

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

FORM 10-Q

(Mark One)

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

For the Quarterly Period Ended September 30, 2018

or

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

For the Transition Period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 333-150332

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

Nevada

(State or other jurisdiction of  
incorporation or organization)

46-5538504

(I.R.S. Employer  
Identification No.)

11651 Central Parkway #118, Jacksonville, FL 32224

(Address of principal executive offices) (zip code)

(904) 834-4400

(Registrant's telephone number, including area code)

Not applicable.

(Former name, former address and former fiscal year, if changed since last report)

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 (§ 232.405 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 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 | <input type="checkbox"/>   | Accelerated filer         | <input type="checkbox"/>            |
| Non-accelerated filer   | <input type="checkbox"/> (Do not check if a smaller reporting company) | Smaller reporting company | <input checked="" type="checkbox"/> |
|                         |  | Emerging growth company   | <input type="checkbox"/>            |

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

As of October 26, 2018, there were 9,182,470 shares of registrant's common stock outstanding.

**DRONE AVIATION HOLDING CORP.**

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

|  | <b>September 30,<br/>2018</b> | <b>December 31,<br/>2017</b> |
|--|-------------------------------|------------------------------|
|  | <b>(Unaudited)</b>            |                              |
| <b>ASSETS</b>  |                               |                              |
| <b>CURRENT ASSETS:</b>   |                               |                              |
| Cash   | \$ 178,781                    | \$ 615,375                   |
| Accounts receivable - trade  | 65,760                        | 110,065                      |
| Inventory, net   | 1,761,663                     | 991,697                      |
| Prepaid expenses and deposits  | 99,770                        | 103,008                      |
|  |                               |                              |
| Total current assets   | <u>2,105,974</u>              | <u>1,820,145</u>             |
| <b>PROPERTY AND EQUIPMENT</b> , at cost:   | 176,955                       | 253,444                      |
| Less - accumulated depreciation  | <u>(114,979)</u>              | <u>(97,507)</u>              |
|  |                               |                              |
| Net property and equipment   | <u>61,976</u>                 | <u>155,937</u>               |
| <b>OTHER ASSETS:</b>   |                               |                              |
| Goodwill   | 99,799                        | 99,799                       |
| Intangible assets, net   | <u>778,667</u>                | <u>997,667</u>               |
|  |                               |                              |
| Total other assets   | <u>878,466</u>                | <u>1,097,466</u>             |
|  |                               |                              |
| <b>TOTAL ASSETS</b>  | <u>\$ 3,046,416</u>           | <u>\$ 3,073,548</u>          |
| <b>LIABILITIES AND STOCKHOLDERS' DEFICIT</b>   |                               |                              |
| <b>CURRENT LIABILITIES:</b>  |                               |                              |
| Accounts payable - trade and accrued liabilities   | \$ 653,302                    | \$ 205,359                   |
| Accounts payable due to related party  | 183,918                       | 171,981                      |
| Unearned revenue   | 9,800                         | -                            |
| Bank Line of Credit  | 1,900,000                     | 1,000,000                    |
| Related party convertible note payable   | <u>1,900,000</u>              | <u>1,000,000</u>             |
|  |                               |                              |
| Total current liabilities  | <u>4,647,020</u>              | <u>2,377,340</u>             |
| <b>LONG TERM LIABILITIES:</b>  |                               |                              |
| Related party convertible note payable   | <u>3,000,000</u>              | <u>3,000,000</u>             |
|  |                               |                              |
| <b>TOTAL LIABILITIES</b>   | <u>\$ 7,647,020</u>           | <u>\$ 5,377,340</u>          |
| <b>COMMITMENTS AND CONTINGENCIES</b>   |                               |                              |
|  | <u>-</u>                      | <u>-</u>                     |
| <b>STOCKHOLDERS' DEFICIT:</b>  |                               |                              |
| Common stock, \$.0001 par value; authorized 300,000,000 shares; 9,182,470 and 9,182,470 shares issued and outstanding, at September 30, 2018 and December 31, 2017, respectively | 918                           | 918                          |
| Additional paid-in capital   | 29,339,511                    | 27,692,067                   |
| Retained Deficit   | <u>(33,941,033)</u>           | <u>(29,996,777)</u>          |
|  |                               |                              |
| Total stockholders' deficit  | <u>(4,600,604)</u>            | <u>(2,303,792)</u>           |
|  |                               |                              |
| <b>TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT</b>   | <u>\$ 3,046,416</u>           | <u>\$ 3,073,548</u>          |

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

**DRONE AVIATION HOLDING CORP.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)**

|  | <u>For the Three Months Ended</u>   |                                     | <u>For the Nine Months Ended</u>    |                                     |
|--|-------------------------------------|-------------------------------------|-------------------------------------|-------------------------------------|
|  | <u>September 30,</u><br><u>2018</u> | <u>September 30,</u><br><u>2017</u> | <u>September 30,</u><br><u>2018</u> | <u>September 30,</u><br><u>2017</u> |
| <b>Revenues</b>  | \$ 84,815                           | \$ 93,105                           | \$ 995,838                          | \$ 474,634                          |
| <b>Cost of good sold</b>   | <u>51,587</u>                       | <u>33,594</u>                       | <u>537,617</u>                      | <u>283,590</u>                      |
| <b>Gross profit</b>  | <u>33,228</u>                       | <u>59,511</u>                       | <u>458,221</u>                      | <u>191,044</u>                      |
| <b>General and administrative expense</b>                                | <u>1,127,266</u>                    | <u>4,544,499</u>                    | <u>4,158,194</u>                    | <u>7,432,226</u>                    |
| <b>Loss from operations</b>  | <u>(1,094,038)</u>                  | <u>(4,484,988)</u>                  | <u>(3,699,973)</u>                  | <u>(7,241,182)</u>                  |
| <b>Other income (expense)</b>  |                                     |                                     |                                     |                                     |
| Derivative gain  | -                                   | 779,787                             | -                                   | 1,831,635                           |
| Debt extinguishment  | -                                   | (681,988)                           | -                                   | (681,988)                           |
| Interest expense   | <u>(95,828)</u>                     | <u>(376,636)</u>                    | <u>(244,283)</u>                    | <u>(1,558,389)</u>                  |
| Total other expense  | <u>(95,828)</u>                     | <u>(278,837)</u>                    | <u>(244,283)</u>                    | <u>(408,742)</u>                    |
| <b>NET LOSS</b>  | <u>(1,189,866)</u>                  | <u>(4,763,825)</u>                  | <u>(3,944,256)</u>                  | <u>(7,649,924)</u>                  |
| Weighted average number of common shares outstanding - basic and diluted | <u>9,182,470</u>                    | <u>9,087,361</u>                    | <u>9,182,470</u>                    | <u>8,880,168</u>                    |
| Basic and diluted net loss per share                                     | <u>\$ (0.13)</u>                    | <u>\$ (0.52)</u>                    | <u>\$ (0.43)</u>                    | <u>\$ (0.86)</u>                    |

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

**DRONE AVIATION HOLDING CORP.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)**

|  | <b>For the Nine Months Ended</b> |                            |
|--|----------------------------------|----------------------------|
|  | <b>September 30,</b>             | <b>September 30,</b>       |
|  | <b>2018</b>                      | <b>2017</b>                |
| <b>OPERATING ACTIVITIES:</b>   |                                  |                            |
| Net loss   | \$ (3,944,256)                   | \$ (7,649,924)             |
| Adjustments to reconcile net loss to net cash used in operating activities:        |                                  |                            |
| Amortization expense of debt discount  | -                                | 1,409,790                  |
| Gain on derivative liability   | -                                | (1,831,635)                |
| Loss on debt extinguishment  | -                                | 681,988                    |
| Depreciation   | 29,238                           | 26,350                     |
| Loss on disposal of property and equipment   | 10,002                           | -                          |
| Amortization expense of intangible assets  | 219,000                          | 219,000                    |
| Stock based compensation   | 1,647,444                        | 4,829,598                  |
| Changes in current assets and liabilities:   |                                  |                            |
| Accounts receivable  | 44,305                           | 293,251                    |
| Inventory  | (769,966)                        | (275,276)                  |
| Prepaid expenses and other current assets  | 3,238                            | 49,340                     |
| Accounts payable and accrued expense   | 447,943                          | (144,000)                  |
| Due from related party   | 11,937                           | 141,368                    |
| Deferred revenue   | 9,800                            | -                          |
| Net cash used in operating activities  | <u>(2,291,315)</u>               | <u>(2,250,150)</u>         |
| <b>INVESTING ACTIVITIES:</b>   |                                  |                            |
| Cash received from sale of vehicle   | 60,000                           | -                          |
| Cash paid on fixed assets  | <u>(5,279)</u>                   | <u>(675)</u>               |
| Net cash provided by (used in) investing activities                                | <u>54,721</u>                    | <u>(675)</u>               |
| <b>FINANCING ACTIVITIES:</b>   |                                  |                            |
| Proceeds from related party convertible note payable                               | 900,000                          | 1,000,000                  |
| Proceeds from bank line of credit  | <u>900,000</u>                   | <u>1,000,000</u>           |
| Net cash provided by financing activities  | <u>1,800,000</u>                 | <u>2,000,000</u>           |
| <b>NET DECREASE IN CASH</b>  | <b>(436,594)</b>                 | <b>(250,825)</b>           |
| <b>CASH, beginning of period</b>   | <b>615,375</b>                   | <b>2,015,214</b>           |
| <b>CASH, end of period</b>   | <b><u>\$ 178,781</u></b>         | <b><u>\$ 1,764,389</u></b> |
| <b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:</b>                           |                                  |                            |
| Cash paid during the nine months ended September 30:                               |                                  |                            |
| Interest   | <u>\$ 232,255</u>                | <u>\$ 5,875</u>            |
| Noncash investing and financing activities for the nine months ended September 30: |                                  |                            |
| Conversion of Series A preferred stock to common stock                             | <u>\$ -</u>                      | <u>\$ 25</u>               |

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

**DRONE AVIATION HOLDING CORP.**  
**NOTES TO INTERIM UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**  
**For the Period Ended September 30, 2018**

**1. BASIS OF PRESENTATION**

The following unaudited interim consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, such interim financial statements do not include all the information and footnotes required by accounting principles generally accepted in the United States for complete annual financial statements. The information furnished reflects all adjustments, consisting only of normal recurring items which are, in the opinion of management, necessary in order to make the financial statements not misleading. The balance sheet as of December 31, 2017 has been derived from the Company's annual financial statements that were audited by an independent registered public accounting firm but does not include all of the information and footnotes required for complete annual financial statements. The consolidated financial statements included in this Quarterly Report on Form 10-Q should be read in conjunction with the consolidated financial statements and the notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2017.

Revenue Recognition

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. We recognized the cumulative effect of adopting this guidance as an adjustment to our opening balance of retained earnings. Prior periods will not be retrospectively adjusted. The adoption of Topic 606 does not have a material impact to our consolidated financial statements, including the presentation of revenues in our Consolidated Statements of Operations.

**2. GOING CONCERN**

The accompanying consolidated financial statements and notes have been prepared assuming the Company will continue as a going concern. For the nine months ended September 30, 2018, the Company incurred a net loss of \$3,944,256, generated negative cash flow from operations, has an accumulated deficit of \$33,941,033 and working capital deficit of \$2,541,046. 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. RELATED PARTY TRANSACTIONS**

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 was for a period of six months beginning on November 1, 2017. On September 26, 2018, the parties amended the agreement to extend the period of service through September 2019 with monthly auto renew extensions thereafter. The Company also agreed to issue 100,000 options to purchase Company stock which were immediately vested, had a strike price of \$1.00 and terminate on September 26, 2022. The Company pays GSIS a fee of \$10,000 per month. 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 September 30, 2018, and December 31, 2017, there was \$183,918 and \$171,981 accrued interest payable, respectively, to related parties on convertible notes payable.

**4. INVENTORY**

Inventories are stated at the net realizable value, 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. At September 30, 2018, \$1,050,740 of the \$1,238,331 Work in Process Inventory was related to the WASP multi-mission capable tactical aerostat valued in excess of \$1.7 million dollars which was delivered to the Department of Defense on October 9, 2018. Inventory consists of the following at September 30, 2018 and December 31, 2017:

|                          | September 30,<br>2018 | December 31,<br>2017 |
|--------------------------|-----------------------|----------------------|
| Raw Materials            | \$ 115,926            | \$ 114,119           |
| Work in Progress         | 1,238,331             | 482,770              |
| Finished Goods           | 416,978               | 398,912              |
| In Transit               | -                     | 5,468                |
| Less valuation allowance | (9,572)               | (9,572)              |
| Total                    | <u>\$ 1,761,663</u>   | <u>\$ 991,697</u>    |

**5. 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 and leasehold improvements. During the nine months ended September 30, 2018, the Company invested \$5,279 in shop machinery and equipment and computers. During that same time period, the company sold a company vehicle for \$60,000 cash and wrote off several items of abandoned equipment resulting in a \$10,002 loss on disposal of assets. Depreciation expense was \$29,238 and \$26,350 for the nine months ended September 30, 2018 and 2017, respectively. Property and equipment consists of the following at September 30, 2018 and December 31, 2017:

|                                 | September 30,<br>2018 | December 31,<br>2017 |
|---------------------------------|-----------------------|----------------------|
| Shop machinery and equipment    | \$ 87,534             | \$ 87,704            |
| Computers and electronics       | 32,093                | 35,270               |
| Office furniture and fixtures   | 37,814                | 37,814               |
| Vehicle                         | -                     | 73,142               |
| Leasehold improvements          | 19,514                | 19,514               |
|                                 | <u>176,955</u>        | <u>253,444</u>       |
| Less - accumulated depreciation | (114,979)             | (97,507)             |
|                                 | <u>\$ 61,976</u>      | <u>\$ 155,937</u>    |

## **6. 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 nine months ended September 30, 2018 was \$219,000. The remaining unamortized balance of \$778,667 is estimated to be amortized in the estimated amounts of \$73,000 during 2018 and \$292,000 per year for 2019 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.

## **7. 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. 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.

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 1, 2019 until October 1, 2020. The Company evaluated the modification under ASC 470-50 and determined that it does not qualify as an extinguishment of debt.

As of September 30, 2018, and December 31, 2017, \$165,986 and \$166,356 accrued interest has been recorded, respectively.

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.

## **8. 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, with a maturity date of August 2, 2018. On September 26, 2018, the Company and CNB agreed to extend the maturity date of the promissory note to August 2, 2019. The Company evaluated the modification under ASC 470-50 and determined that it did not qualify as an extinguishment of debt. The note evidences a revolving line of credit with advances that may be requested by the Company until the maturity date of August 2, 2019 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 initial CNB Note bore an interest rate at a variable rate equal to 0.250 percentage points over the Wall Street Journal Prime Rate payable monthly. At renewal, the variable rate was increased to 1.0 percentage points over the Wall Street Journal Prime Rate. 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 September 30, 2018, \$1,900,000 has been drawn against the line of credit, an increase of \$900,000 over the balance at December 31, 2017. Accrued interest of \$5,558 has been recognized as of September 30, 2018.

### 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.

### **9. 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”). On September 26, 2018, the Company and Frost Nevada agreed to extend the maturity date of the promissory note to August 2, 2019. The Company evaluated the modification under ASC 470-50 and determined that it did not qualify as an extinguishment of debt. 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, 2019 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 #8 above. As of September 30, 2018, \$1,900,000 has been drawn against the line of credit, an increase of \$900,000 over the balance at December 31, 2017. Accrued interest of \$17,932 has been recognized as of September 30, 2018.

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.

### **10. SHAREHOLDERS’ EQUITY**

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 \$22,500 expense for the pro rata portion of shares earned by the two members during the nine months ended September 30, 2018, amortizing the expense over the 12 months of the service agreement regardless of the vesting condition.

In September 2016, the Company issued 1,349,000 shares of restricted common stock outside of the 2015 Equity Plan to Jay Nussbaum, Felicia Hess, Daniyel Erdberg, Kendall Carpenter, Mike Silverman and Reginald Brown 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. 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 probable 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.

On March 28, 2017, these awards were modified in recognition of the Company securing a substantial sales order and recent business development activity and vested on that date. On that date, the awards were determined to be probable for vesting and stock-based compensation was recognized based on the fair market value of the stock on March 28, 2017. The Company recorded \$944,300 in stock-based compensation for these awards during the nine months ended September 30, 2018.

