

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Fiscal Year Ended December 31, 2017

Commission File No. 333-150332

**DRONE AVIATION HOLDING CORP.**  
(Exact name of registrant as specified in its charter)

<u>Nevada</u> (State or other jurisdiction of incorporation or organization)	<u>46-5538504</u> (I.R.S. Employer Identification No.)
<u>11651 Central Parkway #118 Jacksonville FL</u> (Address of principal executive office)	<u>32224</u> (Zip Code)

**(904) 834-4400**

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined by Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

**Note: The registrant is a voluntary filer, but has filed all reports it would have been required to file by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months if it was subject to the filing requirements thereof.**

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 229.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Non-accelerated filer

Accelerated filer

Smaller reporting company

Emerging growth company

(Do not check if a smaller reporting company)

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 7(a)(2)(B) of the Securities Act and Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

The aggregate market value of the voting common equity held by non-affiliates of the registrant was \$5,416,311 based on the average bid price and asked price per share of the Common Stock as quoted on the OTCQB on the last business day of the registrant's most recently completed second fiscal quarter (June 30, 2017).

As of March 23, 2018, there were 9,182,470 shares of registrant's common stock outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

None.

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### **Cautionary Note Regarding Forward-Looking Statements**

This Annual Report on Form 10-K (this “Annual Report”) contains “forward-looking statements” that represent our beliefs, projections and predictions about future events. All statements other than statements of historical fact are “forward-looking statements,” including any projections of earnings, revenue or other financial items, any statements of the plans, strategies and objectives of management for future operations, any statements concerning proposed new projects or other developments, any statements regarding future economic conditions or performance, any statements of management’s beliefs, goals, strategies, intentions and objectives, and any statements of assumptions underlying any of the foregoing. Words such as “may,” “will,” “should,” “could,” “would,” “predicts,” “potential,” “continue,” “expects,” “anticipates,” “future,” “intends,” “plans,” “believes,” “estimates,” and similar expressions, as well as statements in the future tense, identify forward-looking statements.

These statements are necessarily subjective and involve known and unknown risks, uncertainties and other important factors that could cause our actual results, performance or achievements, or industry results, to differ materially from any future results, performance or achievements described in or implied by such statements. Actual results may differ materially from expected results described in our forward-looking statements, including with respect to correct measurement and identification of factors affecting our business or the extent of their likely impact, the accuracy and completeness of the publicly available information with respect to the factors upon which our business strategy is based, or the success of our business. Furthermore, industry forecasts are likely to be inaccurate, especially over long periods of time. Factors that may cause actual results, our performance or achievements, or industry results to differ materially from those contemplated by such forward-looking statements include, without limitation, those discussed in “Item 1A. Risk Factors” of this Annual Report.

Forward-looking statements should not be read as a guarantee of future performance or results and will not necessarily be accurate indications of whether, or the times by which, our performance or results may be achieved. Forward-looking statements are based on information available at the time those statements are made and management’s belief as of that time with respect to future events, and are subject to risks and uncertainties that could cause actual performance or results to differ materially from those expressed in or suggested by the forward-looking statements. Important factors that could cause such differences include, but are not limited to, those factors discussed in “Item 1A. Risk Factors” of this Annual Report and elsewhere in this Annual Report.

## PART I

### Item 1. Business

#### Organization

Drone Aviation Holding Corp. has two wholly-owned subsidiaries: Lighter Than Air Systems Corp. (“LTAS”) and Drone AFS Corp. (“AFS”). Drone Aviation Holding Corp. was incorporated in Nevada on April 17, 2014, as a wholly-owned subsidiary of MacroSolve, Inc., an Oklahoma corporation (“MacroSolve”), and effective April 30, 2014, to consolidate our operations into an entity incorporated in Nevada, MacroSolve merged with and into us. On June 3, 2014, we acquired Drone Aviation Corp. through a share exchange transaction, and on March 26, 2015, Drone Aviation Corp. merged with and into us. As a result of the share exchange and merger with Drone Aviation Corp., we acquired Drone Aviation Corp.’s subsidiary, LTAS. AFS became our subsidiary upon its formation on July 9, 2015. Unless the context otherwise requires, the terms “we,” “our,” “us,” “Company,” “Drone Aviation” and “DAC” as used in this Annual Report refer to Drone Aviation Holding Corp. and its subsidiaries.

Our principal executive offices are located at 11651 Central Parkway #118, Jacksonville, Florida 32224 and our phone number is (904) 834-4400.

#### Business Overview

We design, develop, market and sell lighter-than-air (“LTA”) advanced aerostats and accessories, tethered drones, and land-based intelligence, surveillance and reconnaissance (“ISR”) solutions. We focus primarily on the development of a tethered aerostat known as the Winch Aerostat Small Platform (“WASP”), as well our tethered drone product, the WATT and the FUSE Tether System designed for DJI Inspire 2 and Matrice 200 (M200) professional drones. Our products are designed for commercial and military applications and provide secure and reliable aerial monitoring for extended durations while being tethered to the ground via a high strength armored tether.

#### Products

##### TACTICAL AEROSTATS

The WASP tethered aerostat system is a lighter-than-air, compact aerostat platform that is either self-contained on a trailer that can be towed by a military all-terrain vehicle, or “MATV;” or mine resistant ambush protected vehicle, or “MRAP;” or other standard vehicle, or operated from the bed of a pickup truck. It is designed to provide semi-persistent, mobile, real-time day/night high definition video for ISR, detection of improvised explosive devices, border security and other governmental and civilian uses. All of our products can also be utilized for disaster response missions by supporting two-way and cellular communications and acting as a repeater or provider of wireless networking.

The aerostat systems have a tethered envelope filled with helium gas and carry either a stabilized ISR or communications payload, portable ground control station and a datalink between the ground station and the envelope. Hovering at up to 1,500 feet above the ground, the systems provide surveillance, electronic warfare and communications capabilities with relatively low acquisition and maintenance costs. The systems require an operational crew of a minimum of two personnel, relatively simple maintenance procedures, and a quick retrieval and helium top-off for re-inflation.

The WASP is a mobile, tactical-sized aerostat capable of carrying a variety of payloads in support of military operations helping troops in the field gain a tactical edge while communicating over greater distances. The WASP leverages aerostat technology to elevate network payloads up to 90 pounds to an advantaged height to enable persistent network connectivity while reducing risk to units conducting missions. U.S. Army-owned WASP tactical aerostats have undergone and successfully completed a number of field tests and exercises, including the U.S. Department of Defense (“DoD”) Enterprise Challenge, Stormforce Exercise, and various Army Network Integration Evaluations, which allows the U.S. Government to evaluate, among other things, the WASP’s ability to provide secure communications and capture and relay real-time, high definition video to various handheld devices, tablet computers and other deployed systems. In October 2016, we were awarded contracts from a U.S. Government customer to integrate advanced communication solutions and optical payloads into their WASP aerostats which were delivered in March 2017. In October 2017, we were awarded a contract from a U.S. Government customer for our WASP tactical aerostat and spare parts, which were delivered in February 2018. Because of our ongoing relationship with our U.S. Government customers, we will continue to support the U.S. Army-owned WASP systems for future operations and exercises.

## **POWERED DRONES**

WATT was our first model of a new line of commercial-grade powered tethered drones designed to provide secure and reliable aerial monitoring for extended durations while being connected to a ground-based, software-controlled winch via a safe and secure armored tether line. The concept of the tethered drone system is built on the strength of our experience in developing tethered solutions for our aerostat products and combining that with the advantages of multi-rotor copters. The result is a robust capability designed to be used in almost all-weather environments and controlled with the push of a button. The WATT is designed to take off, hover and land via remote control while connected by a proprietary tether technology where all data, controls and endurance are built into the tether. The same components and systems that our military customers rely on in our launcher systems are being incorporated into the self-contained copter system in order to produce a heavier-than-air, tethered product. The WATT is a complete turnkey system that can be launched within minutes of unpacking from a standard case stored in a host vehicle. Once launched, WATT is designed to hover in a stationary position directly above its launch site at one of several preset altitudes of up to 300 feet for up to 8 hours while a highly-stabilized military-grade/broadcast quality HD video image can provide a 360° live aerial monitoring feed directly through the tether to its host vehicle or to a network of mobile devices, such as tablets or laptop computers. Compact and lightweight, the WATT system features the ability to draw power from either its host vehicle or independently provide up to 8 hours of operation through its own ground power equipment that is specially designed to be transported and deployed from commercial vehicles, such as TV production trucks, first responder vehicles and common agriculture/infrastructure equipment using its standard 120-volt adapter. In September 2016, we were awarded a contract from a U.S. Government customer for our WATT tethered drones, which were delivered in December 2016 and were immediately sent into theater. Because of the classified nature of the operation, we have not been given sufficient feedback to make changes or improvements in the product. No additional units were ordered during 2017. Consequently, until the customer can provide sufficient feedback, we will focus our development and marketing efforts on the WASP systems and continue to explore commercial applications for the WATT product.

We announced the BOLT platform in 2016. Designed to meet a wide range of military and commercial applications requiring persistent, heavy lift capabilities, the BOLT coaxial tethered helicopter delivers rapid setup, high mobility and whisper-quiet operations at altitudes of up to 800 feet. BOLT has a field changeable universal payload bay which supports radio, signals intelligence, or "SIGINT," and ISR packages of up to 15 pounds and requiring up to 1 kilowatt of power. The BOLT prototype was unveiled at ADS, Inc.'s Warrior Expo East industry conference event on July 14, 2016. The Company continues to respond to interest from a select number of potential customers since the introduction and plans to complete development and custom manufacture each vehicle based on order specifications it receives in the future.

## **FUSE TETHER SYSTEM**

In May 2017 we introduced the FUSE Tether System which is an automated smart winch tethering system designed to meet the unique specifications for DJI Inspire and Matrice drones, the world's most popular commercial drones. Utilizing our patent-pending power pack, DJI users can dramatically and affordably increase flight time with uninterrupted power from the ground via a tether and winch. As announced in August 2017, we have partnered with DJI's largest US distributor, Drone Nerds, Inc., to launch a commercial sales program for FUSE. The new program focuses on commercial end users including public safety, law enforcement and newsgathering organizations. Additionally, the program will highlight the role of tethered drones in critical infrastructure inspection and enterprise asset management utilizing high quality imaging systems such as DJI's M200 Zenmuse Z30 aerial camera with 30x optical zoom.

## Market

The market for our LTA advanced aerostats and tethered drones has grown significantly over the last several years and has seen interest increase significantly following the adoption of new commercial drone regulations (Part 107) adopted by the U.S. Federal Aviation Administration (“FAA”) at the end of August 2016 because our tethered drone product line is designed to comply with the FAA’s regulations. The military has transformed into a smaller, more agile fighting force in need of a network of technologies to provide improved observation, communication and precision targeting of combat troop locations, which are often embedded in dense population centers or dispersed in remote locations. Our products provide critical observation and communication capabilities serving the increased demand for ISR and communications, including real-time tactical reconnaissance, tracking, combat assessment and geographic data, while reducing the risks to our troops in theatre. Finally, in a highly constrained fiscal environment, we believe the typically lower acquisition and use/maintenance costs of LTA advanced aerostats and tethered drones make them more appealing compared to their heavier than air manned or larger LTA unmanned system alternatives.

The markets for our systems on a stand-alone basis and/or combined with other payloads relates to the following applications, among others:

### Governmental Markets:

- International, federal, state and local governments and agencies thereof, including DoD, U.S. Drug Enforcement Agency, U.S. Homeland Security, U.S. Customs and Border Protection, U.S. Environmental Protection Agency, U.S. Department of State, U.S. Federal Emergency Management Agency, U.S. and state Departments of Transportation, penitentiaries, and police forces;
- Military, including the U.S. Army Space and Missile Defense Command and U.S. Air Force installations;
- ISR, including the United States Special Operations Forces;
- Border security monitoring, including U.S. Homeland Security, to deter and detect illegal entry;
- Drug enforcement along U.S. borders;
- Monitoring environmental pollution and sampling air emissions; and
- Vehicle traffic monitoring, including aerial speed enforcement by state and local law enforcement agencies.

### Commercial Markets:

- TV and media production mobile communications systems, expanding on-site reporting capabilities to include aerial videography and photography;
- Agriculture monitoring, including monitoring crop health and fields monitoring to reduce costs and increase yields;
- Security for large events, including crowd management;
- Natural disaster instant infrastructure to support first responders;
- Oil pipeline monitoring and exploration; and
- Atmospheric and climate research.

## **Distribution**

We sell our products directly to end customers and through distribution agreements with firms such as ADS Inc., a leading value-added logistics and supply chain solutions provider that serves the U.S. military, federal, state and local government organizations, law enforcement agencies, first responders, partner nations and the defense industry. In addition, our products are included in the U.S. Government's GSA Schedule, which allows government customers to directly negotiate and acquire products and services from commercially-listed suppliers.

## **Competition**

We believe that the principal competitive factors in the markets for the Company's tethered systems (aerostat and drones) include product performance, features, acquisition cost, lifetime operating cost, including maintenance and support, ease of use, integration with existing equipment, size, mobility, quality, reliability, customer support, brand and reputation.

Our proprietary and recently patented tethering technology, in particular, our tension control winch system, is an important competitive differentiator in the market. The winch systems utilized in our products have undergone extensive testing and continued refinement through coordination with customers, including the U.S. Army.

We believe the current market competitors to the WASP aerostat system include a large number of companies ranging from small "mom and pop" tethered aerostat and balloon companies to large defense contractors, including TCOM, Raytheon, Lockheed Martin, ISL, ILC Dover, Compass Systems, Raven Aerostar, American Blimp Corporation, and RT Aerostat Systems, Inc., the American subsidiary of Israeli aerostat company RT LTA. We believe there are numerous commercial drone companies, such as DJI and Parrot, offering free flying drones for pleasure and commercial use, as well as many larger drone manufactures, such as Northrop Grumman, AeroVironment, Inc. and Boeing, offering military grade free flying drones to the U.S. Government, which could compete with the WASP. There are very few commercial grade tethered drone competitors for our WATT tethered drone system that remain tethered to the ground via a high strength armored tether, including Cyphy Works Inc. located in Danvers, MA, Elistair located in Lyon, France, Hoverfly Technologies, Inc. located in Orlando, Florida, and Skysapience located in Yokneam, Israel.

Many of our LTA aerostat competitors have received considerable funding from government or government-related sources to develop and build LTA aerostats. Most of these organizations and many of our other competitors have greater financial, technical, manufacturing, marketing and sales resources and capabilities than we do. We anticipate increasing competition as a result of defense industry consolidation, which has enabled companies to enhance their competitive position and ability to compete against us. In addition, other companies may introduce competing aerostats or solutions based on alternative technologies that may adversely affect our competitive position. As a result, our products may become less or non-competitive or obsolete. For further discussion of certain risks relating to competition, see "Item 1A. Risk Factors" of this Annual Report.

## **Technology, Research and Development**

We conduct the development, commercialization and manufacturing of our products in-house at our facility in Jacksonville, Florida.

Our research and development efforts are largely focused on the LTA aerostat systems, flight control systems for powered drones and the integration of our technology into a third-party product for DJI professional drones. We have developed a "non-military spec" aerostat system for use in more commercial or governmental applications that does not require the level of durability and ruggedness of the current militarized model, and we continue to work on different models with different payloads for various applications.

The concept of the powered drone systems is built on the strength of our years of developing tethered solutions for our LTA aerostat products combined with the advantages of rotor copters. The result is a robust product designed to be utilized in almost all-weather environments and controlled with the push of a button. Our tethered drones are designed to take off, hover and land via remote control all while being connected by a unique tether technology where all data, controls and endurance are built into the tether. The same components and systems that our military customers rely on from our launcher systems are incorporated into our self-contained tethered drone systems in order to produce a unique heavier than air, tethered product offering.

For the year ended December 31, 2017, we spent \$351,768 and for the year ended December 31, 2016, we spent \$1,218,614 on research and development activities. Research and development expenditures are not borne directly by customers nor are the costs accounted for in our pricing models.

### Strategic Partners

We are party to several agreements with strategic partners and distributors to assist us with the marketing and sales of various products, as we currently have limited in-house sales capabilities. Current relationships include:

- A sales and distribution partnership with U.S. government prime contractor ADS Inc.;
- A solution development arrangement with Infor for the integration of the WATT tethered drone and Infor's Enterprise Asset Management system;
- A Master Partner Agreement with Adobe Systems Incorporated to collect video streams for analytics;
- A three-year marketing and integration partnership commenced in March 2015 with L3 Communications Corporation for a "L3-Branded" WASP targeting prime contract customers; and
- Partnered with Drone Nerds, Inc. to launch the first commercial sales program for the FUSE Tether System designed for the DJI Inspire 2 and new Matrice 200 (M200) professional drones.

### Intellectual Property

On September 18 and 19, 2014, we filed provisional patent application numbers "62/052,289" and "62/052,946" entitled "Tethered Portable Aerial Media broadcast System" based on the tethered drone system. On September 18, 2015, we filed a utility patent application claiming a priority date of the two provisional patent applications and having application Serial Number "14858467" entitled "Apparatus and Methods for Tethered Aerial Platform and System." On July 7, 2015, we filed a provisional patent application number "62/189,341" entitled "Apparatus, Methods and System for Tethered Aerial Platform." On September 20, 2016, the United States Patent and Trademark Office ("USPTO") issued patent number 9,446,858 entitled "Apparatus and methods for tethered aerial platform and system." This new patent on our electric tethered aerial platform ("ETAP") technologies covers the core systems currently incorporated into the WATT and BOLT products. On December 5, 2016, we filed a provisional patent application entitled "System for Converting an Onboard Battery Powered Drone to a Ground Powered Tethered Drone." On December 5, 2017 we filed a non-provisional application under the same name and are in patent pending status. Since November 14, 2017, we have been in patent pending status for Communications System Having an Antenna Decoupled from the Radio from a provisional application.

In addition, the Company's intellectual property portfolio includes an exclusive commercial license to vision-based navigation and advanced autonomous flight management software that it acquired in 2015 and exclusive commercial licenses to a number of unmanned vehicle technologies developed by Georgia Tech Research Corporation, including "GUST" (Georgia Tech UAV Simulation Tool) autopilot system.

Our success and ability to compete depends in part on our ability to develop and maintain our intellectual property and proprietary technology and to operate without infringing on the proprietary rights of others. As we continue the development of the tethered drone and aerostat systems, we expect that we will rely on patents, trade secrets, copyrights, trademarks, non-disclosure agreements and other contractual provisions. We have also registered the trademark "Blimp in a Box." In certain cases, when appropriate, we opt to protect our intellectual property through trade secrets as opposed to filing for patent protection in order to preserve confidentiality. All of our employees are subject to non-disclosure agreements and other contractual provisions to establish and maintain our proprietary rights. For further discussion of risks relating to intellectual property, see "Item 1A. Risk Factors" of this Annual Report. For further discussion about the intellectual property rights and licenses and minimum royalties, see *Note 15 – Commitments and Contingencies* in the Notes.



## **Dependence on a Few Customers and Regulatory Matters**

We believe there is a large, growing market for our commercial tethered drones internationally as well as in the U.S. With the recently enacted guidelines for commercial drone use in the U.S. by the FAA (Part 107), we have witnessed a growing U.S. market for commercial drone applications that our tethered drones can serve. Until the FAA officially adopted and published these guidelines in late August 2016, we and our customers were restricted to operating our tethered drones in the National Air Space under either FAA granted exemptions or Certificates of Authorization. In addition to domestic opportunities, we are evaluating various international markets where the FAA does not control the airspace and where our tethered drones can potentially be operated. We anticipate that the majority of our LTA aerostat revenue at least in the foreseeable future will come from U.S. Government and Government-related entities, including the DoD and other departments and agencies. Government programs that we may seek to participate in compete with other programs for consideration during Congress's budget and appropriations hearings, and may be affected by changes not only in political power and appointments, but also general economic conditions and other factors beyond our control. Reductions, extensions or terminations in a program that we are seeking to participate in or overall defense spending could adversely affect our ability to generate revenues and realize any profits. We cannot predict whether potential changes in security, defense and intelligence priorities will afford opportunities for our business in terms of research and development or product contracts, but any reduction in government spending on such programs could negatively impact our ability to generate revenues.

We have registered as a contractor with the U.S. Government and are required to comply with and will be affected by laws and regulations relating to the award, administration and performance of U.S. Government contracts. Government contract laws and regulations affect how we will do business with customers, and in some instances, will impose added costs on our business. A violation of specific laws and regulations could result in the imposition of fines and penalties, the termination of any then existing contracts, or the inability to bid on future contracts. For further discussion of the risks relating to U.S. Government contracts and FAA rules and regulations, see "Item 1A. Risk Factors" of this Annual Report. For further discussion about our dependence on a few major customers see *Note 16 – Concentrations* in the Notes.

International sales of our products may also be subject to U.S. laws, regulations and policies like the U.S. Department of State restrictions on the transfer of technology, International Traffic in Arms Regulations ("ITAR") and other export laws and regulations and may be subject to first obtaining licenses, clearances or authorizations from various regulatory entities. This may limit our ability to sell our products abroad and the failure to comply with any of these regulations could adversely affect our ability to conduct business and generate revenues as well as increase our operating costs. Our products may also be subject to regulation by the National Telecommunications and Information Administration and the Federal Communications Commission, which regulate wireless communications.

## **Sources and Availability of Components**

Certain materials and equipment for our products are custom made for those products and are available only from a limited number of suppliers. Failure of a supplier could cause delays in delivery of the products if another supplier cannot promptly be found or if the quality of such replacement supplier's components is inferior or unacceptable. For further discussion of the risks relating to sources and availability of components, see "Item 1A. Risk Factors" of this Annual Report.

## **Employees**

We have 21 full-time and two part-time employees. Our executive management and accounting team are comprised of six of those full-time employees. We have no labor union contracts and believe relations with our employees are satisfactory.

## Recent Developments

Our marketing efforts include submission of bids on a several government procurement projects that we expect will be awarded in 2018. We also showcased our products and technologies at numerous conferences and live demonstrations, including the 2017 Special Operations Forces Industry Conference, Warrior Expo East, State of Florida HURREX exercise, CyberQuest 2017, and presentations to a variety of federal and state government agencies. We have also increased marketing efforts and announced the following:

- On February 13, 2018, we announced delivery of an enhanced WASP tactical aerostat to the U.S. Army valued in excess of \$800,000. The order itself was announced on October 17, 2017.
- On December 14, 2017, we announced the appointments of Lieutenant General US Army (Retired), John E. Miller and government IT executive, Timothy Hoechst, to our Board of Directors who replaced General Wayne Jackson and Mike Haas after they stepped down from their board seats. Miller and Hoechst bring experience, expertise and strong military and government relations that can further assist the Company to capitalize on momentum.
- On August 28, 2017, we announced the launch of our FUSE Tether System for DJI Commercial Drones through a commercial sales program with Drone Nerds, Inc.
- On May 9, 2017, we announced the new heavy lift WATT 300 Multicopter Tethered Drone and recently upgraded WASP Military Aerostat platforms at the 2017 Special Operations Forces Industry Conference.
- On May 25, 2017, we announced our new product called FUSE which is an automated smart winch tethering system designed to meet the unique specifications for DJI Inspire drones, the world's most popular commercial drone.

## Item 1A. Risk Factors

Investors should carefully consider the risks described below as well as other information provided in this Annual Report. The Company's business, financial condition, results of operations and cash flows could be materially adversely affected, the value of the Company's common stock could decline, and investors may lose all or part of their investment as a result of these risks.

### Risks Related to Our Business and Industry

*Product development is a long, expensive and uncertain process.*

The development of LTA aerostats and tethered drone ISR systems is a costly, complex and time-consuming process, and the investment in product development often involves a long wait until a return, if any, is achieved on such investment. We continue to make significant investments in research and development relating to our aerostats and tethered drones. Investments in new technology and processes are inherently speculative. Technical obstacles and challenges we encounter in our research and development process may result in delays in or abandonment of product commercialization, may substantially increase the costs of development, and may negatively affect our results of operations.

*Successful technical development of our products does not guarantee successful commercialization.*

Even if we successfully complete the technical development for one or all of our product development programs, we may still fail to develop a commercially successful product for a number of reasons, including, among others, the following:

- failure to obtain the required regulatory approvals for their use;
- prohibitive production costs;
- competing products;
- lack of innovation of the product;

- continuing technological changes in the market rendering the product obsolete;
- failure to scale-up our operations sufficiently to satisfy demand for our products;
- ineffective distribution and marketing;
- lack of sufficient cooperation from our partners; and
- demonstrations of the products not aligning with or meeting customer needs.

Although we have sold our WASP aerostat systems and various other aerostat ISR systems and components, our success in the market for the products we develop will depend largely on our ability to prove our products' capabilities. Upon demonstration, our aerostats and tethered drones may not have the capabilities they were designed to have or that we believed they would have. Furthermore, even if we do successfully demonstrate our products' capabilities, potential customers may be more comfortable doing business with a larger, more established, more proven company than us. Moreover, competing products may prevent us from gaining wide market acceptance of our products. We may not achieve significant revenue from new product investments for a number of years, if at all.

