's registered office in Australia; and of its principal administrative office.
The Company is incorporated in Delaware, United States.
The Company's registered office in the USA is:
C/- Incorporating Services Ltd, 3500 South Dupont Highway, Dover, Delaware 19901 USA
The Company's Principal place of business is:
Suite 100, 48389 Fremont Blvd, Fremont, CA 94538 USA.
T: +1 (510) 770 9125

The Company's registered office in Australia is:
Company Matters Pty Ltd
Level 12, 680 George Street, Sydney NSW 2000
T: +61 (02) 8280 7355

**9.** The address and telephone number of each office at which a register of securities, register of depositary receipts or other facilities for registration of transfers is kept.

American Stock Transfer and Trust Company, LLC
6201, 15th Avenue
Brooklyn, NY 11219 USA
Telephone: +1 (718) 921 8386

Link Market Services
Level 12, 680 George Street

Sydney NSW 2000 Australia
T: +61 1300 554 474

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

**11.** There are no restricted securities or securities subject to voluntary escrow on issue.

Note: Official quotation of the Company's CDIs occurred on July 2, 2018.

**12. Review of operations and activities**

A detailed review of operations and activities is reported in the 2022 Annual Report.

**13. On market buy-back**

There is no current on market buy-back.

**14. Other**

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.

Pivotal is not subject to Chapters 6, 6A, 6B and 6C of the Corporations Act 2001 (Cth) dealing with the acquisition of its shares (including substantial holdings and takeovers).
<u>Anti-takeover provisions of Delaware Law, Certificate of Incorporation and Bylaws</u>

Provisions of the Delaware General Corporation Law, the Company's Certificate of Incorporation and the Company's Bylaws could make it more difficult to acquire the Company by means of a tender offer (takeover), a proxy contest or otherwise, or to remove incumbent officers and Directors of the Company. These provisions (summarized below) 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 Company's bylaws do not contain any limitations on the acquisition of securities, except that clause 9 of Article XI, Section 11.1. of the bylaws provides as follows:

> "The Corporation may refuse to acknowledge or register any transfer of shares of the Corporation's capital stock (including shares in the form of CDIs) held or acquired by a stockholder (including shares of the Corporation's capital stock that may be acquired upon exercise of a stock option, warrant or other right) or shares of the Corporation's capital stock which attach to or arise from such shares which are not made:
>
> a. in accordance with the provisions of Regulation S of the Securities Act of 1933 (U.S.), as amended to date and the rules and regulations promulgated thereunder (the "U.S. Securities Act") (Rule 901 through Rule 905 and preliminary notes);
>
> b. pursuant to registration under the U.S. Securities Act; or
>
> c. pursuant to an available exemption from registration."