On August 28, 2018, the Company filed with the Nevada Secretary of State of a Certificate of Withdrawal to withdraw the Certificates of Designations of the Company's previously designated Convertible Preferred Stock, Series A, B, B-1, C, D, E, F, G as no shares of these series of preferred stock are issued or outstanding.

## **11. EMPLOYEE STOCK OPTIONS**

On September 26, 2018, upon approval of the Company's board of directors, the Company granted outside its 2015 Equity Plan, 6,000,000 options to five management employees and four directors. Jay Nussbaum was issued 2,350,000 options, Felicia Hess was issued 1,000,000 options, Daniyel Erdberg was issued 1,000,000 options, Kendall Carpenter was issued 425,000 options, Reginald Brown, Jr. was issued 1,000,000 options. Director David Aguilar was issued 150,000 options and Directors John Miller, Timothy Hoechst and Robert Guerra were each issued 25,000 options. The options vest upon the Company receiving an aggregate of \$4,000,000 in new orders from a prime government contractor or directly from the U.S. government at any time commencing after the date of issuance. The options are exercisable at an exercise price of \$.65 per share and expire September 26, 2022. Of these 6,000,000 options, 5,000,000 options have been accounted for as a modification of the August 22, 2018 options. During the nine months ended September 30, 2018, \$360,593 compensation expense was recognized on these 6,000,000 options with a remaining balance of \$2,238,087 to be recognized over the assumed vesting period.

On August 22, 2018, upon approval of the Company's board of directors, the Company granted outside its 2015 Equity Plan, an aggregate of 5,000,000 options to five management employees and four directors. Included in this award were the following grants to Executive Officers and Directors of the Company: 1,950,000 options to Jay Nussbaum, Chief Executive Officer and Chairman of the Board of Directors, 800,000 options to Felicia Hess, Chief Operating Officer, 800,000 options to Daniyel Erdberg, President, 300,000 options to Kendall Carpenter, Chief Financial Officer and the following directors of the Company: 150,000 options to David Aguilar, 25,000 options to John Miller, 25,000 options to Timothy Hoechst and 25,000 options to Robert Guerra. The options vest upon the Company receiving an aggregate of \$4,000,000 in new orders from a prime government contractor or directly from the U.S. government at any time commencing after the date of issuance. The options are exercisable at an exercise price of \$1.00 per share and expire August 22, 2022. On September 26, 2018, the Board resolved to cancel the Options to purchase 5,000,000 shares of common stock issued on August 22, 2018 that had not vested.

On May 16, 2018, upon approval of the Company's board of directors, the Company granted outside its 2015 Equity Plan, 460,000 options to four employees. Reginald Brown, Jr. was issued 200,000 options and Kendall Carpenter was issued 130,000 options which were immediately vested, are exercisable at an exercise price of \$1.00 per share and expire May 16, 2022. Two engineers received a total of 130,000 shares which vest 50% after one year and the remaining 50% after two years, are exercisable at an exercise price of \$1.00 per share and expire May 16, 2022. During the nine months ended September 30, 2018, \$165,354 compensation expense was recognized on these 460,000 options with a remaining balance of \$36,727 to be recognized over the vesting period.

On March 28, 2018, upon approval of the Company's board of directors, the Company granted outside its 2015 Equity Plan, 100,000 options each to a newly-appointed director, Robert Guerra. These options vest 50% one year after the date of grant and the remaining 50% two years after the date of grant 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 March 28, 2022. During the nine months ended September 30, 2018, \$14,599 compensation expense was recognized on these 100,000 options with a remaining balance of \$23,990 to be recognized over the vesting period.

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 nine months ended September 30, 2018 and twelve months ended December 31, 2017, \$54,638 and \$3,593, respectively, compensation expense was recognized on these 200,000 options with a remaining balance of \$41,558 to be recognized over the vesting period.

During 2016, the Company granted 10,000 options to an employee with two-year vesting and an exercise price of \$3.00 and an expiration date of December 6, 2019. The Company recognized \$1,105 in compensation for the nine months ended September 30, 2018. No additional compensation will be recognized on these options which were cancelled due to the termination of the employee.

On 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 nine months ended September 30, 2018, \$14,369 compensation expense was recognized on these 37,500 options which have been cancelled due to the termination of the employee.

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 nine months ended September 30, 2018, \$33,836 compensation expense was recognized on these 100,000 options with a remaining balance of \$11,280 to be recognized over the vesting period.

The Company used the Black-Scholes option pricing model to estimate the fair value on the date of grant of the 6,560,000 options granted during the nine months ended September 30, 2018.

The following table summarizes the assumptions used to estimate the fair value of the 11,560,000 stock options granted during the nine months ended September 30, 2018 on the date of grant.

|                          | <u>2018</u> |
|--------------------------|-------------|
| Expected dividend yield  | 0%          |
| Expected volatility      | 80-97%      |
| Risk-free interest rate  | 2.48-2.89%  |
| Expected life of options | 4.00 years  |

Under the Black-Scholes option pricing model, the fair value of the 11,560,000 options granted during the nine months ended September 30, 2018 is estimated at \$2,839,360 on the date of grant. During the nine months ended September 30, 2018, \$540,546 compensation expense was recognized on these 11,560,000 options.

The following table represents stock option activity as of and for the nine months ended September 30, 2018:

|                                  | Number of<br>Options | Weighted<br>Average<br>Exercise<br>Price per<br>Share | Weighted<br>Average<br>Contractual<br>Life in<br>Years | Aggregate<br>Intrinsic<br>Value |
|----------------------------------|----------------------|---|--|---------------------------------|
| Outstanding – December 31, 2017  | 7,945,000            | \$ 1.38   | 3.50   |                                 |
| Exercisable – December 31, 2017  | 7,627,500            | \$ 1.35   | 3.50   | \$ 0                            |
| Granted                          | 11,560,000           | \$ 0.82   |  |                                 |
| Cancelled or Expired             | (5,425,000)          | \$ 1.33   |  |                                 |
| Outstanding – September 30, 2018 | 14,080,000           | \$ 0.94   | 3.39   | \$ 0                            |
| Exercisable – September 30, 2018 | 7,600,000            | \$ 1.15   | 2.92   | \$ 0                            |

## 12. WARRANTS

As described above in Footnote #3 – Related Party Transactions, on September 26, 2018, the Company issued 100,000 warrants outside its 2015 Equity Plan to Global Security Innovative Strategies, LLC (“GSIS”) with an exercise price of \$1.00 per share and an expiration date of September 26, 2022 and which were immediately vested. The Company recognized \$36,150 in compensation for the nine months ended September 30, 2018.

The following table summarizes the assumptions used to estimate the fair value of the 560,000 stock warrants granted during the nine months ended September 30, 2018 on the date of grant.

|                          | <u>2018</u> |
|--------------------------|-------------|
| Expected dividend yield  | 0%          |
| Expected volatility      | 91%         |
| Risk-free interest rate  | 2.89%       |
| Expected life of options | 4.00 years  |

Under the Black-Scholes option pricing model, the fair value of the 100,000 warrants granted during the nine months ended September 30, 2018 is estimated at \$36,150 on the date of grant. During the nine months ended September 30, 2018, \$36,150 compensation expense was recognized on these 100,000 warrants.

The following table represents warrant activity as of and for the period ended September 30, 2018:

|                                  | Number of<br>Warrants | Weighted<br>Average<br>Exercise<br>Price per<br>Share | Weighted<br>Average<br>Contractual<br>Life in<br>Years | Aggregate<br>Intrinsic<br>Value |
|----------------------------------|-----------------------|---|--|---------------------------------|
| Outstanding – December 31, 2017  | 2,232,500             | \$ 1.36   | 4.34   |                                 |
| Exercisable – December 31, 2017  | 2,232,500             | \$ 1.36   | 4.34   | \$ 0                            |
| Granted                          | 100,000               | \$ 1.00   |  |                                 |
| Forfeited or Expired             | (37,500)              | \$ 10.00  |  |                                 |
| Outstanding – September 30, 2018 | 2,295,000             | \$ 1.20   | 3.67   | \$ 0                            |
| Exercisable – September 30, 2018 | 2,295,000             | \$ 1.20   | 3.67   | \$ 0                            |

## 13. 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 - \$ 18,075 |
| Year 2019 - \$ 77,309 |
| Year 2020 - \$ 45,651 |

Rent expense was \$65,995 and \$60,425 for the nine months ended September 30, 2018 and 2017, respectively.

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.

#### **14. SUBSEQUENT EVENTS**

On October 9, 2018, the Company took a draw of \$100,000 from the CNB note and a draw of \$100,000 from the Series 2017 Convertible Note which are described in Footnotes #8 and #9 above.

On October 9, 2018, the Company delivered a WASP multi-mission capable tactical aerostat valued in excess of \$1.7 million dollars to a Department of Defense customer. Approximately \$1,050,740 of parts, labor and overhead were carried in Work in Process Inventory at September 30, 2018.

On October 24, 2018, the Company commenced an offering of up to 10,000,000 shares of its common stock (the "Offered Shares") in a private placement of up to \$5,500,000 to certain accredited investors at a purchase price of \$0.55 per share pursuant to a Stock Purchase Agreement (the "SPA"). As of October 26, 2018, the Company has received subscriptions for a total of \$3,256,000 (5,920,000 Shares) pursuant to the SPA. Pursuant to the terms of the SPA, any funds received from investors in the offering prior to the closing date will be held by the Company in a segregated bank account until closing. In the event that the SPA is terminated prior to closing or the closing does not occur by December 31, 2018, any funds received by the Company pursuant to the SPA shall be promptly refunded in full to the investors without deduction of any cost or expense. Closing of the offering pursuant to the SPA is conditioned upon certain, limited customary representations and warranties, as well as the Company having received an aggregate of \$4,000,000 in new orders from a prime government contractor or directly from the U.S. government at any time commencing after October 9, 2018 (the "Qualifying Sales Order"). As required under the SPA, upon receipt by the Company of a Qualifying Sales Order, the Company will give written notice to the investors notifying them that the Company intends to close on the purchase of the Offered Shares pursuant to the SPA. Within three days after the delivery of the notice to the investors, the Company and the investors will then close under the SPA and at closing, the Company will issue to each purchasing investor the number of shares subscribed for by each Investor.

On October 25, 2018, the Board approved Amendment No. 3 to the August 27, 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 November 1, 2018 until October 31, 2019 and provide for the following equity-based compensation: (a) for Dr. Frost, 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).

On October 25, 2018 the Company borrowed \$100,000 from its Chief Executive Officer and Chairman, Jay Nussbaum pursuant to a promissory note. The note bears interest at the rate of 6% per annum and is due on November 30, 2018. The Company plans to use the proceeds from this loan to fund our immediate short-term cash needs pending settlement of the customer invoice for the WASP shipped October 9, 2018.

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

*Certain statements in Management's Discussion and Analysis ("MD&A"), other than historical information, including estimates, projections, statements relating to our business plans, objectives and expected operating results, and the assumptions upon which those statements are based, are "forward-looking statements". Forward-looking statements generally can be identified by the use of forward-looking terminology, such as "may," "would," "expect," "intend," "could," "estimate," "should," "anticipate," "believe," and similar expressions. Forward-looking statements are based on current expectations and assumptions that are subject to risks and uncertainties which may cause actual results to differ materially from the forward-looking statements. These statements are subject to a number of risks, uncertainties and developments beyond our control or foresight, including changes in the trends of the advanced aerostats and tethered drone industry, formation of competitors, changes in governmental regulation or taxation, changes in our personnel and other such factors. We undertake no obligation to update or revise publicly any forward-looking statements, whether as a result of new information, future events, or otherwise. Readers should carefully review the risk factors and related notes included under Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2017 filed with the Securities and Exchange Commission on March 23, 2018.*

*The following MD&A is intended to help readers understand the results of our operations and financial condition and is provided as a supplement to, and should be read in conjunction with, our Unaudited Consolidated Financial Statements and the accompanying Notes to Unaudited Consolidated Financial Statements under Part I, Item 1 of this Quarterly Report on Form 10-Q.*

*Growth and percentage comparisons made herein generally refer to the nine months ended September 30, 2018 compared with the nine months ended September 30, 2017 unless otherwise noted. Unless otherwise indicated or unless the context otherwise requires, all references in this document to "we," "us," "our," the "Company," and similar expressions refer to Drone Aviation Holding Corp. and, depending on the context, its subsidiaries.*

### **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 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.

Our marketing efforts include submission of proposals and bids to the U.S. Government as well as customer demonstrations at customer identified sites as well as in Jacksonville, Florida. We also showcased our products and technologies at numerous conferences and live demonstrations, including the 2017 Special Operations Forces Industry Conference, 2018 ADS 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 October 16, 2018, we announced delivery of a \$1.7 million contract award for enhanced WASP tactical aerostat from the U.S. Department of Defense.
- On June 27, 2018, we announced our participation in the ADS Warrior Expo East showcasing the WASP Tactical Aerostat.
- On June 1, 2018, we announced the livestream of a technology demonstration for Federal and New York State Law Enforcement agencies.
- On May 30, 2018, we announced that the FUSE Tether System was employed by Southern Arizona Law Enforcement for enhanced aerial surveillance.

In addition to our plans to organically grow our lighter than air systems through increased marketing and sales, we intend to continue 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.

The Company commenced an offering of up to 10,000,000 shares of its common stock (the "Offered Shares") in a private placement of up to \$5,500,000 to certain accredited investors at a purchase price of \$0.55 per share pursuant to a Stock Purchase Agreement (the "SPA"). The Company intends to use the proceeds from this offering for working capital it anticipates it will need in order to finance the costs of production and other costs related to new product orders that are in the final stages of completion. As of October 26, 2018, the Company has received subscriptions for a total of \$3,256,000 (5,920,000 Shares) pursuant to the SPA. In addition, on October 25, 2018, the Company borrowed \$100,000 from its Chief Executive Officer and Chairman, Jay Nussbaum on a short-term basis to fund its immediate short-term cash needs. See "Liquidity and Capital Resources" for a further discussion on the Company's working capital requirements.

## **Results of Operations**

### **Three Months Ended September 30, 2018 compared to Three Months Ended September 30, 2017**

**Revenues:** Revenues of \$84,815 for the quarter ended September 30, 2018 decreased \$8,290 or 9% from \$93,105 for the same period in 2017. Sources of revenue were derived primarily from aerostat products, FUSE tether systems and accessories. Revenue from FUSE tether systems was \$63,000 for the quarter ended September 30, 2018, an increase of \$39,000 or 163% from \$24,000 for the same period in 2017. We expect increased sales in future periods based on a product pipeline developed following our increased marketing efforts discussed in the Business Overview section above, including the October 2018 delivery of a WASP tactical aerostat valued in excess of \$1.7 million dollars.

**Cost of Goods Sold and Gross Profit:** Cost of goods sold of \$51,587 for the quarter ended September 30, 2018 increased \$17,993 or 54% from \$33,594 for the same period in 2017. Costs included materials, parts and labor associated with the sale of aerostat products, FUSE tether systems and accessories. Cost of goods sold from FUSE tether systems was \$25,619, an increase of \$12,967 or 102% from \$12,652 for the same period in 2017. The \$33,228 gross profit for the quarter ended September 30, 2018 was a decrease of \$26,283 or 44% from the \$59,511 in gross profit for the same quarter of 2017. Overall gross profit margins were 39% and 64% for the quarters ended September 30, 2018 and 2017, respectively. Gross profit margins on FUSE tether systems was 59% and 47% for the quarters ended September 30, 2018 and 2017, respectively.

**General and Administrative Expense:** General and administrative expense primarily consists of payroll and related costs, sales and marketing costs, research and development costs, business overhead and costs related to maintaining a public entity. General and administrative expenses decreased \$3,417,233 or 75% to \$1,127,266 in the quarter ended September 30, 2018 from \$4,544,499 for the same period in 2017. Contributing to the decrease was non-cash stock-based compensation of \$443,541 which decreased \$3,170,390 from \$3,613,931 in the same period of 2017. Marketing expenses of \$26,353 decreased \$70,862 from \$97,215, travel expenses of \$28,053 decreased \$76,287 from \$104,340 and research and development of \$26,797 decreased \$71,182 from \$97,979 for the quarter ended September 30, 2018 compared to the same period in 2017. In the third quarter of 2017, the Company conducted a thirty-day demonstration on the US/Mexican border which caused marketing and travel expenses to increase. Research and development costs continue to decrease as the Company's products are being commercialized.