***Our potential customers are likely to be U.S. Government or Government-related entities that are subject to appropriations by Congress and reduced funding for defense procurement and research and development programs would likely adversely impact our ability to generate revenues.***

We anticipate that the majority of our revenue (to be derived from our aerostats and tethered drone sales) at least in the foreseeable future will come from U.S. Government and Government-related entities, including the DoD and other departments and agencies. Government programs that we may seek to participate in, and contracts for aerostats or tethered drones, must compete with other programs for consideration during Congress' budget and appropriations hearings, and may be affected by changes not only in political power and appointments but also general economic conditions and other factors beyond our control. A government closure based on a failure of Congress to agree on federal appropriations or the uncertainty surrounding a continuing resolution may result in termination or delay of federal funding opportunities we are pursuing. Reductions, extensions or terminations in a program that we are seeking to participate in or overall defense or other spending could adversely affect our ability to generate revenues and realize any profits. We cannot predict whether potential changes in security, defense, communications and intelligence priorities will afford opportunities for our business in terms of research and development or product contracts, but any reduction in government spending on such programs could negatively impact our ability to generate revenues. In addition, our ability to participate in U.S. Government programs may be affected by the adoption of new laws or regulations relating to Government contracting or changes in existing laws or regulations, changes in political or public support for security and defense programs, and uncertainties associated with the current global threat environment and other geo-political matters.

***Some of our products may be subject to governmental regulations pertaining to exportation.***

International sales of our products may be subject to U.S. laws, regulations and policies like ITAR and other export laws and regulations and may be subject to first obtaining licenses, clearances or authorizations from various regulatory entities. If we are not allowed to export our products or the clearance process is burdensome, our ability to generate revenue would be adversely affected. The failure to comply with any of these regulations could adversely affect our ability to conduct our business and generate revenues as well as increasing our operating costs.

***We compete with companies that have significantly more resources than we have and that already have received government contracts for the development of aerostats and tethered drones.***

A number of our competitors have received considerable funding from government or government-related sources to develop various aerostats and tethered drones. Most of these organizations and many of our other competitors have greater financial, technical, manufacturing, marketing and sales resources and capabilities than we do. Our products will compete not only with other aerostats and tethered drones, but also with heavier-than-air fixed wing aircraft, manned aircraft, communications satellites and balloons. We anticipate increasing competition as a result of defense industry consolidation, which has enabled companies to enhance their competitive position and ability to compete against us. In addition, other companies may introduce competing aerostats, tethered drones, or solutions based on alternative technologies that may adversely affect our competitive position. As a result, our products may become less or non-competitive or obsolete. If we are not able to compete successfully against our current and future competitors, we may fail to generate revenues and our financial condition would be adversely affected.

***We may pursue strategic transactions in the future, which could be difficult to implement, disrupt our business or change our business profile significantly.***

We intend to consider potential strategic transactions, which could involve acquisitions of businesses or assets, joint ventures or investments in businesses, products or technologies that expand, complement or otherwise relate to our current or future business. We may also consider, from time to time, opportunities to engage in joint ventures or other business collaborations with third parties to address particular market segments. These activities create risks such as, among others: (i) the need to integrate and manage the businesses and products acquired with our own business and products, (ii) additional demands on our resources, systems, procedures and controls, (iii) disruption of our ongoing business, and (iv) diversion of management's attention from other business concerns. Moreover, these transactions could involve: (a) substantial investment of funds or financings by issuance of debt or equity securities; (b) substantial investment with respect to technology transfers and operational integration; and (c) the acquisition or disposition of product lines or businesses. Also, such activities could result in one-time charges and expenses and have the potential to either dilute the interests of existing shareholders or result in the issuance of or assumption of debt. Such acquisitions, investments, joint ventures or other business collaborations may involve significant commitments of financial and other resources of our company. Any such activity may not be successful in generating revenue, income or other returns to us, and the resources committed to such activities will not be available to us for other purposes. Moreover, if we are unable to access capital markets on acceptable terms or at all, we may not be able to consummate acquisitions or may have to do so on the basis of a less than optimal capital structure. Our inability to: (i) take advantage of growth opportunities for our business or for our products or (ii) address risks associated with acquisitions or investments in businesses may negatively affect our operating results. Additionally, any impairment of goodwill or other intangible assets acquired in an acquisition or in an investment or charges to earnings associated with any acquisition or investment activity may materially reduce our earnings. These future acquisitions or joint ventures may not result in their anticipated benefits, and we may not be able to properly integrate acquired products, technologies or businesses with our existing products and operations or combine personnel and cultures. Failure to do so could deprive us of the intended benefits of those acquisitions.

***If we fail to protect our intellectual property rights, we could lose our ability to compete in the marketplace.***

Our intellectual property and proprietary rights are important to our ability to remain competitive and for the success of our products and our business. Patent protection can be limited and not all intellectual property is or can be patented. We rely on a combination of patent, trademark, copyright, and trade secret laws as well as confidentiality agreements and procedures, non-competition agreements and other contractual provisions to protect our intellectual property, other proprietary rights and our brand. We have little protection when we must rely on trade secrets and nondisclosure agreements. Our intellectual property rights may be challenged, invalidated or circumvented by third parties. We may not be able to prevent the unauthorized disclosure or use of our technical knowledge or other trade secrets by employees or competitors. Furthermore, our competitors may independently develop technologies and products that are substantially equivalent or superior to our technologies and/or products, which could result in decreased revenues for us. Moreover, the laws of foreign countries may not protect our intellectual property rights to the same extent as the laws of the U.S. Litigation may be necessary to enforce our intellectual property rights, which could result in substantial costs to us and substantial diversion of management attention. If we do not adequately protect our intellectual property, our competitors could use it to enhance their products. Our inability to adequately protect our intellectual property rights could adversely affect our business and financial condition and the value of our brand and other intangible assets.

***If we fail to protect our intellectual property rights, our ability to pursue the development of our technologies and products would be negatively affected.***

Our success will depend in part on our ability to obtain patents and maintain adequate protection of our intellectual property and technologies. Some foreign countries lack rules and methods for defending intellectual property rights and do not protect proprietary rights to the same extent as the United States. We have not filed for any patent protection rights outside the United States, and many companies have had difficulty protecting their proprietary rights in foreign countries. We may not be able to prevent misappropriation of our proprietary rights.

The patent process is subject to numerous risks and uncertainties and there can be no assurance that we will be successful in protecting our technologies by obtaining and enforcing patents. These risks and uncertainties include the following: patents that may be issued or licensed may be challenged, invalidated, or circumvented, or otherwise may not provide any competitive advantage; our competitors, many of which have substantially greater resources than us and many of which have made significant investments in competing technologies, may seek, or may already have obtained, patents that will limit, interfere with, or eliminate our ability to make, use, and license our technologies either in the United States or in international markets; there may be significant pressure on the United States government and other international governmental bodies to limit the scope of patent protection both inside and outside the United States for technologies that prove successful as a matter of public policy regarding security concerns; countries other than the United States may have less restrictive patent laws than those upheld by United States courts, allowing foreign competitors the ability to exploit these laws to create, develop, and market competing products.

Moreover, any patents issued to us may not provide us with meaningful protection, or others may challenge, circumvent or narrow our patents. Third parties may also independently develop technologies similar to ours or design around any patents on our technologies.

In addition, the USPTO and patent offices in other jurisdictions have often required that patent applications concerning software inventions be limited or narrowed substantially to cover only the specific innovations exemplified in the patent application, thereby limiting the scope of protection against competitive challenges. Thus, even if we or our licensors are able to obtain patents, the patents may be substantially narrower than anticipated.

Our success depends on our patents, patent applications that may be licensed exclusively to us, and other patents to which we may obtain assignment or licenses. We may not be aware, however, of all patents, published applications, or published literature that may affect our business by blocking our ability to commercialize our products, by preventing the patentability of future products or services to us or our licensors, or by covering the same or similar technologies that may invalidate our patents, limit the scope of our future patent claims or adversely affect our ability to market our products and services.

In addition to patents, we rely on a combination of trade secrets, confidentiality, nondisclosure and other contractual provisions, and security measures to protect our confidential and proprietary information. These measures may not adequately protect our trade secrets or other proprietary information. If they do not adequately protect our rights, third parties could use our technology, and we could lose any competitive advantage we may have. In addition, others may independently develop similar proprietary information or techniques or otherwise gain access to our trade secrets, which could impair any competitive advantage we may have.

Patent protection and other intellectual property protection are crucial to the success of our business and prospects, and there is a substantial risk that such protections will prove inadequate.

***Other companies may claim that we infringe their intellectual property, which could materially increase our costs and harm our ability to generate future revenue and profit.***

We do not believe our product technologies infringe the proprietary rights of any third party, but claims of infringement are becoming increasingly common and third parties may assert infringement claims against us. It may be difficult or impossible to identify, prior to receipt of notice from a third party, the trade secrets, patent position or other intellectual property rights of a third party, either in the United States or in foreign jurisdictions. Any such assertion may result in litigation or may require us to obtain a license for or otherwise restrict our use of the intellectual property rights of third parties. If we are required to obtain licenses to use any third-party technology, we would have to pay royalties, which may significantly reduce any profit on our products. In addition, any such litigation could be expensive and disruptive to our ability to generate revenue or enter into new market opportunities. If any of our products are found to infringe other parties' proprietary rights and we are unable to come to terms regarding a license with such parties, we may be forced to modify our products to make them non-infringing or to cease production of such products altogether.

***The nature of our business involves significant risks and uncertainties that may not be covered by insurance or indemnity.***

We develop and sell products where insurance or indemnification may not be available, including:

- Designing and developing products using advanced and unproven technologies and aerostats and tethered drones in intelligence and homeland security applications that are intended to operate in high demand, high risk situations; and
- Designing and developing products to collect, distribute and analyze various types of information.

Failure of certain of our products could result in loss of life or property damage. Certain products may raise questions with respect to issues of civil liberties, intellectual property, trespass, conversion and similar concepts, which may raise new legal issues. Indemnification to cover potential claims or liabilities resulting from a failure of technologies developed or deployed may be available in certain circumstances, but not in others. We are not able to maintain insurance to protect against all operational risks and uncertainties. Substantial claims resulting from an accident, failure of our product, or liability arising from our products in excess of any indemnity or insurance coverage (or for which indemnity or insurance is not available or was not obtained) could harm our financial condition, cash flows, and operating results. Any accident, even if fully covered or insured, could negatively affect our reputation among our customers and the public, and make it more difficult for us to compete effectively.

***If critical components or raw materials used to manufacture our products become scarce or unavailable, then we may incur delays in manufacturing and delivery of our products, which could damage our business***

We rely on a limited number of suppliers for the raw materials and hardware components necessary to manufacture our products. We do not have any long-term agreements with any of our suppliers that obligate them to continue to sell their products to us. Our reliance on these suppliers involves significant risks and uncertainties as to whether our suppliers will provide an adequate supply of required raw materials, component parts, and products. In addition, as the demand for these components and other products increases, it is likely that the price for these components will increase. If we are unable to obtain the raw materials and component parts in the quantities and the quality we require on a timely basis and at acceptable prices, we may not be able to deliver our products on a timely or cost-effective basis, which could cause our customers to terminate their contracts with us, increase our costs and materially harm our business, results of operations, and financial condition. Furthermore, if our suppliers are unable or unwilling to supply the raw materials or components we require, we will be forced to locate alternative suppliers and possibly redesign our products to accommodate components from alternative suppliers. This would likely cause significant delays in manufacturing and shipping our products to customers and could materially harm our business.

***Our future profitability may depend on achieving cost reductions from increasing manufacturing quantities of our products. Failing to achieve such reductions in manufacturing costs could materially affect our business.***

We have limited experience manufacturing our products in high volumes and do not know whether or when we will be able to develop efficient, low-cost manufacturing capabilities and processes that will enable us to manufacture our products in large quantities while maintaining our quality, speed, price, engineering and design standards. Our inability to develop such manufacturing processes and capabilities could have a material adverse effect on our business, financial condition, and results of operations. We expect our suppliers to experience an increase in demand for their products, and we may not have reliable access to supplies that we require and may not be able to purchase such materials or components at cost effective prices. There is no assurance that we will obtain any material labor and machinery cost reductions associated with higher production levels, and failure to achieve these cost reductions could adversely impact our business and financial results.

***If we are unable to recruit and retain key management, technical and sales personnel, our business would be negatively affected.***

For our business to be successful, we need to attract and retain highly qualified technical, management and sales personnel. The failure to recruit additional key personnel when needed with specific qualifications and on acceptable terms or to retain good relationships with our partners might impede our ability to continue to develop, commercialize and sell our products. To the extent the demand for skilled personnel exceeds supply, we could experience higher labor, recruiting and training costs in order to attract and retain such employees. The loss of any members of our management team may also delay or impair achievement of our business objectives and result in business disruptions due to the time needed for their replacements to be recruited and become familiar with our business. We face competition for qualified personnel from other companies with significantly more resources available to them and thus may not be able to attract the level of personnel needed for our business to succeed.

***Economic conditions in the U.S. and worldwide could adversely affect our revenues.***

Our revenues and operating results depend on the overall demand for our technologies and services. If the U.S. and worldwide economies weaken, either alone or in tandem with other factors beyond our control (including war, political unrest, shifts in market demand for our services, actions by competitors, etc.), we may not be able to maintain or expand the growth of our revenue.

***We have significant debt and if we are unable to repay our debt when it becomes due, our business, financial condition and results of operations could be materially harmed.***

At March 23, 2018, we had total debt obligations of \$5,500,000, and an aggregate of \$1,500,000 million available for borrowings under our revolving line of credit from City National Bank of Florida and Series 2017 Secured Convertible Notes we issued to related parties. Of this debt, \$2,500,000 matures on August 2, 2018. Our level of indebtedness could have significant effects on our business, such as:

- limiting our ability to borrow additional amounts to fund working capital, capital expenditures, acquisitions, debt service requirements, execution of our growth strategy and other purposes;
- requiring us to dedicate a portion of our cash flow from operations to pay interest on our debt, which would reduce availability of our cash flow to fund working capital, capital expenditures, potential acquisitions, execution of our growth strategy and other general corporate purposes;
- making us more vulnerable to adverse changes in general economic, industry and competitive conditions, in government regulation and in our business by limiting our ability to plan for and react to changing conditions; and
- placing us at a competitive disadvantage compared with our competitors that have less debt.

We may not be able to generate sufficient cash flow from our operations to repay our indebtedness when it becomes due and to meet our other cash needs. If we are not able to pay our debts as they become due, we will be required to pursue one or more alternative strategies, such as selling assets, refinancing or restructuring our indebtedness or selling additional debt or equity securities. We may not be able to refinance our debt or sell additional debt or equity securities or sell our assets on favorable terms, if at all, and if we must sell our assets, we may negatively affect our ability to generate revenue.

***If we are unable to obtain additional funding when needed, our business operations will be harmed, and if we do obtain additional financing, our then existing shareholders may suffer substantial dilution.***

We have historically required additional funds to continue operations and may again in the future upon maturity of the City National Bank of Florida revolving line of credit and the Series 2017 Secured Convertible Notes which mature on August 2, 2018 or sooner if our cash needs exceed the \$1,500,000 currently available to us under these loan facilities. We do not have any contracts or commitments for additional funding, and there can be no assurance that financing will be available in amounts or on terms acceptable to us, if at all, if needed. The inability to obtain additional capital will restrict our ability to grow and may reduce our ability to conduct business operations. If we are unable to obtain additional financing to finance a revised growth plan, we will likely be required to curtail such plans or cease our business operations. Any additional equity financing may involve substantial dilution to our then existing shareholders.

***Opportunities for expanded uses of our products in the United States are limited by federal laws and rulemaking.***

The products we design and manufacture for use within the United States are limited by federal laws and rulemaking, including the new commercial drone regulations (Part 107) adopted by the FAA at the end of August 2016. Our ability to design, manufacture and release new products for use in the United States will be limited by federal law and regulations, which can be slow and subject to delays based on political turnover and disruptions in federal funding, among other reasons. The Part 107 rules limit the altitude, available airspace and weight of a drone and also the certification of remote pilots that can operate a drone for commercial purposes in the United States. We, or our customers, may seek waivers from the Part 107 rules for expanded operations; however, the processing of waivers is lengthy and uncertain. Political limits on the ability to issue new regulations could slow the growth of the aerostat and tethered drone market.

***Misuse of our products or unmanned products manufactured by other companies could result in injury, damage and/or negative press that could depress the market for unmanned systems.***

If any of our products are misused by our customers or their designees, or by the operators of other unmanned systems, in violation of Part 107 or other federal, state or local regulations could result in injuries to the operators or bystanders, damage to property and/or negative press that could result in a reduction in the market for aerostats or tethered drones in the future. The FAA, the press and the public have been closely monitoring the growth of unmanned systems in the United States. For instance, the FAA regularly publishes reports of drone sighting and reported drone strikes of manned aircraft. One or more incidents involving unmanned systems that results in injury or death of individuals, or damaged property could result in negative press that could put at risk current and future growth.

***Our business and operations are subject to the risks of hurricanes, tropical storms, and other natural disasters.***

Our corporate headquarters and manufacturing operations are located in Jacksonville, Florida, where major hurricanes, tropical storms, and other severe weather conditions have occurred. A significant natural disaster, such as a hurricane, tropical storm, or other severe weather storm could severely affect our ability to conduct normal business operations, and as a result, our future operating results could be materially and adversely affected.

#### **Risks Relating to our Common Stock and its Market Value**

***The price of our common stock may be volatile.***

The trading price of our common stock may be highly volatile and could be subject to fluctuations in response to a number of factors beyond our control. Some of these factors are:

- dilution caused by our issuance of additional shares of common stock and other forms of equity securities, which we expect to make in connection with future acquisitions and capital financings to fund our operations and growth, to attract and retain valuable personnel and in connection with future strategic partnerships with other companies;
- our results of operations and the performance of our competitors;
- the public's reaction to our press releases, our other public announcements and our filings with the Securities and Exchange Commission (the "SEC");



- changes in earnings estimates or recommendations by research analysts who follow, or may follow, us or other companies in our industry;
- changes in general economic conditions;
- changes in the valuation of similarly situated companies, both in our industry and in other industries;
- actions of our historical equity investors, including sales of common stock by our directors and executive officers;
- actions by institutional investors trading in our stock;
- disruption of our operations;
- any major change in our management team;
- significant sales of our common stock;
- other developments affecting us, our industry or our competitors; and
- U.S. and international economic, legal and regulatory factors unrelated to our performance.

These and other factors are largely beyond our control, and the impact of these risks, individually or in the aggregate, may result in material adverse changes to the market price of our common stock and/or our results of operations and financial condition.

***There is a limited market for our common stock, which may make it more difficult to dispose of our common stock.***

Our common stock is quoted on the OTCQB under the symbol “DRNE”. However, this is an unorganized, inter-dealer, over-the-counter market which provides significantly less liquidity than the NASDAQ Capital Market or other national securities exchanges. These factors may have an adverse impact on the trading and price of our common stock.

***Sales of substantial amounts of our common stock in the public market could harm the market price of our common stock.***

The sale of a substantial number of shares of our common stock by stockholders could adversely affect the market price of our common stock. As of December 31, 2017, we had 101 stockholders of record and as of December 6, 2016, the date we held our last Annual Shareholder Meeting, there were approximately 5,600 beneficial owners, most of whom have held their shares for the required holding periods under Rule 144 promulgated pursuant to the Securities Act and thus hold freely tradable shares. The shares issued pursuant to conversions under our Series A, B, B-1, D, E, F and G Preferred Stock at various times are now freely tradable pursuant to Rule 144 promulgated pursuant to the Securities Act. If such shares are sold, or if it is perceived they will be sold, the trading price of our common stock could decline. Because investors may be more reluctant to purchase shares of our common stock following substantial sales or issuances, the resale of these shares of common stock could impair our ability to raise capital in the near term.

***We have not paid dividends in the past and do not expect to pay dividends in the future. Any return on investment may be limited to the value of our common stock.***

We have never paid cash dividends on our common stock and do not anticipate paying cash dividends in the foreseeable future. The payment of dividends on our common stock will depend on our earnings, financial condition and other business and economic factors affecting us at such time as our Board of Directors may consider relevant.

***Our common stock is subject to the “penny stock” rules of the SEC and the trading market in our securities is limited, which makes transactions in our stock cumbersome and may reduce the value of an investment in our stock.***

The SEC has adopted Rule 15c-9 which establishes the definition of a “penny stock,” for the purposes relevant to us, as any equity security that has a market price of less than \$5.00 per share or with an exercise price of less than \$5.00 per share, subject to certain exceptions. For any transaction involving a penny stock, unless exempt, the rules require:

- that a broker or dealer approve a person’s account for transactions in penny stocks; and
- that the broker or dealer receive from the investor a written agreement to the transaction, setting forth the identity and quantity of the penny stock to be purchased.

In order to approve a person’s account for transactions in penny stocks, the broker or dealer must:

- obtain financial information, investment experience, and investment objectives of the person; and
- make a reasonable determination that the transactions in penny stocks are suitable for that person and the person has sufficient knowledge and experience in financial matters to be capable of evaluating the risks of transactions in penny stocks.

The broker or dealer must also deliver, prior to any transaction in a penny stock, a disclosure schedule prescribed by the SEC relating to the penny stock market, which, in highlight form:

- sets forth the basis on which the broker or dealer made the suitability determination;
- that it is unlawful for the broker or dealer to effect a transaction in a penny stock unless the broker or dealer has received a signed, written agreement from the investor prior to the transaction; and
- that the broker dealer is required to provide the person with the foregoing written statement and that the person should not sign the written statement unless it accurately reflects the person’s financial situation, investment experience, and investment objectives.

Generally, brokers may be less willing to execute transactions in securities subject to the “penny stock” rules. This may make it more difficult for investors to dispose of our common stock and cause a decline in the market value of our stock.

***FINRA sales practice requirements may also limit a shareholder’s ability to buy and sell our stock.***

In addition to the “penny stock” rules described above, Financial Industry Regulatory Authority, Inc. (“FINRA”) has adopted rules that require that in recommending an investment to a customer, a broker-dealer must have reasonable grounds for believing that the investment is suitable for that customer. Prior to recommending speculative low-priced securities to their non-institutional customers, broker-dealers must make reasonable efforts to obtain information about the customer’s financial status, tax status, investment objectives and other information. Under interpretations of these rules, FINRA believes that there is a high probability that speculative low-priced securities will not be suitable for at least some customers. The FINRA requirements make it more difficult for broker-dealers to recommend that their customers buy our common stock, which may limit a stockholder’s or investor’s ability to buy and sell our stock and have an adverse effect on the market for our shares.

**Item 1B. Unresolved Staff Comments**

None.

**Item 2. Properties**

Our principal executive office is located at 11651 Central Parkway #118, Jacksonville, Florida 32224. Several of our management employees work remotely. We have entered into a 60-month operating lease for 5,533 square feet of office and manufacturing space at 11651 Central Parkway #118, Jacksonville, Florida 32224. The lease commenced February 1, 2015 and we took occupancy in June 2015. Several of our executives work from home-based offices in Florida, Virginia and Oklahoma and receive nominal reimbursement for home office expenses.

**Item 3. Legal Proceedings.**

From time to time, we may become involved in various lawsuits and legal proceedings which arise in the ordinary course of business. We are currently party to the following material legal proceeding:

*Banco Popular North America v Aerial Products Corporation d/b/a Southern Balloon Works, et al. (Fourth Judicial Circuit Court, Duval County Florida-Civil Division) Case No. 16:2016:CA-003343*

On May 16, 2016, Banco Popular North America (“Banco”) filed a lawsuit in Duval County, Florida in the Circuit Court of the Fourth Judicial Circuit against Aerial Products Corporation d/b/a Southern Balloon Works (“Aerial Products”), Kevin M. Hess, LTAS, and the Company to collect on a delinquent Small Business Administration loan that Banco made in 2007 to Aerial Products with Mr. Hess as the personal guarantor. LTAS and the Company filed an Answer on June 30, 2016 and Responses to Interrogatories on December 16, 2016 and we are now in the discovery phase of litigation. The lawsuit is active and discovery is ongoing. It is our position that neither LTAS nor the Company are continuations of Aerial Products, and LTAS and the Company has denied all allegations made by Banco and is vigorously defending itself. The Company has evaluated the probability of loss as possible but the range of loss is unable to be estimated.

Other than as set forth above, there are no pending material claims, actions, suits, proceedings, inquiries, labor disputes or investigations involving the Company.

**Item 4. Mine Safety Disclosures.**

Not applicable.

## PART II

### Item 5. Market For Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

#### Market Information and Price Range of Common Stock

The Company's common stock is quoted on the OTCQB tier of the OTC Markets, Inc. under the ticker symbol "DRNE".

The following sets forth the range of the bid prices for our common stock for the quarters for the prior two fiscal years. Such prices represent inter-dealer quotations, do not represent actual transactions, and do not include retail mark-ups, markdowns or commissions. Such prices were determined from information provided by a majority of the market makers for the Company's common stock.

Quarter Ended	2017		2016	
	Bid Price		Bid Price	
	High	Low	High	Low
March 31	\$ 2.99	\$ 2.17	\$ 3.60	\$ 2.30
June 30	2.27	1.35	3.25	2.67
September 30	1.45	0.71	4.45	2.80
December 31	1.65	0.89	3.35	2.61

#### Holdings

As of March 23, 2018, there were approximately 101 stockholders of record, according to the records of our transfer agent, and an unknown number of additional holders whose stock is held in 'street name'.

#### Dividends

We have not declared any common stock dividends to date. We have no present intention of paying any cash dividends on our common stock in the foreseeable future, as we intend to use earnings, if any, to generate growth. The payment by us of dividends, if any, in the future, is within the discretion of our Board of Directors and will depend upon, among other things, our earnings, capital requirements and financial condition, as well as other relevant factors. There are no material restrictions in our Articles of Incorporation, as amended, or Bylaws that restrict us from declaring dividends.

#### Recent Sales of Unregistered Securities

All sales of unregistered securities during the period covered by this Annual Report have been previously disclosed.

#### Debt Maturity Extension

On March 23, 2018, the Company entered into amendments (the "March 2018 Convertible Note Amendments") with the owners and holders of the Series 2016 Convertible Notes to extend the maturity date from April 2, 2019 to October 1, 2020.

