

DRONE USA, INC. AND SUBSIDIARIES
Consolidated Financial Statements
September 30, 2016 and 2015

DRONE USA, INC. AND SUBSIDIARIES

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September 30, 2016 and 2015

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SALBERG & COMPANY, P.A.
Certified Public Accountants and Consultants

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of
Drone USA, Inc.

We have audited the accompanying consolidated balance sheets of Drone USA, Inc. and Subsidiaries at September 30, 2016 and 2015, and the related consolidated statements of operations, changes in stockholders' deficit, and cash flows for the year ended September 30, 2016 and for the period from July 20, 2015 (inception) to September 30, 2015. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Drone USA, Inc. and Subsidiaries as of September 30, 2016 and 2015, and the consolidated results of its operations and its cash flows for the year ended September 30, 2016 and for the period from July 20, 2015 (inception) to September 30, 2015 in conformity with accounting principles generally accepted in the United States of America.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 2 to the consolidated financial statements, the Company has a net loss and cash used in operating activities of \$5,950,441 and \$1,059,058 in 2016 and has a working capital deficit, stockholders' deficit and accumulated deficit of \$3,411,962, \$739,473 and \$6,029,492 respectively, at September 30, 2016. Furthermore, on April 13, 2017 the Company received a default notice on its payment obligations under the senior secured credit facility agreement. These matters raise substantial doubt about the Company's ability to continue as a going concern. Management's Plan in regards to these matters is also described in Note 2. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ Salberg & Company, P.A.

SALBERG & COMPANY, P.A.
Boca Raton, Florida
May 8, 2017

2295 NW Corporate Blvd., Suite 240 • Boca Raton, FL 33431-7328
Phone: (561) 995-8270 • Toll Free: (866) CPA-8500 • Fax: (561) 995-1920
www.salbergco.com • info@salbergco.com

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DRONE USA, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

	<i>September 30,</i>	
	<u>2016</u>	<u>2015</u>
ASSETS		
<i>Current Assets</i>		
Cash	\$ 631,020	\$ -
Accounts receivable	865,775	-
Inventory	1,391,439	-
Prepaid expenses and other current assets	92,047	-
	<u>2,980,281</u>	<u>-</u>
<i>Other Assets</i>		
Goodwill	2,410,335	-
Tradename	760,000	-
Customer list - net	1,045,278	-
	<u>4,215,613</u>	<u>-</u>
<i>Total Assets</i>	<u>\$ 7,195,894</u>	<u>\$ -</u>
LIABILITIES AND STOCKHOLDERS' DEFICIT		
<i>Current Liabilities</i>		
Accounts payable	2,363,162	\$ -
Accrued liabilities	239,271	1,385
Income tax payable	50	-
Earnout payable	64,500	-
Customers deposits	78,841	-
Note payable - net of unamortized financing costs of \$737,633	1,062,661	-
Note payable - related party seller	900,000	-
Convertible line of credit - related party affiliate	692,126	77,666
Line of credit - bank	49,583	-
Settlement payable - vendor	75,382	-
Contingent liability - advisory fees	850,000	-
Deferred rent	16,667	-
	<u>6,392,243</u>	<u>79,051</u>
<i>Other Liabilities</i>		
Note payable - net of unamortized financing costs of \$338,082	1,361,624	-
Convertible note payable - related party	117,000	-
Earnout payable, net of current portion	64,500	-
	<u>1,543,124</u>	<u>-</u>
<i>Total Liabilities</i>	<u>7,935,367</u>	<u>79,051</u>
<i>Commitments and Contingencies (Note 18)</i>		
<i>Stockholders' Deficit</i>		
Preferred stock, \$.0001 par value, 5,000,000 shares authorized Series A preferred stock - 250 shares designated, issued and outstanding	-	-
Common stock - \$.0001 par value, 200,000,000 shares authorized, 41,719,492 and 38,309,321 shares issued and outstanding at September 30, 2016 and 2015, respectively	4,172	3,831
Additional paid-in capital	5,285,847	(3,831)
Accumulated deficit	(6,029,492)	(79,051)
	<u>(739,473)</u>	<u>(79,051)</u>
<i>Total Stockholders' Deficit</i>	<u>(739,473)</u>	<u>(79,051)</u>
<i>Total Liabilities and Stockholders' Deficit</i>	<u>\$ 7,195,894</u>	<u>\$ -</u>

See accompanying notes to consolidated financial statements.

DRONE USA, INC. AND SUBSIDIARIES

Consolidated Statements of Operations

	<i>For the Year Ended September 30, 2016</i>	<i>For the Period July 20, 2015 (Inception) Through September 30, 2015</i>
Revenues	\$ 1,119,748	\$ -
Cost of Goods Sold	<u>1,074,673</u>	<u>-</u>
Gross Profit	45,075	-
Selling, General, and Administrative Expenses	6,290,913	77,666
Amortization	<u>14,722</u>	<u>-</u>
Total Operating Expenses	<u>6,305,635</u>	<u>77,666</u>
Loss Before Other Expense	(6,260,560)	(77,666)
Other Expense		
Interest and financing costs	<u>150,401</u>	<u>1,385</u>
Net Loss Before Provision for Income Tax	(6,410,961)	(79,051)
Income Tax Benefit	<u>(460,520)</u>	<u>-</u>
Net Loss	<u>\$ (5,950,441)</u>	<u>\$ (79,051)</u>
Basic and Diluted Loss Per Share	<u>(0.15)</u>	<u>(0.00)</u>
Weighted Average Number of Common Shares Outstanding - basic and diluted	<u>40,073,391</u>	<u>38,309,321</u>

See accompanying notes to consolidated financial statements.