**Loss from Operations:** Loss from operations for the quarter ended September 30, 2018 decreased \$3,390,950 or 76% to \$1,094,038 from loss from operations of \$4,484,988 for the same period in 2017. The decrease was primarily due to a decrease in gross profit of \$26,283 and the decrease of general and administrative expense of \$3,417,233 as discussed above.

**Other Expense:** Total other expense of \$95,828 for the quarter ended September 30, 2018 was \$183,009 less than the total other expense of \$278,837 in the same period in 2017. This decrease was primarily due to interest expense on bank and related party notes payable of \$95,828 for the quarter ended September 30, 2018, which was \$36,490 or 61% greater than the \$59,338 interest expense recognized for the same period in 2017 offset by \$317,298 amortization of discount to convertible note and \$97,799 net result of offsetting derivative gain and debt extinguishment recognized in the third quarter of 2017.

**Net Loss:** Net loss decreased \$3,573,959 or 75% to \$1,189,866 for the quarter ended September 30, 2018 from net loss of \$4,763,825 for the same period in 2017. The decrease in net loss was due to factors discussed above.



## **Nine Months Ended September 30, 2018 compared to Nine Months Ended September 30, 2017**

**Revenues:** Revenues of \$995,838 for the nine months ended September 30, 2018 increased \$521,204 or 110% from \$474,634 for the same period in 2017. Sources of revenue were derived primarily from aerostat products, FUSE tether systems and accessories. The increase in sales volume was primarily a result of the delivery of a WASP system valued in excess of \$800,000 to the U.S. Army which was ordered in the fourth quarter of 2017 and delivered in the first quarter of 2018. We expect increased sales in future periods based on a product pipeline developed following our increased marketing efforts discussed in the Business Overview section above, including the October 2018 delivery of a WASP tactical aerostat valued in excess of \$1.7 million dollars.

**Cost of Goods Sold and Gross Profit:** Cost of goods sold of \$537,617 for the nine months ended September 30, 2018 increased \$254,027 or 90% from \$283,590 for the same period in 2017. Costs included materials, parts and labor associated with the sale of aerostat products, FUSE tether systems and accessories. The \$458,221 gross profit for the nine months ended September 30, 2018 was an increase of \$267,177 or 140% from the \$191,044 in gross profit for the same period in 2017. Gross profit margins were 46% and 40% for the nine months ended September 30, 2018 and 2017, respectively, due to the higher margins built into the pricing of the system delivered in 2018.

**General and Administrative Expense:** General and administrative expense primarily consists of payroll and related costs, sales and marketing costs, research and development costs, business overhead and costs related to maintaining a public entity. General and administrative expenses decreased \$3,274,032 or 44% to \$4,158,194 in the nine months ended September 30, 2018 from \$7,432,226 for the same period in 2017. Contributing to the decrease was non-cash stock-based compensation of \$1,647,444 which decreased \$3,182,154 from \$4,829,598 in the same period of 2017. Marketing expenses of \$132,095 decreased \$109,834 from \$241,929, travel expenses of \$169,558 decreased \$18,139 from \$187,697 and research and development of \$94,179 decreased \$183,697 from \$277,876 for the nine months ended September 30, 2018 compared to the same period in 2017. Payroll expense increased by \$288,827 during period to \$1,242,895 from \$954,068 in the prior year as a result of putting the CEO on salary in the third quarter of 2017 and the bonus effect of payroll taxes paid on the vesting of the September 2016 stock awards. During 2017, the Company conducted a thirty-day demonstration on the US/Mexican border which caused marketing and travel expenses to increase that year. Research and development costs continue to decrease as the Company's products are being commercialized.

**Loss from Operations:** Loss from operations for the nine months ended September 30, 2018 decreased \$3,541,209 or 49% to \$3,699,973 from loss from operations of \$7,241,182 for the same period in 2017. The decrease was primarily due to an increase in gross profit of \$267,177 and by the decrease of general and administrative expense of \$3,274,032 as discussed above.

**Other Expense:** Total other expense of \$244,283 for the nine months ended September 30, 2018 was \$164,459 less than the total other expense of \$408,742 in the same period in 2017. This decrease was primarily due to interest expense on bank and related party notes payable of \$244,283 for the nine months ended September 30, 2018, which was \$95,684 or 64% greater than the \$148,599 interest expense recognized for the same period in 2017 offset by \$290,143 combined effect of amortization of discount to convertible note, accounting for derivative gain and debt extinguishment recognized in the third quarter of 2017.

**Net Loss:** Net loss decreased \$3,705,668 or 48% to \$3,944,256 for the nine months ended September 30, 2018 from net loss of \$7,649,924 for the same period in 2017. The decrease in net loss was due to factors discussed above.

## 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 September 30, 2018, the Company had \$178,781 in cash compared to \$615,375 in cash at December 31, 2017, a decrease of \$436,594. As of September 30, 2018, the Company had accounts receivable of \$65,760 compared to \$110,065 at December 31, 2017, a decrease of \$44,305 resulting from increased collections in the first nine months of 2018.

The Company had total current assets of \$2,105,974 and total current liabilities of \$4,647,020 or working capital deficit of \$2,541,046 at September 30, 2018 compared to 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.

We have historically financed our operations through operating revenues and sales of equity and convertible debt securities. Although as of September 30, 2018 we have cash of \$178,781, we have a working capital deficit of \$2,541,046 and incurred a net loss of \$3,944,256. Furthermore, the Company has a history of negative cash flow from operations, primarily due to historically heavy investment in research and development, stock-based compensation and costs associated with maintaining a public entity. We expect a substantial increase in revenues for the remainder of 2018. To this end, we have delivered a WASP tactical aerostat system to a customer in October 2018 which will increase revenues by more than \$1.7 million in the fourth quarter of 2018. In addition, we are conducting a private offering of our common stock of up to \$5,500,000 at a purchase price of \$0.55 per share pursuant to the SPA. The Company intends to use the proceeds from this offering for working capital it anticipates it will need in order to finance the costs of production and other costs related to new product orders that are in the final stages of completion. As of October 26, 2018, the Company has received subscriptions for a total of \$3,256,000 (5,920,000 Shares) pursuant to the SPA. If we are unable to complete a sale of all or a portion of this planned offering and we receive new orders, we will not have sufficient working capital to continue our operations for the next 12 months.

On October 25, 2018 we borrowed \$100,000 from our Chief Executive Officer and Chairman, Jay Nussbaum pursuant to a promissory note. The note bears interest at the rate of 6% per annum and is due on November 30, 2018. We plan to use the proceeds from this loan to fund our immediate short-term cash needs.

In the event we are unable to complete a sale of all or a substantial portion of the offering of our common stock pursuant to the SPA and refinance our revolving line of credit from City National Bank of Florida and our Series 2017 Secured Convertible Notes on the extended maturity date of August 2, 2019, 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 or potentially curtail some aspects of our operations. 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.

Other than the recent loan from Mr. Nussbaum, the commitments we have received for purchases of our common stock pursuant to the SPA or the Revolving Line of Credit from City National Bank of Florida as discussed below, we currently have no agreements, arrangements or understandings with any person to obtain funds through bank loans, lines of credit or any other sources. Consequently, our inability to raise funds to meet our expected working capital requirements 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.

We have delivered a WASP tactical aerostat system to a customer in October 2018 which will increase revenues by more than \$1.7 million dollars in the fourth quarter. In anticipation of increased sales resulting from our developing product pipeline, we extended financing transactions that provide us with up to \$4,000,000 in credit and we extended the maturity date on \$3,000,000 of convertible debt until October 2020 providing us with 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, with a maturity date of August 2, 2018. On September 26, 2018, the Company and CNB agreed to extend the maturity date of the promissory note to August 2, 2019. The note evidences a revolving line of credit with advances that may be requested by the Company until the maturity date of August 2, 2019 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 initial CNB Note bore an interest rate at a variable rate equal to 0.250 percentage points over the Wall Street Journal Prime Rate payable monthly. At renewal, the variable rate was increased to 1.0 percentage points over the Wall Street Journal Prime Rate. 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 \$120,000. As of October 26, 2018, we have borrowed a total of \$2,000,000 under the CNB Note leaving availability of \$0 under such note.

*Series 2017 Secured 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”). On September 26, 2018, the Company and Frost Nevada agreed to extend the maturity date of the promissory note to August 2, 2019. 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, 2019 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 October 26, 2018, we have borrowed a total of \$2,000,000 under the Series 2017 Secured Convertible Note leaving availability of \$0 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 owner and holder of the aggregate principal amount \$3,000,000 Series 2016 Convertible Notes (the “Series 2016 Convertible Notes”) issued to our Chairman of the Board and the Chairman of the Strategic Advisory Board and a substantial shareholder of our company on September 29, 2016. The November 2017 Convertible Note Amendments 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 of the amendment. 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.

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 1, 2019 until October 1, 2020.

As of September 30, 2018, and December 31, 2017, \$165,986 and \$166,356 accrued interest has been recorded, respectively on the Series 2016 Convertible Notes.

The accompanying consolidated financial statements and notes have been prepared assuming the Company will continue as a going concern. For the nine months ended September 30, 2018, the Company incurred a net loss of \$3,944,256, generated negative cash flow from operations, has an accumulated deficit of \$33,941,033 and working capital deficit of \$2,541,046. 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>Nine Months Ended<br/>September 30,</b> |                     |
|---|--|---------------------|
|   | <b>2018</b>                                | <b>2017</b>         |
| Cash flows (used in) operating activities             | \$ (2,291,315)                             | \$ (2,250,150)      |
| Cash flows provided by (used in) investing activities | 54,721                                     | (675)               |
| Cash flows provided by financing activities           | 1,800,000                                  | 2,000,000           |
| Net (decrease) in cash and cash equivalents           | <u>\$ (436,594)</u>                        | <u>\$ (250,825)</u> |

#### Operating Activities

Net cash used in operating activities during the nine months ended September 30, 2018 was \$2,291,315, which was an increase of \$41,165, or 2%, from \$2,250,150 net cash used in operating activities for the same period in 2017. The net loss of \$3,944,256 for the first nine months of 2018 was \$3,705,668 less than the same period of 2017, which was a net loss of \$7,649,924. In addition to the decreased net loss, the Company recognized \$3,182,154 less non-cash stock-based compensation in the first nine months of 2018 than the previous year. The Company experienced a working capital deficit of \$2,541,046 in the first nine months of 2018 which was \$2,874,480 less than the same period in 2017, which had a working capital balance of \$333,434. The Company recognized a non-cash gain on derivative liability of \$1,831,635 offset by \$1,409,790 amortization of debt discount expense and 681,988 loss on debt extinguishment in the first nine months of 2017. The Company grew inventory by \$769,966 and was carrying \$447,943 more in accounts payable during the nine months ended September 30, 2018, mostly related to the WASP tactical system that was delivered in October 2018.

### ***Investing Activities***

Net cash provided by investing activities was \$54,721 during the nine months ended September 30, 2018 compared to \$675 net cash used in investing activities during the nine months ended September 30, 2017. Net cash provided by investing activities for the nine months ended September 30, 2018 was comprised of \$60,000 from the sale of a vehicle partially offset in both periods by purchases of fixed assets that included shop machines and equipment, computers and electronics and furniture and equipment.

### ***Financing Activities***

Financing activities during the first nine months of 2018 included \$900,000 proceeds from a bank line of credit and \$900,000 proceeds from a related party convertible note payable. 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.

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

We do not have any off-balance sheet arrangements that materially effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures, or capital resources.

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

The Company's accounting policies are more fully described in Note 1 of the Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2017 filed with the Securities and Exchange Commission on March 23, 2018. As disclosed therein, the preparation of the Company's financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions about future events that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ significantly from those estimates. The Company believes that the following discussion addresses the Company's most critical accounting policies, which are those that are most important to the portrayal of the Company's financial condition and results of operations and require management's most difficult, subjective and complex judgments.

#### **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 September 30, 2018 and December 31, 2017, none of the Company's accounts receivable-trade was deemed uncollectible.

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

The Company accounts for revenue in accordance with Accounting Standards Update No. 2014-09 (Topic 606) and recognizes revenue when obligations under the terms of a contract with our customer are satisfied. Generally, this occurs with the transfer of control of our aerostat products, FUSE tether systems, accessories and services. Revenue is measured as the amount of consideration we expect to receive in exchange for transferring goods or providing services. Sales, value add, and other taxes we collect concurrent with revenue-producing activities are excluded from revenue. Incidental items that are immaterial in the context of the contract are recognized as expense. The expected costs associated with our base warranties and field service actions continue to be recognized as expenses when the products are sold.

#### **Derivative Financial Instruments:**

The Company evaluates its 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, the Company uses 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 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 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK**

As a smaller reporting company, as that term is defined in Item 10(f)(1) of Regulation S-K, we are not required to provide information required by this Item.

### **ITEM 4. 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 Exchange Act as of the end of the period covered by this Quarterly Report on Form 10-Q. 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.

Management, with the participation of our Chief Executive Officer and Chief Financial Officer, performed an evaluation of the effectiveness of our disclosure controls and procedures as of September 30, 2018. Based on that evaluation, our management, including our Chief Executive Officer and Chief Financial Officer, concluded that our disclosure controls and procedures were not effective as of September 30, 2018 for the reasons discussed below. In addition, management identified the following material weaknesses in its assessment of the effectiveness of disclosure controls and procedures as of September 30, 2018:

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 Quarterly Report, we believe that our consolidated financial statements contained in this Quarterly Report fairly present our financial position, results of operations and cash flows for the years covered hereby in all material respects.

We expect to be dependent upon our Chief Financial Officer who is knowledgeable and experienced in the application of U.S. Generally Accepted Accounting Principles to maintain our disclosure controls and procedures and the preparation of our financial statements for the foreseeable future. We plan on increasing the size of our accounting staff at the appropriate time for our business and its size to ameliorate our concern that we do not effectively segregate certain accounting duties, which we believe would resolve the material weakness in disclosure controls and procedures, but there can be no assurances as to the timing of any such action or that we will be able to do so.

#### *(b) Changes in internal control over financial reporting.*

There were no changes in our internal control over financial reporting that occurred during the quarter ended September 30, 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## **PART II - OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS**

From time to time, we may become involved in various lawsuits and legal proceedings which arise in the ordinary course of business. Except as discussed below, we are not currently aware of any such legal proceedings or claims that we believe will have, individually or in the aggregate, a material adverse effect on our business, financial condition, or operating results.

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

### **ITEM 1A. RISK FACTORS**

Smaller reporting companies are not required to provide the information required by this Item.

### **ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

None.

### **ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

### **ITEM 4. MINE SAFETY DISCLOSURES**

Not applicable.

### **ITEM 5. OTHER INFORMATION**

On October 24, 2018, the Company commenced an offering of up to 10,000,000 shares of its common stock (the “Offered Shares”) in a private placement of up to \$5,500,000 to certain accredited investors at a purchase price of \$0.55 per share pursuant to a Stock Purchase Agreement (the “SPA”). As of October 26, 2018, the Company has received subscriptions for a total of \$3,256,000 (5,920,000 Shares) pursuant to the SPA. Pursuant to the terms of the SPA, any funds received from investors in the offering prior to the closing date will be held by the Company in a segregated bank account until closing. In the event that the SPA is terminated prior to closing or the closing does not occur by December 31, 2018, any funds received by the Company pursuant to the SPA shall be promptly refunded in full to the investors without deduction of any cost or expense. Closing of the offering pursuant to the SPA is conditioned upon certain, limited customary representations and warranties, as well as the Company having received an aggregate of \$4,000,000 in new orders from a prime government contractor or directly from the U.S. government at any time commencing after October 9, 2018 (the “Qualifying Sales Order”). As required under the SPA, upon receipt by the Company of a Qualifying Sales Order, the Company will give written notice to the investors notifying them that the Company intends to close on the purchase of the Offered Shares pursuant to the SPA. Within three days after the delivery of the notice to the investors, the Company and the investors will then close under the SPA and at closing, the Company will issue to each purchasing investor the number of shares subscribed for by each Investor.

On October 25, 2018, the Company entered into Amendment No. 3 to the August 27, 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 November 1, 2018 until October 31, 2019 and provide for the following equity-based compensation: (a) for Dr. Frost, 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).