#### Item 6. Selected Financial Data.

Not required under Regulation S-K for smaller reporting companies.

## Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

### Introduction

The following management discussion and analysis of financial condition and results of operations (this "MD&A") should be read in conjunction with our Consolidated Financial Statements and the notes to those statements (the "Notes") that appear elsewhere in this Annual Report. Except for the historical information contained therein, the discussions in this MD&A contain forward-looking statements based upon current expectations that involve risks and uncertainties, such as plans, strategies, objectives, expectations and intentions. Actual results and the timing of events could differ materially from those anticipated in these forward-looking statements as a result of a number of factors, including those set forth under "Item 1A. Risk Factors" and elsewhere in this Annual Report.

### Business Overview

For this information please see "Item 1. Business" of this Annual Report. The information regarding an overview of our business is set forth under "Item 1. Business—Business Overview" of this Annual Report and is incorporated into this MD&A by this reference.

### Results of Operations

#### *Year Ended December 31, 2017 Compared to Year Ended December 31, 2016*

*Total Net Revenues:* Total net revenues decreased \$906,384, or 62%, to \$562,078 in 2017 from \$1,468,462 in 2016. Sources of revenue were derived primarily from aerostat products, refurbishments and accessories ordered in 2016 and delivered in 2017. The reason for the decrease is that revenues in 2017 were primarily related to refurbishments and enhancements of aerostat systems and the revenues in 2016 were primarily from the sale of an aerostat system. Also contributing to the decrease in sales volume was a longer sales cycle stemming in part from the change in presidential administration and congressional budgeting delays. We expect increased sales in future periods based on a product pipeline developed following our increased marketing efforts discussed in Item 1. Business-Business Overview included elsewhere in this report.

*Cost of Goods Sold and Gross Profit:* Cost of goods sold for 2017 decreased \$219,146, or 39%, from \$557,725 in 2016 to \$338,579 in 2017, primarily consisting of materials, parts and labor associated with the sale of aerostat systems, refurbishment of aerostat systems and sale of tethered drones. The aerostat system delivered in the first quarter of 2016 had a 73% gross profit margin which was greater than the gross profit realized in the first quarter of 2017 on aerostat system refurbishments due to the increased time and material costs to disassemble and reassemble refurbished systems. The \$223,499 gross profit for 2017 was a decrease of \$687,238 or 75% from the \$910,737 in gross profit for 2016. Gross profit margins were 40% and 62% for 2017 and 2016, respectively. Margins also vary based on customer payload selection; therefore, future margins may vary accordingly.

*General and Administrative Expenses:* General and administrative ("G&A") expense increased by \$337,622, or 3%, to \$10,069,841 in 2017 from \$9,732,219 in 2016. The Company's legal fees in 2017 were \$132,418 which is a decrease of \$119,028, or 47% from legal fees in 2016 of \$251,446. The decrease is attributable to the Company's hiring of competent and respected SEC counsel on an hourly versus retainer basis. Marketing expenses in 2017 were \$314,184 which is an increase of \$60,991, or 24% from marketing expenses of \$253,183 in 2016. Travel expenses in 2017 were \$221,215 which is an increase of \$68,151, or 45% from travel expenses of \$153,064 in 2016. The increase in both marketing and travel expense is related to a month long on-site demonstration conducted in the third quarter of 2017. Research and development expenses decreased \$866,846, or 71% to \$351,768 in 2017 from \$1,218,614 in 2016. This decrease was anticipated as the Company is relying on past research and development efforts to support its current products. Future research and development costs are not expected to increase significantly. Stock based compensation, a non-cash expense, increased \$1,049,780, or 19% to \$6,602,806 in 2017 from \$553,026 in 2016.

*Loss from Operations:* Loss from operations for 2017 of \$9,846,342 was an increase of \$1,024,860, or 12%, more than the loss from operations in 2016 of \$8,821,482. The increase was primarily due to an increase in non-cash stock based compensation.

*Other Income and Expense:* Total other expense of \$477,650 in 2017 was \$765,617, or 266%, less than the total other income of \$287,967 in 2016. This increase was primarily due to \$1,627,297 interest expense associated with convertible notes payable, bank and related party lines of credit and amortization of debt discount, \$681,988 loss recorded on debt extinguishment from the modification of terms of the 2016 related party convertible note payable partially offset by \$1,831,635 non-cash income due to a derivative gain on convertible debt. In the same period of 2016, the other income mainly included \$75,000 recorded for gain on debt forgiveness and \$11,000 recorded for gain on settlement of make whole provision.

*Net Loss:* Net loss of \$10,323,992 in 2017 was \$1,790,477, or 21%, greater than the net loss in 2016 of \$8,533,515 primarily due to the factors discussed above.

There was no provision for income taxes for the fiscal years ended 2017 and 2016 due to a valuation allowance of \$2,250,939 and \$2,574,915 recorded for the years ended December 31, 2017 and 2016, respectively, on the total tax provision, because we believed that it is more likely than not that the tax asset will not be utilized during the next year.

## **Liquidity and Capital Resources**

Liquidity is the ability of an enterprise to generate adequate amounts of cash to meet its needs for cash requirements. As of December 31, 2017, the Company had \$615,375 in cash compared to \$2,015,214 in cash at December 31, 2016, a decrease of \$1,399,839. As of December 31, 2017, the Company had accounts receivable of \$110,065 compared to \$394,000 at December 31, 2016, a decrease of \$283,935 resulting from increased collections in 2017.

The Company had total current assets of \$1,820,145 and total current liabilities of \$2,377,340, or working capital deficit of \$557,195 at December 31, 2017 compared to total current assets of \$2,989,713 and total current liabilities of \$3,080,628, or working capital deficit of \$90,915 at December 31, 2016.

We have historically financed our operations through operating revenues, loans from banks and shareholders and sales of equity and convertible debt securities. Although as of December 31, 2017 we have cash of \$615,375, we have a working capital deficit of \$557,195 and incurred a net loss from operations in 2017 of \$10,323,992. Furthermore, the Company has a history of negative cash flow from operations, primarily due to historically heavy investment in research and development and costs associated with maintaining a public entity.

In the event we are unable to refinance our revolving line of credit from City National Bank of Florida and our Series 2017 Secured Convertible Notes which mature on August 2, 2018, we will not have sufficient resources to continue our operations for the next 12 months and to effectuate all aspects of our business plan. We will have to raise additional funds to pay for all of our planned expenses. We potentially will have to issue additional debt or equity, or enter into a strategic arrangement with a third party to carry out some aspects of our business plan. If we need to raise additional funds through the issuance of equity, equity-related or convertible debt securities in the future, these securities may have rights, preferences or privileges senior to those of the rights of holders of our common stock. We cannot predict whether additional financing will be available to us on favorable terms when required, or at all. The issuance of additional common stock may have the effect of further diluting the proportionate equity interest and voting power of holders of our common stock. Historically, we have financed our cash needs by private placements of our securities and loans, bank financing and revenues from sales of our products. There is no assurance that we will be able to obtain financing on terms consistent with our past financings or satisfactory to us, if at all.

We currently have no agreements, arrangements or understandings with any person to obtain funds through bank loans, lines of credit or any other sources. Since we have no other such arrangements or plans currently in effect, our inability to raise funds for the above purposes will have a severe negative impact on our ability to remain a viable company. We are dependent upon our significant shareholders to provide or loan us funds to meet our working capital needs.

In anticipation of increased sales resulting from our developing product pipeline, on August 2, 2017, we completed financing transactions that provided us with up to \$4,000,000 in cash and extended the maturity date on \$3,000,000 of convertible debt until April 2019 providing us with significant increased liquidity and a strengthened balance sheet. The following is a summary of these completed financing transaction:

*Revolving Line of Credit from City National Bank of Florida.* On August 2, 2017, the Company issued a promissory note to City National Bank of Florida (“CNB”) in the principal amount of \$2,000,000, the CNB Note. The note evidences a revolving line of credit with advances that may be requested by the Company until the maturity date of August 2, 2018 so long as no event of default exists under the note, the Company or Mr. Nussbaum does not cease doing business, Mr. Nussbaum does not seek to revoke or modify his guarantee of the Note, the Company does not misapply the proceeds of this loan or CNB in good faith does not believe itself insecure. The CNB Note bears interest at a variable rate equal to 0.250 percentage points over the Wall Street Journal Prime Rate payable monthly. The Company will pay to CNB a late charge of 5.0% of any monthly payment not received by Lender within 10 calendar days after its due date. The Company may prepay the note at any time without penalty. In the event of a default, the interest rate will increase to the highest lawful rate. The Company is obligated to maintain depository accounts with CNB with a minimum average annual balance of \$600,000. In the event the Company does not maintain this account balance, CNB may charge the Company a fee equal to 2% of the deficiency as additional interest under the note. The CNB Note is personally guaranteed by Mr. Nussbaum, the Company’s Chief Executive Officer pursuant to written guarantee in favor of CNB (the “CNB Guarantee”). Mr. Nussbaum and the Company are obligated to maintain an unencumbered liquidity of no less than \$6,000,000 in the form of cash, repurchase agreements, certificates of deposit or marketable securities acceptable to CNB. In addition, to secure our obligations under the note, we entered into a security agreement in favor of CNB (the “Security Agreement”) encumbering all of our accounts, inventory and equipment along with an assignment of a bank account we maintain at CNB with an approximate balance of \$90,000. As of March 23, 2018, we have borrowed a total of \$1,250,000 under the CNB Note leaving availability of \$750,000 under such note.

*Series 2017 Secured Convertible Note.* On August 2, 2017, the Company issued a Secured Convertible Promissory Note Series 2017 due August 2, 2018 in the aggregate principal amount of \$2,000,000 (the “Series 2017 Convertible Note”) in a private placement to Frost Nevada Investments Trust (“Frost Nevada”). Frost Nevada is a trust that is controlled by Dr. Frost, a substantial shareholder of the Company. The note evidences a revolving line of credit with advances that may be requested by the Company until the maturity date of August 2, 2018 so long as no event of default exists under the loan. The Company may request advances of principal under this note equal to and at the same time as it requests advances, if any, pursuant to the CNB Note. The note bears interest at a variable rate equal to 0.250 percentage points over the Wall Street Journal Prime Rate. The Company may prepay the notes at any time without penalty. If the Company does not prepay the note in full or the holder does not convert the note before the maturity date, the Company may pay the outstanding principal amount and any accrued and unpaid interest on the maturity date with cash or with common stock or through a combination of cash and stock at Frost Nevada’s discretion. The conversion price under the note is \$1.00 per share subject to proportional adjustment in the event of stock splits, stock dividends and similar corporate events. The Series 2017 Convertible Note is secured by a security interest in all of the Company’s assets. This security interest is subordinate to the security interest of CNB discussed above.

As of March 23, 2018, we have borrowed a total of \$1,250,000 under the Series 2017 Secured Convertible Note leaving availability of \$750,000 under such note.

*Amendments to Related Party Convertible Promissory Notes.* On August 3, 2017, the Company entered into amendments (the “Convertible Note Amendments”) with the owners and holders of the following convertible promissory notes issued by the Company (the “Convertible Notes”):

- Convertible Promissory Note in the original principal amount of \$1,500,000 issued by the Company on September 29, 2016 to Frost Gamma Investments Trust (“Frost Gamma”). Frost Gamma is a trust that is controlled by Dr. Phillip Frost, a substantial shareholder of the Company; and
- Convertible Promissory Note in the original principal amount of \$1,500,000 issued by the Company on September 29, 2016 to Jay H. Nussbaum, the Company’s Chief Executive Officer and Chairman of the Board of Directors.

The Convertible Note Amendments extend the maturity date for each of the Convertible Notes to April 1, 2019 (the “Maturity Date”) and revise the conversion price to mean \$1.00 per share subject to proportional adjustment in the event of stock splits, stock dividends and similar corporate events. Consistent with the original terms of the Convertible Notes, interest accrues at the rate of 6% interest per annum and is payable on the Maturity Date. The accrued interest is payable at the holders’ option in cash or shares of our common stock valued at the \$1.00 per share conversion price. The Convertible Note Amendments provide that an event of default in the City National Bank Loan will be treated as an event of default under the Convertible Notes. On March 23, 2018, the Company entered into additional amendments further extending the maturity date from April 1, 2019 until October 1, 2020.

On November 9, 2017, the Company entered into amendments (the “November 2017 Convertible Note Amendments”) with the owners and holders of the Series 2016 Convertible Notes to permit the payment of, at the holders’ election, accrued and unpaid interest either in monthly or quarterly payments at any time after the Effective Date. Both principal amount and accrued interest may be paid with: (i) cash; (ii) the issuance and delivery to the holder of shares of common stock of the Company at the conversion price provided for in the Series 2016 Convertible Note; or (iii) any combination of cash and shares of Common Stock, as determined by the holder in its sole discretion.

The accompanying consolidated financial statements and notes have been prepared assuming the Company will continue as a going concern. For the year ended December 31, 2017, the Company incurred a net loss of \$10,323,992, generated negative cash flow from operations, has an accumulated deficit of \$29,996,777 and working capital deficit of \$557,195. These circumstances raise substantial doubt as to the Company’s ability to continue as a going concern. The Company’s ability to continue as a going concern is dependent upon the Company’s ability to create and market innovative products, raise capital, reduce debt or renegotiate terms, and to sustain adequate working capital to finance its operations. The failure to achieve the necessary levels of profitability and cash flows or obtain additional funding would be detrimental to the Company. The consolidated financial statements do not include any adjustments that might be necessary if the Company is unable to continue as a going concern

**Sources and Uses of Cash**

	<b>Years Ended Dec 31,</b>	
	<b>2017</b>	<b>2016</b>
Cash flows (used in) operating activities	\$ (3,326,022)	\$ (3,593,184)
Cash flows (used in) investing activities	(73,817)	(16,336)
Cash flows provided by financing activities	2,000,000	2,965,000
Net (decrease) in cash and cash equivalents	<u>\$ (1,399,839)</u>	<u>\$ (644,520)</u>

***Operating Activities:***

Net cash used in operating activities during 2017 was \$3,326,022, which was a decrease of \$267,162, or 7%, from \$3,593,184 net cash used in operating activities during 2016. The net loss of \$10,323,992 for 2017 was \$1,790,477 greater than the same period of 2016, which was \$8,533,515. Accounts Receivables decreased \$283,935 and Accounts Payables decreased by \$(88,563) in 2017 due to decreased sales activity. Inventory increased \$531,812 to \$991,697 in 2017 primarily due to a WASP system that was nearly completed and that was delivered in February 2018. The Company recorded \$6,602,766 in non-cash stock based compensation expenses which was an increase of \$1,049,740 in 2017 from the previous year. The Company recorded a non-cash gain on derivative liability of \$1,831,635, an increase of \$1,268,674 from 2016, which was \$562,961. Amortization expense of \$292,000 on intangible assets during 2017 was \$121,667 greater than the same period in 2016, which was \$170,333.

***Investing Activities:***

Net cash used in investing activities was \$73,817 in 2017 and \$16,336 in 2016. The Company acquired a truck in 2017 for \$73,142 and equipment of \$675. In 2016, the Company invested in the purchase of shop machines and equipment, computers and electronics and furniture and equipment. The Company expects the investment in furniture and equipment in 2018 to be no greater than the investment in furniture and equipment in 2017, but we can give no assurance that such furniture and equipment costs will remain within that range in 2018.

***Financing Activities:***

Financing activities during 2017 included \$1,000,000 proceeds from a bank line of credit and \$1,000,000 proceeds from a related party convertible note payable. Financing activities for 2016 included \$3,000,000 in proceeds from the issuance of convertible notes payable offset by \$35,000 paid to satisfy the delinquent Oklahoma Technology Commercialization Center loan.



As of December 31, 2017, the Company has common stock outstanding, as well as a bank line of credit and Convertible Notes payable to related persons of the Company.

#### **Off-Balance Sheet Arrangements**

We do not have any off balance sheet arrangements that have had or are reasonably likely to have a current or future material effect on our financial condition, changes in financial condition, revenues, expenses, results of operations, liquidity, capital expenditures or capital resources.

#### **Critical Accounting Policies and Estimates**

The following is not intended to be a comprehensive list of our accounting policies or estimates. Our significant accounting policies are more fully described in *Note 1—Summary of Significant Accounting Policies* in the Notes. In preparing our financial statements and accounting for the underlying transactions and balances, we apply our accounting policies and estimates as disclosed in the Notes. We consider the policies and estimates discussed below as critical to an understanding of our financial statements because their application places the most significant demands on our judgment, with financial reporting results dependent on estimates about the effect of matters that are inherently uncertain and may change in subsequent periods. Specific risks for these critical accounting estimates are described in the following paragraphs. The impact and any associated risks related to these estimates on our business operations are discussed throughout this MD&A where such estimates affect our reported and expected financial results. Preparation of this Annual Report requires us to make estimates and assumptions that affect the reported amount of assets and liabilities, disclosure of contingent assets and liabilities at the date of our financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results may differ from those estimates.

Besides estimates that meet the “critical” accounting estimate criteria, we make many other accounting estimates in preparing our financial statements and related disclosures. All estimates, whether or not deemed critical, affect reported amounts of assets, liabilities, revenue and expenses as well as disclosures of contingent assets and liabilities. Estimates are based on experience and other information available prior to the issuance of the financial statements. Materially different results can occur as circumstances change and additional information becomes known, including for estimates that we do not deem “critical.”

##### *Accounts Receivable and Credit Policies:*

Accounts receivable-trade consists of amounts due from the sale of tethered aerostats, accessories, spare parts, and customization and refurbishment of aerostats. Such accounts receivable are uncollateralized customer obligations due under normal trade terms requiring payment within 30 days of receipt of the invoice. We provide an allowance for doubtful accounts equal to the estimated uncollectible amounts based on historical collection experience and a review of the current status of trade accounts receivable. At December 31, 2017 and 2016, none of the Company’s accounts receivable-trade was deemed uncollectible.

##### *Revenue Recognition and Unearned Income:*

The Company recognizes revenue when all four of the following criteria are met: (1) persuasive evidence of an arrangement exists; (2) delivery has occurred and title has transferred or services have been rendered; (3) our price to the buyer is fixed or determinable; and (4) collectability is reasonably assured. We record unearned revenue as a liability and their associated costs of sales as work in process inventory. There was a balance of \$110,065 in accounts receivable at December 31, 2017 of which \$76,995 was for sales on account and \$33,070 was for advances against future commissions to an employee.

#### *Long-Lived Assets:*

We account for long-lived assets in accordance with the provisions of ASC 360-10-35, "Impairment or Disposal of Long-lived Assets." This accounting standard requires that long-lived assets be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset.

On July 20, 2015, we, through our wholly-owned subsidiary AFS, entered into an agreement to acquire exclusive commercial software licenses for the "GUST" (Georgia Tech UAV Simulation Tool) autopilot system from AFI. Through the purchase of the assets of AFI, we assumed the transferable licenses from the Georgia Tech Research Corporation, which include flight simulation tools and fault tolerant flight control algorithms. In addition, we acquired AFI's dedicated flight computer and additional related hardware and airframes. We paid \$100,000 in immediately available funds and \$100,000 to be held in escrow. In addition, we issued 150,000 shares of unregistered common stock valued at \$8.40 per share, on a post-reverse split basis, on the closing date of the acquisition, to be held in escrow. We issued 50,000 shares of common stock to AFI in the second quarter of 2016 after all milestones had been met as a requirement of the terms of the acquisition because the value of the escrowed shares fell below \$1,400,000 and triggered a 'make whole' provision. The asset acquisition with AFI did not qualify as a business combination under ASC 805-10, "Business Combinations," and has been accounted for as a regular asset purchase.

We account for goodwill and intangible assets in accordance with ASC 350, "Intangibles-Goodwill and Other." ASC 350 requires that goodwill and other intangibles with indefinite lives be tested for impairment annually or on an interim basis if events or circumstances indicate that the fair value of an asset has decreased below its carrying value.

#### *Derivative Financial Instruments:*

We evaluate our financial instruments to determine if such instruments are derivatives or contain features that qualify as embedded derivatives. For derivative financial instruments that are accounted for as liabilities, the derivative instrument is initially recorded at its fair value and is then re-valued at each reporting date, with changes in the fair value reported in the statements of operations. For stock-based derivative financial instruments, we use a Black-Scholes option pricing model, in accordance with ASC 815-15, "Derivative and Hedging," to value the derivative instruments at inception and on subsequent valuation dates. The classification of derivative instruments, including whether such instruments should be recorded as liabilities or as equity, is evaluated at the end of each reporting period. Derivative instrument liabilities are classified in the balance sheet as current or non-current based on whether or not net-cash settlement of the derivative instrument could be required within 12 months of the balance sheet date.

#### *Stock-Based Compensation:*

We account for stock-based compensation in accordance with ASC 718, "Compensation-Stock Compensation." ASC 718 requires companies to measure the cost of employee services received in exchange for an award of equity instruments, including stock options, based on the grant-date fair value of the award and to recognize it as compensation expense over the period the employee is required to provide service in exchange for the award, usually the vesting period.

#### **Recently Issued Accounting Pronouncements**

In May 2014, the FASB issued Accounting Standards Update No. 2014-09 (Topic 606) "Revenue from Contracts with Customers." Topic 606 supersedes the revenue recognition requirements in Topic 605 "Revenue Recognition" (Topic 605), and requires entities to recognize revenues when control of the promised goods or services is transferred to customers at an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services. We adopted Topic 606 as of January 1, 2018 using the modified retrospective transition method. Upon adoption, we will recognize the cumulative effect of adopting this guidance as an adjustment to our opening balance of retained earnings. Prior periods will not be retrospectively adjusted. We expect the adoption of Topic 606 will not have a material impact to our consolidated financial statements, including the presentation of revenues in our Consolidated Statements of Operations.

In February 2016, the FASB issued ASU 2016-02, Leases, which will amend current lease accounting to require lessees to recognize (i) a lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis, and (ii) a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the least term. ASU 2016-02 does not significantly change lease accounting requirements applicable to lessors; however, certain changes were made to align, where necessary, lessor accounting with the lessee accounting model. This standard will be effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company is currently reviewing the provisions of this ASU to determine if there will be any impact on our results of operations cash flows or financial condition.

Other than those pronouncements, management does not believe that there are any other recently issued, but not effective, accounting standards which, if currently adopted, would have a material effect on the Company's financial statements.

**Item 7A. Quantitative and Qualitative Disclosures About Market Risk.**

Not required under Regulation S-K for smaller reporting companies.

**Item 8. Financial Statements and Supplementary Data.**

Our consolidated financial statements, together with the independent registered public accounting firm report of MaloneBailey, LLP, begin on page F-1 of this Annual Report.

**Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure.**

None.

**Item 9A. Controls and Procedures.**

*(a) Evaluation of disclosure controls and procedures.*

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures pursuant to Rule 13a-15 under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), as of the end of the period covered by this Annual Report. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, the design of disclosure controls and procedures must reflect the fact that there are resource constraints and that management is required to apply its judgment in evaluating the benefits of possible controls and procedures relative to their costs.

Based on management's evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of December 31, 2017, due to the weakness in internal control over financial reporting described below, our disclosure controls and procedures are not designed at a reasonable assurance level or effective to provide reasonable assurance that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in SEC rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. As discussed below, we plan on increasing the size of our accounting staff at the appropriate time for our business and its size to ameliorate our auditor's concern that the Company does not effectively segregate certain accounting duties, which we believe would resolve the material weakness in internal control over financial reporting and similarly improve disclosure controls and procedures, but there can be no assurances as to the timing of any such action or that the Company will be able to do so.

*(b) Management's Annual Report on Internal Control Over Financial Reporting.*

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Exchange Act Rule 13a-15(f). Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, conducted an evaluation of the effectiveness of our internal control over financial reporting based on the criteria set forth in Internal Control-Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

Our management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2017. Based on that assessment, our management determined that, as of December 31, 2017, the Company's internal control over financial reporting was not effective for the purposes for which it is intended. Specifically, management's determination was based on the following material weaknesses which existed as of December 31, 2017:

The Company did not effectively segregate certain accounting duties due to the small size of its accounting staff.

A material weakness is a deficiency, or a combination of control deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of our annual or interim consolidated financial statements will not be prevented or detected on a timely basis. Notwithstanding the determination that our internal control over financial reporting was not effective, as of December 31, 2017, and that there was a material weakness as identified in this Annual Report, we believe that our consolidated financial statements contained in this Annual Report fairly present our financial position, results of operations and cash flows for the years covered hereby in all material respects.

This Annual Report does not include an attestation report by MaloneBailey LLP, our independent registered public accounting firm, regarding internal control over financial reporting. As a smaller reporting company, our management's report was not subject to attestation by our registered public accounting firm pursuant to rules of the SEC that permit us to provide only management's report in this Annual Report.

*Changes in internal control over financial reporting.*

We regularly review our system of internal control over financial reporting and make changes to our processes and systems to improve controls and increase efficiency. Changes may include such activities as implementing new, more efficient systems, consolidating activities, and migrating processes. In the prior year, we identified a material weakness related to not maintaining a fully-integrated financial reporting system which has since been remediated. There were no changes in our internal control over financial reporting that occurred during the three months ended December 31, 2017 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. Although we plan to increase the size of our accounting staff at the appropriate time for our business and its size to ameliorate our auditor's concern that the Company does not effectively segregate certain accounting duties, there can be no assurances as to the timing of any such action or that the Company will be able to do so.

**Item 9B. Other Information.**

None.

### PART III

#### Item 10. Directors, Executive Officers and Corporate Governance

The following table sets forth the names and ages of the members of our Board of Directors and our executive officers and the positions held by each. Our Board of Directors elects our executive officers annually by majority vote. Each director's term continues until his or her successor is elected or qualified at the next annual meeting, unless such director earlier resigns or is removed.