DRONE USA, INC. AND SUBSIDIARIES

Consolidated Statements of Changes in Stockholders' Deficit

	<i>Series A Preferred Stock</i>		<i>Common Stock</i>		<i>Additional Paid-in Capital</i>	<i>Accumulated Deficit</i>	<i>Total Stockholders' Deficit</i>
	<i>Shares</i>	<i>Amount</i>	<i>Shares</i>	<i>Amount</i>			
Balance - July 20, 2015 (Inception)	250	\$ -	38,309,321	\$ 3,831	\$ (3,831)	\$ -	\$ -
Net loss	-	-	-	-	-	(79,051)	(79,051)
Balance - September 30, 2015	250	-	38,309,321	3,831	(3,831)	(79,051)	(79,051)
Deemed issuance of common stock for recapitalization	-	-	2,532,196	253	(253)	-	-
Share-based compensation	-	-	-	-	4,897,499	-	4,897,499
Shares issued for settlement payable conversion	-	-	57,000	6	81,694	-	81,700
Shares issued for services	-	-	11,500	1	30,819	-	30,820
Shares for services subject to make whole provision	-	-	539,204	54	(54)	-	-
Sale of common stock	-	-	270,271	27	99,973	-	100,000
Warrants issued for acquisition	-	-	-	-	180,000	-	180,000
Net loss	-	-	-	-	-	(5,950,441)	(5,950,441)
Balance - September 30, 2016	<u>250</u>	<u>\$ -</u>	<u>41,719,492</u>	<u>\$ 4,172</u>	<u>\$ 5,285,847</u>	<u>\$ (6,029,492)</u>	<u>\$ (739,473)</u>

See accompanying notes to consolidated financial statements.

	<i>For the Year Ended September 30, 2016</i>	<i>For the Period July 20, 2015 (Inception) Through September 30, 2015</i>
<i>Cash Flows from Operating Activities</i>		
Net loss	\$ (5,950,441)	\$ (79,051)
Adjustments to reconcile net loss to net cash (used in) operating activities:		
Intangibles amortization	14,722	-
Amortization of debt discounts	30,735	-
Accretion of premium to interest expense	54,979	-
Share-based compensation expense	4,928,319	-
Income tax benefit	(460,570)	-
Deferred rent	16,667	-
<i>Changes in operating assets and liabilities:</i>		
Accounts receivable	(85,656)	-
Inventory	(827,353)	-
Prepaid expenses and other assets	(91,000)	-
Accounts payable and accrued expenses	1,310,490	1,385
Income tax payable	50	-
	<u>(1,059,058)</u>	<u>(77,666)</u>
<i>Cash Flows from Investing Activities</i>		
Cash acquired in acquisition	165,485	-
Acquisition of subsidiary	<u>(2,600,000)</u>	<u>-</u>
<i>Cash Used in Investing Activities</i>	<u>(2,434,515)</u>	<u>-</u>
<i>Cash Flows from Financing Activities</i>		
Proceeds from note payable - acquisition	3,500,000	-
Cash financing costs	(256,450)	-
Proceeds from issuance of common stock	100,000	-
Net proceeds from line of credit - bank	49,583	-
Proceeds from line of credit - related parties	751,460	77,666
Repayment of line of credit - related parties	<u>(20,000)</u>	<u>-</u>
<i>Cash Provided by Financing Activities</i>	<u>4,124,593</u>	<u>77,666</u>
<i>Net Increase in Cash</i>	631,020	-
<i>Cash - beginning of period</i>	<u>-</u>	<u>-</u>
<i>Cash - end of period</i>	<u>\$ 631,020</u>	<u>\$ -</u>

See accompanying notes to consolidated financial statements.

	<i>For the Year Ended September 30, 2016</i>	<i>For the Period July 20, 2015 (Inception) Through September 30, 2015</i>
<i>Supplemental Disclosures of Cash Flow Information</i>		
<i>Cash paid for:</i>		
Interest	\$ 1,240	\$ -
Income taxes	\$ -	\$ -
<i>Noncash financing and investing activities:</i>		
Issuance of note payable for acquisition of subsidiary	\$ 900,000	\$ -
Issuance of settlement payable to satisfy accounts payable	\$ 102,103	\$ -
Issuance of common stock upon conversion of settlement payable	\$ 81,700	\$ -
Issuance of warrants for acquisition	\$ 180,000	\$ -
Earn-out liability recorded for acquisition	\$ 129,000	\$ -
Issuance of common stock for deferred financing costs	\$ 850,000	\$ -

See accompanying notes to consolidated financial statements.

1 - NATURE OF OPERATIONS

Headquartered in New York, New York, Drone USA, Inc. (“Drone”) is an Unmanned Aerial Vehicles (“UAV”) and related services and technologies company that intends to engage in the research, design, development, testing, manufacturing, distribution, exportation, and integration of advanced low altitude UAV systems, services and products. Drone also provides procurement, distribution, and logistics services through its wholly-owned subsidiary, HowCo Distributing Co., (“HowCo”) (collectively, the “Company”) to the United States Department of Defense and Defense Logistics Agency. The Company has operations based in New York, New York and Vancouver, Washington. The Company is registered with the U.S. State Department and has met the requirements of the Arms Export Control Act and International Traffic in Arms Regulations (“ITAR”). The registration allows for the company to apply for export, and temporary import, of product, technical data, and services related to defense articles. The Company continues to seek strategic acquisitions and partnerships with UAV firms that offer superior technologies in high-growth markets, as well as acquisitions and partnerships with firms that have complementary technologies and infrastructure.