On October 25, 2018 we borrowed \$100,000 from our Chief Executive Officer and Chairman, Jay Nussbaum pursuant to a promissory note. The note bears interest at the rate of 6% per annum and is due on November 30, 2018. We plan to use the proceeds from this loan to fund our immediate short-term cash needs pending settlement of the customer invoice for the WASP shipped October 9, 2018.

### **ITEM 6. EXHIBITS**

The Exhibits listed in the accompanying Exhibit Index are filed, furnished herewith, or incorporated by reference as part of this Quarterly Report on Form 10-Q, in each case as set forth in the Exhibit Index.



**SIGNATURES**

Pursuant to the requirements 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: October 26, 2018

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

Date: October 26, 2018

By: /s/ KENDALL CARPENTER  
Kendall Carpenter  
Chief Financial Officer  
(Principal Financial Officer and  
Principal Accounting Officer)

**EXHIBIT INDEX**

| Exhibit Number | Exhibit Description  | Incorporation by Reference |             |                | SEC File No. | Filed Herewith |
|----------------|--|----------------------------|-------------|----------------|--------------|----------------|
|                |  | Form                       | Filing Date | Exhibit Number |              |                |
| 2.1            | <a href="#"><u>Agreement and Plan of Merger, dated April 30, 2014, between Drone Aviation Holding Corp. and MacroSolve, Inc.</u></a>   | 8-K                        | 5/5/14      | 2.1            | 333-150332   |                |
| 2.2            | <a href="#"><u>Plan of Merger, effective March 26, 2015, between Drone Aviation Holding Corp. and Drone Aviation Corp.</u></a>   | 10-K                       | 3/31/15     | 10.14          | 333-150332   |                |
| 2.3            | <a href="#"><u>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.</u></a> | 8-K                        | 7/21/15     | 10.1           | 333-150332   |                |
| 3.1            | <a href="#"><u>Articles of Incorporation of Drone Aviation Holding Corp., dated April 17, 2014</u></a>   | 8-K                        | 5/5/14      | 3.1            | 333-150332   |                |
| 3.2            | <a href="#"><u>Certificate of Amendment to Articles of Incorporation of Drone Aviation Holding Corp., dated October 29, 2015</u></a>   | 8-K                        | 10/30/15    | 3.1            | 333-150332   |                |
| 3.3            | <a href="#"><u>Bylaws of Drone Aviation Holding Corp.</u></a>  | 8-K                        | 5/5/14      | 3.6            | 333-150332   |                |
| 3.4            | <a href="#"><u>Certificate of Designation of Preferences, Rights and Limitations of Series A Convertible Preferred Stock</u></a>   | 8-K                        | 5/5/14      | 3.2            | 333-105332   |                |
| 3.5            | <a href="#"><u>Certificate of Designation of Preferences, Rights and Limitations of Series B Convertible Preferred Stock</u></a>   | 8-K                        | 5/5/14      | 3.3            | 333-105332   |                |
| 3.6            | <a href="#"><u>Certificate of Designation of Preferences, Rights and Limitations of Series B-1 Convertible Preferred Stock</u></a>   | 8-K                        | 5/5/14      | 3.4            | 333-105332   |                |
| 3.7            | <a href="#"><u>Certificate of Designation of Preferences, Rights and Limitations of Series C Convertible Preferred Stock</u></a>   | 8-K                        | 5/5/14      | 3.5            | 333-105332   |                |
| 3.8            | <a href="#"><u>Certificate of Designation of Preferences, Rights and Limitations of Series D Convertible Preferred Stock</u></a>   | 8-K                        | 6/5/14      | 3.1            | 333-105332   |                |
| 3.9            | <a href="#"><u>Certificate of Designation of Preferences, Rights and Limitations of Series E Convertible Preferred Stock</u></a>   | 8-K                        | 6/5/14      | 3.2            | 333-105332   |                |
| 3.10           | <a href="#"><u>Certificate of Amendment to Certificate of Designation of Preferences, Rights and Limitations of Series E Convertible Preferred Stock</u></a>                                     | 8-K                        | 6/3/15      | 3.3            | 333-105332   |                |
| 3.11           | <a href="#"><u>Certificate of Designation of Preferences, Rights and Limitations of Series F Convertible Preferred Stock</u></a>   | 8-K                        | 8/28/14     | 3.1            | 333-105332   |                |
| 3.12           | <a href="#"><u>Certificate of Amendment to Certificate of Designation of Preferences, Rights and Limitations of Series F Convertible Preferred Stock</u></a>                                     | 8-K                        | 6/3/15      | 3.4            | 333-105332   |                |
| 3.13           | <a href="#"><u>Certificate of Designation of Preferences, Rights and Limitations of Series G Convertible Preferred Stock</u></a>   | 8-K                        | 6/3/15      | 3.1            | 333-105332   |                |
| 3.14           | <a href="#"><u>Certificate of Correction to the Certificate of Designation of Preferences, rights and Limitations of Series G Convertible Preferred Stock</u></a>                                | 8-K                        | 6/3/15      | 3.2            | 333-105332   |                |
| 3.15           | <a href="#"><u>Form of Certificate of Withdrawal to be filed with Nevada Secretary of State.</u></a>   | 8-K                        | 8/24/2018   | 3.1            | 333-105332   |                |

| Exhibit Number | Exhibit Description  | Incorporation by Reference |             |                | SEC File No. | Filed Herewith |
|----------------|--|----------------------------|-------------|----------------|--------------|----------------|
|                |  | Form                       | Filing Date | Exhibit Number |              |                |
| 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>  | 10-K                       | 3/23/18     | 4.1(c)         | 333-150332   |                |
| 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 Common Stock Purchase Agreement.</a>   | –                          | –           | –              | –            | X              |
| 10.2*          | <a href="#">Form of Amendment No. 3 to Independent Contractor Agreement dated August 3, 2017</a>   | –                          | –           | –              | –            | X              |
| 10.24          | <a href="#">Amendment to promissory between Drone Aviation Holding Corp. and City National Bank of Florida dated September 26, 2018.</a>   | 8-K                        | 9/28/2018   | 10.1           | 333-105332   |                |
| 10.25          | <a href="#">Amendment to Secured Convertible Promissory Note issued by Drone Aviation Holding Corp. to Frost Nevada Investment Trust dated September 26, 2018.</a>                                     | 8-K                        | 9/28/2018   | 10.2           | 333-105332   |                |
| 10.26          | <a href="#">Form of Promissory Note between Drone Aviation Holding Corp and Jay Nussbaum dated October 25, 2018</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

**DRONE AVIATION HOLDING CORP.  
COMMON STOCK PURCHASE AGREEMENT**

This Common Stock Purchase Agreement (this "*Agreement*") is made as of October 24, 2018 (the "Effective Date") by and among **Drone Aviation Holding Corp.**, a Nevada corporation with its principal office at 11651 Central Parkway #118, Jacksonville, FL 32224 (the "*Company*"), and those purchasers listed on the attached Exhibit A, as such exhibit may be amended from time to time (each a "*Purchaser*", and collectively, the "*Purchasers*").

**Recitals**

A. The Company has authorized the sale and issuance of up to 10,000,000 shares (the "*Shares*" or "*Securities*") of the common stock of the Company, \$0.0001 par value per share (the "*Common Stock*") to certain investors in a private placement at a price of \$0.55 per Share (the "*Offering*").

B. Pursuant to Section 4(a)(2) of the Securities Act of 1933 (the "*Securities Act*") and Rule 506(b) promulgated thereunder, the Company desires to sell to the Purchasers listed on the attached Exhibit A, as such exhibit may be amended from time to time, and such Purchasers, severally and not jointly, desire to purchase from the Company that aggregate number of shares of Common Stock set forth opposite such Purchaser's name on Exhibit A on the terms and subject to the conditions set forth in this Agreement.

**Terms and Conditions**

Now, therefore, in consideration of the foregoing recitals and the mutual covenants and agreements contained herein, the parties hereto, intending to be legally bound, do hereby agree as follows:

**1. Purchase of the Securities.**

**1.1 Agreement to Sell and Purchase.** Upon the Company's receipt of the Qualifying Sales Order (as hereinafter defined), the Company shall notify the Purchaser, by its delivery to the Purchaser of a Closing Notice, that the Company intends to close on the purchase of the Shares as provided for in this Agreement. "Closing Notice" means written notice from the Company to the Purchaser notifying them of receipt of the Qualifying Sales Order. Within three (3) business days after delivery of the Closing Notice, the parties will conduct a Closing (as hereinafter defined). At Closing, the Company will issue and sell to each of the Purchasers, and each Purchaser will, severally and not jointly, purchase from the Company, the number of Shares set forth opposite such Purchaser's name on Exhibit A for an aggregate purchase price set forth opposite such Purchaser's name on Exhibit A (the "*Purchase Price*").

**1.2 Closing; Closing Date; Additional Closings.**

**(a) Closing.** The completion of the sale and purchase of the Securities (the "*Closing*") shall be held at 9:00 a.m. (Central Time) as soon as practicable following the satisfaction of the conditions set forth in Section 4 (the "*Closing Date*"), remotely by facsimile or other electronic transmission of documents or at such other time and place as the Company and Purchasers may agree.

**1.3 Delivery of the Shares; Purchase Price Payment.** At Closing, subject to the terms and conditions hereof, the Company will issue each Purchaser stock in 'book form' or alternatively, certificate or certificates if the Purchaser requests, in such denominations and registered in such names as such Purchaser may designate by notice to the Company, representing the Securities, dated as of such Closing Date (each a "Certificate"), against payment of the purchase price therefor by cash in the form of wire transfer, unless other means of payment shall have been agreed upon by the Purchasers and the Company. Purchaser's shall fund their Purchase Price at any time after the Effective Date and no later than two (2) business days prior to the Closing Date by wire transfer of the Purchase Price to the Company's account set forth below:

Bank Name: City National Bank of Florida

Bank Address: 25 W. Flagler St, Miami, FL 33130

ABA#: [REDACTED]

For credit to: Drone Aviation Holding Corp. Wire Account

Account No.: [REDACTED]

Re: DRNE Common Stock Offering October 2018

Any portion of the Purchase Price received prior to the Closing Date will be held by the Company in a segregated bank account. In the event that this Agreement is terminated prior to the Closing Date as set forth in Section 4.3, any funds received by the Company pursuant to this Agreement shall be promptly refunded in full without deduction of any cost or expense.

**2. Representations and Warranties of the Company.** The Company hereby represents and warrants to each Purchaser:

**2.1 Authorization.** All corporate action on the part of the Company, its officers, directors and shareholders necessary for the authorization, execution and delivery of this Agreement has been taken. The Company has the requisite corporate power to enter into this Agreement and carry out and perform its obligations under the terms of this Agreement. At Closing, the Company will have the requisite corporate power to issue and sell the Securities. This Agreement has been duly authorized, executed and delivered by the Company and, upon due execution and delivery by the Purchasers, this Agreement will be a valid and binding agreement of the Company, enforceable against the Company in accordance with its terms, except as rights to indemnity hereunder may be limited by federal or state securities laws and except as enforceability may be limited by bankruptcy, insolvency, reorganization, moratorium or similar laws affecting creditors' rights generally or by equitable principles.

**2.2 No Conflict with Other Instruments.** The execution, delivery and performance of this Agreement, the issuance and sale of the Securities to be sold by the Company under this Agreement and the consummation of the actions contemplated by this Agreement will not (A) result in a violation of, be in conflict with, or constitute a default under, with or without the passage of time or the giving of notice: (i) any provision of the Company's or its subsidiaries' Articles of Incorporation or Bylaws as in effect on the date hereof or at Closing; (ii) any provision of any judgment, arbitration ruling, decree or order to which the Company or its subsidiaries are a party or by which they are bound; (iii) any bond, debenture, note or other evidence of indebtedness, or any lease, contract, mortgage, indenture, deed of trust, loan agreement, joint venture or other agreement, instrument or commitment to which the Company or any subsidiary is a party or by which they or their respective properties are bound; or (iv) any statute, rule, law or governmental regulation or order applicable to the Company or any of its subsidiaries; or (B) result in the creation or imposition of any lien, encumbrance, claim, security interest or restriction whatsoever upon any of the properties or assets of the Company or any subsidiary or any acceleration of indebtedness pursuant to any obligation, agreement or condition contained in any bond, debenture, note or any other evidence of indebtedness or any indenture, mortgage, deed of trust or any other agreement or instrument to which the Company or any subsidiary are a party or by which they are bound or to which any of the property or assets of the Company or any subsidiary is subject other than such conflicts, defaults or rights that could not reasonably be expected to have a Material Adverse Effect. No consent, approval, authorization or other order of, or registration, qualification or filing with, any regulatory body, administrative agency, or other governmental body is required for the execution and delivery of this Agreement by the Company and the valid issuance or sale of the Securities by the Company pursuant to this Agreement, other than such as have been made or obtained and that remain in full force and effect and except for the filing of a Form D or any filings required to be made under state securities laws. "Material Adverse Effect" means any material adverse effect on (i) the business, properties, assets, liabilities, operations (including results thereof), condition (financial or otherwise) or prospects of the Company or any Subsidiary, either individually or taken as a whole, (ii) the transactions contemplated hereby or in any of the other Transaction Documents or (iii) the authority or ability of the Company or any of its Subsidiaries to perform any of their respective obligations under any of the Transaction Documents. Other than as set forth on Schedule 2.2(a), the Company has no Subsidiaries. "Subsidiaries" means any Person in which the Company, directly or indirectly, (I) owns any of the outstanding capital stock or holds any equity or similar interest of such Person or (II) controls or operates all or any part of the business, operations or administration of such Person, and each of the foregoing, is individually referred to herein as a "Subsidiary."

**2.3 Articles of Incorporation; Bylaws.** The Company has made publicly available on the SEC's EDGAR system true, correct and complete copies of the Articles of Incorporation and Bylaws of the Company, as in effect on the date hereof.

**2.4 Organization, Good Standing and Qualification.** The Company is a corporation duly organized, validly existing and in good standing under the laws of the State of Nevada and has all requisite corporate power and authority to carry on its business as now conducted. The Company and each of its subsidiaries has full power and authority to own, operate and occupy its properties and to conduct its business as presently conducted and is duly qualified to transact business and is in good standing in each jurisdiction in which the failure so to qualify would have a Material Adverse Effect.

**2.5 SEC Filings; Financial Statements.** As used herein, the "*Company SEC Documents*" means all reports, schedules, forms, statements and other documents filed or furnished, as applicable, by the Company under the Securities Exchange Act of 1934 (the "*Exchange Act*"), including pursuant to Section 13(a) or 15(d) thereof, including the exhibits thereto and documents incorporated by reference therein during the period commencing December 31, 2014 and ending on the date hereof. As of their respective filing dates, true, correct and complete copies of each of the SEC Documents are available on the SEC's EDGAR system. The Company SEC Documents complied in all material respects with the requirements of the Securities Act and the Exchange Act and the rules and regulations of the Securities and Exchange Commission (the "*SEC*") promulgated thereunder, and none of these Company SEC Documents, when filed, contained any untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein in light of the circumstances under which they were made not misleading. As of the date of filing, the consolidated financial statements contained in the Company SEC Documents: (i) complied in all material respects with applicable accounting requirements and the published rules and regulations of the SEC applicable thereto; (ii) were prepared in accordance with generally accepted accounting principles applicable in the United States applied on a consistent basis throughout the periods covered, except as may be indicated in the notes to such financial statements and (in the case of unaudited statements) as permitted by Form 10-Q of the SEC, and except that unaudited financial statements may not contain footnotes and are subject to year-end audit adjustments; and (iii) fairly present the consolidated financial position of the Company and its subsidiaries as of the respective dates thereof and the consolidated results of operations cash flows and the changes in shareholders' equity of the Company and its subsidiaries for the periods covered thereby.