NAME	AGE	Positions and Offices
Kevin Hess	51	Chief Technology Officer and Director
Felicia Hess	50	Chief Operating Officer
Daniyel Erdberg	39	President
Kendall Carpenter	62	Chief Financial Officer, Executive Vice President, Secretary and Treasurer
Jay H. Nussbaum	73	Chairman of the Board of Directors and Chief Executive Officer
Timothy Hoechst	52	Director and Chairman of the Compensation Committee
John E. Miller	76	Director and Chairman of the Audit Committee
David Aguilar	62	Director

#### Executive Biographies:

**Jay H. Nussbaum**, 73, joined our Board of Directors on June 1, 2015 and was named Chief Executive Officer on April 26, 2016. He has extensive executive experience and expertise in government and commercial sales and management. Mr. Nussbaum is the founder of Agilex Technologies, Inc. and served as its Vice Chairman and Chief Operating Officer from 2006 to March 2015, when it was acquired by Accenture Federal Services, a provider of mission and technology solutions to the national security, healthcare and public sectors of the U.S. government. He previously served as Executive Vice President of Oracle Service Industries ("Oracle"), under Oracle's then Chairman and Chief Executive Officer Larry Ellison, where Mr. Nussbaum oversaw Government, Education, Health, Communications, Utilities and Financial Services operations. He also served as Global Head of Sales, Marketing and Business Development for Citigroup Global Transaction Services, and as President of Integrated Systems Operation at Xerox Corp. Mr. Nussbaum has been a director of Grand Slam Acquisition Corp. since October 24, 2007, a director of Victory Acquisition Corp. since January 12, 2007 and a director at Agilex Technologies, Inc. since 2006. Mr. Nussbaum is a graduate of the University of Maryland with a B.A. in Business. Mr. Nussbaum's government and commercial sales and management experience qualifies him to serve on our Board of Directors.

**Kevin Hess**, 51, was appointed Chief Technology Officer on April 27, 2016. He served as Chief Executive Officer between October 2, 2015 and April 27, 2016. Upon the closing of the Share Exchange on June 3, 2014, he was appointed Director of Engineering. Mr. Hess became one of our directors on October 2, 2015. Mr. Hess has more than 20 years of technology experience comprising electronic systems design for DoD programs and image processing and analytics for companies such as Hughes, Kodak and Dainippon. Mr. Hess has been integrally involved with LTAS as an engineer and consultant since its founding in 2009, overseeing the development of its proprietary aerostat and drone products. As an IT executive at Fortune 250 companies, Mr. Hess performed lead roles in software development, application architecture, mission-critical infrastructure, and multi-million dollar project sponsorship and oversight. Mr. Hess continues to leverage his background and education in computer science, having attended the Harvard Business School's Program for Management Development to further his strong track record of technology innovation and financial management. Mr. Hess brings his unique talents to the design, manufacturing and support of our solutions. Mr. Hess's technology industry experience qualifies him to serve on our Board of Directors.

**Felicia Hess**, 50, was appointed Chief Executive Officer and one of our directors upon the closing of the Share Exchange on June 3, 2014. She resigned those positions on October 2, 2015 and was appointed Chief Operating Officer that same day. Ms. Hess founded and began serving as President and a director of LTAS in 2009. Ms. Hess continued serving as President and a director of LTAS after it was sold in 2013 to World Surveillance Group Inc. (“WSGI”), a developer of lighter-than-air aerostats and unmanned aerial systems, and continued serving as President and a director of LTAS after it was acquired from WSGI by Drone Aviation Corp. until Drone Aviation Corp. merged with and into us. Ms. Hess leverages her background in marketing, web site development and customer acquisition to further the Company’s growth strategies. Ms. Hess graduated from the University of Virginia with a B.A. in Rhetoric and Communications.

**Daniyel Erdberg**, 39, was appointed Chief Operating Officer upon the closing of the Share Exchange on June 3, 2014. He resigned that position on October 2, 2015 and was appointed President that same day. Mr. Erdberg served as Director of Business Development at WSGI, a developer of lighter-than-air aerostats and unmanned aerial systems, from 2010 through May 2014, where he worked with LTAS and specialized in advanced, custom designed ISR solutions. Mr. Erdberg successfully worked with LTAS’s aerial surveillance solutions for various government and commercial customers. Over the past 14 years, Mr. Erdberg has been involved in operations of companies in various sectors of technology, including software development, telecommunications, wireless networking and unmanned aerial systems. Mr. Erdberg graduated from Florida International University with a B.A. in International Business.

**Kendall W. Carpenter, CPA, CGMA, CMA**, 62, joined MacroSolve in 2006 as Controller. She was promoted to Executive Vice President and Chief Financial Officer in 2008 and transitioned to Drone Aviation in 2014. Ms. Carpenter is also the Corporate Secretary and Treasurer. Ms. Carpenter’s previous experience includes Division Controller with Allied Waste Industries, over 10 years of experience as the top financial officer of an enterprise software company with an international customer base and over 8 years of public accounting experience. Ms. Carpenter graduated with a B.S. in Accounting from Oklahoma State University and has earned the professional designations of Certified Public Accountant, Chartered Global Management Accountant and Certified Management Accountant.

**John E. Miller**, 76, was appointed to our Board of Directors on December 13, 2017 and agreed to serve as Chair of the Audit Committee. From September 2007 to the present, General Miller has operated his own consulting practice providing operational and technical assessments in support of fielding new military hardware and innovations for military training and education. From January 2005 until August 2007, he served as a Divisional President for L-3 Communication providing linguist, intelligence analyst and technical support for deployed forces in 13 countries. From September 1997 to January 2005, LTG Miller was a regional Vice President for Oracle Corporation’s Public Sector Division. Lieutenant General Miller (Retired) is a decorated combat veteran who served in the US Army from 1963 to 1997. At the time of his retirement from active duty on September 1, 1997, he was serving as the Deputy Commanding General of the US Army Training and Doctrine Command (TRADOC) responsible for coordinating the implementation of the Army’s first digitized command and control system in a combat brigade. He also had multiple assignments at the US Army Command and General Staff College where help positions from Tactics Instructor to Commandant. While Commandant, he was concurrently responsible for 11 other Army Schools that provide tactical training and education for Commissioned and Non-Commissioned Officers. General Miller holds a B.S. in Mathematics from Missouri State University and an M.S. in Operations Research from Georgia Tech. He is a graduate of the Army Command and General Staff College and the Army War College. For these reasons, we believe General Miller has the requisite set of skills and experience to serve as a valuable member of our Board of Directors and its committees on which he serves.

**Timothy Hoechst**, 52, was appointed to our Board of Directors on December 13, 2017 and agreed to serve as Chair of the Compensation Committee. Prior to his retirement in June 2016, Mr. Hoechst held the position of Chief Technology Officer at Accenture Federal Services (AFS), a leading IT solutions provider to the US government from March 2015 until June 2016. At AFS, he was responsible for identifying and introducing new technologies to help the government with challenging IT problems. From March 2007 until March 2015, he served as Chief Technology Officer at Agilex Technologies, an IT consulting firm service the Department of Defense, Homeland Security and various government agencies. Agilex was acquired by AFS in 2015. From June 1997 until December 2006, Mr. Hoechst held senior positions at Oracle Corporation, including serving as Senior Vice President of the Public Sector Division. Mr. Hoechst has a B.A. in Computer Science from Harvard University. Mr. Hoechst’s government and management experience qualifies him to serve on the board of directors.

**David Aguilar**, 62, was appointed to our Board of Directors on January 9, 2017. Since February 2013, Mr. Aguilar has been a principal at Global Security Innovation Strategies, LLC. In April 2010, Mr. Aguilar became Deputy Commissioner of U.S. Customs and Border Protection (“CBP”) and, from December 2011 until his retirement in February 2013, he served as acting Commissioner of CBP. From July 2004 to January 2010, he served as Chief of the U.S. Border Patrol within the CBP. As Acting Commissioner of CBP, Mr. Aguilar took the helm of a workforce of 60,000 agents, officers, and other personnel with responsibility for strategic planning and oversight of an annual budget of nearly \$12 billion. Mr. Aguilar is a recipient of the 2005 President’s Meritorious Excellence Award, and in 2008, was a recipient of the Presidential Rank Award. Prior to joining the CBP, Mr. Aguilar held a variety of operational and administrative positions within the U.S. Board Patrol since entering duty in June 1978. Mr. Aguilar holds an Associate’s Degree in Accounting from Laredo Community College and attended Laredo State University and the University of Texas at Arlington. He is a graduate of the Senior Executive Fellows program at Harvard University’s John F. Kennedy School of Government. Mr. Aguilar’s government and management experience qualifies him to serve on the board of directors.

All executive officers are employed under agreements which run through December 31, 2018.

#### **Family Relationships**

Kevin Hess, our Chief Technology Officer and a director, is married to Felicia Hess, our Chief Operating Officer.

#### **Meetings of the Board of Directors**

During the fiscal year ended December 31, 2017, our Board of Directors held four meetings and approved certain actions by unanimous written consent. We expect our directors to attend all meetings of the Board of Directors and the committees thereof on which such directors serve and to spend the time needed to prepare for such meetings and meet as frequently as necessary to properly discharge their responsibilities.

#### **Board Committees**

Even though we are not required to have any committees of the Board of Directors, our board has two standing committees: an Audit Committee and a Compensation Committee. Our Board of Directors performs the functions customarily performed by a nominating committee.

#### **Audit Committee**

The Board of Directors has adopted a written charter for the Audit Committee. Our Audit Committee is responsible for: (1) the integrity of our financial reporting process, systems of internal controls, and financial statements and reports; (2) the compliance by us with legal and regulatory requirements; and (3) the appointment, compensation and oversight of our independent auditor’s preparation and issuance of an audit report or related work. A more detailed description of our Audit Committee’s purposes and responsibilities is contained in its charter. The Audit Committee is comprised of Chairman General John Miller, Jay Nussbaum and Timothy Hoechst. Our Board of Directors has determined in its business judgment that, other than Mr. Nussbaum, all of the members of our Audit Committee are independent within the meaning of the OTCQX Rules for U.S. Companies, the Sarbanes-Oxley Act of 2002, and related SEC rules. None of our directors is an ‘audit committee financial expert’ within the meaning of Item 401E of Regulation S-K. During the fiscal year ended December 31, 2017, our Audit Committee held one meeting independent of the Board of Directors.

## Compensation Committee

Our Board of Directors has adopted a written charter setting forth the authority and responsibilities of the Compensation Committee. Our Compensation Committee has responsibility for assisting the Board of Directors in, among other things, evaluating and making recommendations regarding the compensation of our executive officers and directors, assuring that the executive officers are compensated effectively in a manner consistent with our stated compensation strategy, producing an annual report on executive compensation in accordance with the rules and regulations promulgated by the SEC, periodically evaluating the terms and administration of our incentive plans and benefit programs, and monitoring of compliance with the legal prohibition on loans to our directors and executive officers. A more detailed description of our Compensation Committee's purposes and responsibilities is contained in its charter. The Compensation Committee is comprised of Chairman Timothy Hoechst, Jay Nussbaum and General Miller. Our Board of Directors has determined in its business judgment that a majority of our Compensation Committee is independent within the meaning of the OTCQX Rules for U.S. Companies and SEC rules. During the fiscal year ended December 31, 2017, our Compensation Committee held two meetings.

### Board Leadership Structure and Role in Risk Oversight

Our Board of Directors is primarily responsible for overseeing our risk management processes. Our Board of Directors receives and reviews periodic reports from management, auditors, legal counsel, and others, as considered appropriate regarding our Company's assessment of risks. The Board of Directors focuses on the most significant risks facing our Company and our Company's general risk management strategy, and also ensures that risks undertaken by our Company are consistent with the Board's appetite for risk. While the Board oversees our Company, our Company's management is responsible for day-to-day risk management processes. We believe this division of responsibilities is the most effective approach for addressing the risks facing our Company and that our Board leadership structure supports this approach.

### Section 16(a) Beneficial Owner Reporting Compliance

Because we do not have a class of securities registered under Section 12 of the Exchange Act, our executive officers and directors and beneficial owners of more than 10% of our common stock are not required to file reports pursuant to Section 16(a) of the Exchange Act.

### Code of Ethics

The Company has adopted a Code of Ethics and Business Conduct that applies to all of its directors, officers (including our principal executive officer, principal financial officer, principal accounting officer or controller, and any person performing similar functions) and employees. The Code of Ethics and Business Conduct is available on our website at [ir.droneaviationcorp.com/governance-docs](http://ir.droneaviationcorp.com/governance-docs).

### Item 11. Executive Compensation.

The following table provides certain summary information concerning compensation awarded to, earned by or paid to the individuals who served as our principal executive officer during fiscal 2017 and our two other most highly compensated officers in fiscal 2017.

Name and Principal Position	Year	Salary (\$)	Bonus (\$)	Stock Awards (\$)(5)	Option Awards (\$)(6)	All Other Compensation (\$)	Total (\$)
<b>Jay Nussbaum, Chief Executive Officer and Chairman (1),</b>	2017	128,000	0	0	2,115,659	0	2,243,659
	2016	48,001	75,000	1,309,545(1)	0	0	1,432,546
<b>Kevin Hess, Chief Technology Officer and Director (2)</b>	2017	200,000	0	0	0	510	200,510
	2016	200,000	50,000	145,500	0	13,762	409,262
<b>Felicia Hess, Chief Operating Officer (3)</b>	2017	150,000	0	0	1,050,433	0	1,200,433
	2016	150,000	10,000	1,018,500(3)	0	130,216	1,308,716
<b>Daniyel Erdberg, President (4)</b>	2017	156,250	0	0	919,453	3,500	1,079,203
	2016	147,500	50,000	727,500(4)	0	99,115	1,024,115

(1) Mr. Nussbaum was appointed Chairman of our Board of Directors on June 1, 2015 and was named Chief Executive Officer on April 27, 2016.



For service as Chief Executive Officer in 2017, Mr. Nussbaum received two option awards. The first award of 2,000,000 option shares were immediately vested with a strike price of \$1.00 and an expiration date of August 3, 2021 and valued at \$1,284,925. The second award of 900,000 option shares were immediately vested with a strike price of \$1.35 and an expiration date of November 9, 2021 and valued at \$830,734. For service as Chief Executive Officer in 2016, Mr. Nussbaum received two awards of common stock in 2016. The first award of 450,000 shares of common stock was subject to performance-based vesting and fully vested on September 26, 2016. The shares were valued at \$2.91 per share, or \$1,309,500, on the date of the award. The second award of 450,000 shares of common stock is subject to performance-based vesting, which has not yet occurred. The shares were valued at \$3.305 per share, or \$1,487,250, on the date of the award. This amount was subsequently reversed as the vesting condition was determined to be improbable in 2017. As a result of this reversal, the previously reported stock award of \$2,796,750 in 2016 was reduced by \$1,487,205 to \$1,309,545 in the table above.

For service as a director and Chairman of our Board of Directors in 2016, Mr. Nussbaum received a monthly director fee of \$4,000 pursuant to a Director Agreement entered into with the Company in June 2015, which totaled \$28,000 in 2017 and \$48,000 in 2016. Mr. Nussbaum began receiving a monthly salary of \$20,000 in August 2017 in lieu of his director fee, which salary totaled \$100,000 in 2017. Mr. Nussbaum was awarded a \$75,000 bonus on December 6, 2016 which was accrued and paid in January 2017.

- (2) On April 27, 2016, Mr. Hess resigned as Chief Executive Officer and was appointed Chief Technology Officer. He previously served as Director of Engineering. Mr. Hess is also a member of our Board of Directors, but receives no compensation for his service as a director.

For services as Chief Technology Officer and Chief Executive Officer in 2016, Mr. Hess received an award of 50,000 shares of common stock subject to performance-based vesting that fully vested on September 26, 2016. The shares were valued at \$2.91 per share, or \$145,500, on the date of the award. In addition to his annual salary, Mr. Hess received \$11,946 in 2016 for withholding taxes paid on his award of common stock. Mr. Hess recognized additional compensation of \$510 and \$1,816 in 2017 and 2016, respectively, for personal use of a company vehicle, grossed up for taxes. Mr. Hess was awarded a \$50,000 bonus on December 6, 2016 which was accrued and paid in January 2017.

- (3) Ms. Hess was appointed Chief Executive Officer and a director of the Company on June 3, 2014. On October 2, 2015, Ms. Hess resigned as Chief Executive Officer and director and was appointed Chief Operating Officer. Ms. Hess did not receive any compensation for her service as a director in 2015.

For service as Chief Operating Officer in 2017, Ms. Hess received two option awards. The first award of 1,200,000 option shares were immediately vested with a strike price of \$1.00 and an expiration date of August 3, 2021 and valued at \$773,522. The second award of 300,000 option shares were immediately vested with a strike price of \$1.35 and an expiration date of November 9, 2021 and valued at \$276,911. For service as Chief Operating Officer in 2016, Ms. Hess received two common stock awards in 2016. The first award of 350,000 shares of common stock was subject to performance-based vesting and fully vested on September 26, 2016. The shares were valued at \$2.91 per share, or \$1,018,500, on the date of the award. The second award of 431,500 shares of common stock is subject to performance-based vesting and has not yet vested. The shares were valued at \$3.305 per share, or \$1,426,108, on the date of the award. This amount was subsequently reversed as the vesting condition was determined to be improbable in 2017. As a result of this reversal, the previously reported stock award of \$2,444,608 in 2016 was reduced by \$1,426,108 to \$1,018,500 in the table above. In addition to her annual salary, Ms. Hess received a bonus of \$115,971 in 2016 for withholding taxes paid in on her stock awards and additional compensation of \$14,245 for the personal use of a company vehicle, grossed up for taxes. Ms. Hess was awarded a \$10,000 bonus on December 6, 2016 which was accrued and paid in January 2017.

- (4) For service as President in 2017, Mr. Erdberg received two option awards. The first award of 1,140,000 option shares were immediately vested with a strike price of \$1.00 and an expiration date of August 3, 2021 and valued at \$734,846. The second award of 200,000 option shares were immediately vested with a strike price of \$1.35 and an expiration date of November 9, 2021 and valued at \$184,607. For service as President in 2016, Mr. Erdberg received two stock awards in 2016. The first award of 250,000 shares of common stock was subject to performance-based vesting and fully vested on September 26, 2016. The shares were valued at \$2.91 per share, or \$727,500, on the date of the award. The second award of 332,500 shares of common stock remains subject to performance-based vesting. The shares were valued at \$3.305 per share, or \$1,098,913, on the date of the award. This amount was subsequently reversed as the vesting condition was determined to be improbable in 2017. As a result of this reversal, the previously reported stock award of \$1,826,413 in 2016 was reduced by \$1,098,913 to \$727,500 in the table above. In addition to his annual salary, Mr. Erdberg received a bonus of \$93,115 in 2016 for withholding taxes paid on his stock awards and additional compensation of \$3,500 and 6,000 in 2017 and 2016, respectively, for an auto allowance. Mr. Erdberg was awarded a \$50,000 bonus on December 6, 2016 which was accrued and paid in January 2017.
- (5) Amounts shown in the “Stock Awards” column reflect the aggregate grant date fair value calculated in accordance with FASB ASC 718 for the respective fiscal year with respect to shares of restricted stock and immediately vested shares granted to our named executive officers. Amounts reflect our accounting for these awards and do not necessarily correspond to the actual values that may be realized by our named executive officers. The grant date fair values of shares of restricted stock and immediately vested shares were determined as of the grant date using the closing bid price of our common stock on the grant date. The assumptions used for the valuations are set forth in *Note 10 – Shareholder Equity* in the Notes. Pursuant to SEC rules, we disregarded the estimates of forfeitures related to service-based vesting conditions. See the Outstanding Equity Awards at Fiscal Year-End Table in this Annual Report and related notes for information with respect to equity awards made prior to fiscal 2017.
- (6) Amounts shown in the “Option Awards” column reflect the aggregate grant date fair value calculated in accordance with FASB ASC 718 for the respective fiscal year with respect to stock options granted to our named executive officers. Amounts reflect our accounting for these option grants and do not necessarily correspond to the actual values that may be realized by our named executive officers. The grant date fair values of these option grants were calculated at the grant date using the Black-Scholes-Merton option-pricing model. The assumptions used for the valuations are set forth in *Note 12 – Employee Stock Options* in the Notes. Pursuant to SEC rules, we disregarded the estimates of forfeitures related to service-based vesting conditions. See the Outstanding Equity Awards at Fiscal Year-End Table in this Annual Report and related notes for information with respect to stock options granted prior to fiscal 2017.

#### **Employment Contracts and Potential Payments Upon Termination or Change in Control**

**Jay Nussbaum Employment Agreement.** On April 27, 2016, we entered into an Employment Agreement with Jay Nussbaum (as amended, the “Nussbaum Employment Agreement”), whereby Mr. Nussbaum agreed to serve as our Chief Executive Officer and a director (with such service as a director subject to the terms of a Director Agreement, dated June 1, 2015) for a period of two (2) years and twenty-two (22) days, subject to renewal for successive one year terms, in consideration of an annual salary of \$1 base salary. The Nussbaum Employment Agreement was subsequently amended to extend the term of Mr. Nussbaum’s employment to December 31, 2018. On August 3, 2017, the Nussbaum Employment Agreement was amended to reflect an increase in Mr. Nussbaum’s base salary to \$240,000. Additionally, Mr. Nussbaum is eligible for an annual cash bonus if we meet or exceed criteria adopted by the Compensation Committee of the Board of Directors. Mr. Nussbaum shall also be eligible for grants of awards under stock option or other equity incentive plans of our Company as our Compensation Committee may from time to time determine and shall be entitled to participate in all benefits plans we provide to our senior executives. We shall reimburse Mr. Nussbaum for all reasonable out-of-pocket expenses actually incurred or paid by Mr. Nussbaum in the course of his employment. In the event Mr. Nussbaum’s employment is terminated without Cause or by Mr. Nussbaum with Good Reason (as such terms are defined in the Nussbaum Employment Agreement), then in addition to receiving accrued but unpaid compensation and vacation pay through the end of the term of employment, benefits accrued and outstanding under benefit plans, and the reimbursement of documented, unreimbursed expenses prior to the date of termination, Mr. Nussbaum will be entitled to receive severance benefits equal to six months of his then-current base salary, continued coverage under our benefit plans for a period of twelve months and payment of his pro-rated earned annual bonus. Mr. Nussbaum has also agreed to non-competition and non-solicitation provisions effective during his term of employment and for one year thereafter. On September 26, 2016, the Company and Mr. Nussbaum amended the Nussbaum Employment Agreement to extend the term of Mr. Nussbaum’s until December 31, 2018.

**Kevin Hess Employment Agreement.** On October 2, 2015, we entered into an Amended and Restated Employment Agreement with Kevin Hess (as further amended, the “K. Hess Employment Agreement”), whereby Mr. Hess agreed to serve as our Chief Executive Officer for a period of two (2) years, subject to renewal for successive one year terms, in consideration for an annual salary of \$200,000. On April 27, 2016, the Company and Mr. Hess amended the K. Hess Employment Agreement to reflect Mr. Hess’s appointment as Chief Technology Officer and extend the term of employment until May 18, 2018, which was further extended to December 31, 2018 pursuant to a subsequent amendment to the K. Hess Employment Agreement. Additionally, Mr. Hess is eligible for an annual cash bonus in an amount equal to up to one hundred percent (100%) of his then-current base salary if we meet or exceed criteria adopted by the Compensation Committee of the Board of Directors. Mr. Hess shall also be eligible for grants of awards under stock option or other equity incentive plans of our Company as our Compensation Committee may from time to time determine and shall be entitled to participate in all benefits plans we provide to our senior executives. Mr. Hess is also entitled to the use of a company-provided vehicle. We shall reimburse Mr. Hess for all reasonable out-of-pocket expenses actually incurred or paid by Mr. Hess in the course of his employment. In the event Mr. Hess’ employment is terminated without Cause or by Mr. Hess with Good Reason (as such terms are defined in the K. Hess Employment Agreement), Mr. Hess shall be entitled to receive his accrued and unpaid base salary through the date of termination, continued coverage under our benefit plans for a period of one month and reimbursement of documented, unreimbursed expenses incurred prior to the date of termination. Mr. Hess has also agreed to non-competition and non-solicitation provisions effective during the term of his employment and for one year thereafter.

**Felicia Hess Employment Agreement.** On May 18, 2015, we entered into an employment agreement with Felicia Hess (as amended, the “F. Hess Employment Agreement”), whereby Ms. Hess agreed to serve as our Chief Executive Officer and director for a period of two (2) years, subject to renewal for successive one year terms, in consideration for an annual salary of \$150,000. On October 2, 2015, Ms. Hess resigned as Chief Executive Officer and as a director, and the F. Hess Employment Agreement was amended to reflect Ms. Hess’s appointment as Chief Operating Officer. The F. Hess Employment Agreement was subsequently amended to extend the term of Ms. Hess’s employment to December 31, 2018. Under the F. Hess Employment Agreement, Ms. Hess is eligible for an annual cash bonus in an amount equal to up to one hundred percent (100%) of her then-current base salary if we meet or exceed criteria adopted by the Compensation Committee of the Board of Directors. Ms. Hess shall also be eligible for grants of awards under stock option or other equity incentive plans of our Company as our Compensation Committee may from time to time determine and shall be entitled to participate in all benefits plans we provide to our senior executives. Ms. Hess was entitled to the use of a company-provided vehicle until that benefit was removed from the F. Hess Employment Agreement on August 3, 2017. We shall reimburse Ms. Hess for all reasonable out-of-pocket expenses actually incurred or paid in the course of her employment. In the event Ms. Hess’ employment is terminated without Cause or by Ms. Hess with Good Reason (as such terms are defined in the F. Hess Employment Agreement), then in addition to receiving accrued but unpaid compensation and vacation pay through the end of the term of employment, benefits accrued and outstanding under benefit plans, and the reimbursement of documented, unreimbursed expenses prior to the date of termination, Ms. Hess shall be entitled to receive severance benefits equal to six months of her then-current base salary, continued coverage under our benefit plans for a period of twelve months, payment of her pro-rated earned annual bonus, and the vesting of all unvested options or restricted stock awards will be accelerated. Ms. Hess has also agreed to non-competition and non-solicitation provisions during her term of employment and for one year thereafter.