On January 26, 2016, Texas Wyoming Drilling, Inc., an inactive company trading on the Over-the-Counter Markets, acquired 100% of the outstanding membership interests of Drone USA, LLC pursuant to an Equity Exchange Agreement and Drone USA, LLC paid a \$100,000 cash fee which was expensed and included in Selling, General and Administrative expenses. Pursuant to the merger, the sole member of Drone USA, LLC received 38,309,321 shares of Texas Wyoming Drilling, Inc. common stock. As a result of this merger, the former sole member of Drone USA, LLC owned approximately 94% of the outstanding common stock of Texas Wyoming Drilling, Inc. immediately following the merger. In connection with the merger, the name of the company was changed to Drone USA, Inc. In connection with the merger, effective January 26, 2016, the Company accepted the resignation of the former Chief Executive Officer and any remaining former officers and directors, and appointed a new Chief Executive Officer, President, Chairman, and board member and a new Chief Financial Officer, Secretary, Treasurer, and board member. The transaction has been accounted for as a reverse merger in which Drone USA, LLC is considered to be the acquirer of Texas Wyoming Drilling, Inc. Accordingly, the reverse merger was accounted for as a recapitalization of Drone USA, LLC in which (i) the assets and liabilities of Drone USA, LLC were recorded at their historical book values, (ii) the common stock and additional paid-in capital accounts which replaced Drone USA, LLC’s member interests were retroactively restated to give effect to the exchange of the Drone USA, LLC member interests for Texas Wyoming Drilling, Inc. common stock, and (iii) the historical member deficit of Drone USA, LLC was recorded as stockholders’ (deficiency). There were no assets, liabilities, or equity to be accounted for related to the former operations of Texas Wyoming Drilling, Inc. In connection with the merger, Drone USA, Inc. is deemed to have issued 2,532,196 shares of common stock to the shareholders of Texas Wyoming Drilling, Inc. In February 2016 the Company effected a 1 for 150 reverse split of the common stock as contemplated by the Equity Exchange Agreement and in April 2016 effected a 1 for 12 reverse split of the common stock. All share and per share information in the accompanying consolidated financial statements and footnotes has been retroactive restated to reflect both reverse splits.

2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND GOING CONCERN

- a. **Going Concern** - The accompanying consolidated financial statements have been prepared assuming the Company will continue as a going concern, which contemplates the recoverability of assets and the satisfaction of liabilities in the normal course of business.

Continued

For the year ended September 30, 2016, the Company has incurred losses of approximately \$5,950,000 and used cash in operations of approximately \$1,059,000. The working capital deficit, stockholders' deficit and accumulated deficit was \$3,411,962, \$739,473, and \$6,029,492 at September 30, 2016. Furthermore, on April 13, 2017 the Company received a default notice on its payment obligations under the senior secured credit facility agreement (See Notes 10 and 20). These matters raise substantial doubt about the Company's ability to continue as a going concern for a period of twelve months from the issuance date of this report. The ability of the Company to continue as a going concern is dependent upon management's ability to further implement its business plan and raise additional capital as needed from the sales of stock or debt. The accompanying financial statements do not include any adjustments that might be required should the Company be unable to continue as a going concern.

- b. **Use of Estimates** - The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates include the allowance for bad debt on accounts receivable, reserves on inventory, valuation of non-cash compensation paid in business combinations, fair values of assets acquired and liabilities assumed in business combinations, valuation of goodwill and intangible assets for impairment analysis, valuation of the earn-out liability at balance sheet dates, valuation of stock based compensation and the valuation allowance on deferred tax assets.
- c. **Principles of Consolidation** - The accompanying consolidated financial statements for the year ended September 30, 2016 and the period July 20, 2015 (inception) through September 30, 2015 include the accounts of Drone USA, Inc., Drone USA, LLC and HowCo. All significant intercompany accounts and transactions have been eliminated in consolidation.
- d. **Cash and Cash Equivalents** - Cash equivalents consist of liquid investments with maturities of three months or less at the time of purchase. There are no cash equivalents at the balance sheet date.
- e. **Accounts Receivable** - Trade receivables are recorded at net realizable value consisting of the carrying amount less the allowance for doubtful accounts, as needed. Factors used to establish an allowance include the credit quality of the customer and whether the balance is significant. The Company may also use the direct write-off method to account for uncollectible accounts that are not received. Using the direct write-off method, trade receivable balances are written off to bad debt expense when an account balance is deemed to be uncollectible.
- f. **Inventory** - Inventory consists of finished goods, which are purchased directly from manufacturers. The Company utilizes a just in time type of inventory system where products are ordered from the vendor only when the Company has received sales order from its customers. Inventory is stated at the lower of cost and net realizable value on a first-in, first-out basis.
- g. **Property and Equipment** - Property and equipment is stated at cost, less accumulated depreciation and amortization. Depreciation and amortization is computed on a straight-line basis over the estimated useful lives of the assets, which range from 3 to 7 years. Upon disposition of assets, the related cost and accumulated depreciation and amortization is eliminated, and any gain or loss is included in the statement of operations. Expenditures for major improvements are capitalized. Maintenance and repairs are expensed as incurred.
- h. **Goodwill and Intangible Assets** - The Company's goodwill and tradename assets are deemed to have indefinite lives and, accordingly, are not amortized, but are evaluated for impairment at least annually, but more often whenever changes in facts and circumstances occur which may indicate that the carrying value may not be recoverable. The customer list was deemed to have a life of 4 years and will be amortized through September 2020.
- i. **Long-Lived Assets** - Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Impairment is measured by comparing the carrying value of the long-lived assets to the estimated undiscounted future cash flows expected to result from use of the assets and their ultimate disposition. In instances where impairment is determined to exist, the Company writes down the asset to its fair value based on the present value of estimated future cash flows.

Continued

- j. **Fair Value Measurements** - The Company follows the FASB *Fair Value Measurements* standard, as they apply to its financial instruments. This standard defines fair value, outlines a framework for measuring fair value, and details the required disclosures about fair value measurements.