**2.6 Capitalization.** As of the Effective Date, the authorized capital stock of the Company consists of 300,000,000 shares of Common Stock, of which (A) 9,182,470 shares were issued and outstanding as of the date of this Agreement, and (B) 21,540,986 shares are reserved for issuance upon the exercise or conversion, as the case may be, of outstanding options, warrants or other convertible securities as of the date of this Agreement. Except as set forth on Schedule 2.6 or the Company SEC Documents (including the Exhibits thereto), there are no (i) outstanding rights (including, without limitation, preemptive rights), warrants or options to acquire, or instruments convertible into or exchangeable for, any unissued shares of capital stock or other equity interest in the Company, or any contract, commitment, agreement, understanding or arrangement of any kind to which the Company or any subsidiary is a party and relating to the issuance or sale of any capital stock or convertible or exchangeable security of the Company or any subsidiary, other than options granted to directors and employees of the Company and its subsidiaries pursuant to its 2015 Equity Incentive Plan; or (ii) obligations of the Company to purchase redeem or otherwise acquire any of its outstanding capital stock or any interest therein or to pay any dividend or make any other distribution in respect thereof. Except as disclosed in the Company SEC Documents (or Exhibits thereto): there are no anti-dilution or price adjustment provisions, co-sale rights, registration rights, rights of first refusal or other similar rights contained in the terms governing any outstanding security of the Company that will be triggered by the issuance of the Securities; and no person has any right to cause the Company to effect the registration under the Securities Act of any securities of the Company except as provided in this Agreement.

**2.7 Subsidiaries.** Except as set forth on Schedule 2.2(a), the Company does not presently own or control, directly or indirectly, and has no stock or other interest as owner or principal in, any other corporation or partnership, joint venture, association or other business venture or entity (each a “*subsidiary*”). Each subsidiary is duly incorporated or organized, validly existing and, if applicable to the jurisdiction, in good standing under the laws of its jurisdiction of incorporation or organization and has all requisite power and authority to carry on its business as now conducted. Each subsidiary is duly qualified to transact business and is in good standing in each jurisdiction in which the failure to so qualify would have a Material Adverse Effect. All of the outstanding capital stock or other securities of each subsidiary is owned by the Company, directly or indirectly, free and clear of any liens, claims, or encumbrances.

**2.8 Valid Issuance of Securities.** The Securities are duly authorized and, when issued, sold and delivered and paid for in accordance with the terms hereof, will be duly and validly authorized and issued, fully paid and nonassessable, free from all taxes, liens, claims, encumbrances and charges with respect to the issue thereof; provided, however, that the Securities may be subject to restrictions on transfer under state and/or federal securities laws or as otherwise set forth herein. The issuance, sale and delivery of the Securities in accordance with the terms of this Agreement will not be subject to preemptive rights of shareholders of the Company.

**2.9 Offering.** Assuming the accuracy of the representations of the Purchasers in Section 3.3 of this Agreement on the date hereof and on the Closing Date, the offer, issue and sale of the Securities are and will be exempt from the registration and prospectus delivery requirements of the Securities Act and have been or will be registered or qualified (or are or will be exempt from registration and qualification) under the registration, permit or qualification requirements of all applicable state securities laws. Neither the Company, nor any of its affiliates, nor any person acting on its or their behalf, has directly or indirectly made any offers or sales of any security or solicited any offers to buy any security under circumstances that would require registration under the Securities Act of the issuance of the Securities to the Purchasers. Other than the Company SEC Documents and the Transaction Documents, the Company has not distributed and will not distribute prior to the Closing Date any offering material in connection with the offering and sale of the Securities. The Company has not taken any action to sell, offer for sale or solicit offers to buy any securities of the Company which would bring the offer, issuance or sale of the Securities within the registration provisions of Section 5 of the Securities Act, unless such offer, issuance or sale was or shall be within the exemptions of the Securities Act.

**2.10 Litigation.** Except as set forth in the Company SEC Documents or on Schedule 2.10 hereto, there is no action, suit, proceeding nor investigation pending or, to the Company’s knowledge, currently threatened against the Company or any of its subsidiaries that (a) if adversely determined would reasonably be expected to have a Material Adverse Effect or (b) would be required to be disclosed in the Company’s Annual Report on Form 10-K under the requirements of Item 103 of Regulation S-K. The foregoing includes, without limitation, any action, suit, proceeding or investigation, pending or to the Company’s knowledge threatened, that questions the validity of this Agreement or the right of the Company to enter into this Agreement and perform its obligations hereunder. Neither the Company nor any subsidiary is subject to any injunction, judgment, decree or order of any court, regulatory body, arbitral panel, administrative agency or other government body of which it has received written notice.

**2.11 Governmental Consents.** No consent, approval, order or authorization of, or registration, qualification, designation, declaration or filing with, any federal, state, local or provincial governmental authority on the part of the Company or any of its subsidiaries is required in connection with the consummation of the transactions contemplated by this Agreement, except for notices required or permitted to be filed with certain state and federal securities commissions, which notices will be filed on a timely basis.

**2.12 No Brokers.** No broker, finder or investment banker is entitled to any brokerage, finder's or other fee or commission in connection with the transactions contemplated by this Agreement based on arrangements made by the Company.

**2.13 Compliance.** Neither the Company nor any of its Subsidiaries is in violation of its Articles of Incorporation or Bylaws (or similar organizational documents). Neither the Company nor the subsidiaries have been advised or have reason to believe, that it is not conducting its business in compliance with all applicable laws, rules and regulations of the jurisdictions in which it is conducting business, including, without limitation, all applicable local, state and federal environmental laws and regulations, except where failure to be so in compliance would not have a Material Adverse Effect. Each of the Company and the subsidiaries has all necessary franchises, licenses, certificates and other authorizations from any foreign, federal, state or local government or governmental agency, department or body that are currently necessary for the operation of the business of the Company and its subsidiaries as currently conducted, except where the failure to currently possess such franchises, licenses, certificates and other authorizations would not reasonably be expected to have a Material Adverse Effect.

**2.14 No Material Changes.** Except as disclosed in the Company SEC Documents, since June 30, 2018, there has been no material adverse change in the assets, liabilities, business, properties, operations, financial condition or results of operations of the Company and its subsidiaries, taken as a whole. Since June 30, 2018, the Company has not declared or paid any dividend or distribution or its capital stock.

**2.15 Contracts.** Except for matters which are not reasonably likely to have a Material Adverse Effect and those contracts that are substantially or fully performed or expired by their terms, the contracts listed as exhibits to or described in the Company SEC Documents are in full force and effect on the date hereof, and neither the Company nor any applicable subsidiary of the Company nor, to the Company's knowledge, any other party to such contracts is in breach of or default under any of such contracts. Neither the Company nor any of its subsidiaries has any contracts or agreements that would constitute a material contract as such term is defined in Item 601(b) of Regulation S-K, except for such contracts or agreements that are filed as exhibits to or described in the Company SEC Documents.

**2.16 Intellectual Property.** The Company and its Subsidiaries own or possess adequate rights or licenses to use all trademarks, trade names, service marks, service mark registrations, service names, patents, patent rights, copyrights, original works, inventions, licenses, approvals, governmental authorizations, trade secrets, know how, customer lists, designs, manufacturing or other processes, computer software, systems, data compilation, research results and other intellectual property rights and all applications and registrations therefore ("*Intellectual Property Rights*") necessary to conduct their respective businesses as now conducted and as proposed to be conducted, except where the failure to do so would not reasonably be expected to, individually or in the aggregate, have a Material Adverse Effect. None of the Company's or its Subsidiaries' Intellectual Property Rights have expired, terminated or been abandoned, or are expected to expire, terminate or be abandoned, within three years from the date of this Agreement. The Company has no knowledge of any infringement by the Company or any of its Subsidiaries of Intellectual Property Rights of others. There is no claim, action or proceeding being made or brought, or to the knowledge of the Company or any of its Subsidiaries, being threatened, against the Company or any of its Subsidiaries regarding their Intellectual Property Rights. The Company is not aware of any facts or circumstances which are likely to give rise to any of the foregoing infringements or claims, actions or proceedings. The Company and each of its Subsidiaries have taken reasonable security measures to protect the secrecy, confidentiality and value of all of their Intellectual Property Rights. The Company and each of its Subsidiaries has taken all reasonable steps required in accordance with sound business practice and business judgment to establish and preserve its ownership of all material Intellectual Property with respect to their products and technology. Neither the Company nor any Subsidiary is making unauthorized use of any confidential information or trade secrets of any person. The activities of any of the employees on behalf of the Company or of any Subsidiary do not violate any agreements or arrangements between such employees and third parties are related to confidential information or trade secrets of third parties or that restrict any such employee's engagement in business activity of any nature. All licenses or other agreements under which (i) the Company or any Subsidiary employs Intellectual Property Rights, or (ii) the Company or any subsidiary has granted rights to others in Intellectual Property Rights owned or licensed by the Company or any Subsidiary are in full force and effect, and there is no default (and there exists no condition which, with the passage of time or otherwise, would constitute a default by the Company or such Subsidiary) by the Company or any subsidiary with respect thereto which would result in a Material Adverse Effect.



**2.17 Exchange Compliance.** The Company's common stock is not registered pursuant to the Exchange Act but is qualified to be quoted on the OTCQB tier of the OTC Markets (the "*Principal Market*"), and the Company has taken no action designed to, or likely to have the effect of, delisting the Common Stock (including the Shares) from the Principal Market. The Company is in compliance with all of the presently applicable requirements for continued quotation of the Common Stock on the Principal Market. The issuance of the Securities does not require shareholder approval including, without limitation, pursuant to the rules and regulations of the Principal Market.

**2.18 Accountants.** MaloneBailey, LLP, who expressed their opinion with respect to the consolidated financial statements contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2017 and 2016, respectively have advised the Company that they are, and to the knowledge of the Company they are, independent accountants as required by the Securities Act and the rules and regulations promulgated thereunder. The Company covenants to file its Form 10-K containing audited consolidated financial statements for the year ended December 31, 2018 within the time period required by applicable securities laws (including any permitted extension).

**2.19 Taxes.** The Company and each of its subsidiaries has filed all necessary federal, state, local and foreign income and franchise tax returns and has paid or accrued all taxes shown as due thereon, and the Company has no knowledge of a tax deficiency which has been or might be asserted or threatened against it or any of its subsidiaries by any taxing jurisdiction.

**2.20 Insurance.** The Company and each of its subsidiaries maintains and will continue to maintain insurance of the types and in the amounts that the Company reasonably believes is adequate for its business, including, but not limited to, insurance covering all real and personal property owned or leased by the Company and its subsidiaries against theft, damage, destruction, acts of vandalism and all other risks customarily insured against by similarly situated companies, all of which insurance is in full force and effect.

**2.21 Transfer Taxes.** On the Closing Date, all stock transfer or other taxes (other than income taxes) that are required to be paid in connection with the sale and transfer of the Securities hereunder will be, or will have been, fully paid or provided for by the Company and the Company will have complied with all laws imposing such taxes.

**2.22 Investment Company.** The Company (including its subsidiaries) is not an "investment company" or an "affiliated person" of, or "promoter" or "principal underwriter" for an investment company, within the meaning of the Investment Company Act of 1940 and will not be deemed an "investment company" as a result of the transactions contemplated by this Agreement.

**2.23 Related Party Transactions.** To the knowledge of the Company, no transaction has occurred between or among the Company or any of its affiliates (including, without limitation, any of its subsidiaries), officers or directors or any affiliate or affiliates of any such affiliate, officer or director that with the passage of time will be required to be disclosed pursuant to Section 13, 14 or 15(d) of the Exchange Act other than those transactions that have already been so disclosed or as appear in the SEC Documents.

**2.24 Books and Records.** The books, records and accounts of the Company and its subsidiaries accurately and fairly reflect, in reasonable detail, the transactions in, and dispositions of, the assets of, and the operations of, the Company and its subsidiaries.

## **2.25 Disclosure Controls and Internal Controls.**

(a) The Company has established and maintains disclosure controls and procedures (as such term is defined in Rule 13a-15 under the Exchange Act), which (i) are designed to ensure that material information relating to the Company is made known to the Company's principal executive officer and its principal financial officer by others within the Company particularly during the periods in which the periodic reports required under the Exchange Act are being prepared; and (ii) provide for the periodic evaluation of the effectiveness of such disclosure controls and procedures as of the end of the period covered by the Company's most recent annual or quarterly report filed with the SEC.

(b) Except as set forth in the SEC Documents, the Company maintains a system of internal accounting controls sufficient to provide reasonable assurance that (i) transactions are executed in accordance with management's general or specific authorizations, (ii) transactions are recorded as necessary to permit preparation of financial statements in conformity with generally accepted accounting principles and to maintain asset and liability accountability, (iii) access to assets or incurrence of liabilities is permitted only in accordance with management's general or specific authorization and (iv) the recorded accountability for assets and liabilities is compared with the existing assets and liabilities at reasonable intervals and appropriate action is taken with respect to any difference. Except as set forth in the SEC Documents, the Company maintains disclosure controls and procedures (as such term is defined in Rule 13a-14 under the Exchange Act) that are effective in ensuring that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the rules and forms of the SEC, including, without limitation, controls and procedures designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the Company's management, including its principal executive officer or officers and its principal financial officer or officers, as appropriate, to allow timely decisions regarding required disclosure. Except as set forth in the SEC Documents, the Company is not aware of (i) any significant deficiency in the design or operation of internal controls which could adversely affect the Company's or any of its subsidiary's ability to record, process, summarize and report financial data or any material weaknesses in internal controls; or (ii) any fraud, whether or not material, that involves management or other employees who have a significant role in the Company's or any of its subsidiary's internal controls.

(c) Except as set forth in the SEC Documents, since the date of the most recent evaluation of such disclosure controls and procedures, there have been no changes that have materially affected, or are reasonably likely to materially affect, the Company's or any of its subsidiary's internal control over financial reporting, including any corrective actions with regard to significant deficiencies and material weaknesses.

(d) Except as described in the Company SEC Documents, there are no material off-balance sheet arrangements (as defined in Item 303 of Regulation S-K), or any other relationships with unconsolidated entities (in which the Company or its control persons have an equity interest) that may have a material current or future effect on the Company's or any of its/subsidiary's financial condition, revenues or expenses, changes in financial condition, results of operations, liquidity, capital expenditures or capital resources.

**2.26 No General Solicitation.** Neither the Company, nor any of its affiliates, nor any person acting on its or their behalf, has engaged in any form of general solicitation or general advertising (within the meaning of Regulation D promulgated under the Securities Act) in connection with the offer or sale of the Securities.

**2.27 Application of Takeover Protections; Rights Agreement .** The Company and its board of directors have taken all necessary action, if any, in order to render inapplicable any control share acquisition, business combination, poison pill (including any distribution under a rights agreement) or other similar anti-takeover provision under the Articles of Incorporation or the laws of the jurisdiction of its formation which is or could become applicable to any Purchaser as a result of the transactions contemplated by this Agreement, including, without limitation, the Company's issuance of the Securities and any Purchaser's ownership of the Securities. The Company has not adopted a shareholder rights plan or similar arrangement relating to accumulations of beneficial ownership of Common Stock or a change in control of the Company.

**2.28 Foreign Corrupt Practices.** Neither the Company nor any of its subsidiaries nor any director, officer, agent, employee or other person acting on behalf of the Company or any of its subsidiaries has, in the course of its actions for, or on behalf of, the Company (i) used any corporate funds for any unlawful contribution, gift, entertainment or other unlawful expenses relating to political activity; (ii) made any direct or indirect unlawful payment to any foreign or domestic government official or employee from corporate funds; (iii) violated or is in violation of any provision of the U.S. Foreign Corrupt Practices Act of 1977; or (iv) made any unlawful bribe, rebate, payoff, influence payment, kickback or other unlawful payment to any foreign or domestic government official or employee.

**2.29 Sarbanes-Oxley Act.** The Company is in compliance in all material respects with any and all applicable requirements of the Sarbanes-Oxley Act of 2002 that are effective as of the date hereof, and any and all applicable rules and regulations promulgated by the SEC thereunder that are effective as of the date hereof.

**2.30 Employee Relations.** Neither the Company nor any of its subsidiaries is a party to any collective bargaining agreement or employs any member of a union. The Company reasonably believes that its and its subsidiaries' relations with its employees are good. No executive officer of the Company (as defined in Rule 501(f) of the Securities Act) has notified the Company that such officer intends to leave the Company or otherwise terminate such officer's employment with the Company. To the knowledge of the Company, no executive officer of the Company is, or is expected to be, in violation of any material term of any employment contract, confidentiality, disclosure or proprietary information agreement, non-competition agreement, or any other contract or agreement or any restrictive covenant, and the continued employment of each such executive officer does not subject the Company to any liability with respect to any of the foregoing matters.

The Company and each of its subsidiaries is in compliance with all federal, state, local and foreign laws and regulations respecting labor, employment and employment practices and benefits, terms and conditions of employment and wages and hours, except where failure to be in compliance would not, either individually or in the aggregate, reasonably be expected to result in a Material Adverse Effect.