**Daniyel Erdberg Employment Agreement.** On May 18, 2015, we entered into an employment agreement with Daniyel Erdberg (as amended, the “Erdberg Employment Agreement”), whereby Mr. Erdberg agreed to serve as our Chief Operating Officer for a period of two (2) years, subject to renewal for successive one year terms, in consideration for an annual salary of \$140,000. On October 2, 2015, Mr. Erdberg resigned as Chief Operating Officer, and the Erdberg Employment Agreement was amended to reflect his appointment as President of the Company. The Erdberg Employment Agreement was subsequently further amended to increase Mr. Erdberg’s base salary to \$150,000 and to extend his term of employment to December 31, 2018. On August 3, 2017, the Erdberg Employment Agreement was amended to reflect an increase in Mr. Erdberg’s base salary to \$165,000. Under the Erdberg Employment Agreement, Mr. Erdberg is eligible for an annual cash bonus in an amount equal to up to one hundred percent (100%) of his then-current base salary if we meet or exceed criteria adopted by the Compensation Committee of the Board of Directors. Mr. Erdberg shall also be eligible for grants of awards under stock option or other equity incentive plans of our Company as the Compensation Committee may from time to time determine and shall be entitled to participate in all benefits plans we provide to our executives. We shall reimburse Mr. Erdberg for all reasonable out-of-pocket expenses actually incurred or paid in the course of his employment. Mr. Erdberg was granted a \$500 per month car allowance for the term of his employment by the Board of Directors in December 2015 which was discontinued in August 2017. In the event Mr. Erdberg’s employment is terminated without Cause or by Mr. Erdberg with Good Reason (as such terms are defined in the Erdberg Employment Agreement), then in addition to receiving accrued but unpaid compensation and vacation pay through the end of the term of employment, benefits accrued and outstanding under benefit plans, and the reimbursement of documented, unreimbursed expenses prior to the date of termination, Mr. Erdberg shall be entitled to receive severance benefits equal to six months of his then-current base salary, continued coverage under our benefit plans for a period of twelve months after his termination date and payment of his pro-rated earned annual bonus. Mr. Erdberg has also agreed to non-competition and non-solicitation provisions during the term of his employment and for one year thereafter.

## Outstanding Equity Awards at Fiscal Year-End

The following table sets forth outstanding equity awards to our named executive officers as of December 31, 2017.

Name	Option awards			Stock awards	
	Number of securities underlying unexercised options (#) exercisable	Option exercise price (\$)	Option expiration date	Number of shares or units of stock that have not vested (#) (1)	Market value of shares of units of stock that have not vested (\$) (2)
(a)	(b)	(e)	(f)	(g)	(h)
Jay Nussbaum					
Option Grant	50,000	5.00	12/10/2018		
Option Grant	2,000,000	1.00	8/3/2021		
Option Grant	900,000	1.35	11/9/2021		
Stock Grant				450,000	418,500
Kendall Carpenter					
Option Grant	25,000	6.00	05/18/2018		
Option Grant	5,000	5.00	12/10/2018		
Option Grant	275,000	1.00	8/3/2021		
Option Grant	170,000	1.35	11/9/2021		
Stock Grant				50,000	46,500
Felicia Hess					
Option Grant	75,000	6.00	05/18/2018		
Option Grant	5,000	5.00	12/10/2018		
Option Grant	1,200,000	1.00	8/3/2012		
Option Grant	300,000	1.35	11/9/2021		
Stock Grant				431,500	401,295
Daniyel Erdberg					
Option Grant	75,000	6.00	05/18/2018		
Option Grant	10,000	5.00	12/10/2018		
Option Grant	1,140,000	1.00	8/3/2012		
Option Grant	200,000	1.35	11/9/2021		
Stock Grant				332,500	309,225

(1) These are unvested awards of restricted stock which will vest, if at all, as follows: (i) in the case of Mr. Nussbaum, 450,000 shares of common awarded on September 26, 2016, that vest subject to performance-based vesting which has not yet occurred (ii) in the case of Ms. Carpenter, 46,500 shares of common awarded on September 26, 2016 that vest subject to performance-based vesting which has not yet occurred (iii) in the case of Ms. Hess, 431,500 shares of common awarded on September 26, 2016 that vest subject to performance-based vesting which has not yet occurred; and (iv) in the case of Mr. Erdberg, 332,500 shares of common awarded on September 26, 2016 that vest subject to performance-based vesting which has not yet occurred.

(2) The market value shown was determined by multiplying the number of shares of restricted stock that have not vested by the \$.93 closing bid price per share of our common stock on December 31, 2017, the last trading day of our fiscal 2017.

### Director Compensation Table for 2017

The following table sets forth director compensation for the fiscal year ended December 31, 2017 (excluding compensation to the Company's executive officers set forth in the summary compensation table above) paid by the Company.

Name	Fees Earned or Paid in Cash	Stock Awards <sup>(1)</sup>	Total (\$)
Michael Haas <sup>(2)</sup>	\$ 24,000	\$ 15,676	\$ 39,676
Maj. Gen. Wayne P. Jackson (Ret.) <sup>(3)</sup>	\$ 24,000	\$ 15,676	\$ 39,676
David Aguilar <sup>(4)</sup>	\$ 24,000	\$ 73,691	\$ 97,691
Timothy Hoechst <sup>(5)</sup>	\$ 2,000	\$ 49,894	\$ 51,894
LTG John E. Miller (Ret.) <sup>(6)</sup>	\$ 3,000	\$ 49,894	\$ 52,894
<b>Total:</b>	<u>\$ 77,000</u>	<u>\$ 204,832</u>	<u>\$ 281,832</u>

(1) The amounts reflected for Stock Awards in the table above represent the dollar amount recognized for financial statement reporting purposes with respect to the fair value of securities granted in accordance with SFAS 123R. Pursuant to SEC rules, the amounts shown exclude the impact of estimated forfeitures related to service-based vesting conditions. These amounts reflect our accounting expense for these awards, and do not correspond to the actual value that may be realized upon exercise.

(2) Mr. Haas resigned from the Board on December 13, 2017. All amounts paid to Mr. Haas are for his services on the Board prior to December 13, 2017.

The Board approved a monthly fee of \$2,000 for Mr. Haas for his services on the Board in 2017. In recognition of the past performance of services by Mr. Haas, the Company entered into an Amendment to Nonqualified Stock Option Agreement on December 13, 2017 (the "Amendment to Stock Option Agreement") to extend the exercise period from 30 days to August 3, 2021 for his options to purchase shares of the Company's common stock previously issued to him.

(3) Maj. Gen. Jackson resigned from the Board on December 13, 2017. All amounts paid to Maj. Gen. Jackson are for his services on the Board prior to December 13, 2017.

The Board approved a monthly fee of \$2,000 for Maj. Gen. Jackson for his services in 2017 on the Board. In recognition of the past performance of services by Gen. Jackson, the Company entered into an Amendment to Nonqualified Stock Option Agreement on December 13, 2017 (the "Amendment to Stock Option Agreement") to extend the exercise period from 30 days to August 3, 2021 for his options to purchase shares of the Company's common stock previously issued to him.

(4) Mr. Aguilar was appointed on January 9, 2017 for a term of two years and, pursuant to the terms of a Director Agreement with Global Security Innovative Strategies, LLC ("GSIS"), will be paid an annual fee of \$24,000 and was awarded Stock Options (the "Options") to purchase 100,000 shares of the Company's common stock with an exercise price of \$2.90 per share. The Options vest as follows: 50,000 shares one year after the date of appointment so long as he is a member of the Board and 50,000 shares two years after the date of appointment so long as he is a member of the Board. Mr. Aguilar's appointment will terminate, however, upon his resignation, removal or failure to be appointed or re-appointed by the Company's shareholders as a director of the Company as provided for in its bylaws or as provided for under Nevada law, or upon request of the Company's Chief Executive Officer.

(5) Mr. Hoechst was appointed on December 13, 2017 for a term of two years and, pursuant to the terms of a Director Agreement, will be paid an annual fee of \$24,000 and was awarded Stock Options (the "Options") to purchase 100,000 shares of the Company's common stock with an exercise price of \$1.00 per share. The Options vest as follows: 50,000 shares one year after the date of appointment so long as he is a member of the Board and 50,000 shares two years after the date of appointment so long as he is a member of the Board. Mr. Hoechst's appointment will terminate, however, upon his resignation, removal or failure to be appointed or re-appointed by the Company's shareholders as a director of the Company as provided for in its bylaws or as provided for under Nevada law, or upon request of the Company's Chief Executive Officer.

(6) Mr. Miller was appointed on December 13, 2017 for a term of two years and, pursuant to the terms of a Director Agreement, will be paid an annual fee of \$36,000 and was awarded Stock Options (the "Options") to purchase 100,000 shares of the Company's common stock with an exercise price of \$1.00 per share. The Options vest as follows: 50,000 shares one year after the date of appointment so long as he is a member of the Board and 50,000 shares two years after the date of appointment so long as he is a member of the Board. Mr. Miller's appointment will terminate, however, upon his resignation, removal or failure to be appointed or re-appointed by the Company's shareholders as a director of the Company as provided for in its bylaws or as provided for under Nevada law, or upon request of the Company's Chief Executive Officer.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.**

The following table sets forth the number of shares of and percent of the Company's common stock beneficially owned as of March 23, 2017, by all directors, our named executive officers, our directors and executive officers as a group, and persons or groups known by us to own beneficially 5% or more of our Common Stock having voting rights.

The business address of each of the beneficial owners listed below is c/o Drone Aviation Holding Corp., 11651 Central Parkway #118, Jacksonville, Florida 32224.

<b>Name of Beneficial Owner</b>	<b>Title of Class</b>	<b>Amount and Nature of Beneficial Ownership</b>	<b>Percentage of Class (1)</b>
<b>5% Shareholders</b>			
Dr. Phillip Frost (2)	Common Stock	6,076,667	43.6%
<b>Named Executive Officers and Directors</b>			
Jay Nussbaum (3)	Common Stock	6,043,433	44.3%
Felicia Hess (4)	Common Stock	2,769,833	25.7%
Daniyel Erdberg (5)	Common Stock	2,278,833	21.5%
Kevin Hess (6)	Common Stock	140,000	1.5%
Timothy Hoechst	Common Stock	0	0%
John E. Miller	Common Stock	0	0%
David Aquilar (7)	Common Stock	50,000	*
Executive Officers and Directors as a Group (8 persons)	Common Stock	17,358,766	48.3%

\* less than 1%.

- (1) The percentages in the table have been calculated on the basis of treating as outstanding for a particular person, all shares of our capital stock outstanding on March 23, 2018. On March 23, 2018, there were 9,182,470 shares of our common stock outstanding. To calculate a stockholder's percentage of beneficial ownership, we include in the numerator and denominator the common stock outstanding and all shares of our common stock issuable to that person in the event of the exercise of outstanding options and other derivative securities owned by that person which are exercisable within 60 days of March 23, 2018. Common stock options and derivative securities held by other stockholders are disregarded in this calculation. Therefore, the denominator used in calculating beneficial ownership among our stockholders may differ. Unless we have indicated otherwise, each person named in the table has sole voting power and sole investment power for the shares listed opposite such person's name.
- (2) Represents 1,326,667 shares of common stock and 2,750,000 shares of common stock on an as-converted basis in respect of two convertible notes payable by the Company to Dr. Frost and 2,000,000 shares underlying vested warrants with an exercise price of \$1.00 which expire on August 3, 2022.
- (3) Represents 1,593,433 shares of common stock, 1,500,000 shares of common stock on an as-converted basis in respect of a convertible note payable by the Company to Mr. Nussbaum and 50,000 shares underlying vested options with an exercise price of \$5.00 which expire on December 10, 2018, 2,000,000 shares underlying vested options with an exercise price of \$1.00 which expire on August 3, 2021 and 900,000 shares underlying vested options with an exercise price of \$1.35 which expire on November 9, 2021.
- (4) Represents 1,189,833 shares of common stock, 75,000 shares underlying vested options with an exercise price of \$6.00 which expire in May 2018, 5,000 shares underlying vested options with an exercise price of \$5.00 which expire in December 2018, 1,200,000 shares underlying vested options with an exercise price of \$1.00 which expire on August 3, 2021 and 300,000 shares underlying vested options with an exercise price of \$1.35 which expire on November 9, 2021.
- (5) Represents 853,833 shares of common stock, 75,000 shares underlying vested options with an exercise price of \$6.00 which expire in May 2018, 10,000 shares underlying vested options with an exercise price of \$5.00 which expire in December 2018, 1,140,000 shares underlying vested options with an exercise price of \$1.00 which expire on August 3, 2021 and 200,000 shares underlying vested options with an exercise price of \$1.35 which expire on November 9, 2021.
- (6) Represents 50,000 shares of common stock, 75,000 shares underlying vested options with an exercise price of \$6.00 which expire in May 2018 and 15,000 shares underlying vested options with an exercise price of \$5.00 which expire in December 2018.
- (7) Represents 50,000 shares underlying vested options with an exercise price of \$2.90 which expire on January 9, 2021.

## Equity Compensation Plan Information

The following table provides information as of December 31, 2017, regarding our compensation plans under which equity securities are authorized for issuance:

<b>Plan category</b>	<b>Number of securities to be issued upon exercise of outstanding options, warrants and rights</b>	<b>Weighted-average exercise price of outstanding options, warrants and rights</b>	<b>Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))</b>
	<b>(a)</b>	<b>(b)</b>	<b>(c)</b>
Equity compensation plans approved by security holders	222,500	\$ 3.97	695,747
Equity compensation plans not approved by security holders	9,885,000	1.29	0
<b>Total</b>	<b>10,107,500</b>	<b>\$ 1.35</b>	<b>695,747</b>

## Item 13. Certain Relationships and Related Transactions, and Director Independence.

### Certain Relationships and Related Transactions

During the last two fiscal years, there have been no transactions in which any director, executive officer or beneficial holder of more than 5% of the outstanding common or preferred stock, or any of their respective relatives, spouses, associates or affiliates, has had or will have any direct or material indirect interest. We have no policy regarding entering into transactions with affiliated parties.

From time to time we engage in transactions with related parties. The following is a summary of the related party transactions reflected on our consolidated balance sheet at December 31, 2017 and 2016.

#### *Series 2016 Convertible Notes*

On September 29, 2016, the Company issued Convertible Promissory Notes Series 2016 due October 1, 2017 in the aggregate principal amount of \$3,000,000 in a private placement to the Chairman of the Board and the Chairman of the Strategic Advisory Board of the Company, both of whom are greater than 10% shareholders of the Company. The notes bear interest at a rate of six percent (6%) per annum. The Company may prepay the notes at any time without penalty.

On August 3, 2017, the Company entered into amendments with the owners and holders of the Series 2016 Convertible Notes to extend the maturity date for each of the notes to April 1, 2019 and revise the conversion price to mean \$1.00 per share subject to proportional adjustment in the event of stock splits, stock dividends and similar corporate events.

#### *Series 2017 Convertible Note*

On August 3, 2017, the Company issued a Secured Convertible Promissory Note Series 2017 due August 2, 2018 in the aggregate principal amount of \$2,000,000 (the "Series 2017 Convertible Note") in a private placement to Frost Nevada Investments Trust ("Frost Nevada"). Frost Nevada is a trust that is controlled by Dr. Frost, a substantial shareholder of the Company. The note evidences a revolving line of credit with advances that may be requested by the Company until the maturity date of August 2, 2018 so long as no event of default exists under the loan. As of December 31, 2017, we have borrowed a total of \$1,000,000 under the Series 2017 Secured Convertible Note leaving availability of \$1,000,000 under such note. Accrued interest of \$5,625 has been recognized as of December 31, 2017.

### ***Global Security Innovative Strategies, LLC***

On November 10, 2017, the Company and Global Security Innovative Strategies, LLC (“GSIS”), a related party, entered in an agreement whereby GSIS will provide business development support and general consulting services for sales opportunities with U.S. government agencies and other identified prospects and consulting support services for the Company’s role and activities as part of the Security Center of Excellence in Orlando, Florida. The agreement is for a period of six months beginning on November 1, 2017. The Company agreed to pay GSIS a fee of \$10,000 per month and will evaluate the fee after 90 days. The Company agreed to pay the expenses of GSIS incurred in connection with the performance of its duties under the agreement. Either party may terminate or renew the agreement at any time, for any reason or no reason, upon at least 30 days’ notice to the other party. David Aguilar, a member of the Company’s board of directors, is a principal at GSIS.

### **Director Independence**

Our securities are not quoted on an exchange that has requirements that a majority of our Board of Directors be independent and we are not currently otherwise subject to any law, rule or regulation requiring that all or any portion of our Board of Directors include “independent” directors nor are we required to establish or maintain an Audit Committee or other committee of our Board of Directors.

Even though we are not required to have any committees of the Board of Directors, our board Our Board of Directors has two standing committees: an Audit Committee and a Compensation Committee. Our Board of Directors performs the functions customarily performed by a nominating committee. See Item 0. Directors, Executive Officers and Corporate Governance.

### **Item 14. Principal Accounting Fees and Services.**

The Audit Committee pre-approves all auditing services and all permitted non-auditing services (including the fees and terms thereof) to be performed by our independent registered public accounting firm.

#### Audit Fees

Audit fees consist of fees billed for services associated with the audit of our annual financial statements, review of the Company’s financial statements included in Quarterly Reports on Form 10-Q, and services normally provided by the accounting firm for statutory and regulatory filings or engagements. For the year ended December 31, 2017, the audit fees totaled approximately \$61,000. For the year ended December 31, 2016, the audit fees totaled approximately \$50,500.

#### Audit-Related Fees

We did not incur any fees payable to our independent auditors for assurance and related services reasonably related to the performance of the audit or review of our financial statements during the fiscal years ended December 31, 2017 and 2016.

#### Tax Fees

We did not incur any fees payable to our independent auditors for professional services for tax compliance, tax advice, and tax planning during the fiscal years ended December 31, 2017 and 2016.

#### All Other Fees

We did not incur any fees payable to our independent auditors during the fiscal years ended December 31, 2017 and 2016 for products or services provided by our independent registered public accounting firm.



## PART IV

### Item 15. Exhibits and Financial Statement Schedules.

(a) The following documents are filed as a part of this report or incorporated herein by reference:

- (1) Our Consolidated Financial Statements and Notes thereto begin on page F-1 of this Annual Report immediately after the signature page.

#### *Index to Financial Statements:*

<a href="#">Report of Independent Registered Public Accounting Firm</a>	F-1
<a href="#">Consolidated Balance Sheets for the Years Ended December 31, 2016 and 2017</a>	F-2
<a href="#">Consolidated Statements of Operations for the Years Ended December 31, 2016 and 2017</a>	F-3
<a href="#">Consolidated Statements of Stockholders' Equity for the Years Ended December 31, 2016 and 2017</a>	F-4
<a href="#">Consolidated Statements of Cash Flows for the Years Ended December 31, 2016 and 2017</a>	F-5
<a href="#">Notes to Consolidated Financial Statements</a>	F-6

- (2) Financial Statement Schedules: All schedules have been omitted because the required information is included in the Consolidated Financial Statements or the Notes thereto, or because it is not required.
- (3) Exhibits: The information required by Section (a)(3) of Item 15 of Form 10-K is set forth on the Exhibit Index that immediately precedes the exhibits filed with this Annual Report.

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

### DRONE AVIATION HOLDING CORP.

Date: March 23, 2018

By: /s/ JAY H. NUSSBAUM  
Jay H. Nussbaum  
Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons in the capacities and on the dates indicated.

<u>Name</u>	<u>Position</u>	<u>Date</u>
<u>/s/ JAY H. NUSSBAUM</u> Jay H. Nussbaum	Chief Executive Officer and Director (Principal Executive Officer)	March 23, 2018
<u>/s/ KENDALL CARPENTER</u> Kendall Carpenter	Chief Financial Officer (Principal Financial and Accounting Officer)	March 23, 2018
<u>/s/ KEVIN HESS</u> Kevin Hess	Chief Technology Officer and Director	March 23, 2018
<u>/s/ DAVID AGUILAR</u> David Aguilar	Director	March 23, 2018
<u>/s/ JOHN E. MILLER</u> John E. Miller	Director	March 23, 2018
<u>/s/ TIMOTHY HOECHST</u> Timothy Hoechst	Director	March 23, 2018

**EXHIBIT INDEX**

Exhibit Number	Exhibit Description	Incorporation by Reference			SEC File No.	Filed Herewith
		Form	Filing Date	Exhibit Number		
2.1	<a href="#">Agreement and Plan of Merger, dated April 30, 2014, between Drone Aviation Holding Corp. and MacroSolve, Inc.</a>	8-K	5/5/14	2.1	333-150332	
2.2	<a href="#">Plan of Merger, effective March 26, 2015, between Drone Aviation Holding Corp. and Drone Aviation Corp.</a>	10-K	3/31/15	10.14	333-150332	
2.3	<a href="#">Asset Purchase Agreement, dated July 20, 2015, between Drone AFS Corp. Drone Aviation Holding Corp., Adaptive Flight, Inc., and the shareholders of Adaptive Flight, Inc.</a>	8-K	7/21/15	10.1	333-150332	
3.1	<a href="#">Articles of Incorporation of Drone Aviation Holding Corp., dated April 17, 2014</a>	8-K	5/5/14	3.1	333-150332	
3.2	<a href="#">Certificate of Amendment to Articles of Incorporation of Drone Aviation Holding Corp., dated October 29, 2015</a>	8-K	10/30/15	3.1	333-150332	
3.3	<a href="#">Bylaws of Drone Aviation Holding Corp.</a>	8-K	5/5/14	3.6	333-150332	
3.4	<a href="#">Certificate of Designation of Preferences, Rights and Limitations of Series A Convertible Preferred Stock</a>	8-K	5/5/14	3.2	333-105332	
3.5	<a href="#">Certificate of Designation of Preferences, Rights and Limitations of Series B Convertible Preferred Stock</a>	8-K	5/5/14	3.3	333-105332	
3.6	<a href="#">Certificate of Designation of Preferences, Rights and Limitations of Series B-1 Convertible Preferred Stock</a>	8-K	5/5/14	3.4	333-105332	
3.7	<a href="#">Certificate of Designation of Preferences, Rights and Limitations of Series C Convertible Preferred Stock</a>	8-K	5/5/14	3.5	333-105332	
3.8	<a href="#">Certificate of Designation of Preferences, Rights and Limitations of Series D Convertible Preferred Stock</a>	8-K	6/5/14	3.1	333-105332	
3.9	<a href="#">Certificate of Designation of Preferences, Rights and Limitations of Series E Convertible Preferred Stock</a>	8-K	6/5/14	3.2	333-105332	
3.10	<a href="#">Certificate of Amendment to Certificate of Designation of Preferences, Rights and Limitations of Series E Convertible Preferred Stock</a>	8-K	6/3/15	3.3	333-105332	
3.11	<a href="#">Certificate of Designation of Preferences, Rights and Limitations of Series F Convertible Preferred Stock</a>	8-K	8/28/14	3.1	333-105332	
3.12	<a href="#">Certificate of Amendment to Certificate of Designation of Preferences, Rights and Limitations of Series F Convertible Preferred Stock</a>	8-K	6/3/15	3.4	333-105332	
3.13	<a href="#">Certificate of Designation of Preferences, Rights and Limitations of Series G Convertible Preferred Stock</a>	8-K	6/3/15	3.1	333-105332	
3.14	<a href="#">Certificate of Correction to the Certificate of Designation of Preferences, rights and Limitations of Series G Convertible Preferred Stock</a>	8-K	6/3/15	3.2	333-105332	