Fair value is defined as the price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date. The standard establishes a hierarchy in determining the fair value of an asset or liability. The fair value hierarchy has three levels of inputs, both observable and unobservable. Level 1 inputs include quoted market prices for identical assets or liabilities in an active market that the Company has the ability to access at the measurement date. Level 2 inputs are market data, other than Level 1, that are observable either directly or indirectly. Level 2 inputs include quoted market prices for similar assets or liabilities, quoted market prices in an inactive market, and other observable information that can be corroborated by market data. Level 3 inputs are unobservable and corroborated by little or no market data. The standard requires the utilization of the lowest possible level of input to determine fair value.

- k. **Deferred Financing Costs** - All unamortized deferred financing costs related to the Company's borrowings are presented in the consolidated balance sheets as a direct deduction from the related debt rather than as an asset. Amortization of these costs is reported as *interest and financing costs*.
- l. **Deferred Rent** - The Company leases office space in New York City whose operating lease agreements contain provisions for future rent increases, or periods in which rent payments are reduced (abated). In accordance with GAAP, the Company records monthly rent expense equal to the total of the payments due over the lease term, divided by the number of months of the lease term. The difference between rent expense recorded and the amount paid is credited or charged to *deferred rent*, which is reflected as a separate line item on the accompanying consolidated balance sheets.
- m. **Revenue Recognition** - Sales are recognized upon shipment of product to the customer. Provisions for returns and allowances are recorded in the period the sales occur. Payments received from customers prior to shipment of the product to them, are recorded as customer deposit liabilities.
- n. **Stock-Based Compensation** - The cost of all share-based payments to employees, including grants of restricted stock and stock options, is recognized in the financial statements based on their fair values measured at the grant date, or the date of any later modification, over the requisite service period. The cost of all share-based payments to non-employees, including grants of restricted stock and stock options, is recognized in the financial statements based on their fair values at each reporting date until measurement date occurs, over the requisite service period. The Company recognizes compensation cost for unvested stock awards on a straight-line basis over the requisite vesting period.
- o. **Shipping and Handling Costs** - The Company has included freight-out as a component of cost of sales, which amounted to \$13,159 and \$0 for the periods ended September 9, 2016 and September 30, 2015, respectively.
- p. **Income Taxes** - The Company's current provision for income taxes is based upon its estimated taxable income in each of the jurisdictions in which it operates, after considering the impact on taxable income of temporary differences resulting from different treatment of items for tax and financial reporting purposes. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and any operating loss or tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the year in which those temporary differences are expected to be recovered or settled. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income in those periods in which temporary differences become deductible. Should management determine that it is more likely than not that some portion of the deferred tax assets will not be realized, a valuation allowance against the deferred tax assets would be established in the period such determination was made.

Continued

The Company follows the accounting for uncertainty in income taxes guidance, which clarifies the accounting and disclosures for uncertainty in income taxes recognized in the Company's financial statements and prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. It also provides guidance on derecognition and measurement of a tax position taken or expected to be taken in a tax return.

The Company currently has no federal or state tax examinations in progress. As of September 30, 2016, the Company's tax returns for the tax years 2016 and 2015 remain subject to audit, primarily by the Internal Revenue Service.

The Company did not have material unrecognized tax benefits as of September 30, 2016 and 2015 and does not expect this to change significantly over the next 12 months. The Company will recognize interest and penalties accrued on any unrecognized tax benefits as a component of provision for income taxes.

- q. **Net (Loss) Per Share** - Basic loss per share is calculated by dividing the loss attributable to stockholders by the weighted-average number of shares outstanding for the period. Diluted loss per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that shared in the earnings (loss) of the Company. Diluted loss per share is computed by dividing the loss available to stockholders by the weighted average number of shares outstanding for the period and dilutive potential shares outstanding unless such dilutive potential shares would result in anti-dilution. The assumed exercise of common stock equivalents was not utilized for the year ended September 30, 2016 and the period July 20, 2015 through September 30, 2015, since the effect would have been anti-dilutive. As of September 30, 2016, 26,800,000 options were outstanding of which 24,000,000 were exercisable, 500,000 warrants were outstanding of which 500,000 were exercisable, and convertible debt totaling approximately \$809,127 was convertible into approximately 479,551 shares of common stock and \$48,998 of vendor settlement payable converted into 460,200 common shares. As of September 30, 2015, there were no options outstanding.
- r. **Recent Accounting Pronouncements** - In March 2016, the Financial Accounting Standards Board ("FASB") issued an accounting standards update that will change how companies account for certain aspects of its share-based payments to employees. For public business entities, the amendments in this update are effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. Early adoption is permitted for any entity in any interim or annual period. The Company has elected to early adopt. As a result, the Company will recognize share-based award forfeitures in the period they occur as a reversal of previously recognized compensation expense. The reduction in compensation expense will be determined based on the specific awards forfeited during that period. There were no forfeitures during the periods presented in the consolidated financial statements.

In May 2014, the FASB issued a new accounting standard that attempts to establish a uniform basis for recording revenue to virtually all industries financial statements, under U.S. GAAP as amended in March 2016 and April 2016. The revenue standard's core principle is built on the contract between a vendor and a customer for the provision of goods and services. It attempts to depict the exchange of rights and obligations between the parties in the pattern of revenue recognition based on the consideration to which the vendor is entitled. In order to accomplish this objective, companies must evaluate the following five basic steps: (i) identify the contract with the customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations in the contract, and (v) recognize revenue when (or as) the entity satisfies a performance obligation. There are three basic transition methods that are available – full retrospective, retrospective with certain practical expedients, and a cumulative effect approach. Under the third alternative, an entity would apply the new revenue standard only to contracts that are incomplete under legacy U.S. guidance at the date of initial application and recognize the cumulative effect of the new standard as an adjustment to the opening balance of retained earnings. Prior years would not be restated and additional disclosures would be required to enable users of the financial statements to understand the impact of adopting the new standard in the current year compared to prior years that are presented under legacy U.S. guidance. For public business entities, this standard is effective for annual periods beginning after December 15, 2017, and interim periods within those annual periods. Early adoption is prohibited. The Company is currently evaluating the impact of this new accounting standard on its consolidated financial position and results of operations.