**2.31 Environmental Laws.** The Company and each of its subsidiaries (i) is in compliance with any and all Environmental Laws (as hereinafter defined), (ii) has received all permits, licenses or other approvals required of it under applicable Environmental Laws to conduct its business and (iii) is in compliance with all terms and conditions of any such permit, license or approval where, in each of the foregoing clauses (i), (ii) and (iii), the failure to so comply could be reasonably expected to have, individually or in the aggregate, a Material Adverse Effect. The term "*Environmental Laws*" means all federal, state, local or foreign laws relating to pollution or protection of human health or the environment (including, without limitation, ambient air, surface water, groundwater, land surface or subsurface strata), including, without limitation, laws relating to emissions, discharges, releases or threatened releases of chemicals, pollutants, contaminants, or toxic or hazardous substances or wastes (collectively, "*Hazardous Materials*") into the environment, or otherwise relating to the manufacture, processing, distribution, use, treatment, storage, disposal, transport or handling of Hazardous Materials, as well as all authorizations, codes, decrees, demands or demand letters, injunctions, judgments, licenses, notices or notice letters, orders, permits, plans or regulations issued, entered, promulgated or approved thereunder.

**2.32 No Manipulation; Disclosure of Information.** The Company has not taken and will not take any action designed to or that might reasonably be expected to cause or result in an unlawful manipulation of the price of the Common Stock to facilitate the sale or resale of the Securities. The Company confirms that, to its knowledge, with the exception of the proposed sale of Securities as contemplated herein (as to which the Company makes no representation), neither it nor any other person acting on its behalf has provided any of the Purchasers or their agents or counsel with any information that constitutes or might constitute material, non-public information. The Company understands and confirms that the Purchasers shall be relying on the foregoing representations in effecting transactions in securities of the Company. All disclosures provided to the Purchasers regarding the Company, its business and the transactions contemplated hereby furnished by the Company are true and correct and do not contain any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements made therein, in light of the circumstances under which they were made, not misleading.

**2.33 Forward-Looking Information.** No forward-looking statement (within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act) made by the Company or any of its officers or directors contained in the SEC Documents, or made available to the public generally since December 31, 2014, has been made or reaffirmed without a reasonable basis or has been disclosed other than in good faith.

**2.34 No Additional Agreements.** Other than with respect to closing mechanics, the Company has no other agreements or understandings (including, without limitation, side letters) with any Purchaser or other person to purchase Shares on terms more favorable to such person than as set forth herein.

**2.35 No “Bad Actor” Disqualification.** The Company has exercised reasonable care, in accordance with SEC rules and guidance, and has conducted a factual inquiry, the nature and scope of which reflect reasonable care under the relevant facts and circumstances, to determine whether any Covered Person (as defined below) is subject to any of the “bad actor” disqualifications described in Rule 506(d)(1) (i) to (viii) under the Securities Act (“*Disqualification Events*”). To the Company’s knowledge, after conducting such sufficiently diligent factual inquiries, no Covered Person is subject to a Disqualification Event, except for a Disqualification Event covered by Rule 506(d)(2) or (d)(3) under the Securities Act. The Company has complied, to the extent applicable, with any disclosure obligations under Rule 506(e) under the Securities Act. “*Covered Persons*” are those persons specified in Rule 506(d)(1) under the Securities Act, including the Company; any predecessor or affiliate of the Company; any director, executive officer, other officer participating in the offering, general partner or managing member of the Company; any beneficial owner of 20% or more of the Company’s outstanding voting equity securities, calculated on the basis of voting power; any promoter (as defined in Rule 405 under the Securities Act) connected with the Company in any capacity at the time of the sale of the Securities; and any person that has been or will be paid (directly or indirectly) remuneration for solicitation of purchasers in connection with the sale of the Securities (a “*Solicitor*”), any general partner or managing member of any Solicitor, and any director, executive officer or other officer participating in the offering of any Solicitor or general partner or managing member of any Solicitor.

**3. Representations and Warranties of the Purchasers.** Each Purchaser, severally and not jointly, hereby represents and warrants to the Company as follows:

**3.1 Legal Power.** The Purchaser has the requisite authority to enter into this Agreement and to carry out and perform its obligations under the terms of this Agreement. All action on the Purchaser’s part required for the lawful execution and delivery of this Agreement have been or will be effectively taken prior to the Closing.

**3.2 Due Execution.** This Agreement has been duly authorized, executed and delivered by the Purchaser, and, upon due execution and delivery by the Company, this Agreement will be a valid and binding agreement of the Purchaser, except as rights to indemnity hereunder may be limited by federal or state securities laws and except as enforceability may be limited by bankruptcy, insolvency, reorganization, moratorium or similar laws affecting creditors’ rights generally or by equitable principles.

**3.3 Investment Representations.** In connection with the sale and issuance of the Securities, the Purchaser, for itself and no other Purchaser, makes the following representations:

**(a) Investment for Own Account.** The Purchaser is acquiring the Securities for its own account, not as nominee or agent, and not with a view to, or for resale in connection with, any distribution or public offering thereof within the meaning of the Securities Act; provided, however, that by making the representations herein, the Purchaser does not agree to hold any of the Securities for any minimum or specific term and reserves the right to dispose of the securities at any time in accordance with or pursuant to a registration statement or an exemption from the registration requirements of the Securities Act.

**(b) Transfer Restrictions; Legends.** The Purchaser understands that (i) the Securities have not been registered under the Securities Act; (ii) the Securities are being offered and sold pursuant to an exemption from registration, based in part upon the Company's reliance upon the statements and representations made by the Purchasers in this Agreement, and that the Securities must be held by the Purchaser indefinitely, and that the Purchaser must, therefore, bear the economic risk of such investment indefinitely, unless a subsequent disposition thereof is registered under the Securities Act or is exempt from such registration; (iii) each Certificate representing the Securities will be endorsed with the following legend until the earlier of (1) such date as the Shares have been registered for resale by the Purchaser or (2) the date the Shares are eligible for sale under Rule 144 under the Securities Act:

THE SECURITIES REPRESENTED HEREBY HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED (THE "*SECURITIES ACT*"), OR UNDER THE SECURITIES LAWS OF ANY STATES. THESE SECURITIES ARE SUBJECT TO RESTRICTIONS ON TRANSFERABILITY AND RESALE AND MAY NOT BE TRANSFERRED OR RESOLD EXCEPT AS PERMITTED UNDER THE SECURITIES ACT AND THE APPLICABLE STATE SECURITIES LAWS, PURSUANT TO REGISTRATION OR EXEMPTION THEREFROM. UNLESS SOLD PURSUANT TO EITHER AN EFFECTIVE REGISTRATION STATEMENT OR RULE 144 UNDER THE SECURITIES ACT, THE ISSUER OF THESE SECURITIES MAY REQUIRE AN OPINION OF COUNSEL IN FORM AND SUBSTANCE SATISFACTORY TO THE ISSUER TO THE EFFECT THAT ANY PROPOSED TRANSFER OR RESALE IS IN COMPLIANCE WITH THE SECURITIES ACT.

(iv) the Company will instruct any transfer agent not to register the transfer of the Securities (or any portion thereof) until the applicable date set forth in clause (iii) above unless (A) the conditions specified in the foregoing legends are satisfied, (B) if the opinion of counsel referred to above is to the further effect that such legend is not required in order to establish compliance with any provisions of the Securities Act or this Agreement, (C) if the Holder provides the Company with reasonable assurance, such as through a representation letter, that the Securities may be sold pursuant to Rule 144 under the Securities Act, or (D) other reasonably satisfactory assurances of such nature are given to the Company. If so required by the Company's transfer agent, the Company shall cause its counsel, at the expense of the Company, to issue and deliver a legal opinion to the transfer agent to effect the removal of the restrictive legend contemplated by this Agreement.

The Company acknowledges and agrees that a Purchaser may from time to time pledge, and/or grant a security interest in some or all of the Securities pursuant to a bona fide margin agreement in connection with a bona fide margin account and, if required under the terms of such agreement or account, the Purchaser may transfer pledged or secured Securities to the pledgees or secured parties. Such a pledge or transfer shall not be subject to approval or consent of the Company and no legal opinion of legal counsel to the pledgee, secured party or pledgor shall be required in connection with the pledge, but such legal opinion may be required in connection with a subsequent transfer following default by the Purchaser transferee of the pledge. No notice shall be required of such pledge. At the appropriate Purchaser's expense, the Company will execute and deliver such reasonable documentation as a pledgee or secured party of Securities may reasonably request in connection with a pledge or transfer of the Securities.

Certificates evidencing the Shares shall not contain any legend (including the legend set forth in this Section): (i) upon the effectiveness of a registration statement covering the Shares, or (ii) following a sale of such Shares pursuant to Rule 144, or (iii) while such Shares are eligible for sale under Rule 144, if such Shares have been held for one year pursuant to the requirements of Rule 144, or (iv) if such legend is not required under applicable requirements of the Securities Act (including judicial interpretations and pronouncements issued by the Staff of the SEC). Following such time as restrictive legends are not required to be placed on certificates representing Shares, the Company will, no later than three business days following the delivery by a Purchaser to the Company or the Company's transfer agent of a certificate representing Shares containing a restrictive legend and such other documentation and representations as the Company, its legal counsel or Transfer Agent may reasonably request to confirm compliance with the preceding sentence as applicable (provided, however, that neither the Company nor its legal counsel will require a legal opinion in connection with any sale pursuant to Rule 144), deliver or cause to be delivered to such Purchaser a certificate representing such Shares that is free from all restrictive and other legends. The Company shall cause its counsel to issue a legal opinion to the Company's transfer agent promptly after the effective date of a registration statement covering the Shares if required by the Company's transfer agent to effect the removal of the legend hereunder. The Company may not make any notation on its records or give instructions to any transfer agent of the Company that enlarge the restrictions on transfer set forth in this Section. Certificates for Shares subject to legend removal hereunder shall be transmitted by the transfer agent of the Company to the Purchasers by crediting the account of the Purchaser's prime broker with the Depository Trust Company system. The Company will pay all fees and expenses of its transfer agent and the Depository Trust Company in connection with the removal of legends pursuant to this Section 3.3(b).

Each Purchaser, severally and not jointly with the other Purchasers, agrees that the removal of the restrictive legend from certificates representing Shares as set forth in this Section 3.3(b) is predicated upon the Company's reliance that the Purchaser will sell any Shares pursuant to either the registration requirements of the Securities Act, including any applicable prospectus delivery requirements, or an exemption therefrom.

**(c) Financial Sophistication; Due Diligence.** The Purchaser has such knowledge and experience in financial or business matters that it is capable of evaluating the merits and risks of the investment in connection with the transactions contemplated in this Agreement. Such Purchaser has, in connection with its decision to purchase the Securities, relied only upon the representations and warranties contained herein and the information contained in the Company SEC Documents. Further, the Purchaser has had such opportunity to obtain additional information and to ask questions of, and receive answers from, the Company, concerning the terms and conditions of the investment and the business and affairs of the Company, as the Purchaser considers necessary in order to form an investment decision.

**(d) Accredited Investor Status.** The Purchaser is an "accredited investor" as such term is defined in Rule 501(a) of the rules and regulations promulgated under the Securities Act.

**(e) Residency.** The Purchaser is organized under the laws of the jurisdiction set forth beneath such Purchaser's name on the signature page attached hereto, and its principal place of operations is in the state set forth beneath such Purchaser's name on the signature page attached hereto.

**(f) General Solicitation.** The Purchaser is not purchasing the Securities as a result of any advertisement, article, notice or other communication regarding the Securities published in any newspaper, magazine or similar media or broadcast over the television or radio or presented at any seminar or any other general solicitation or general advertisement. Prior to the time that the Purchaser was first contacted by the Company or the Placement Agent such Purchaser had a pre-existing and substantial relationship with the Company or the Placement Agent.

**3.4 No Investment, Tax or Legal Advice.** Each Purchaser understands that nothing in the Company SEC Documents, this Agreement, or any other materials presented to the Purchaser in connection with the purchase and sale of the Securities constitutes legal, tax or investment advice. Each Purchaser has consulted such legal, tax and investment advisors as it, in its sole discretion, has deemed necessary or appropriate in connection with its purchase of Securities.

**3.5 Additional Acknowledgement.** Each Purchaser acknowledges that it has independently evaluated the merits of the transactions contemplated by this Agreement, that it has independently determined to enter into the transactions contemplated hereby, that it is not relying on any advice from or evaluation by any other person. Each Purchaser acknowledges that the Placement Agent has acted solely as placement agent for the Company in connection with the Offering of the Securities by the Company, that the information and data provided to the Purchaser in connection with the transaction contemplated hereby has not been subjected to independent verification by the Placement Agent, and that the Placement Agent has made no representation or warranty whatsoever with respect to the accuracy or completeness of such information, data or other related disclosure material. Each Purchaser acknowledges that it has not taken any actions that would deem the Purchasers to be members of a "group" for purposes of Section 13(d) of the Exchange Act.

**3.6 No Short Position.** As of the date hereof, and as of the date of the public announcement of the Offering, each Purchaser acknowledges and agrees that it does not and will not (between the date hereof and the date of the public announcement of the Offering) engage in any short sale of the Company's voting stock or any other type of hedging transaction involving the Company's securities (including, without limitation, depositing shares of the Company's securities with a brokerage firm where such securities are made available by the broker to other customers of the firm for purposes of hedging or short selling the Company's securities).

#### **4. Conditions to Closing.**

**4.1 Conditions to Obligations of Purchasers at Closing.** Each Purchaser's obligation to purchase the Securities at a Closing is subject to the fulfillment to that Purchaser's reasonable satisfaction, on or prior to the Closing, of all of the following conditions, any of which may be waived by the Purchaser:

**(a) Representations and Warranties True; Performance of Obligations.** The representations and warranties made by the Company in Section 2 shall be true and correct in all respects on the Closing Date with the same force and effect as if they had been made on and as of said date and the Company shall have performed and complied with all obligations and conditions herein required to be performed or complied with by it on or prior to Closing and a certificate duly executed by an officer of the Company, to the effect of the foregoing, shall be delivered to the Purchasers.

**(b) Proceedings and Documents.** All corporate and other proceedings in connection with the transactions contemplated at Closing and all documents and instruments incident to such transactions shall be reasonably satisfactory in substance and form to counsel to the Purchaser, and counsel to the Purchaser shall have received all such counterpart originals or certified or other copies of such documents as they may reasonably request. The Company shall have delivered (or caused to have been delivered) to each Purchaser, the certificates required by this Agreement.

**(c) Qualifications, Legal Investment.** All authorizations, approvals, or permits, if any, of any governmental authority or regulatory body of the United States or of any state that are required in connection with the lawful sale and issuance of the Securities shall have been duly obtained and shall be effective on and as of Closing. No stop order or other order enjoining the sale of the Securities shall have been issued and no proceedings for such purpose shall be pending or, to the knowledge of the Company, threatened by the SEC, or any commissioner of corporations or similar officer of any state having jurisdiction over this transaction. At the time of Closing, the sale and issuance of the Securities shall be legally permitted by all laws and regulations to which Purchasers and the Company are subject. No litigation, statute, rule, regulation, executive order, decree, ruling or injunction will have been enacted, entered, promulgated or endorsed by or in any court or governmental authority of competent jurisdiction or any self-regulatory organization having authority over the matters contemplated hereby which prohibits the consummation of any of the transactions contemplated by this Agreement.

**(d) Execution of Agreements.** The Company shall have executed this Agreement and have delivered this Agreement to the Purchasers.

**(e) Secretary's Certificate.** The Company shall have delivered to the Purchasers a certificate of the Secretary of the Company certifying as to (i) the truth and accuracy of the resolutions of the board of directors relating to the transaction contemplated hereby (a copy of which shall be included with such certificate) and (ii) the current versions of the Company's Articles of Incorporation and bylaws.

**(f) Trading and Listing.** Trading and quotation of the Company's common stock on the Principal Market shall not have been suspended by the SEC or the Principal Market.

**(g) Market Listing.** The Company will comply with all of the requirements of the Financial Industry Regulatory Authority, Inc. and the Principal Market with respect to the issuance of the Securities and will obtain approval for quotation of the Shares on the Principal Market, as required.

**(h) Blue Sky.** The Company shall have obtained all necessary "blue sky" law permits and qualifications, or have the availability of exemptions therefrom, required by any state for the offer and sale of the Securities.