Exhibit Number	Exhibit Description	Incorporation by Reference				Filed Herewith
		Form	Filing Date	Exhibit Number	SEC File No.	
4.1	<a href="#">Form of Convertible Promissory Note Series 2016 due October 1, 2017</a>	8-K	9/30/16	4.1	333-105332	
4.1(a)	<a href="#">(a) Form of Amendment to Convertible Promissory Note Series 2016</a>	10-Q	8/4/17	4.1(a)	333-150332	
4.1(b)	<a href="#">(b) Form of November 2017 Amendment to Convertible Promissory Note Series 2016</a>	10-Q	11/13/17	4.1(b)	333-150332	
4.1(c)	<a href="#">(c) Form of March 2018 Amendment to Convertible Promissory Note Series 2016</a>					X
4.2	<a href="#">Form of Secured Convertible Promissory Note Series 2017-08 due August 2, 2018</a>	10-Q	8/4/17	4.2	333-150332	
10.1	<a href="#">Form of Indemnification Agreement for Directors and Officers</a>	8-K	6/5/14	10.4	333-105332	
10.2	<a href="#">Independent Contractor Agreement, dated July 29, 2013, by and among US Technik, Inc., Lighter Than Air Systems Corp., and World Surveillance Group, Inc.</a>	8-K	6/5/14	10.9	333-105332	
10.3	<a href="#">Form of Independent Contractor Agreement for members of the Strategic Advisory Board of Drone Aviation Holding Corp.</a>	8-K	8/28/14	10.2	333-10532	
10.4*	<a href="#">Employment Agreement, dated May 18, 2015, between Drone Aviation Holding Corp. and Daniyel Erdberg</a>	10-Q	5/15/15	10.17	333-150332	
10.4(a)*	<a href="#">(a) Amendment No. 1 to Employment Agreement, dated October 2, 2015, between Drone Aviation Holding Corp. and Daniyel Erdberg</a>	8-K	10/7/15	10.2	333-150332	
10.4(b)*	<a href="#">(b) Amendment No. 2 to Employment Agreement, dated April 27, 2016, between Drone Aviation Holding Corp., and Daniyel Erdberg</a>	10-Q	4/29/16	10.4	333-150332	
10.4(c)*	<a href="#">(c) Amendment No. 3 to Employment Agreement, dated September 26, 2016, by and between Drone Aviation Holding Corp. and Daniyel Erdberg</a>	8-K	9/30/16	10.5	333-150332	
10.4(d)*	<a href="#">(d) Amendment No. 4 to Employment Agreement, dated August 3, 2017, between Drone Aviation Holding Corp., and Daniyel Erdberg</a>	10-Q	8/4/17	10.4(d)	333-150332	
10.5*	<a href="#">Employment Agreement, dated May 18, 2015, between Drone Aviation Holding Corp. and Felicia A. Hess</a>	10-Q	5/15/15	10.15	333-150332	
10.5(a)*	<a href="#">(a) Amendment No. 1 to Employment Agreement, dated October 2, 2015, between Drone Aviation Holding Corp. and Felicia Hess</a>	8-K	10/7/15	10.1	333-150332	
10.5(a)*	<a href="#">(b) Amendment No. 2 to Employment Agreement, dated April 27, 2016, between Drone Aviation Holding Corp. and Felicia Hess</a>	10-Q	4/29/16	10.5	333-150332	

Exhibit Number	Exhibit Description	Incorporation by Reference			SEC File No.	Filed Herewith
		Form	Filing Date	Exhibit Number		
10.5(b)*	<a href="#">(c) Amendment No. 3 to Employment Agreement, dated September 26, 2016, by and between Drone Aviation Holding Corp. and Felicia Hess</a>	8-K	9/30/16	10.3	333-150332	
10.5(c)*	<a href="#">(d) Amendment No. 4 to Employment Agreement, dated August 3, 2017, by and between Drone Aviation Holding Corp. and Felicia Hess</a>	10-Q	8/4/17	10.5(d)	333-150332	
10.6*	<a href="#">Employment Agreement, dated May 18, 2015, between Drone Aviation Holding Corp. and Kendall Carpenter</a>	10-Q	5/15/15	10.16	333-150332	
10.6(a)*	<a href="#">(a) Amendment No. 1 to Employment Agreement, dated April 27, 2016, between Drone Aviation Holding Corp. and Kendall Carpenter</a>	10-Q	4/29/16	10.3	333-150332	
10.6(b)*	<a href="#">(b) Amendment No. 2 to Employment Agreement, dated September 26, 2016, by and between Drone Aviation Holding Corp. and Kendall Carpenter</a>	8-K	9/30/16	10.6	333-150332	
10.6(c)*	<a href="#">(c) Amendment No. 3 to Employment Agreement, dated August 3, 2017, by and between Drone Aviation Holding Corp. and Kendall Carpenter</a>	10-Q	8/4/17	10.6(c)	333-150332	
10.7*	<a href="#">Director Agreement, dated June 4, 2015, between Drone Aviation Holding Corp. and Jay Nussbaum</a>	8-K	6/5/15	10.1	333-150332	
10.8	<a href="#">Intellectual Property Assignment Agreement, dated July 20, 2015, between Adaptive Flight, Inc., and Drone AFS Corp.</a>	8-K	7/21/15	10.5	333-150332	
10.9	<a href="#">Form of Non-Exclusive, Perpetual Intellectual Property and Patent License Agreement of Drone Aviation Holding Corp., dated July 20, 2015</a>	8-K	7/21/15	10.6	333-150332	
10.10*	<a href="#">Drone Aviation Holding Corp. 2015 Equity Incentive Plan</a>	8-K	9/11/15	99.1	333-150332	
10.11*	<a href="#">Amended and Restated Employment Agreement, dated October 2, 2015, between Drone Aviation Holding Corp. and Kevin Hess</a>	8-K	10/7/15	10.3	333-150332	
10.11(a)*	<a href="#">(a) Amendment No. 2 [sic] to Employment Agreement, dated April 27, 2016, between Drone Aviation Holding Corp. and Kevin Hess</a>	10-Q	4/29/16	10.1	333-150332	
10.11(b)*	<a href="#">(b) Amendment No. 3 [sic] to Employment Agreement, dated September 26, 2016, between Drone Aviation Holding Corp. and Kevin Hess</a>	8-K	9/30/16	10.4	333-150332	
10.12	<a href="#">Form of Drone Aviation Holding Corp. Warrant to purchase Common Stock issued to Dougherty &amp; Company, LLC, as Placement Agent</a>	8-K	11/23/15	4.1	333-150332	
10.13	<a href="#">Form of Drone Aviation Holding Corp. Common Stock Purchase Agreement for Private Offering Under Section 4(a)(2) of the Securities Act of 1933 and Rule 506(b)</a>	8-K	11/23/15	10.1	333-150332	

Exhibit Number	Exhibit Description	Incorporation by Reference			SEC File No.	Filed Herewith
		Form	Filing Date	Exhibit Number		
10.14	<a href="#">Form of Preferred Stock Conversion and Lockup Agreement for Series A Convertible Preferred Stock</a>	8-K	11/23/15	10.2	333-150332	
10.15	<a href="#">Form of Preferred Stock Conversion and Lockup Agreement for Series B Convertible Preferred Stock</a>	8-K	11/23/15	10.3	333-150332	
10.16	<a href="#">Form of Exchange Agreement for Series B-1 Convertible Preferred Stock</a>	8-K	11/23/15	10.9	333-150332	
10.17	<a href="#">Form of Preferred Stock Conversion and Lockup Agreement for Series C Convertible Preferred Stock</a>	8-K	11/23/15	10.4	333-150332	
10.18	<a href="#">Form of Preferred Stock Conversion and Lockup Agreement for Series D Convertible Preferred Stock</a>	8-K	11/23/15	10.5	333-150332	
10.19	<a href="#">Form of Preferred Stock Conversion Agreement for Series E Convertible Preferred Stock</a>	8-K	11/23/15	10.6	333-150332	
10.20	<a href="#">Form of Preferred Stock Conversion Agreement for Series F Convertible Preferred Stock</a>	8-K	11/23/15	10.7	333-150332	
10.21	<a href="#">Form of Preferred Stock Conversion Agreement for Series G Convertible Preferred Stock</a>	8-K	11/23/15	10.8	333-150332	
10.22*	<a href="#">Employment Agreement, dated April 27, 2016, between Drone Aviation Holding Corp. and Jay H. Nussbaum</a>	10-Q	4/29/16	10.2	333-150332	
10.22(a)*	<a href="#">(a) Amendment No. 1 to Employment Agreement, dated September 26, 2016, by and between Drone Aviation Holding Corp. and Jay H. Nussbaum</a>	8-K	9/30/16	10.2	333-150332	
10.22(b)*	<a href="#">(b) Amendment No. 2 to Employment Agreement, dated August 3, 2017, by and between Drone Aviation Holding Corp. and Jay H. Nussbaum</a>	10-Q	8/4/17	10.22(b)	333-150332	
10.23*	<a href="#">Form of Drone Aviation Holding Corp. Restricted Stock Agreement (Non-Assignable) (Effective April 27, 2016)</a>	10-Q	7/29/16	10.7	333-150332	
10.24*	<a href="#">Form of Drone Aviation Holding Corp. Restrictive Stock Agreement (Non-Assignable)</a>	8-K	9/30/16	10.7	333-150332	
10.25	<a href="#">Form of Subscription Agreement for Convertible Promissory Notes Series 2016 due October 1, 2017</a>	8-K	9/30/16	10.1	333-150332	

Exhibit Number	Exhibit Description	Incorporation by Reference			SEC File No.	Filed Herewith
		Form	Filing Date	Exhibit Number		
10.26	<a href="#">Offer Letter between Drone Aviation Holding Corp. and David V. Aguilar, accepted January 9, 2017</a>	8-K	1/12/17	10.1	333-150332	
10.27	<a href="#">Director Agreement, dated January 9, 2017, between Drone Aviation Holding Corp. and David V. Aguilar</a>	8-K	1/12/17	10.2	333-150332	
10.28*	<a href="#">Form of Drone Aviation Holding Corp. Nonqualified Stock Option Agreement</a>	8-K	1/12/17	10.3	333-150332	
10.29	<a href="#">Form of Promissory Note and Security Agreement issued by Drone Aviation Holding Corp. to City National Bank of Florida dated August 2, 2017</a>	10-Q	8/4/17	10.29	333-150332	
10.30	<a href="#">Form of Guarantee issued by Jay Nussbaum to City National Bank of Florida dated August 2, 2017</a>	10-Q	8/4/17	10.30	333-150332	
10.31	<a href="#">Indemnification Agreement between Drone Aviation Holding Corp. and Jay H. Nussbaum</a>	10-Q	8/4/17	10.31	333-150332	
10.32*	<a href="#">Form of Drone Aviation Holding Corp. Amendment to Restricted Stock Agreement dated August 3, 2017</a>	10-Q	8/4/17	10.32	333-150332	
10.33*	<a href="#">Form of Amendment No. 2 to Independent Contractor Agreement dated August 3, 2017</a>	10-Q	8/4/17	10.33	333-150332	
10.34*	<a href="#">Warrant issued by Drone Aviation Holding Corp. to Dr. Phillip Frost dated August 3, 2017</a>	10-Q	8/4/17	10.34	333-150332	
10.35	<a href="#">Consulting Agreement between Drone Aviation Holding Corp. and Global Security Innovative Strategies, LLC dated November 10, 2017</a>	10-Q	11/13/2017	10.35	333-150332	
21	<a href="#">List of Subsidiaries of Drone Aviation Holding Corp.</a>	–	–	–	–	X
31.1	<a href="#">Certification of the Chief Executive Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</a>	–	–	–	–	X
31.2	<a href="#">Certification of the Chief Financial Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</a>	–	–	–	–	X
32**	<a href="#">Certifications of the Chief Executive Officer and the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</a>	–	–	–	–	X
101 INS***	XBRL Instance Document	–	–	–	–	X
101 SCH***	XBRL Taxonomy Extension Schema Document	–	–	–	–	X
101 CAL***	XBRL Taxonomy Calculation Linkbase Document	–	–	–	–	X
101 LAB***	XBRL Taxonomy Labels Linkbase Document	–	–	–	–	X
101 PRE***	XBRL Taxonomy Presentation Linkbase Document	–	–	–	–	X
101 DEF***	XBRL Taxonomy Extension Definition Linkbase Document	–	–	–	–	X

\* Indicates management contract or compensatory plan or arrangement.

\*\* Furnished herewith

\*\*\* These documents formatted in XBRL (Extensible Business Reporting Language) have been attached as Exhibit 101 to this report

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the shareholders and board of directors of  
Drone Aviation Holding Corp.

### ***Opinion on the Financial Statements***

We have audited the accompanying consolidated balance sheets of Drone Aviation Holding Corp. and its subsidiaries (collectively, the "Company") as of December 31, 2017 and 2016, and the related consolidated statements of operations, stockholders' equity, and cash flows for the years then ended, and the related notes (collectively referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2017 and 2016, and the results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

### ***Going Concern 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 financial statements, the Company has suffered recurring losses from operations and has a net capital deficiency that raises substantial doubt about its ability to continue as a going concern. Management's plans in regard to 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.

### ***Basis for Opinion***

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control over financial reporting. Accordingly, we express no such opinion.

Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ *MaloneBailey, LLP*

[www.malonebailey.com](http://www.malonebailey.com)

We have served as the Company's auditor since 2013.

Houston, Texas

March 23, 2018



**DRONE AVIATION HOLDING CORP.  
CONSOLIDATED BALANCE SHEETS**

	<u>12/31/2017</u>	<u>12/31/2016</u>
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash	\$ 615,375	\$ 2,015,214
Accounts receivable - trade	110,065	394,000
Inventory, net	991,697	459,885
Prepaid expenses and deposits	103,008	120,614
Total current assets	<u>1,820,145</u>	<u>2,989,713</u>
<b>PROPERTY AND EQUIPMENT, at cost:</b>	253,444	179,627
Less - accumulated depreciation	<u>(97,507)</u>	<u>(60,784)</u>
Net property and equipment	<u>155,937</u>	<u>118,843</u>
<b>OTHER ASSETS:</b>		
Goodwill	99,799	99,799
Intangible assets, net	<u>997,667</u>	<u>1,289,667</u>
Total other assets	<u>1,097,466</u>	<u>1,389,466</u>
<b>TOTAL ASSETS</b>	<u>\$ 3,073,548</u>	<u>\$ 4,498,022</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable - trade and accrued liabilities	\$ 205,359	\$ 293,922
Accounts payable due to related party	171,981	46,849
Bank Line of Credit	1,000,000	-
Related party convertible note payable, net of discount of \$0 and \$2,092,156, respectively	1,000,000	907,844
Derivative liability	-	1,832,013
Total current liabilities	<u>2,377,340</u>	<u>3,080,628</u>
<b>LONG TERM LIABILITIES:</b>		
Related party convertible note payable	<u>3,000,000</u>	<u>-</u>
<b>TOTAL LIABILITIES</b>	<u>\$ 5,377,340</u>	<u>\$ 3,080,628</u>
<b>COMMITMENTS AND CONTINGENCIES</b>		
	<u>-</u>	<u>-</u>
<b>STOCKHOLDERS' EQUITY (DEFICIT):</b>		
Convertible Preferred stock, Series A, \$.0001 par value; authorized 595,000 shares; 0 and 100,100 shares issued and outstanding, at December 31, 2017 and December 31, 2016, respectively	\$ -	\$ 10
Convertible Preferred stock, Series B, \$.0001 par value; authorized 324,671 shares; 0 shares issued and outstanding, at December 31, 2017 and December 31, 2016, respectively	-	-
Convertible Preferred stock, Series B-1, \$.0001 par value; authorized 156,231 shares; 0 shares issued and outstanding, at December 31, 2017 and December 31, 2016, respectively	-	-
Convertible Preferred stock, Series C, \$.0001 par value; authorized 355,000 shares; 0 shares issued and outstanding, at December 31, 2017 and December 31, 2016, respectively	-	-
Convertible Preferred stock, Series D, \$.0001 par value; authorized 36,050,000 shares; 0 shares issued and outstanding, at December 31, 2017 and December 31, 2016, respectively	-	-
Convertible Preferred stock, Series E, \$.0001 par value; authorized 5,400,000 shares; 0 shares issued and outstanding, at December 31, 2017 and December 31, 2016, respectively	-	-
Convertible Preferred stock, Series F, \$.0001 par value; authorized 3,300,999 shares; 0 shares issued and outstanding, at December 31, 2017 and December 31, 2016, respectively	-	-
Convertible Preferred stock, Series G, \$.0001 par value; authorized 8,000,000 shares; 0 shares issued and outstanding, at December 31, 2017 and December 31, 2016, respectively	-	-
Common stock, \$.0001 par value; authorized 300,000,000 shares; 9,182,470 and 8,682,220 shares issued and outstanding, at December, 2017 and December 31, 2016	918	868
Additional paid-in capital	27,692,067	21,089,301
Accumulated Deficit	<u>(29,996,777)</u>	<u>(19,672,785)</u>
Total stockholders' equity (deficit)	<u>(2,303,792)</u>	<u>1,417,394</u>
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)</b>	<u>\$ 3,073,548</u>	<u>\$ 4,498,022</u>

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

**DRONE AVIATION HOLDING CORP.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**

For the Years Ended December 31,	<u>2017</u>	<u>2016</u>
<b>Revenues</b>	\$ 562,078	\$ 1,468,462
<b>Cost of good sold</b>	<u>338,579</u>	<u>557,725</u>
<b>Gross profit</b>	<u>223,499</u>	<u>910,737</u>
<b>General and administrative expense</b>	<u>10,069,841</u>	<u>9,732,219</u>
<b>Loss from operations</b>	<u>(9,846,342)</u>	<u>(8,821,482)</u>
<b>Other income (expense)</b>		
Debt forgiveness	-	75,000
Loss on debt extinguishment	(681,988)	-
Derivative Gain	1,831,635	562,961
Interest expense	<u>(1,627,297)</u>	<u>(349,994)</u>
Total other income (expense)	<u>(477,650)</u>	<u>287,967</u>
<b>NET LOSS</b>	<u>(10,323,992)</u>	<u>(8,533,515)</u>
<b>NET LOSS ATTRIBUTABLE TO COMMON STOCKHOLDERS</b>	<u>(10,323,992)</u>	<u>(8,533,515)</u>
Weighted average number of common shares outstanding - basic and diluted	<u>8,956,365</u>	<u>6,919,510</u>
Basic and diluted net loss per share	<u>\$ (1.15)</u>	<u>\$ (1.23)</u>

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

**DRONE AVIATION HOLDING CORP.  
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**

**For the Years Ended December 31, 2017 and 2016**

	Common Stock		Preferred Stock Ser A		Preferred Stock Ser C		Preferred Stock Ser D		Preferred Stock Ser F		Preferred Stock Ser G		Additional Paid-in Capital	Accumulated Deficit	Total
	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount			
<b>BALANCE, at December 31, 2015</b>	5,125,585	\$ 513	101,100	\$ 10	73,387	\$ 7	2,000,000	\$ 200	1,999,998	\$ 200	2,000,000	\$ 200	\$15,385,523	\$(11,139,270)	\$ 4,247,383
Net Loss														(8,533,515)	(8,533,515)
Conversion of Series A preferred stock to common stock	2,500	-	(1,000)	-											-
Conversion of Series C preferred stock to common stock	183,468	18			(73,387)	(7)								(11)	-
Conversion of Series D preferred stock to common stock	50,000	5					(2,000,000)	(200)						195	-
Conversion of Series F preferred stock to common stock	50,000	5							(1,999,998)	(200)				195	-
Conversion of Series G preferred stock to common stock	50,000	5									(2,000,000)	(200)		195	-
Adaptive Flight Asset Made Whole Stock	50,000	5												150,495	150,500
Stock Based Comp. - Employee Shares - Vesting for PY share issuance														874,440	874,440
Stock Based Comp. - Employee Shares - Vesting for CY share issuance	2,464,000	246												3,952,309	3,952,555
Stock Based Compensation - Non-employee Shares	210,000	21												377,766	377,787
Stock Based Compensation - Options and Warrants														348,244	348,244
Deemed Dividend	496,667	50												1,641,434	1,641,484
Deemed Dividend														(1,641,484)	(1,641,484)
<b>Balance - December 31, 2016</b>	8,682,220	\$ 868	100,100	\$ 10	-	\$ -	-	\$ -	-	\$ -	-	\$ -	\$21,089,301	\$(19,672,785)	\$ 1,417,394
Net Loss														(10,323,992)	(10,323,992)
Stock Based Comp. - Employee Shares - Vesting for PY share issuance														1,071,323	1,071,323

Stock Based Compensation - Non-employee	250,000	25										195,720	195,745		
Shares															
Stock Based Compensation - Options and Warrants												6,824,334	6,824,334		
Conversion of Series A preferred stock to common stock	250,250	25	(100,100)	(10)								(15)	-		
Stock Based Compensation - reverse amortization, vesting deemed improbable												(1,488,596)	(1,488,596)		
<b>Balance - December 31, 2017</b>	<b>9,182,470</b>	<b>\$ 918</b>	<b>-</b>	<b>\$ -</b>	<b>-</b>	<b>\$ -</b>	<b>-</b>	<b>\$ -</b>	<b>-</b>	<b>\$ -</b>	<b>-</b>	<b>\$ -</b>	<b>\$27,692,067</b>	<b>\$(29,996,777)</b>	<b>\$ (2,303,792)</b>

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

**DRONE AVIATION HOLDING CORP.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

	<u>2017</u>	<u>2016</u>
<b>OPERATING ACTIVITIES:</b>		
Net loss	\$(10,323,992)	\$(8,533,515)
Adjustments to reconcile net loss to net cash used in operating activities:		
Gain on derivative liability	(1,831,635)	(562,961)
Amortization expense of debt discount	1,409,790	302,818
Loss on debt extinguishment	681,988	-
Depreciation expense	36,723	33,789
Amortization expense of intangible assets	292,000	170,333
Gain on settlement of make whole provision	-	(11,000)
Gain on settlement of debt	-	(75,000)
Stock based compensation	6,602,806	5,553,026
Changes in current assets and liabilities:		
Accounts receivable	283,935	(310,712)
Inventory	(531,812)	(341,090)
Prepaid expenses and other current assets	17,606	(64,990)
Accounts payable and accrued expense	(88,563)	213,165
Due to related party	125,132	40,849
Deferred revenue	-	(7,896)
Net cash used in operating activities	<u>(3,326,022)</u>	<u>(3,593,184)</u>
<b>INVESTING ACTIVITIES:</b>		
Cash paid for purchase of fixed assets	(73,817)	(16,336)
Net cash used in investing activities	<u>(73,817)</u>	<u>(16,336)</u>
<b>FINANCING ACTIVITIES:</b>		
Proceeds from related party convertible note payable	1,000,000	-
Proceeds from bank line of credit	1,000,000	-
Cash repayment on OTCC loan	-	(35,000)
Proceeds from convertible Note Payable Series 2016	-	3,000,000
Net cash provided by financing activities	<u>2,000,000</u>	<u>2,965,000</u>
<b>NET INCREASE (DECREASE) IN CASH</b>	<b>(1,399,839)</b>	<b>(644,520)</b>
<b>CASH, beginning of period</b>	<b>2,015,214</b>	<b>2,659,734</b>
<b>CASH, end of period</b>	<b>\$ 615,375</b>	<b>\$ 2,015,214</b>
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:</b>		
Cash paid during the year ended December 31:		
Interest	\$ 86,750	\$ 327
Noncash investing and financing activities for the year ended December 31:		
Common Stock issued for Adaptive Flight asset purchase make whole provision	\$ -	\$ 150,500
Conversion of Series A preferred stock to common stock	\$ 25	\$ -
Conversion of Series C preferred stock to common stock	\$ -	\$ 18
Conversion of Series D preferred stock to common stock	\$ -	\$ 5
Conversion of Series F preferred stock to common stock	\$ -	\$ 5
Conversion of Series G preferred stock to common stock	\$ -	\$ 5
Derivative liability on reset provision of Convertible Notes Payable Series 2016	\$ -	\$ 2,394,974
Stock Issued for November 2015 PIPE Investors as consent shares	\$ -	\$ 50

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

**Drone Aviation Holding Corp.**  
**Notes to Consolidated Financial Statements**

**For the Years ended December 31, 2017 and 2016**

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Description of Business:

Drone Aviation Holding Corp. (“Drone” or “Company”) develops and manufactures cost-effective, compact and rapidly deployable aerial platforms including lighter-than-air aerostats and electric-powered drones designed to provide government and commercial customers with enhanced surveillance and communication capabilities. Utilizing a proprietary tether system, the Company’s products are designed to provide prolonged operational duration capabilities combined with improved reliability, uniquely fulfilling critical requirements in military, law enforcement and commercial and industrial applications.

Basis of Presentation:

The accompanying financial statements of the Company were prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”).

Principle of Consolidation:

Our consolidated financial statements as of December 31, 2017 and 2016 include the accounts of Drone Aviation Holding Corp. and its subsidiaries: Drone AFS Corp. and Lighter Than Air Systems Corp (“LTAS”).

Use of Estimates:

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Concentration of Credit Risk:

Financial instruments which potentially subject the Company to concentrations of credit risk consist of cash and trade receivables. The Company places its cash with high credit quality financial institutions. At times such cash may be in excess of the FDIC limit of \$250,000 per depositor. With respect to trade receivables, the Company routinely assesses the financial strength of its customers and, as a consequence, believes that the receivable credit risk exposure is limited.

Cash Equivalents:

Cash equivalents are represented by operating accounts or money market accounts maintained with insured financial institutions, including all highly-liquid investments with maturities of three months or less when purchased to be cash equivalents. The Company had no cash equivalents as of December 31, 2017 and 2016.

Accounts Receivable and Credit Policies:

Accounts receivable-trade consists of amounts due from the sale of tethered aerostats, accessories, spare parts customization and refurbishment of aerostats. Such accounts receivable are uncollateralized customer obligations due under normal trade terms requiring payment within 30 days of receipt of the invoice. The Company provides an allowance for doubtful accounts equal to the estimated uncollectible amounts based on historical collection experience and a review of the current status of trade accounts receivable. At December 31, 2017 and 2016, the Company characterized \$0 and \$0 as uncollectible, respectively. There is a balance of \$110,065 in accounts receivable-trade at December 31, 2017 for sales on account.

### Inventories

Inventories are stated at the lower of cost or market, using the first-in first-out method. Cost includes materials, labor and manufacturing overhead related to the purchase and production of inventories. We regularly review inventory quantities on hand, future purchase commitments with our supplies, and the estimated utility of our inventory. If the review indicates a reduction in utility below carrying value, we reduce our inventory to a new cost basis through a charge to cost of goods sold.