In February 2016, the FASB issued a new accounting standard on leases. The new standard, among other changes, will require lessees to recognize a right-of-use asset and a lease liability on the balance sheet for all leases. The lease liability will be measured at the present value of the lease payments over the lease term. The right-of-use asset will be measured at the lease liability amount, adjusted for lease prepayments, lease incentives received and the lessee's initial direct costs (e.g. commissions). The new standard is effective for annual reporting periods beginning after December 15, 2018, including interim reporting periods within those annual reporting periods. The adoption will require a modified retrospective approach for leases that exist or are entered into after the

beginning of the earliest period presented. The Company is currently evaluating the impact of this new accounting standard on its consolidated financial position and results of operations.

Continued

DRONE USA, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements
September 30, 2016 and 2015

The Company does not believe that any other recently issued but not yet effective accounting pronouncements, if adopted, would have a material effect on the accompanying consolidated financial statements.

3 - ACCOUNTS RECEIVABLE

The Company's accounts receivable at September 30, 2016 is as follow:

	September 30,
	2016
Accounts receivable	\$ 865,775
Reserve for doubtful accounts	-
	<u>\$ 865,775</u>

4 - INVENTORY

At September 30, 2016, inventory consists primarily of finished goods and was valued at \$1,391,439.

5 - ACQUISITION OF SUBSIDIARY

On September 9, 2016, the Company purchased HowCo a Washington-based entity with customers in the U.S. federal government and Department of Defense. The Company acquired all outstanding shares of stock of this entity. In exchange for these shares, the Company paid \$2,600,000 in cash and issued a note payable in the amount of \$900,000, bearing interest of 5.5%, with a maturity date of August 26, 2017. In addition to the payment in the form of cash and notes, warrants for 500,000 shares of common stock and additional contingent earn-out payments, with an estimated fair value of \$129,000, are also required. The warrants were granted with an exercise price of \$0.01 per share, vested immediately, and have a five year term. Assumptions related to the estimated fair value of these warrants on their date of grant, which the Company estimated using the Black-Scholes option pricing model, are as follows: risk-free interest rate of approximately 1.22%; expected divided yield of 0%; expected option life of 2.5 years; and expected volatility of approximately 841%. The aggregate grant date fair value of the warrants amounted to \$180,000.

The expected benefits from the purchase of HowCo include immediate revenues and cash flows to the Company. In addition, HowCo's relationship with the United States Department of Defense and Defense Logistics Agency will help Drone achieve its goal of selling its products to the United States governmental agencies. HowCo may also serve as a supply chain for our future California factory.

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DRONE USA, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements
September 30, 2016 and 2015

The purchase price exceeded the fair value of net assets acquired by \$3,769,765. The Company allocated \$1,060,000 to the customer list which will be amortized over a 48 month period. The balance was allocated to goodwill and tradename. The results of operations of HowCo are included in the consolidated results of operations of the Company from the effective date of September 10, 2016. For the period from the effective date of September 10, 2016 to September 30, 2016, revenues and net loss included in the consolidated statements of operations from HowCo amounted to \$1,119,748 and \$18,664, respectively. Total acquisition related costs expensed were approximately \$100,000 for the year ended September 30, 2016.

In connection with the combination, the Company entered into two employment agreements with the former owner/operators of HowCo. The Company determined that the consideration under these employment agreements did not qualify as additional purchase consideration.

The purchase price is summarized as follow:

Cash	\$ 2,600,000
Promissory note	900,000
Warrants	180,000
Earn-out provision	129,000
	<u>\$ 3,809,000</u>

At September 9, 2016, the fair value of the assets acquired and liabilities assumed from HowCo are as follows:

<i>Assets Acquired</i>	
Cash	\$ 165,485
Accounts receivable	780,119
Inventory	564,086
Goodwill	2,410,335
Tradename	760,000
Customer list	1,060,000
Other	1,047
	<u>5,741,072</u>
<i>Liabilities Assumed</i>	
Accounts payable	1,392,661
Accrued expenses and other current liabilities	78,841
Deferred tax liability	460,570
	<u>1,932,072</u>
<i>Purchase Price</i>	<u><u>\$ 3,809,000</u></u>

Goodwill is not expected to be deductible for income tax purposes.

Continued

DRONE USA, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements
September 30, 2016 and 2015

For the year ended September 30, 2016, the following unaudited pro forma consolidated results of operations have been prepared as if the combination of HowCo had occurred as of October 1, for each period presented.

	<i>Years Ended September 30,</i>	
	<u>2016</u>	<u>2015</u>
<i>Approximate Net Revenues</i>	\$ 19,870,000	\$ 24,858,000
<i>Approximate Net Income (Loss)</i>	\$ (5,500,000)	\$ 934,000
<i>Net Loss Per Share</i>	(0.06)	-

Pro forma data does not purport to be indicative of the results that would have been obtained had these events actually occurred at the beginning of the periods presented and is not intended to be a projection of future results.