**(i) Material Adverse Change.** Since the date of this Agreement, there shall not have occurred any event which results in a Material Adverse Effect.

**(j) Receipt of Order.** The Company shall have received an aggregate of \$4,000,000 in new orders from a prime government contractor or directly from the U.S. government at any time commencing after the Effective Date (the "Qualifying Sales Order").

**4.2 Conditions to Obligations of the Company.** The Company's obligation to issue and sell the Securities at the Closing is subject to the fulfillment to the Company's reasonable satisfaction, on or prior to the Closing of the following conditions, any of which may be waived by the Company:

**(a) Representations and Warranties True.** The representations and warranties made by the Purchasers in Section 3 shall be true and correct in all respects on the Closing Date with the same force and effect as if they had been made on and as of said date.

**(b) Performance of Obligations.** The Purchasers shall have performed and complied with all agreements and conditions herein required to be performed or complied with by them on or before the Closing. The Purchasers shall have delivered the Purchase Price, by wire transfer, to the account designated by the Company for such purpose.

**(c) Qualifications, Legal Investment.** All authorizations, approvals, or permits, if any, of any governmental authority or regulatory body of the United States or of any state that are required in connection with the lawful sale and issuance of the Securities shall have been duly obtained and shall be effective on and as of the Closing. No stop order or other order enjoining the sale of the Securities shall have been issued and no proceedings for such purpose shall be pending or, to the knowledge of the Company, threatened by the SEC, or any commissioner of corporations or similar officer of any state having jurisdiction over this transaction. At the time of the Closing, the sale and issuance of the Securities shall be legally permitted by all laws and regulations to which the Purchasers and the Company are subject. No litigation, statute, rule, regulation, executive order, decree, ruling or injunction will have been enacted, entered, promulgated or endorsed by or in any court or governmental authority of competent jurisdiction or any self-regulatory organization having authority over the matters contemplated hereby which prohibits the consummation of any of the transactions contemplated by this Agreement.

**(d) Execution of Agreements.** The Purchasers shall have executed this Agreement and delivered this Agreement to the Company.

#### **4.3 Termination of Obligations to Effect Closing; Effects.**

**(a) Termination.** The obligations of the Company, on the one hand, and the Purchasers, on the other hand, to effect a Closing shall terminate as follows:

(i) upon the mutual written consent of the Company and the Purchasers;

(ii) by the Company if any of the conditions set forth in Section 4.2 shall have become incapable of fulfillment, and shall not have been waived by the Company;

(iii) by a Purchaser (with respect to itself only) if any of the conditions set forth in Section 4.1 shall have become incapable of fulfillment, and shall not have been waived by the Purchaser; or



(iv) by either the Company or any Purchaser (with respect to itself only) if the Closing has not occurred on or prior to December 31, 2018;

provided, however, that, except in the case of clause (i) above, the party seeking to terminate its obligation to effect a Closing shall not then be in breach of any of its representations, warranties, covenants, or agreements contained in this Agreement if such breach has resulted in the circumstances giving rise to such party's seeking to terminate its obligation to effect a Closing.

**(b) Effect of Termination .** In the event of termination by the Company or any Purchaser of its obligations to effect a Closing pursuant to this Section 4.3, written notice thereof shall be given promptly to the other Purchasers by the Company and the other Purchasers shall have the right to terminate their obligations to effect a Closing upon written notice to the Company and the other Purchasers. Nothing in this Section 4.3 shall be deemed to release any party from any liability for any breach by such party of the terms and provisions of this Agreement or to impair the right of any party to compel specific performance by any other party of its obligations under this Agreement.

## **5. Additional Covenants.**

**5.1 Reporting Status.** With a view to making available to the Purchasers the benefits of certain rules and regulations of the SEC which may permit the sale of the Shares to the public without registration, the Company agrees to use its reasonable efforts to file with the SEC, in a timely manner all reports and other documents required of the Company under the Exchange Act. The Company will otherwise take such further action as a Purchaser may reasonably request, all to the extent required from time to time to enable such Purchaser to sell the Shares without registration under the Securities Act or any successor rule or regulation adopted by the SEC.

**5.2 Listing.** So long as a Purchaser owns any of the Securities, the Company will use its reasonable efforts to maintain the qualification or listing of its Common Stock, including the Shares, on the Principal Market or an alternative tier of the OTC Markets, NASDAQ Stock Market, New York Stock Exchange or NYSE MKT and will comply in all material respects with the Company's reporting, filing and other obligations under the rules of such exchanges, as applicable.

**5.3 Non-Public Information.** Other than as contemplated hereby, the Company covenants and agrees that neither it nor any other person acting on its behalf will provide any Purchaser or its agents or counsel with any information that the Company believes constitutes material non-public information, unless prior thereto such Purchaser shall have executed a written agreement regarding the confidentiality and use of such information. The Company understands and confirms that each Purchaser shall be relying on the foregoing representations in effecting transactions in securities of the Company. Furthermore, as of the Closing Date, if the Company has disclosed any material, non-public information to the Purchaser, the Purchaser has no duty to keep such information confidential following the public announcement of the Offering.

**5.4 Equal Treatment of Purchasers.** No consideration (including any modification of this Agreement and any other documents or agreements executed in connection with the transaction contemplated hereunder) shall be offered or paid to any person to amend or consent to a waiver or modification of any provision of any of this Agreement unless the same consideration is also offered to all of the parties to this Agreement. For clarification purposes, this provision constitutes a separate right granted to each Purchaser by the Company and negotiated separately by each Purchaser, and is intended for the Company to treat the Purchasers as a class and shall not in any way be construed as the Purchasers acting in concert or as a group with respect to the purchase, disposition or voting of securities of the Company or otherwise.

## 6. Miscellaneous.

**6.1 Public Statements; Limitation on Information .** The Company shall, within the time required under the Exchange Act, file with the SEC a report on Form 8-K relating to (A) the transactions contemplated by, and describing the material terms and conditions of, this Agreement and the Offering, (B) the material terms of the Qualifying Sales Order; and (C) after Closing, file a Current Report on Form 8-K within the time required by and in accordance with the requirements of the Exchange Act. From and after the issuance of such press release, the Company represents to the Purchasers that it shall have publicly disclosed all material, non-public information delivered to any of the Purchasers by the Company or any of its subsidiaries, or any of their respective officers, directors, employees or agents in connection with the Offering. Neither the Company nor any Purchaser shall issue any other press release with respect to the transactions contemplated hereby nor otherwise make any such public statement without the prior consent of the Company and the Placement Agent, which consents in each case shall not unreasonably be withheld or delayed, except if such disclosure is required by law, in which case the disclosing party shall promptly provide the other party with prior notice of such public statement or communication. Notwithstanding the foregoing, the Company will not make any public disclosure listing a Purchaser as one of the purchasers of the Securities without that Purchaser's prior written consent, except as may be required by applicable law or rules of any exchange on which the Company's securities are listed.

**6.2 Governing Law; Jurisdiction:** This agreement shall be governed and construed in accordance with the laws of the State of Florida, regardless of the laws that might otherwise govern under applicable principles of conflicts of law thereof. You agree, on behalf of yourself and your representatives, to submit to the jurisdiction of any court of competent jurisdiction located in the State of Florida, County of Duval, to resolve any dispute relating to this agreement and waive any right to move to dismiss or transfer any such action brought in any such court on the basis of any objection to personal jurisdiction or venue.

**6.3 Successors and Assigns.** Except as otherwise expressly provided herein, the provisions hereof shall inure to the benefit of, and be binding upon, the successors, assigns, heirs, executors, and administrators of the parties hereto. Notwithstanding the foregoing, the Company may not assign this Agreement or any rights or obligations hereunder without the prior written consent of the Purchasers or their affiliates holding Shares that constitute at least a majority of the Shares then held by the Purchasers and their affiliates).

**6.4 Entire Agreement.** This Agreement and the exhibits hereto, and the other documents delivered pursuant hereto, constitute the full and entire understanding and agreement among the parties with regard to the subjects hereof and no party shall be liable or bound to any other party in any manner by any representations, warranties, covenants, or agreements except as specifically set forth herein or therein. Nothing in this Agreement, express or implied, is intended to confer upon any party, other than the parties hereto and their respective successors and assigns, any rights, remedies, obligations, or liabilities under or by reason of this Agreement, except as expressly provided herein.

**6.5 Severability.** In the event any provision of this Agreement shall be invalid, illegal, or unenforceable, it shall to the extent practicable, be modified so as to make it valid, legal and enforceable and to retain as nearly as practicable the intent of the parties, and the validity, legality, and enforceability of the remaining provisions shall not in any way be affected or impaired thereby.

**6.6 Amendment and Waiver.** Except as otherwise provided herein, any term of this Agreement may be amended and the observance of any term of this Agreement may be waived (either generally or in a particular instance, either retroactively or prospectively, and either for a specified period of time or indefinitely), with the written consent of the Company and Purchasers holding an aggregate of at least 50% of the Shares issued hereunder and outstanding at the time of such consent. Any amendment or waiver effected in accordance with this Section 6.8 shall be binding upon any holder of any Securities purchased under this Agreement, each future holder of all such securities, and the Company.

**6.7 Fees and Expenses.** Except as otherwise set forth herein, the Company and the Purchasers shall bear their own expenses and legal fees incurred on their behalf with respect to this Agreement and the transactions contemplated hereby. Each party hereby agrees to indemnify and to hold harmless of and from any liability the other parties for any commission or compensation in the nature of a finder's fee to any broker or other person or firm (and the costs and expenses of defending against such liability or asserted liability) for which such indemnifying party or any of its employees or representatives are responsible.

**6.8 Notices.** All notices, requests, consents and other communications hereunder shall be in writing, shall be delivered (A) if within the United States, by first-class registered or certified airmail, or nationally recognized overnight express courier, postage prepaid or by facsimile or electronic mail, or (B) if from outside the United States, by International Federal Express (or comparable service) or by facsimile or electronic mail, and shall be deemed given (i) if delivered by first-class registered or certified mail domestic, upon the business day received, (ii) if delivered by nationally recognized overnight carrier, one business day after timely delivery to such carrier, (iii) if delivered by International Federal Express (or comparable service), two business days after so mailed, or (iv) if delivered by facsimile or electronic mail at or prior to 5:30 p.m. (Eastern time) on a Trading Day, on the Trading Day so delivered or, if delivered by facsimile or electronic mail after 5:30 p.m. (Eastern time) on a Trading Day or on a day that is not a Trading Day, the next Trading Day after the date of delivery, and shall be addressed as follows, or to such other address or addresses as may have been furnished in writing by a party to another party pursuant to this paragraph:

- if to the Company, to the address of the Company's principal office set forth on the first page of this Agreement, Attention: President, facsimile: 904-834-4360, e-mail: [derdberg@droneaviationcorp.com](mailto:derdberg@droneaviationcorp.com), with a copy to (which shall not constitute notice to the Company): Legal & Compliance, LLC, 330 Clematis Street #217, West Palm Beach FL 33401 Attention: Laura Anthony, facsimile: 561-514-0832, email: [lanthony@legalandcompliance.com](mailto:lanthony@legalandcompliance.com) and Lazarus Rothstein, Esq. email: [lrothstein@legalandcompliance.com](mailto:lrothstein@legalandcompliance.com).
- if to a Purchaser, at its address on the signature page to this Agreement.

**6.9 Survival of Representations, Warranties and Agreements .** Notwithstanding any investigation made by any party to this Agreement or by the Placement Agent, all covenants, agreements, representations and warranties made by the Company and the Purchasers herein shall survive the execution of this Agreement, the delivery to the Purchasers of the Securities being purchased and the payment therefor, and a party's reliance on such representations and warranties shall not be affected by any investigation made by such party or any information developed thereby.

**6.10 Counterparts.** This Agreement may be executed by facsimile signature and in any number of counterparts, each of which shall be deemed an original, but all of which together shall constitute one instrument.

**6.113 Headings.** The headings herein are for convenience only, do not constitute a part of this Agreement and shall not be deemed to limit or affect any of the provisions hereof.

**6.12 Independent Nature of Purchasers' Obligations and Rights.** The obligations of each Purchaser under this Agreement are several and not joint with the obligations of any other Purchaser, and no Purchaser shall be responsible in any way for the performance of the obligations of any other Purchaser under this Agreement. Nothing contained herein, and no action taken by any Purchaser pursuant hereto, shall be deemed to constitute the Purchasers as a partnership, an association, a joint venture or any other kind of entity, or create a presumption that the Purchasers are in any way acting in concert or as a group with respect to such obligations or the transactions contemplated by this Agreement. Each Purchaser confirms that it has independently participated in the negotiation of the transaction contemplated hereby with the advice of its own counsel and advisors. Each Purchaser shall be entitled to independently protect and enforce its rights, including, without limitation, the rights arising out of this Agreement, and it shall not be necessary for any other Purchaser to be joined as an additional party in any proceeding for such purpose. It is expressly understood and agreed that each provision contained in this Agreement is between the Company and a Purchaser, solely, and not between the Company and the Purchasers collectively and not between and among the Purchasers.

*[The Remainder of this Page is Blank; Signature Pages Follow]*

In witness whereof, the foregoing Common Stock Purchase Agreement is hereby executed as of the date first above written.

**Drone Aviation Holding Corp.**

By: \_\_\_\_\_

Name: Kendall W. Carpenter

Title: EVP, CFO and Corporate Secretary

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In witness whereof, the foregoing Common Stock Purchase Agreement is hereby executed as of the date first above written.

\_\_\_\_\_  
**Name of Investor**

By: \_\_\_\_\_

Name: \_\_\_\_\_

Title: \_\_\_\_\_

Investment Amount (# shares): \_\_\_\_\_

Investment Amount (\$): \_\_\_\_\_

Tax Identification No.: \_\_\_\_\_

Jurisdiction of Organization: \_\_\_\_\_

Jurisdiction of Principal Place of Operations:  
\_\_\_\_\_

Address for Notice:  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Attention: \_\_\_\_\_

Telephone: \_\_\_\_\_

Facsimile: \_\_\_\_\_

E-mail: \_\_\_\_\_

Delivery Instructions (if different from above):  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Attention: \_\_\_\_\_

Telephone: \_\_\_\_\_

\_\_\_\_\_

SCHEDULE OF PURCHASERS

| Purchaser | Common<br>Shares | Aggregate<br>Purchase<br>Price | Jurisdiction<br>of<br>Organization | Jurisdiction<br>of Principal<br>Place of<br>Operations |
|-----------|------------------|--------------------------------|------------------------------------|--|
|           |                  |                                |                                    |  |
|           |                  |                                |                                    |  |
|           |                  |                                |                                    |  |

## DISCLOSURE SCHEDULE

This Disclosure Schedule (this “Disclosure Schedule”), dated as of October 24, 2018, has been prepared and delivered in connection with the Common Stock Purchase Agreement (the “Purchase Agreement”), dated as of the date first written above, by and between Drone Aviation Holding Corp., a Nevada corporation (the “Company”), and certain purchasers identified on the signature pages thereto (the “Purchasers”). All capitalized terms used and not otherwise defined herein shall have the meanings given them in the Purchase Agreement.

The section or subsection numbers in this Disclosure Schedule correspond to the section or subsection numbers in the Purchase Agreement. The matters disclosed in any section or subsection of this Disclosure Schedule with respect to any section or subsection of the Purchase Agreement shall be deemed to qualify the corresponding section or subsection of the Purchase Agreement and any other section and subsection of the Purchase Agreement to the extent the applicability of such matter to such other section or subsection is reasonably apparent on its face.

Nothing in this Disclosure Schedule constitutes an admission of any liability or obligation of the Company to any party that is not a party to the Purchase Agreement, nor an admission to any such party against Company’s interests, nor an admission that any particular matter disclosed is material. All per share and dollar amounts set forth in this Disclosure Schedule are reflective of a reverse split of the Company’s issued and outstanding Common Stock on a 1 for 40 basis, which was effective on October 30, 2015.

### **Schedule 2.2(a) – Subsidiaries**

Lighter Than Air Systems Corp.  
Drone AFS Corp.