### Property and Equipment:

Property and equipment is recorded at cost when acquired. Depreciation is provided principally on the straight-line method over the estimated useful lives of the related assets, which is 3-7 years for equipment, furniture and fixtures, hardware and software. Property and equipment consists of the following at December 31, 2017 and 2016:

	2017	2016
Shop Machinery and equipment	\$ 87,704	\$ 87,029
Computers and electronics	35,270	35,270
Office furniture and fixtures	37,814	37,814
Vehicle	73,142	-
Leasehold improvements	19,514	19,514
	<u>253,444</u>	<u>179,627</u>
Less - accumulated depreciation	<u>(97,507)</u>	<u>(60,784)</u>
	<u>\$ 155,937</u>	<u>\$ 118,843</u>

Expenditures for maintenance and repairs are charged to expense as incurred, whereas expenditures for major renewals and betterments that extend the useful lives of property and equipment are capitalized.

During the year ended December 31, 2017, the Company purchased a vehicle for \$73,142 and shop equipment for \$675. During 2016, the Company purchased \$16,336 of furniture and equipment.

The Company recognized \$36,723 and \$33,789 of depreciation expense for the year ended December 31, 2017 and 2016, respectively.

### Long-Lived Assets & Goodwill:

The Company accounts for long-lived assets in accordance with the provisions of Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 360-10-35, "Impairment or Disposal of Long-lived Assets." This accounting standard requires that long-lived assets be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset.

The Company accounts for goodwill and intangible assets in accordance with ASC 350 "Intangibles Goodwill and Other". ASC 350 requires that goodwill and other intangibles with indefinite lives be tested for impairment annually or on an interim basis if events or circumstances indicate that the fair value of an asset has decreased below its carrying value. The Company performed impairment analysis using the qualitative analysis under ASC 350-20 and noted no impairment issues for 2017 and 2016.

#### Derivative Financial Instruments:

The Company evaluates the embedded conversion feature within its convertible debt instruments under ASC 815-15 and ASC 815-40 to determine if the conversion feature meets the definition of a liability and, if so, whether to bifurcate the conversion feature and account for it as a separate derivative liability. For derivative financial instruments that are accounted for as liabilities, the derivative instrument is initially recorded at its fair value and is then re-valued at each reporting date, with changes in the fair value reported in the statements of operations. For stock-based derivative financial instruments, the Company uses a lattice model, in accordance with ASC 815-15 “Derivative and Hedging” to value the derivative instruments at inception and on subsequent valuation dates. The classification of derivative instruments, including whether such instruments should be recorded as liabilities or as equity, is evaluated at the end of each reporting period. Derivative instrument liabilities are classified in the balance sheet as current or non-current based on whether net-cash settlement of the derivative instrument could be required within 12 months after the balance sheet date.

#### Beneficial Conversion Features:

The Company evaluates the conversion feature for whether it was beneficial as described in ASC 470-30. The intrinsic value of a beneficial conversion feature inherent to a convertible note payable, which is not bifurcated and accounted for separately from the convertible note payable and may not be settled in cash upon conversion, is treated as a discount to the convertible note payable. This discount is amortized over the period from the date of issuance to the date the note is due using the effective interest method. If the note payable is retired prior to the end of its contractual term, the unamortized discount is expensed in the period of retirement to interest expense. In general, the beneficial conversion feature is measured by comparing the effective conversion price, after considering the relative fair value of detachable instruments included in the financing transaction, if any, to the fair value of the shares of common stock at the commitment date to be received upon conversion.

#### Fair Value of Financial Instruments:

The Company measures its financial assets and liabilities in accordance with the requirements of FASB ASC 820, “Fair Value Measurements and Disclosures”. As defined in FASB ASC 820, the fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price). The Company utilized the market data of similar entities in its industry or assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, market corroborated, or generally unobservable. The Company classifies fair value balances based on the observability of those inputs. FASB ASC 820 established a fair value hierarchy that prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurement) and the lowest priority to unobservable inputs (level 3 measurement) as follows:

Level 1 – Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions for the asset or liability occur in sufficient frequency and volume to provide pricing information on an ongoing basis. Level 1 primarily consists of financial instruments such as exchange-traded derivatives, marketable securities and listed equities.

Level 2 – Pricing inputs are other than quoted prices in active markets included in level 1, which are either directly or indirectly observable as of the reported date and includes those financial instruments that are valued using models or other valuation methodologies. These models are primarily industry-standard models that consider various assumptions, including quoted forward prices for commodities, time value, volatility factors, and current market and contractual prices for the underlying instruments, as well as other relevant economic measures. Substantially all of these assumptions are observable in the marketplace throughout the full term of the instrument, can be derived from observable data or are supported by observable levels at which transactions are executed in the marketplace. Instruments in this category generally include non-exchange-traded derivatives such as commodity swaps, interest rate swaps, options and collars.

Level 3 – Pricing inputs include significant inputs that are generally less observable from objective sources. These inputs may be used with internally developed methodologies that result in management’s best estimate of fair value.



#### Revenue Recognition and Unearned Revenue:

The Company recognizes revenue when all four of the following criteria are met: 1) persuasive evidence of an arrangement exists; 2) delivery has occurred and title has transferred or services have been rendered; 3) our price to the buyer is fixed or determinable; and 4) collectability is reasonably assured. We record unearned revenue as a liability and the associated costs of sales as work in process inventory.

#### Income Taxes:

The Company accounts for income taxes utilizing ASC 740, "Income Taxes" (SFAS No. 109). ASC 740 requires the measurement of deferred tax assets for deductible temporary differences and operating loss carry forwards, and of deferred tax liabilities for taxable temporary differences. Measurement of current and deferred tax liabilities and assets is based on provisions of enacted tax law. The effects of future changes in tax laws or rates are not included in the measurement. The Company recognizes the amount of taxes payable or refundable for the current year and recognizes deferred tax liabilities and assets for the expected future tax consequences of events and transactions that have been recognized in the Company's financial statements or tax returns. The Company has recorded a 100% valuation allowance against net deferred tax assets due to uncertainty of their ultimate realization. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized.

The Company also follows the guidance for accounting for income tax uncertainties. In accounting for uncertainty in income taxes, the Company recognizes the financial statement benefit of a tax position only after determining that the relevant tax authority would more likely than not sustain the position following an audit. For tax positions meeting the more likely than not threshold, the amount recognized in the consolidated financial statements is the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement with the relevant tax authority. No liability for unrecognized tax benefits was recorded as of December 31, 2017 and 2016.

#### Employee Stock-Based Compensation:

The Company accounts for stock-based compensation in accordance with ASC 718, "Compensation-Stock Compensation". ASC 718 requires companies to measure the cost of employee services received in exchange for an award of equity instruments, including stock options, based on the grant-date fair value of the award and to recognize it as compensation expense over the period the employee is required to provide service in exchange for the award, usually the vesting period. The Company has elected to adopt ASU 2016-09 and has a policy to account for forfeitures as they occur.

#### Non-Employee Stock-Based Compensation:

The Company accounts for stock-based compensation in accordance with the provision of ASC 505-50, "Equity Based Payments to Non-Employees," which requires that such equity instruments are recorded at their fair value on the measurement date. The measurement of stock-based compensation is subject to periodic adjustment as the underlying equity instruments vest.

#### Related Parties:

The Company accounts for related party transactions in accordance with ASC 850 ("Related Party Disclosures"). A party is considered to be related to the Company if the party directly or indirectly or through one or more intermediaries, controls, is controlled by, or is under common control with the Company. Related parties also include principal owners of the Company, its management, members of the immediate families of principal owners of the Company and its management and other parties with which the Company may deal if one party controls or can significantly influence the management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interests. A party which can significantly influence the management or operating policies of the transacting parties or if it has an ownership interest in one of the transacting parties and can significantly influence the other to an extent that one or more of the transacting parties might be prevented from fully pursuing its own separate interests is also a related party.

On November 10, 2017, the Company and Global Security Innovative Strategies, LLC (“GSIS”), a related party, entered in an agreement whereby GSIS will provide business development support and general consulting services for sales opportunities with U.S. government agencies and other identified prospects and consulting support services for the Company’s role and activities as part of the Security Center of Excellence in Orlando, Florida. The agreement is for a period of six months beginning on November 1, 2017. The Company agreed to pay GSIS a fee of \$10,000 per month and will evaluate the fee after 90 days. The Company agreed to pay the expenses of GSIS incurred in connection with the performance of its duties under the agreement. Either party may terminate or renew the agreement at any time, for any reason or no reason, upon at least 30 days’ notice to the other party. David Aguilar, a member of the Company’s board of directors, is a principal at GSIS.

As of December 31, 2017 and 2016, there was \$171,981 and \$46,849 accrued interest payable, respectively, to related parties on convertible notes payable. See Note 6 – Related Party Convertible Notes Payable and Derivative Liability and Note 8 – Series 2017 Secured Convertible Note – Related Party for further information.

#### Earnings or Loss per Share:

The Company accounts for earnings per share pursuant to ASC 260, Earnings per Share, which requires disclosure on the financial statements of "basic" and "diluted" earnings (loss) per share. Basic earnings (loss) per share are computed by dividing net income (loss) by the weighted average number of common shares outstanding for the year. Diluted earnings (loss) per share is computed by dividing net income (loss) by the weighted average number of common shares outstanding plus common stock equivalents (if dilutive) related to stock options and warrants for each year. As further described in Footnote #6 – Related Party Convertible Notes Payable and Derivative Liability, \$3,000,000 in convertible debt could be converted into 3,000,000 shares of common stock. As further described in Footnote #8 – Series 2017 Secured Convertible Note – Related Party, \$1,000,000 in convertible debt could be converted into 1,000,000 shares of common stock. As further described in Footnote #12 – Employee Stock Options, 7,627,500 options are exercisable. As further described in Footnote #13 – Warrants, 2,232,500 warrants are exercisable. As there was a net loss for the years ended December 31, 2017 and 2016, basic and diluted losses per share in each such year are the same.

#### Recent Accounting Pronouncements

In May 2014, the FASB issued Accounting Standards Update No. 2014-09 (Topic 606) “Revenue from Contracts with Customers.” Topic 606 supersedes the revenue recognition requirements in Topic 605 “Revenue Recognition” (Topic 605), and requires entities to recognize revenues when control of the promised goods or services is transferred to customers at an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services. We adopted Topic 606 as of January 1, 2018 using the modified retrospective transition method. Upon adoption, we will recognize the cumulative effect of adopting this guidance as an adjustment to our opening balance of retained earnings. Prior periods will not be retrospectively adjusted. We expect the adoption of Topic 606 will not have a material impact to our consolidated financial statements, including the presentation of revenues in our Consolidated Statements of Operations.

In February 2016, the FASB issued ASU 2016-02, Leases, which will amend current lease accounting to require lessees to recognize (i) a lease liability, which is a lessee’s obligation to make lease payments arising from a lease, measured on a discounted basis, and (ii) a right-of-use asset, which is an asset that represents the lessee’s right to use, or control the use of, a specified asset for the least term. ASU 2016-02 does not significantly change lease accounting requirements applicable to lessors; however, certain changes were made to align, where necessary, lessor accounting with the lessee accounting model. This standard will be effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company is currently reviewing the provisions of this ASU to determine if there will be any impact on our results of operations cash flows or financial condition.

Other than those pronouncements, management does not believe that there are any other recently issued, but not effective, accounting standards which, if currently adopted, would have a material effect on the Company's financial statements.

## 2. GOING CONCERN

The accompanying consolidated financial statements and notes have been prepared assuming the Company will continue as a going concern. For the year ended December 31, 2017, the Company incurred a net loss of \$10,323,992, generated negative cash flow from operations, has an accumulated deficit of \$29,996,777 and working capital deficit of \$557,195. These circumstances raise substantial doubt as to the Company's ability to continue as a going concern. The Company's ability to continue as a going concern is dependent upon the Company's ability to create and market innovative products, raise capital, reduce debt or renegotiate terms, and to sustain adequate working capital to finance its operations. The failure to achieve the necessary levels of profitability and cash flows or obtain additional funding would be detrimental to the Company. The consolidated financial statements do not include any adjustments that might be necessary if the Company is unable to continue as a going concern.

## 3. INVENTORIES

Inventories consisted of the following:

	2017	2016
Raw Materials	\$ 114,119	\$ 48,014
Work in progress	482,770	254,258
Finished Goods	398,912	160,819
In Transit	5,468	-
Less valuation allowance	(9,572)	(3,206)
Total	<u>\$ 991,697</u>	<u>\$ 459,885</u>

## 4. PREPAID EXPENSES

Prepaid expenses consisted of the following:

	2017	2016
Prepaid insurance	\$ 30,847	\$ 29,911
Prepaid products and services	66,246	83,515
Prepaid rent and security deposit	5,915	7,188
	<u>\$ 103,008</u>	<u>\$ 120,614</u>

## 5. INTANGIBLE ASSETS

On July 20, 2015, the Company, through its wholly-owned subsidiary Drone AFS Corp., purchased substantially all the assets of Adaptive Flight, Inc. ("AFI"), a Georgia corporation. The Company purchased assets, including, but not limited to, intellectual property, licenses and permits, including commercial software licenses for the "GUST" (Georgia Tech UAV Simulation Tool) autopilot system and other transferable licenses which include flight simulation and fault tolerant flight control algorithms. The Company paid \$100,000 in immediately available funds and \$100,000 to be held in escrow. In addition, the Company issued 150,000 shares of unregistered common stock valued at \$8.40 per share, on a post-October 29, 2015 reverse stock split basis, on the date of agreement, to be held in escrow.

The Company had a milestone of twelve months to complete a technology integration plan, the non-completion of which could result in the return of the purchased assets and termination of the Company's obligations to release the escrow cash and shares. Additional milestones included exclusive, no-cost and perpetual licenses to all contributing intellectual property included or related to the purchased assets. As such time as all milestones were met, one-half of the escrow shares were to be released to AFI. Upon termination of the escrow agreement, anticipated to be twelve months from the closing of the asset purchase, if all milestones had been met, the remaining escrow shares would be released to AFI; but if all milestones have not been met, the escrow cash and escrow shares would be released to the Company and the purchased assets would be returned to AFI. According to the terms of the Escrow Agreement, if the escrow share value was less than \$1,400,000, the Company must issue an additional number of unregistered shares, not to exceed 50,000 shares. At December 31, 2015, the value of the 150,000 shares was \$3.23 per share, or \$484,500. The Company recorded \$161,500 as an additional liability and expense at December 31, 2015 for the cost of 50,000 shares at \$3.23 per share. On June 3, 2016, the Integration Plan was deemed to be completed. At June 3, 2016, the value of the 150,000 shares was \$3.01 per share, or \$451,150. The additional liability was reduced to \$150,500 for the cost of 50,000 shares at \$3.01 per share. The Company recorded the \$11,000 reduction in the additional liability through the statement of operations at June 3, 2016. The Company began amortizing the \$1,460,000 of purchased assets over a sixty-month period on June 3, 2016 in the amount of \$24,333 per month. Total amortization expense for the years ended December 31, 2017 and 2016 was \$292,000 and \$170,333, respectively. The remaining unamortized balance of \$997,667 is estimated be amortized in the estimated amounts of \$292,000 per year for 2018 through 2020 and \$121,667 in 2021.

The asset acquisition did not qualify as a business combination under ASC 805-10 and has been accounted for as a regular asset purchase.

## **6. RELATED PARTY CONVERTIBLE NOTES PAYABLE AND DERIVATIVE LIABILITY**

On September 29, 2016, the Company issued Convertible Promissory Notes Series 2016 due October 1, 2017 in the aggregate principal amount of \$3,000,000 in a private placement to the Chairman of the Board and the Chairman of the Strategic Advisory Board of the Company, both of whom are greater than 10% shareholders of the Company. The notes bear interest at a rate of six percent (6%) per annum. The Company may prepay the notes at any time without penalty. If the Company does not prepay a note in full or the holder does not convert the note before the maturity date, the Company may pay the outstanding principal amount and any accrued and unpaid interest on the maturity date with cash or with common stock or through a combination of cash and stock at the Company's discretion. The conversion price of the notes is the lesser of \$3.00 per share or eight-five percent (85%) of the lowest per share purchase price of common stock in the next sale of common stock in which the Company receives gross proceeds of an amount greater than or equal to \$3,000,000.

On August 3, 2017 (the "Effective Date"), the Company entered into amendments (the "Convertible Note Amendments") with the owners and holders of the following convertible promissory notes issued by the Company (the "Series 2016 Convertible Notes"):

- Convertible Promissory Note in the original principal amount of \$1,500,000 issued by the Company on September 29, 2016 to Frost Gamma Investments Trust ("Frost Gamma"). Frost Gamma is a trust that is controlled by Dr. Phillip Frost, a substantial shareholder of the Company; and
- Convertible Promissory Note in the original principal amount of \$1,500,000 issued by the Company on September 29, 2016 to Jay H. Nussbaum, the Company's Chief Executive Officer and Chairman of the Board of Directors.

The Convertible Note Amendments extend the maturity date for each of the Series 2016 Convertible Notes to April 1, 2019 (the "Maturity Date") and revise the conversion price to mean \$1.00 per share subject to proportional adjustment in the event of stock splits, stock dividends and similar corporate events. Accordingly, the notes have been reclassified as long-term debt. Consistent with the original terms of the Series 2016 Convertible Notes, interest accrues at the rate of 6% interest per annum and is payable on the Maturity Date. The accrued interest is payable at the holders' option in cash or shares of our common stock valued at the \$1.00 per share conversion price. The Convertible Note Amendments provide that an event of default in the City National Bank Loan will be treated as an event of default under the Series 2016 Convertible Notes.

On November 9, 2017, the Company entered into amendments (the "November 2017 Convertible Note Amendments") with the owners and holders of the Series 2016 Convertible Notes to permit the payment of, at the holders' election, accrued and unpaid interest either in monthly or quarterly payments at any time after the Effective Date. Both the principal amount and accrued interest may be paid with: (i) cash; (ii) the issuance and delivery to the holder of shares of common stock of the Company at the conversion price provided for in the Series 2016 Convertible Note; or (iii) any combination of cash and shares of Common Stock, as determined by the holder in its sole discretion.

The Company evaluated the modification under ASC 470-50 and determined that is qualified as an extinguishment of debt. The aggregate loss on extinguishment of debt in 2017 is \$681,988, including (\$378) on derivative liabilities, and \$682,366 on unamortized debt discount. The embedded conversion feature of the notes pre-modification required liability classification.

The Company analyzed the conversion option in the notes for derivative accounting treatment under ASC Topic 815, “Derivatives and Hedging,” and determined that the instrument does not qualify for derivative accounting.

The Company therefore performed an analysis to determine if the conversion option was subject to a beneficial conversion feature and determined that the instrument does not have a beneficial conversion feature.

The following table sets forth, by level within the fair value hierarchy, the Company’s financial liabilities that were accounted for at fair value as of December 31, 2017 and December 31, 2016:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
LIABILITIES:				
Derivative liabilities as of December 31, 2017	\$ 0	\$ 0	\$ 0	\$ 0
Derivative liabilities as of December 31, 2016	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 1,832,013</u>	<u>\$ 1,832,013</u>

The Company used the lattice model for valuation of derivative liabilities at December 31, 2016.

The following table represents the change in the fair value of the derivative liabilities during the years ended December 31, 2017 and 2016:

Fair value of derivative liabilities as of December 31, 2015	\$ 0
Fair value of derivative liability at September 30, 2016 recorded as debt discount	2,394,974
Change in fair value of derivative liabilities	<u>(562,961)</u>
Fair value of derivative liabilities as of December 31, 2016	\$ 1,832,013
Change in fair value of derivative liabilities	<u>(1,831,635)</u>
Gain on extinguishment of debt	<u>(378)</u>
Fair value of derivative liabilities as of December 31, 2017	<u>\$ 0</u>

The amortization of the debt discount is \$1,409,790 and \$302,818 for the years ended December 31, 2017 and 2016, respectively. The \$3,000,000 payable associated with the Convertible Promissory Notes Series 2016 due October 1, 2017 is \$907,844 as of December 31, 2016, net of a \$2,092,156 debt discount which is being amortized over the life of the loan using the effective interest method.

## **7. REVOLVING LINE OF CREDIT**

On August 2, 2017, the Company issued a promissory note to City National Bank of Florida (“CNB”) in the principal amount of \$2,000,000, the CNB Note. The note evidences a revolving line of credit with advances that may be requested by the Company until the maturity date of August 2, 2018 so long as no event of default exists under the note, the Company or Mr. Nussbaum does not cease doing business, Mr. Nussbaum does not seek to revoke or modify his guarantee of the Note, the Company does not misapply the proceeds of this loan or CNB in good faith does not believe itself secure. The CNB Note bears interest at a variable rate equal to 0.250 percentage points over the Wall Street Journal Prime Rate payable monthly. The Company will pay to CNB a late charge of 5.0% of any monthly payment not received by Lender within 10 calendar days after its due date. The Company may prepay the note at any time without penalty. In the event of a default, the interest rate will increase to the highest lawful rate. The Company is obligated to maintain depository accounts with CNB with a minimum average annual balance of \$600,000. In the event the Company does not maintain this account balance, CNB may charge the Company a fee equal to 2% of the deficiency as additional interest under the note. The CNB Note is personally guaranteed by Mr. Nussbaum, the Company’s Chief Executive Officer pursuant to written guarantee in favor of CNB (the “CNB Guarantee”). Mr. Nussbaum and the Company are obligated to maintain an unencumbered liquidity of no less than \$6,000,000 in the form of cash, repurchase agreements, certificates of deposit or marketable securities acceptable to CNB. In addition, to secure our obligations under the note, we entered into a security agreement in favor of CNB (the “Security Agreement”) encumbering all of our accounts, inventory and equipment along with an assignment of a bank account we maintain at CNB with an approximate balance of \$90,000. As of December 31, 2017, \$1,000,000 has been drawn against the line of credit. Accrued interest of \$5,625 has been recognized as of December 31, 2017.

## Indemnification Agreement

On August 3, 2017, the Company entered into an Indemnification Agreement with Mr. Nussbaum in order to indemnify and defend him to the fullest extent permitted by law for any claim, expense or obligation which might arise as a result of his guarantee of the CNB Note.

## **8. SERIES 2017 SECURED CONVERTIBLE NOTE – RELATED PARTY**

On August 3, 2017, the Company issued a Secured Convertible Promissory Note Series 2017 due August 2, 2018 in the aggregate principal amount of \$2,000,000 (the “Series 2017 Convertible Note”) in a private placement to Frost Nevada Investments Trust (“Frost Nevada”). Frost Nevada is a trust that is controlled by Dr. Frost, a substantial shareholder of the Company. The note evidences a revolving line of credit with advances that may be requested by the Company until the maturity date of August 2, 2018 so long as no event of default exists under the loan. The Company may request advances of principal under this note equal to and at the same time as it requests advances, if any, pursuant to the CNB Note. The note bears interest at a variable rate equal to 0.250 percentage points over the Wall Street Journal Prime Rate. The Company may prepay the notes at any time without penalty. If the Company does not prepay the note in full or the holder does not convert the note before the maturity date, the Company may pay the outstanding principal amount and any accrued and unpaid interest on the maturity date with cash or with common stock or through a combination of cash and stock at Frost Nevada’s discretion. The conversion price under the note is \$1.00 per share subject to proportional adjustment in the event of stock splits, stock dividends and similar corporate events. The Series 2017 Convertible Note is secured by a security interest in all the Company’s assets. This security interest is subordinate to the security interest of CNB discussed in Footnote #7 above. As of December 31, 2017, \$1,000,000 has been drawn against the line of credit. Accrued interest of \$5,625 has been recognized as of December 31, 2017.

The Company analyzed the conversion option in the notes for derivative accounting treatment under ASC Topic 815, “Derivatives and Hedging,” and determined that the instrument does not qualify for derivative accounting.

The Company therefore performed an analysis to determine if the conversion option was subject to a beneficial conversion feature and determined that the instrument does not have a beneficial conversion feature.

## **9. OKLAHOMA TECHNOLOGY COMMERCIALIZATION CENTER**

At the time of the April 30, 2014 merger between MacroSolve, Inc. (“MacroSolve”) and the Company, MacroSolve had a \$110,000 balance on its refundable award from the State of Oklahoma Technology Business Finance Program. On September 23, 2016, the parties agreed to settle the obligation for \$35,000 with the balance of \$75,000 written off and recorded as debt forgiveness.

## **10. SHAREHOLDERS’ EQUITY**

### **For the year ended December 31, 2017**

The Company issued a total of 500,250 shares of common stock during the year ended December 31, 2017, as described below:

On April 24, 2017, the holder of Series A preferred stock converted a total of 100,100 shares of Series A for an aggregate of 250,250 shares of restricted common stock in accordance with their conversion rights which includes a blocker with respect to individual ownership percentages.

On August 3, 2017, the Company entered into an amendment to the August 24, 2014 Independent Contractor Agreements it entered into with Dr. Philip Frost and Steven Rubin who serve as members of the Company’s Strategic Advisory Board (the “SAB Amendments”). The SAB Amendments extend the term of the agreements from May 1, 2017 until April 30, 2018 and provide for the following equity based compensation: (a) for Dr. Frost, a warrant to purchase 2,000,000 shares of the Company’s Common Stock (the “Frost Warrant”) and an award of 150,000 shares of the Company’s unregistered restricted Common Stock and (b) for Mr. Rubin, an award of 100,000 shares of the Company’s unregistered restricted Common Stock. The restricted stock vests upon the occurrence of a change of control (as defined in the SAB Amendments). The Warrant has a term of five years and exercise price of \$1.00 per share subject to proportional adjustment in the event of stock splits, stock dividends and similar corporate events. The Company recognized \$155,001 expense for the pro rata portion of shares earned by the two members during the twelve months ended December 31, 2017, amortizing the expense over the 12 months of the service agreement regardless of the vesting condition.

As of December 31, 2017, the Company had unamortized stock compensation of \$77,500 for non-employees.

**For the year ended December 31, 2016**

The Company issued a total of 3,556,635 shares of common stock during the year ended December 31, 2016, as described below:

The Company issued 2,500 shares of common stock pursuant to conversions of an aggregate of 1,000 shares of Series A preferred stock.