6 - GOODWILL AND INTANGIBLE ASSETS

The changes in the carrying amount of goodwill are as follows:

<i>Balance</i> - July 20, 2015	\$ -
<i>Acquisition of Subsidiary - goodwill</i>	<u>2,410,335</u>
<i>Balance</i> - September 30, 2016	<u>\$ 2,410,335</u>

The changes in carrying amount of tradename are as follows:

<i>Balance</i> - July 20, 2015	\$ -
<i>Acquisition of Subsidiary - tradename</i>	<u>760,000</u>
<i>Balance</i> - September 30, 2016	<u>\$ 760,000</u>

At September 30, 2016, intangible assets other than goodwill consisted of:

	<i>Carrying Amount</i>
<i>Balance</i> - July 20, 2015	\$ -
<i>Acquisition of Subsidiary - Customer List</i>	1,060,000
<i>Accumulated amortization</i>	<u>(14,722)</u>
<i>Balance</i> - September 30, 2016	<u>\$ 1,045,278</u>

The customer list is being amortized over 48 months from the acquisition date.

Amortization expense for the year ended September 30, 2016 was \$14,722.

Continued

Future amortization expense of the customer list is as follows:

<i>For the Years Ending</i>	
<i>December 31,</i>	
<u>2017</u>	<u>\$</u>
2017	265,000
2018	265,000
2019	265,000
2020	250,278

7 - LINE OF CREDIT - BANK

The Company has a revolving line of credit with a financial institution. This revolving line of credit is in the amount of \$50,000, and is personally guaranteed by the Company's Chief Executive Officer ("CEO"). The line bears interest at a fluctuating rate equal to the prime rate, which at September 30, 2016 was 3.50%, plus 4.25%. As of September 30, 2016, the balance of the line of credit was \$49,583 with \$417 available.

8 - SETTLEMENT PAYABLE - VENDOR

During August 2016, the Company entered into a settlement agreement with a third party who had purchased certain payables from the Company's vendors of \$102,103. The agreement provides for the issuance of free trading shares of common stock under the 3(a)(10) exemption as satisfaction of the settlement to this third party. The conversion rate will be based upon a discount of 35% to the lowest intraday price during the ten-day period prior to the request for the shares of common stock. This settlement payable qualifies as stock settled debt under ASC 480 and a debt premium of \$54,979 was recorded with a charge to interest expense on the note date. In addition, 11,500 shares were issued as a settlement fee. In connection with this agreement, the Company was required to reserve 2,000,000 shares of common stock related to this transaction. As of September 30, 2016, the balance of this note was \$75,382 including remaining premium of \$26,384 as a result of the issuance of 57,000 shares to satisfy \$81,700 of the debt including premium of \$28,595. Subsequent to September 30, 2016, the balance of the loan was satisfied through the issuance of an additional 460,200 shares of common stock. Upon satisfaction of the debt the remaining reserved shares were released.

9 - NOTE PAYABLE – RELATED PARTY SELLER

In connection with the acquisition of HowCo, the Company issued a note payable in the amount of \$900,000 to the sellers of HowCo. The note matures on August 26, 2017 and bears interest at 5.50%. The note requires payment of unpaid principal and interest upon maturity. The note is secured by all assets of HowCo Distribution Co. and subordinated to the Senior Secured Credit Facility discussed below.

10 - CONVERTIBLE NOTES PAYABLE

The Company has an \$840,000 convertible note payable ("Note 1") to a related party entity controlled by the Company's CEO. Note 1 bears interest at an annual rate of 7% with a maturity date of June 11, 2017, at which time all unpaid principal and interest is due. The holder of Note 1 has the option to convert the outstanding principal and accrued interest, in whole or in part, into shares of common stock at a conversion price equal to the volume weighted average price per share of common stock for the 30-day period prior to conversion. As of September 30, 2016, Note 1 has not been converted and the balance of the note was \$692,126 and accrued interest was \$28,034. This note is considered a stock settled debt in accordance with ASU 480 and the fixed amount is equal to the principal amount based on the conversion formula.

Continued

The Company has a \$117,000 convertible note payable (“Note 2”) with the Company’s CEO. Note 2 bears interest at an annual rate of 7% with a maturity date of December 31, 2017, at which time all unpaid principal and interest is due. The holder of Note 2 has the option to convert the outstanding principal and accrued interest, in whole or in part, into shares of common stock at a conversion price equal to the volume weighted average price per share of common stock for the 30-day period prior to conversion. As of September 30, 2016, Note 2 has not been converted and the balance was \$117,000 and accrued interest was \$2,093. This note is considered a stock settled debt in accordance with ASU 480 and the fixed amount is equal to the principal amount based on the conversion formula.

Effective September 13, 2016, the Company entered into a senior secured credit facility agreement (the “Agreement”) with an investment fund to provide capital for this acquisition. The Company can borrow up to \$6,500,000, with an initial loan at closing of \$3,500,000. The Agreement bears interest at a rate of 18%, requires monthly payments of \$52,500 which is interest only starting on October 13, 2016 through February 13, 2017, and monthly payments, including interest and principal, of \$298,341 starting on March 13, 2017 through maturity on March 13, 2018. Events of default are defined in the Agreement. In the event of default the note balance will bear interest at 25%. In connection with this Agreement, the Company was obligated to pay additional advisory fees of \$850,000 payable in the form of cash or common stock in accordance with the terms of the Agreement. The Company was also required to reserve 7,000,000 shares of common stock related to this transaction. The reserved shares will be released upon the satisfaction of the loan. In the event the lender makes additional loans under the Agreement, the Company agrees to pay additional advisory fees under similar terms as the \$850,000 fee. As of September 30, 2016, the Company issued 539,204 shares of common stock in satisfaction of the \$850,000 in accordance with the terms of the agreement. Based upon the value of the shares, at the time the lender sells the shares, the Company may be required to redeem unsold shares for the difference between the \$850,000 and the lender’s sales proceeds. Accordingly the \$850,000 has been reflected as a current liability as of September 30, 2016. Notwithstanding anything contained in the Agreement to the contrary, in the event the Lender has not realized net proceeds from the sale of Advisory Fee Shares equal to at least the Advisory Fee by the earlier to occur of: (A) the twelve (12) month anniversary of the Effective Date; (B) the occurrence of an Event of Default; or (C) the Maturity Date, then at any time thereafter, the Lender shall have the right, upon written notice to the Borrower, to require that the Borrower redeem all Advisory Fee Shares then in Lender’s possession for cash equal to the Advisory Fee, less any cash proceeds received by the Lender from any previous sales of Advisory Fee Shares, if any. In the event such redemption notice is given by the Lender, the Borrower shall redeem the then remaining Advisory Fee Shares in Lender’s possession for an amount of Dollars equal to the Advisory Fee, less any cash proceeds received by the Lender from any previous sales of Advisory Fee Shares, if any, payable by wire transfer to an account designated by Lender within five (5) Business Days from the date the Lender delivers such redemption notice to the Borrower. As of September 30, 2016, the note payable has not been converted and the balance of the note was \$3,500,000 and accrued interest was \$31,500. The note is only convertible upon default or mutual agreement by both parties. Once a default occurs the note will be accounted for as stock settled debt at its fixed monetary value and any shares issued upon conversion are also subject to a make whole provision similar to that described above for the \$850,000. (see Note 20)