### **Schedule 2.6 – Options and Warrants and Other Convertible Securities**

| Name               | Issuance | Expiration | Strike/Conversion<br>Price | Outstanding | Vested    | Vesting     |
|--------------------|----------|------------|----------------------------|-------------|-----------|-------------|
| <b>OPTIONS</b>     |          |            |                            |             |           |             |
| Aguilar, David     | 9/26/18  | 9/26/2022  | \$ 0.65                    | 150,000     | -         | performance |
| Aguilar, David     | 8/3/17   | 8/3/2021   | \$ 1.00                    | 100,000     | 100,000   |             |
| Aguilar, David     | 11/9/17  | 11/9/2021  | \$ 1.35                    | 10,000      | 10,000    |             |
| Aguilar/GSIS       | 1/9/17   | 1/9/2021   | \$ 2.90                    | 100,000     | 50,000    |             |
| Brown, Reginald    | 9/26/18  | 9/26/2022  | \$ 0.65                    | 1,000,000   | -         | performance |
| Brown, Reginald    | 11/9/17  | 11/9/2021  | \$ 1.35                    | 400,000     | 400,000   |             |
| Brown, Reginald    | 8/3/17   | 8/3/2021   | \$ 1.00                    | 365,000     | 365,000   |             |
| Brown, Reginald    | 5/16/18  | 5/16/2022  | \$ 1.00                    | 200,000     | 200,000   |             |
| Carpenter, Kendall | 9/26/18  | 9/26/2022  | \$ 0.65                    | 425,000     | -         | performance |
| Carpenter, Kendall | 8/3/17   | 8/3/2021   | \$ 1.00                    | 275,000     | 275,000   |             |
| Carpenter, Kendall | 11/9/17  | 11/9/2021  | \$ 1.35                    | 170,000     | 170,000   |             |
| Carpenter, Kendall | 5/16/18  | 5/16/2022  | \$ 1.00                    | 130,000     | 130,000   |             |
| Carpenter, Kendall | 12/10/15 | 12/10/2018 | \$ 5.00                    | 5,000       | 5,000     |             |
| Daas, Michelle     | 8/3/17   | 8/3/2021   | \$ 1.00                    | 5,000       | 5,000     |             |
| Erdberg, Dan       | 8/3/17   | 8/3/2021   | \$ 1.00                    | 1,140,000   | 1,140,000 |             |
| Erdberg, Dan       | 9/26/18  | 9/26/2022  | \$ 0.65                    | 1,000,000   | -         | performance |
| Erdberg, Dan       | 11/9/17  | 11/9/2021  | \$ 1.35                    | 200,000     | 200,000   |             |
| Erdberg, Dan       | 12/10/15 | 12/10/2018 | \$ 5.00                    | 10,000      | 10,000    |             |

|                  |          |            |    |      |                   |                  |             |
|------------------|----------|------------|----|------|-------------------|------------------|-------------|
| Guerra, Robert   | 9/26/18  | 9/26/2022  | \$ | 0.65 | 25,000            | -                | performance |
| Guerra, Robert   | 3/28/18  | 3/28/2022  | \$ | 1.00 | 50,000            | -                | 3/28/2019   |
| Guerra, Robert   | 3/28/18  | 3/28/2022  | \$ | 1.00 | 50,000            | -                | 3/29/2020   |
| Haas, Mike       | 8/3/17   | 8/3/2021   | \$ | 1.00 | 10,000            | 10,000           |             |
| Haas, Mike       | 11/9/17  | 11/9/2021  | \$ | 1.35 | 10,000            | 10,000           |             |
| Hess, Felicia    | 8/3/17   | 8/3/2021   | \$ | 1.00 | 1,200,000         | 1,200,000        |             |
| Hess, Felicia    | 9/26/18  | 9/26/2022  | \$ | 0.65 | 1,000,000         | -                | performance |
| Hess, Felicia    | 11/9/17  | 11/9/2021  | \$ | 1.35 | 300,000           | 300,000          |             |
| Hess, Felicia    | 12/10/15 | 12/10/2018 | \$ | 5.00 | 5,000             | 5,000            |             |
| Hess, Kevin      | 12/10/15 | 12/10/2018 | \$ | 5.00 | 15,000            | 15,000           |             |
| Hoechst, Timothy | 9/26/18  | 9/26/2022  | \$ | 0.65 | 25,000            | -                | performance |
| Hoechst, Timothy | 12/13/17 | 12/13/2021 | \$ | 1.00 | 50,000            | -                | 12/13/2018  |
| Hoechst, Timothy | 12/13/17 | 12/13/2021 | \$ | 1.00 | 50,000            | -                | 12/13/2019  |
| Hughes, Art      | 5/16/18  | 5/10/2022  | \$ | 1.00 | 45,000            | -                | 5/16/2019   |
| Hughes, Art      | 5/16/18  | 5/10/2022  | \$ | 1.00 | 45,000            | -                | 5/16/2020   |
| Hughes, Art      | 8/3/17   | 8/3/2021   | \$ | 1.00 | 20,000            | 20,000           |             |
| Jackson, Wayne   | 8/3/17   | 8/3/2021   | \$ | 1.00 | 10,000            | 10,000           |             |
| Jackson, Wayne   | 11/9/17  | 11/9/2021  | \$ | 1.35 | 10,000            | 10,000           |             |
| Miller, John     | 12/13/17 | 12/13/2021 | \$ | 1.00 | 50,000            | -                | 12/13/2018  |
| Miller, John     | 12/13/17 | 12/13/2021 | \$ | 1.00 | 50,000            | -                | 12/13/2019  |
| Miller, John     | 9/26/18  | 9/26/2022  | \$ | 0.65 | 25,000            | -                | performance |
| Nussbaum, Jay    | 9/26/18  | 9/26/2022  | \$ | 0.65 | 2,350,000         | -                | performance |
| Nussbaum, Jay    | 11/9/17  | 11/9/2021  | \$ | 1.35 | 900,000           | 900,000          |             |
| Nussbaum, Jay    | 8/3/17   | 8/3/2021   | \$ | 1.00 | 2,000,000         | 2,000,000        |             |
| Nussbaum, Jay    | 12/10/15 | 12/10/2018 | \$ | 5.00 | 50,000            | 50,000           |             |
| Pinckney, Caleb  | 5/16/18  | 5/16/2022  | \$ | 1.00 | 20,000            | -                | 5/16/2019   |
| Pinckney, Caleb  | 5/16/18  | 5/16/2022  | \$ | 1.00 | 20,000            | -                | 5/16/2020   |
| Pinckney, Caleb  | 8/3/17   | 8/3/2021   | \$ | 1.00 | 10,000            | 10,000           |             |
| Total            |          |            |    |      | <u>14,080,000</u> | <u>7,600,000</u> |             |

#### WARRANTS

|                   |          |            |    |      |                  |                  |  |
|-------------------|----------|------------|----|------|------------------|------------------|--|
| Brown, Reginald   | 12/10/15 | 12/10/2018 | \$ | 5.00 | 5,000            | 5,000            |  |
| Brown, Reginald   | 4/27/16  | 4/27/2019  | \$ | 2.91 | 20,000           | 20,000           |  |
| Dougherty & Co    | 11/20/15 | 11/20/2020 | \$ | 5.00 | 70,000           | 70,000           |  |
| Frost, Dr. Philip | 8/3/17   | 8/3/2021   | \$ | 1.00 | 2,000,000        | 2,000,000        |  |
| Gertsen, Steve    | 4/27/16  | 4/27/2019  | \$ | 2.91 | 15,000           | 15,000           |  |
| Gertsen, Steve    | 8/3/17   | 8/3/2021   | \$ | 1.00 | 10,000           | 10,000           |  |
| Gertsen, Steve    | 11/3/17  | 11/3/2021  | \$ | 1.35 | 10,000           | 10,000           |  |
| Glickman, Michael | 4/27/16  | 4/27/2019  | \$ | 2.91 | 15,000           | 15,000           |  |
| Glickman, Michael | 11/9/17  | 11/9/2021  | \$ | 1.35 | 10,000           | 10,000           |  |
| Graham, Tom       | 12/10/15 | 12/10/2018 | \$ | 5.00 | 5,000            | 5,000            |  |
| GSIS              | 9/26/18  | 9/26/2022  | \$ | 1.00 | 100,000          | 100,000          |  |
| Kinney, Pancho    | 8/3/17   | 8/3/2021   | \$ | 1.00 | 10,000           | 10,000           |  |
| Wise, Louis       | 12/10/15 | 12/10/2018 | \$ | 5.00 | 5,000            | 5,000            |  |
| Wise, Louis       | 4/27/16  | 4/27/2019  | \$ | 2.91 | 10,000           | 10,000           |  |
| Wise, Louis       | 8/3/17   | 8/3/2021   | \$ | 1.00 | 10,000           | 10,000           |  |
| Total             |          |            |    |      | <u>2,295,000</u> | <u>2,295,000</u> |  |



Other Convertible Securities

|                                |  |    |      |                  |                  |
|--------------------------------|--|----|------|------------------|------------------|
|                                | 2016<br>Convertible<br>Note and<br>accrued<br>interest | \$ | 1.00 | 1,582,993        | 1,582,993        |
| Frost Gamma Investments Trust  |  |    |      |                  |                  |
|                                | 2016<br>Convertible<br>Note and<br>accrued<br>interest | \$ | 1.00 | 1,582,993        | 1,582,993        |
| Nussbaum, Jay H.               |  |    |      |                  |                  |
|                                | 2017<br>Convertible<br>Note                            | \$ | 1.00 | 2,000,000        | 2,000,000        |
| Frost Nevada Investments Trust |  |    |      |                  |                  |
| Total                          |  |    |      | <u>5,165,986</u> | <u>5,165,986</u> |

**Schedule 2.10 – Legal Proceedings**

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

AMENDMENT NO. 3

TO

INDEPENDENT CONTRACTOR AGREEMENT

This Amendment No. 3 to the Independent Contractor Agreement (“Amendment”), dated November \_\_, 2018 (the “Effective Date”), is by and between **Drone Aviation Holding Corp.**, a Nevada corporation with an address 11651 Central Parkway #118, Jacksonville, FL 32224 (the “Company”), and \_\_\_\_\_ (the “Contractor”).

**WHEREAS**, the parties entered into an Independent Contractor Agreement on August 27, 2014 (the “Agreement”); and

**WHEREAS**, the parties amended the Agreement on May 1, 2016 pursuant to that certain Amendment No. 1 (the “First Amendment”); and

**WHEREAS**, the parties amended the Agreement on August 3, 2017 pursuant to that certain Amendment No. 2 (the “Second Amendment”); and

**WHEREAS**, the parties wish to further amend the Agreement as set forth below, with the understanding that all other provisions of the Agreement shall remain unchanged;

**NOW, THEREFORE**, in consideration of the terms and conditions hereinafter set forth, the parties hereto agree as follows:

1. Section 3 of the Agreement - Term The term of the Agreement is hereby extended from November 1, 2018 until October 31, 2019 (the “Expiration Date”).
2. Section 4 of the Agreement shall be amended in its entirety to include the following:

*Compensation:* As compensation for the Services performed by Contractor during the term from November 1, 2018 until October 31, 2019, the Company shall compensate Contractor as follows:

(a) *Equity Compensation:* As Compensation for the Services performed by Contractor during the term of this Amendment, Drone shall issue Contractor \_\_\_\_\_ unregistered shares of the Company’s Common Stock (the “Consulting Shares”), which Consulting Shares shall fully vest upon the occurrence of a Change of Control (as hereinafter defined).

(b) A “Change of Control” shall be deemed to have occurred if, after the Effective Date, (i) the beneficial ownership (as defined in Rule 13d-3 under the Securities Exchange Act of 1934, as amended (the “Exchange Act”)) of securities representing more than 30% of the combined voting power of the Company is acquired by any “person” as defined in sections 13(d) and 14(d) of the Exchange Act (other than the Company, any subsidiary of the Company, or any trustee or other fiduciary holding securities under an employee benefit plan of the Company), (ii) the merger or consolidation of the Company with or into another corporation where the shareholders of the Company, immediately prior to the consolidation or merger, would not, immediately after the consolidation or merger, beneficially own (as such term is defined in Rule 13d-3 under the Exchange Act), directly or indirectly, shares representing in the aggregate 50% or more of the combined voting power of the securities of the corporation issuing cash or securities in the consolidation or merger (or of its ultimate parent corporation, if any) in substantially the same proportion as their ownership of the Company immediately prior to such merger or consolidation, (iii) the sale or other disposition of all or substantially all of the Company’s assets to an entity, other than a sale or disposition by the Company of all or substantially all of the Company’s assets to an entity, at least 50% of the combined voting power of the voting securities of which are owned directly or indirectly by shareholders of the Company, immediately prior to the sale or disposition, in substantially the same proportion as their ownership of the Company immediately prior to such sale or disposition, or (iv) during any period of two consecutive years, individuals who at the beginning of such period were members of the Company’s Board of Directors (“Incumbent Directors”) cease for any reason (other than death) to constitute at least a majority thereof; provided that each new director whose election, or nomination for election by the Company’s shareholders, was approved by a vote of at least a majority of the directors then still in office who were directors at the beginning of such period shall be deemed an Incumbent Director unless such approval was made directly or indirectly in connection with an actual or threatened election contest with respect to directors or as a result of any other actual or threatened solicitation of proxies or consents by or on behalf of any person other than the Board.

3. This Amendment shall be deemed part of, but shall take precedence over and supersede any provisions to the contrary contained in the Agreement. All initial capitalized terms used in this Amendment shall have the same meaning as set forth in the Agreement unless otherwise provided. Except as specifically modified hereby, all of the provisions of the Agreement, which are not in conflict with the terms of this Amendment, shall remain in full force and effect.

IN WITNESS WHEREOF, the parties have executed this agreement as of the date first stated above.

**DRONE AVIATION HOLDING CORP.**

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

## PROMISSORY NOTE

\$ 100,000.00

October 25, 2018

FOR VALUE RECEIVED, the undersigned, DRONE AVIATION HOLDING CORP., a Nevada corporation (the "Maker"), promises to pay to Jay Nussbaum, (the "Payee"), at Jacksonville, Florida, or at such other place as the legal holder hereof may designate in writing, the principal sum of \$100,000.00, with interest thereon from the date hereof at the Applicable Rate (as hereinafter defined). All principal and accrued interest shall be due and payable on November 30, 2018. The "Applicable Rate," means Six Percent (6%) per annum.

The Maker may voluntarily prepay in cash all or a portion of the principal indebtedness and accrued interest hereunder, at any time, without premium or penalty.

All sums not paid when due hereunder shall bear interest from the due date until paid at 18% per annum.

If all or any portion of the indebtedness hereby evidenced is not paid when due, or in the event of the dissolution, insolvency, bankruptcy or receivership of the Maker, the holder may, without further notice or demand, declare this indebtedness to be immediately due and payable in cash.

The Maker agrees that if, and as often as, this Note is placed in the hands of an attorney for collection or to defend or enforce any of the holder's rights hereunder or under any instruments securing payment of this Note, the Maker will pay to the holder its reasonable attorneys' fees and all court costs and other expenses incurred in connection therewith.

The makers, endorsers, sureties, guarantors and all other persons who may become liable for all or any part of this obligation severally waive presentment for payment, protest and notice of nonpayment. Said parties consent to any extension of time (whether one or more) of payment hereof, release of all or any part of the security for the payment hereof and the release of any party liable for payment of this obligation. Any such extension of time or release may be made at any time and from time to time without notice to any such party and without discharging said party's liability hereunder.

This Note is to be construed according to the laws of the State of Florida.

DRONE AVIATION HOLDING CORP.

By /s/ Kendall Carpenter  
Kendall Carpenter, Chief Financial Officer

## CERTIFICATION

I, Jay Nussbaum, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q for the period ended on September 30, 2018 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.

Date: October 26, 2018

/s/ Jay Nussbaum

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

## CERTIFICATION

I, Kendall Carpenter, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q for the period ended on September 30, 2018 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.

Date: October 26, 2018

/s/ Kendall Carpenter  
**Chief Financial Officer**  
**(Principal Financial Officer)**

**CERTIFICATIONS OF CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER  
PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report on Form 10-Q of Drone Aviation Holding Corp. (the "Company") for the quarterly period ended September 30, 2018 as filed with the Securities and Exchange Commission (the "Report"), I, Jay H. Nussbaum, Chief Executive Officer and I, Kendall Carpenter, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to the best of our knowledge:

1. The Report fully complies with the requirements of Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: October 26, 2018

/s/ Jay H. Nussbaum

Jay H. Nussbaum  
Chief Executive Officer

Date: October 26, 2018

/s/ Kendall Carpenter

Kendall Carpenter  
Chief Financial Officer