The Company issued 183,468 shares of common stock pursuant to conversions of an aggregate of 73,387 shares of Series C preferred stock.

The Company issued 50,000 shares of common stock pursuant to conversions of an aggregate of 2,000,000 shares of Series D preferred stock.

The Company issued 50,000 shares of common stock pursuant to conversions of an aggregate of 1,999,998 shares of Series F preferred stock.

The Company issued 50,000 shares of common stock pursuant to conversions of an aggregate of 2,000,000 shares of Series G preferred stock.

The Company issued 50,000 shares of common stock to AFI, as discussed above in Note 5 – Intangible Assets, after all milestones had been met as a requirement of the terms of the Escrow Agreement because the value of the escrowed shares fell below \$1,400,000 and triggered a “make whole” provision. A gain of \$11,000 was recognized since the fair value of \$150,500 on the date of issuance was less than the original accrual.

The Company issued 100,000 shares of common stock with monthly vesting provisions to a newly-appointed director, Lt. Gen. Michael T. Flynn, for 24 months of services. Lt. Gen. Flynn could earn a pro rata portion of the shares, calculated based on the twenty-four-month vesting schedule. Lt. General Flynn resigned as a director on December 31, 2016 due to his appointment as National Security Advisor to President Donald Trump. Lt. General Flynn forfeited 66,667 unvested shares and disclaimed 33,333 vested shares. The Company recorded \$97,000 in stock based compensation related to General Flynn’s board service which could not be reversed upon his disclaimer due to ASC 718-20-35-3 which stipulated that once an award vested, the compensation cost could not be reversed.

The Company issued an aggregate of 1,150,000 shares of common stock outside of the 2015 Equity Plan to Jay Nussbaum, Felicia Hess, Daniyel Erdberg, Kendall Carpenter, and Kevin Hess pursuant to Stock Award Agreements. The shares will vest upon consummation of a significant equity and/or debt financing at least equal to the November 2015 financing which raised \$3,725,000 provided that the holder remains engaged by the Company through the vesting date. Stock based compensation of \$3,346,615 was recognized during the year ended December 31, 2016 as the shares became fully vested on September 29, 2016 by resolution of the Board of Directors that the issuance of the Convertible Promissory Notes Series 2016 due October 1, 2017 qualified as such a significant financing.

In September 2016, the Company issued 1,339,000 shares of restricted common stock outside of the 2015 Equity Plan to employees Jay Nussbaum, Felicia Hess, Daniyel Erdberg, Kendall Carpenter, Mike Silverman and Lt. Gen. Michael Flynn pursuant to Stock Award Agreements. The shares will vest upon consummation of a significant equity and/or debt financing of at least \$5,000,000 provided that the holder remains engaged by the Company through the vesting date. Lt. Gen. Flynn resigned as a director on December 31, 2016 due to his appointment as National Security Advisor to President Donald Trump. Lt. Gen. Flynn forfeited 25,000 unvested shares. The Company did not recognize any expense for the 25,000 cancelled Flynn shares for the year ended December 31, 2016. The Company recognized \$970,067 stock based compensation during the six months ended June 30, 2017 and \$508,940 in stock based compensation during the twelve months ended December 31, 2016. On that same date, the Company issued 35,000 shares of common stock outside the 2015 Equity Plan with the same conditions to Reginald Brown pursuant to Stock Aware Agreement for consulting services. The Company recognized \$11,065 stock based compensation during the twelve months ended December 31, 2016. As of August 3, 2017, the Company does not believe the vesting conditions are probable of being achieved, and as such, no stock-based compensation expense is expected to be recognized in connection with the September 2016 shares. Consequently, previously recorded stock based compensation of \$1,488,596 was reversed during the nine months ended September 30, 2017.

On August 3, 2017, these awards were modified so that the restrictions set forth in the RSA lapse upon the earlier of (i) consummation of a significant equity and/or debt financing from which the Company receives gross proceeds of at least \$7,000,000 or (ii) a change in control (as defined in the RSA Amendment), provided that, in either case, the holder remains engaged by the Company through the date of such event. The Company does not believe the modified vesting conditions are probably of being achieved, and as such, no stock-based compensation expense has been recorded. The Company will reassess whether achievement of the vesting conditions is probable at each reporting date. If it is probable, stock-based compensation will be recognized.

The Company issued 150,000 shares of common stock with monthly vesting provisions to Strategic Advisory Board members, Dr. Philip Frost and Steven Rubin, for 12 months of services. The advisors can earn a pro rata portion of the shares, calculated based on the twelve-month vesting period, in the event the service agreements are terminated prior to the expiration date as described in the agreements. The Company recognized a total of \$29,500 and \$284,000 expense for the pro rata portion of shares earned by the two members during the years ended December 31, 2017 and 2016, respectively.

The Company issued 25,000 shares of common stock to a member of the Strategic Advisory Board for services which were immediately vested and recorded at the fair market value of \$82,722.

On September 29, 2016, the Company issued 496,667 shares of common stock to twelve investors, including 406,666 shares to four affiliate investors that were party to the November 2015 private placement, pursuant to the purchase agreement for such private placement. These investors purchased stock at \$5.00 per share and under the purchase agreement received twelve months of price protection. The Convertible Promissory Notes Series 2016 due October 1, 2017 included a \$3.00 per share conversion factor, thereby triggering the price protection feature. The value of the shares that were issued, based upon the closing stock price on the date of issuance, was \$1,641,484 and was treated as a deemed dividend.

On June 1, 2015, the Company issued 50,000 shares of common stock with monthly vesting provisions to the Chairman of the Board for twenty-four months services pursuant to a Director Agreement. The Chairman can earn a pro rata portion of the shares, calculated on a twenty-four month vesting period, in the event the Chairman relinquishes his position and board seat prior to the expiration date of the Director Agreement. The Company recognized a total of \$112,500 and \$270,000 expense for the pro rata portion of shares earned by the Chairman during 2017 and 2016, respectively.

On September 4, 2015, the Company issued 450,000 shares of common stock to four management employees and one director pursuant to stock award agreements. The vesting condition of the shares was for consummation of a \$4,000,000 equity or debt financing provided that the holder remains engaged by the Company through the vesting date. On February 4, 2016, the Board deemed that vesting had occurred. Stock based compensation of \$604,440 was recognized in 2016.

## **11. PREFERRED STOCK**

### **For the year ended December 31, 2017**

All the preferred stock of the Company is convertible into common shares. The Series A stock conversion ratio is 1 to 2.5 common shares. All preferred stock has voting rights equal to the number of shares it would have on an 'as if converted' basis subject to any ownership limitations governing such preferred shares. All preferred stock is entitled to dividends rights equal to the number of shares it would have on an 'as if converted' basis. None of the preferred stock is redeemable, participating nor callable.



The Company analyzed the embedded conversion option for derivative accounting consideration under ASC 815-15 “Derivatives and Hedging” and determined that the conversion option should be classified as equity.

On April 24, 2017, the holder of Series A preferred stock converted a total of 100,100 shares of Series A for an aggregate of 250,250 shares of restricted common stock in accordance with their conversion rights which includes a blocker with respect to individual ownership percentages.

#### **For the year ended December 31, 2016**

During the year ended December 31, 2016, one investor who held Series A preferred stock converted a total of 1,000 shares of Series A preferred stock for an aggregate of 2,500 shares of common stock in accordance with their conversion rights which includes a blocker with respect to individual ownership percentages. During the same period, two investors who held Series C preferred stock converted a total of 73,387 shares of Series C for an aggregate of 183,468 shares of common stock, one investor who held Series D preferred stock converted a total of 2,000,000 shares of Series D for an aggregate of 50,000 shares of common stock, one investor who held Series F preferred stock converted a total of 1,999,998 shares of Series F for an aggregate of 50,000 shares of common stock, and two investors who held Series G preferred stock converted a total of 2,000,000 shares of Series G for an aggregate of 50,000 shares of common stock, all in accordance with their conversion rights which includes a blocker with respect to individual ownership percentages.

## **12. EMPLOYEE STOCK OPTIONS**

#### **For the year ended December 31, 2017**

On January 9, 2017, the Company issued an option to purchase 100,000 shares of common stock with an exercise price of \$2.90 per share to a director. The option vests 50,000 after one year from grant date and another 50,000 two years from grant date with an expiration date of four years from grant date provided that the Director is still providing service to the Company. During the twelve months ended December 31, 2017, \$129,059 compensation expense was recognized on these 100,000 options.

On August 3, 2017, upon approval of the Company’s board of directors, the Company issued outside its 2015 Equity Plan, 5,210,000 options to purchase the Company’s common stock to officers, directors and employees for services provided. Jay Nussbaum was issued 2,000,000 options, Felicia Hess was issued 1,200,000 options, Dan Erdberg was issued 1,140,000 options, Kendall Carpenter was issued 275,000 options, Directors David Aguilar, Mike Haas and General Wayne Jackson were issued 100,000, 10,000 and 10,000 options, respectively. The remaining 475,000 options were issued to employees and consultants. These stock options immediately vested, are exercisable at an exercise price of \$1.00 per share and expire on August 3, 2021. During the twelve months ended December 31, 2017, \$3,354,097 compensation expense was recognized on these 5,210,000 options.

On November 9, 2017, upon approval of the Company’s board of directors, the Company issued outside its 2015 Equity Plan, 2,000,000 options to purchase the Company’s common stock to officers, directors, and for services provided. Jay Nussbaum was issued 900,000 options, Felicia Hess was issued 300,000 options, Dan Erdberg was issued 200,000 options, Kendall Carpenter was issued 170,000 options, Directors David Aguilar, Mike Haas and General Wayne Jackson were issued 10,000, 10,000 and 10,000 options, respectively. Reginald Brown, Jr. was issued 400,000 options. These stock options immediately vested, are exercisable at an exercise price of \$1.35 per share and expire on November 9, 2021. During the twelve months ended December 31, 2017, \$1,846,075 compensation expense was recognized on these 2,000,000 options

On December 13, 2017, upon approval of the Company’s board of directors the Company issued outside its 2015 Equity Plan, 100,000 options each to two newly-appointed directors, or a total of 200,000 options. These options vest 50% after one year and the remaining 50% after two years provided the director is still actively involved with the Company. The options are exercisable at an exercise price of \$1.00 per share and expire on December 13, 2021. During the twelve months ended December 31, 2017, \$3,593 compensation expense was recognized on these 200,000 options with a remaining balance of \$96,196 to be recognized over the vesting period.

One June 1, 2015, the Company issued an option award to an employee for 37,500 shares vesting over three years with an exercise price of \$10.80 and expiration date of May 4, 2019. During the twelve months ended December 31, 2017 and 2016, \$54,943 and \$122,058 compensation expense was recognized on these 37,500 options, respectively.

The Company used the Black-Scholes option pricing model to estimate the fair value on the date of grant of the 7,510,000 options granted during the twelve months ended December 31, 2017.

The following table summarizes the assumptions used to estimate the fair value of stock options granted during 2017 and 2016:

	2017	2016
Expected dividend yield	0%	0%
Expected volatility	82-100%	102-108%
Risk-free interest rate	1.50-2.01%	0.79 – 1.38%
Expected life of options	2.5-4.0 years	2.0 – 3.0 years

Under the Black-Scholes option pricing model, the fair value of the 7,510,000 options granted during the twelve months ended December 31, 2017 is estimated at \$5,474,133 on the date of grant. During the twelve months ended December 31, 2017, \$5,332,824 compensation expense was recognized on these 7,510,000 options.

During 2017, the Company cancelled 2,500 options issued December 10, 2015 with a strike price of \$5.00 and cancelled 5,000 options issued July 28, 2016 with a strike price of \$3.77 that had been issued to two employees who left the Company without exercising their options.

The following table represents stock option activity as of and for the period ended December 31, 2017:

	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life in Years	Aggregate Intrinsic Value
Outstanding – December 31, 2015	392,500	\$ 6.19	2.62	\$ 0.00
Exercisable – December 31, 2015	355,000	\$ 5.70	2.55	\$ 0.00
Granted	65,000	\$ 2.99		
Exercised or Vested	-	\$ 0.00		
Cancelled or Expired	(15,000)	\$ 3.61		
Outstanding – December 31, 2016	442,500	\$ 5.81	1.72	
Exercisable – December 31, 2016	407,500	\$ 5.57	1.65	\$ 0.00
Granted	7,510,000	\$ 1.12		
Cancelled or Expired	(7,500)	\$ 4.18		
Outstanding – December 31, 2017	7,945,000	\$ 1.38	3.50	
Exercisable – December 31, 2017	7,627,500	\$ 1.35	3.50	\$ 0.00

**For the year ended December 31, 2016**

During 2016, the Company granted 65,000 common stock options to employees for service provided. Of these, 50,000 options were granted to two employees and were immediately vested with an exercise price of \$2.91 and the expiration date is April 27, 2019. One of these employees terminated and did not exercise her 10,000 options resulting in the expiration of the option. Another 5,000 options were immediately vested and were granted with an exercise price of \$3.77 and the expiration date is July 29, 2019. Another employee received 10,000 options with two-year vesting and an exercise price of \$3.00 and an expiration date of December 6, 2019. The Company recognized \$10,516 expense in 2017 relative to that option. Two employees who received 2,500 options each in December 2015 terminated their employment and did not exercise their options resulting in the expiration of a total of 5,000 options. During 2016, \$229,563 compensation expense was recognized.

**13. WARRANTS****For the year ended December 31, 2017**

On August 3, 2017, upon approval of the Company's board of directors, the Company issued outside its 2015 Equity Plan, 30,000 warrants to purchase the Company's common stock to consultants for services provided. These warrants are immediately vested, are exercisable at an exercise price of \$1.00 per share and expire on August 3, 2021. The Company recognized \$19,269 in compensation cost during the twelve months ended December 31, 2017.

On August 3, 2017, the Company issued a warrant to purchase 2,000,000 shares of the Company's common stock to Dr. Philip Frost for services to be provided under the terms of his service to the Strategic Advisory Board through April 2018. These warrants immediately vested, are exercisable at an exercise price of \$1.00 per shares and expire on August 3, 2022. The Company recognized \$1,391,793 in compensation cost during the twelve months ended December 31, 2017.

On November 9, 2017, upon approval of the Company's board of directors, the Company issued outside its 2015 Equity Plan, 20,000 warrants to purchase the Company's common stock to consultants for services provided. These warrants are immediately vested, are exercisable at an exercise price of \$1.35 per share and expire on November 9, 2021. The Company recognized \$18,456 in compensation cost during the twelve months ended December 31, 2017.

The following table summarizes the assumptions used to estimate the fair value of the 2,050,000 warrants granted during 2017 as of re-measurement dates:

	<u>2017</u>
Expected dividend yield	0%
Expected volatility	190-212%
Risk-free interest rate	1.52-1.88%
Expected life of warrants	4-5 years

**For the year ended December 31, 2016**

For the year 2016, 60,000 common stock purchase warrants were granted to four consultants for services provided. Each warrant was granted with the exercise price of \$2.91, which immediately vested, and the expiration date is April 27, 2019.

During 2016, 10,472 MacroSolve warrants expired that were issued in 2011 with exercise prices ranging between \$141.00 and \$404.50 on a post-reverse split basis.

The Company used the Black-Scholes warrant pricing model to estimate the fair value on the re-measurement dates of the 12,500 warrants that vested on June 10, 2017.

The following table summarizes the assumptions used to estimate the fair value of the 12,500 warrants granted during 2015 as of re-measurement dates:

	<u>2017</u>
Expected dividend yield	0%
Expected volatility	107%
Risk-free interest rate	1.53%
Expected life of warrants	1 year

Under the Black-Scholes warrant pricing model, fair value of the 12,500 warrants granted during 2015 is estimated at \$0 as of re-measurement dates. During the twelve months ended December 31, 2017, \$(3,467) compensation expense was recognized on these 12,500 warrants.

During 2016, \$118,681 compensation expense was recognized.

The following table represents warrant activity as of and for the period ended December 31, 2017 and 2016:

	Number of Warrants	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life in Years	Aggregate Intrinsic Value
Outstanding – December 31, 2015	134,209	\$ 23.87	3.66	
Exercisable – December 31, 2015	104,209	\$ 27.87	4.01	\$ 0.00
Granted	60,000	\$ 2.91		
Forfeited or Expired	(10,472)	\$ 193.72		
Outstanding – December 31, 2016	183,737	\$ 7.35	2.70	
Exercisable – December 31, 2016	171,237	\$ 7.15	2.79	\$ 0.00
Granted	2,050,000	\$ 1.00		
Forfeited or Expired	(1,237)	\$ 303.37		
Outstanding – December 31, 2017	2,232,500	\$ 1.36	4.34	
Exercisable – December 31, 2017	2,232,500	\$ 1.36	4.34	\$ 0.00

#### 14. INCOME TAXES

The Company uses the liability method, where deferred tax assets and liabilities are determined based on the expected future tax consequences of temporary differences between the carrying amounts of assets and liabilities for financial and income tax reporting purposes. On December 22, 2017, H.R. 1, formally known as the Tax Cut and Jobs Act (the "Act") was enacted into law. The Act provides for significant tax law changes and modifications with varying effective dates. The major change that affects the Company is reducing the corporate income tax rate from 35% to 21%.

The net deferred asset generated by the loss carry-forward has been fully reserved. The cumulative net operating loss carry-forward is approximately \$10,718,755 for 2017 and \$7,573,280 for 2016 and will begin expiring in 2034. Section 382 of the Internal Revenue Code generally imposes an annual limitation on the amount of net operating loss carryforwards that may be used to offset taxable income when a corporation has undergone significant changes in its stock ownership. The \$10,718,755 estimate of net operating loss carry-forward is calculated after we consider the effect of Section 382.

Deferred tax assets consist of the tax effect of net operating loss carry-forwards. The Company has provided a full valuation allowance on the deferred tax assets because of the uncertainty regarding its realizability. Deferred tax assets consist of the following:

	December 31, 017	December 31, 2016
Net operating loss carry-forwards	\$ 2,250,939	\$ 2,574,915
Valuation allowance	(2,250,939)	(2,574,915)
	<u>\$ 0</u>	<u>\$ 0</u>

The Company's tax expense does not reflect the statutory rate since the Company's deferred tax asset is fully offset by a valuation allowance. The statute of limitations is open for the tax years ending December 31, 2014 and thereafter.

#### **15. COMMITMENTS AND CONTINGENCIES**

On November 17, 2014, the Company entered into a 60-month lease for 5,533 square feet of office and manufacturing space at 11651 Central Parkway Suite 118, Jacksonville, Florida, with an anticipated lease commencement date of February 1, 2015. The actual commencement date was July 1, 2015 and the lease was amended to 61 months expiring July 31, 2020. The monthly rent, including operating expenses and sales tax, for each year of the initial lease term is estimated to be \$5,915. Anticipated total rent during the term of the lease is as follows:

Year 2018 - \$ 75,437
Year 2019 - \$ 77,309
Year 2020 - \$ 45,651

Rent expense in 2017 and 2016 was \$131,710, and \$108,600, respectively.

The Company acquired licenses to certain technology of Georgia Tech Research Corporation (GTRC) through its purchase of Adaptive Flight, Inc.'s assets on July 20, 2015 and through direct license from GTRC. The licenses are perpetual and if the technology is patented, are protected through the expiration date of the patented know-how. Two of the licenses require a minimum royalty of \$1,500 per year. Royalties are based on vehicle weight and range from \$12.50 to \$75.00 per vehicle on one license and \$25.00 to \$150.00 per vehicle on another license.

As of December 31, 2015, the Company was a party in a pending motion by Newegg Inc. for recovery of defendant legal fees of approximately \$400,000 from the Company in the matter of MacroSolve, Inc. v Newegg Inc. (U.S.D.C.E.D. TX) case No 6:12-cv-46-MSS-KNM. On April 24, 2015, Newegg filed a Notice of Appeal with the United States Court of Appeals for the Federal Circuit, which issued an opinion on February 9, 2016, affirming the district court's denial of Newegg's motion to recover its legal fees. On May 9, 2016, Newegg filed a Petition for a Writ of Certiorari with the United States Supreme Court. On June 13, 2016, the United States Supreme Court issued an order denying that petition. Consequently, MacroSolve prevailed in the matter.

On May 16, 2016, Banco Popular North America ("Banco") filed a lawsuit in Duval County, Florida in the Circuit Court of the Fourth Judicial Circuit against Aerial Products Corporation d/b/a Southern Balloon Works ("Aerial Products"), Kevin M. Hess, LTAS, and the Company to collect on a delinquent Small Business Administration loan that Banco made in 2007 to Aerial Products with Mr. Hess as the personal guarantor. LTAS and the Company filed an Answer on June 30, 2016 and Responses to Interrogatories on December 16, 2016. The lawsuit is active and discovery is ongoing. It is our position that neither LTAS nor the Company are continuations of Aerial Products, and LTAS and the Company have denied all allegations made by Banco and will vigorously defend that position. The Company has evaluated the probability of loss as possible but the range of loss is unable to be estimated.

Other than the Banco matter, there are no material claims, actions, suits, proceedings inquiries, labor disputes or investigations pending.

#### **16. CONCENTRATIONS**

Financial instruments, which potentially subject the Company to concentrations of credit risk, consist primarily of trade accounts receivable. The Company performs ongoing credit evaluations of its customers and generally does not require collateral related to its trade accounts receivable. At December 31, 2017, accounts receivable from two customers comprised 100% of the Company's total accounts receivable-trade. Revenues from four customers approximated 85% of total revenues for 2017. At December 31, 2016, accounts receivable from one customer comprised 100% of the Company's total accounts receivable-trade. Revenues from one customer approximated 87% of total revenues for 2016.

#### **17. SUBSEQUENT EVENTS**

On February 22, 2018, the Company drew down on the Revolving Line of Credit described in Footnote #7 in the amount of \$250,000. On the same day, the Company drew down on the Series 2017 Secured Convertible Note described in Footnote #8 in the amount of \$250,000.

On March 23, 2018, the Company entered into amendments (the "March 2018 Convertible Note Amendments") with the owners and holders of the Series 2016 Convertible Notes described in Footnote #6 to extend the maturity date from April 1, 2019 until October 1, 2020.

**MARCH 2018 AMENDMENT TO CONVERTIBLE PROMISSORY NOTE**

THIS MARCH 2018 AMENDMENT TO CONVERTIBLE PROMISSORY NOTE SERIES 2016 (the “March 2018 Amendment”) is made effective as of March 23, 2018 (the “Effective Date”) by and between Drone Aviation Holding Corp., a Nevada corporation (the “Company”) and \_\_\_\_\_ (the “Holder”) (collectively the “Parties”).

**BACKGROUND**

A. The Company and Holder are the parties to that certain Convertible Promissory Note Series 2016, originally issued by the Company to the Holder on September 29, 2016, in the original principal amount of \$1,500,000.00 (the “Note”);

B. The Parties amended the Note on August 3, 2017 pursuant to the terms of an Amendment to Convertible Promissory Note (the “August 2017 Amendment”);

C. The Parties amended the Note on November 9, 2017 pursuant to the terms of an Amendment to Convertible Promissory Note (the “November 2017 Amendment”);

D. The Parties desire to further amend the Note as amended by the August 2017 and November 2017 Amendments, as set forth below.

NOW THEREFORE, in consideration of the execution and delivery of the March 2018 Amendment and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties agree as follows:

1. Extension of Maturity Date. The Maturity Date of the Note shall be extended to October 1, 2020.

IN WITNESS WHEREOF, the parties hereto have executed this November 2017 Amendment as of the date first above written.

**DRONE AVIATION HOLDING CORP.**

By: \_\_\_\_\_ By: \_\_\_\_\_  
Kendall W. Carpenter  
Chief Financial Officer

**SUBSIDIARIES**

Drone Aviation Holding Corp., a Nevada corporation, had the domestic and international subsidiaries shown below as of March 23, 2018.

<b>Name of Subsidiary</b>	<b>Jurisdiction Where Incorporated</b>
Lighter Than Air Systems Corporation	Florida
Drone AFS Corp.	Nevada

## CERTIFICATION

I, Jay Nussbaum, certify that:

1. I have reviewed this Annual Report on Form 10-K of Drone Aviation Holding Corp.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rule 13a-15 (f) and 15 (d)-15(f)) for the registrant and have:
  - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) designed such internal control over financing reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect the registrant's internal control over the financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ Jay Nussbaum

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**Chief Executive Officer**  
**(Principal Executive Officer)**

Date: March 23, 2018



## CERTIFICATION

I, Kendall Carpenter, certify that:

1. I have reviewed this Annual Report on Form 10-K of Drone Aviation Holding Corp.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rule 13a-15 (f) and 15 (d)-15(f)) for the registrant and have:
  - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) designed such internal control over financing reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect the registrant's internal control over the financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ Kendall Carpenter

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**Chief Financial Officer**  
**(Principal Financial Officer)**

Date: March 23, 2018

**Certification**  
**Pursuant To Section 906 of the Sarbanes-Oxley Act Of 2002**  
**(Subsections (A) And (B) Of Section 1350, Chapter 63 of Title 18, United States Code)**

Pursuant to section 906 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of section 1350, chapter 63 of title 18, United States Code), each of the undersigned officers of Drone Aviation Holding Corp. (the "Company"), does hereby certify, that:

The Annual Report on Form 10-K for the fiscal year ended December, 2017 (the "Form 10-K") of the Company fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and the information contained in the Form 10-K fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Jay Nussbaum

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**Chief Executive Officer**  
(Principal Executive Officer)

Dated: March 23, 2018

/s/ Kendall Carpenter

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**Chief Financial Officer**  
(Principal Financial Officer)

Dated: March 23, 2018