The note balance and deferred financing costs at September 30, 2016 was as follows:

	<i>Principal</i>	<i>Deferred Financing Cost</i>	<i>Total</i>
Promissory note	\$ 3,500,000	\$ 1,106,450	\$ 2,393,550
Accumulated amortization	-	(30,735)	30,735
	<u>3,500,000</u>	<u>1,075,715</u>	<u>2,424,285</u>
Less: Current portion	(1,800,294)	(737,633)	(1,062,661)
Balance	<u>\$ 1,699,706</u>	<u>\$ 338,082</u>	<u>\$ 1,361,624</u>

11 - DEFINED CONTRIBUTION PLAN

In August 2016, Drone established a qualified 401(k) plan with a discretionary employer matching provision. All employees who are at least twenty-one years of age are eligible to participate in the plan. The plan allows participants to defer up to 90% of their annual compensation, up to statutory limits. There was no employer contribution for the year ended September 30, 2016.

Continued

12 - RELATED PARTY TRANSACTIONS

Company entered into an employment agreement with the Company's Chief Strategy Officer which provides for annual base compensation of \$400,000 for a period of three years and provides for other additional benefits as defined in the agreement including a signing bonus of \$100,000 payable during the first year of employment. As of September 30, 2016, the bonus has not been paid and is included in *accounts payable and accrued expenses*.

In connection with the acquisition of HowCo, the Company entered into two separate employment agreements with both executive vice presidents of HowCo, formerly the owner operators. Each agreement provides for annual base compensation of \$125,000 for a period of two years.

The Company has certain convertible notes payable to related parties (see Note 10) and a note payable to the seller of HowCo (see Note 9).

13 - EXCLUSIVE AGREEMENT

The Company entered into an exclusive agreement with a Brazilian entity in the drone technology market. The agreement provides that the Company will acquire exclusive rights to this entity's UAV technology and intellectual property that includes research and development efforts completed by this entity. The Company will also secure exclusive export and representation rights to this entity's products along with the option to acquire full ownership of this entity should the companies agree at a later date it would be in the best interest of both businesses.

14 - COMMON STOCK

As of September 30, 2016, the Company is authorized to issue 200,000,000 shares of \$0.0001 par value common stock, of which 41,719,492 shares have been issued.

The Company issued 38,309,321 shares of common stock to the Company's President and CEO as founder shares.

In January 2016, 2,532,196 shares of common stock were deemed issued to existing holders of Texas Wyoming Drilling, Inc. in connection with the recapitalization transaction with Texas Wyoming Drilling, Inc.

The Company issued 57,000 shares of common stock upon conversion of \$53,105 of the settlement payable - vendor and \$28,595 of the premium was reclassified to equity.

In August 2016, the Company issued 11,500 shares of common stock as payment of the settlement fee related to the settlement payable - vendor. The shares were valued at \$2.68 per share based on the quoted trading price on the grant date for total expense of \$30,820.

In September 2016, the Company issued 539,204 shares of common stock as payment of an \$850,000 advisory fee related to the senior secured credit facility agreement. (see Note 10)

In September 2016, the Company sold 270,271 shares of common stock at \$0.37 per share for proceeds of \$100,000.

Continued

15 - PREFERRED STOCK

As of September 30, 2016, the Company has designated 250 shares of \$0.0001 par value Series A preferred stock, of which 250 shares have been issued. These preferred shares have voting rights per share equal to the total number of issued and outstanding shares of common stock divided by 0.99.

As of September 30, 2016, the Company is authorized to issue 5,000,000 shares of \$.0001 par value preferred stock, with designations, voting, and other rights and preferences to be determined by the Board of Directors of which 4,999,750 remain available for designation and issuance.

16 - SHARE BASED PAYMENTS

The Company established its 2016 Stock Incentive Plan (the "Plan") that permits the granting of incentive stock options and other common stock awards. The maximum number of shares available under the Plan is 100,000,000 shares. The Plan is open to all employees, officers, directors, and non-employees of the Company.

OPTIONS

On July 1, 2016, the Company granted options under the 2016 Stock Incentive Plan to purchase 22,500,000 shares of its common stock to several employees, and an additional 4,300,000 to certain non-employees for services at an exercise price of \$0.20 per share. The fair value of the shares of the underlying common stock at the date of grant based on the quoted trading price was \$0.20 per share. 20,000,000 of the options issued to certain employees vested immediately and have a ten year term. The remaining 6,800,000 options cliff vest 50% per year over the following two year period and have a ten year term. Assumptions related to the estimated fair value of these stock options on their date of grant, which the Company estimated using the Black-Scholes option pricing model, are as follows: risk-free interest rate of approximately 1.46%; expected divided yield of 0%; expected option life of 5 years for the shares that vest immediately; expected option life of 5.75 years for the shares that vest over a two year period using the simplified method; and expected volatility of approximately 841%. The value of the options granted to non-employees which vested over time are remeasured at each reporting date until vesting occurs. The aggregate grant date fair value of the award amounted to \$5,579,990 as of September 30, 2016. The Company recognizes compensation cost for unvested stock-based incentive awards on a straight-line basis over the requisite service period.

The Company recorded \$4,897,499 of compensation expense for the year ended September 30, 2016 related to these options. Total unrecognized compensation expense related to unvested stock options at September 30, 2016 amounted to \$682,491. The weighted average period over which share-based compensation expense related to these options will be recognized is approximately 2 years.

A summary of the Company's stock options is as follows:

<i>Stock Options</i>	<i>Shares</i>	<i>Weighted-Average Exercise Price</i>	<i>Weighted-Average Remaining Contractual Term (Years)</i>	<i>Weighted-Average Grant-Date Fair Value</i>	<i>Aggregate Intrinsic Value</i>
Outstanding at October 1, 2015	-	\$ -	-	\$ -	\$ -
Granted	26,800,000	0.20	-	0.20	-
Outstanding at September 30, 2016	<u>26,800,000</u>	<u>\$ 0.20</u>	<u>9.80</u>	<u>\$ -</u>	<u>\$ 19,564,000</u>
Exercisable at September 30, 2016	<u>24,000,000</u>	<u>\$ 0.20</u>	<u>9.80</u>	<u>\$ -</u>	<u>\$ 17,520,000</u>

Continued

DRONE USA, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements
September 30, 2016 and 2015

As of September 30, 2016, 24,000,000 of the 26,800,000 outstanding stock options were exercisable. The following table summarizes information about stock options at September 30, 2016:

<i>Range of Exercise Prices</i>	<i>Remaining Number Outstanding</i>	<i>Weighted Average Contractual Life (Years)</i>	<i>Weighted Average Exercise Price</i>
\$ 0.20	26,800,000	9.8	\$ 0.20

All options were issued at an options price equal to the market price on the date of the grant.

WARRANTS

A summary of the Company's warrants is as follows:

<i>Warrants</i>	<i>Shares</i>	<i>Weighted- Average Exercise Price</i>	<i>Weighted- Average Remaining Contractual Term (Years)</i>	<i>Weighted- Average Grant-Date Fair Value</i>	<i>Aggregate Intrinsic Value</i>
Outstanding at October 1, 2015	-	\$ -	-	\$ -	\$ -
Issued	500,000	0.01	-	0.36	-
Outstanding at September 30, 2016	500,000	\$ 0.01	9.98	\$ 0.36	\$ 461,650
Exercisable at September 30, 2016	500,000	\$ 0.01	9.98	\$ 0.36	\$ 461,650

On September 9, 2016, 500,000 5-year warrants exercisable at \$0.01 per share were issued as part of the consideration for the HowCo acquisition. These warrants was valued at aggregate of \$180,000 (see Note 5).

17 - INCOME TAXES

Prior to January 26, 2016, Drone USA, LLC was a single member limited liability company. As such, the sole member of the Company is required to include the Company's taxable income or loss on his individual income tax return. Accordingly, the accompanying consolidated financial statements do not include a provision for federal income taxes for the year ended September 30, 2015.

The Company recognizes deferred tax assets and liabilities for the tax effects of differences between the financial statement and tax basis of assets and liabilities. A valuation allowance is established to reduce the deferred tax assets if it is more likely than not that a deferred tax asset will not be realized.

As of September 30, 2016, the Company has net operating loss carryforwards of approximately \$1,328,200 to reduce future taxable income through 2036. A valuation allowance for the entire deferred tax benefit has been established as of September 30, 2016.

Continued

DRONE USA, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements
September 30, 2016 and 2015

The benefit from income taxes consists of the following:

	<i>Year Ended September 30, 2016</i>
Current	
Federal	\$ -
State	50
	<u>50</u>
Deferred	
Federal	(371,000)
State	(89,570)
	<u>(460,570)</u>
Total income tax provision (benefit)	<u>\$ (460,520)</u>

A reconciliation of the provision for income taxes at the federal statutory rate of 35% to the Company's provision for income tax is as follows:

	<i>Year Ended September 30, 2016</i>
U.S. Federal (tax benefit) provision at statutory rate	\$ (2,243,836)
State (tax benefit) income taxes, net of federal benefit	(500,697)
Permanent differences	169,807
Changes in valuation allowance	2,114,206
Other	-
Total	<u>\$ (460,520)</u>

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

	<i>Year Ended September 30, 2016</i>
Deferred Tax Assets	
Stock compensation	\$ 1,984,035
Net operating losses	577,103
Other	7,242
Total deferred tax assets	<u>2,568,380</u>
Valuation allowance	<u>(2,114,206)</u>
Net deferred tax assets	<u>454,173</u>
Deferred Tax Liabilities	
Identifiable intangibles - HowCo Purchase	<u>(454,173)</u>
Total deferred tax liabilities	<u>(454,173)</u>
Net deferred tax	<u>\$ -</u>

Continued

The Company determines its valuation allowance on deferred tax assets by considering both positive and negative evidence in order to ascertain whether it is more likely than not that deferred tax assets will be realized. Realization of deferred tax assets is dependent upon the generation of future taxable income, if any, the timing and amount of which are uncertain. Due to the history of losses the Company has generated in the past, the Company believes that it is not more likely than not that all of the deferred tax assets in the U.S. can be realized as of September 30, 2016, accordingly, the Company has recorded a full valuation allowance on its U.S. deferred tax assets.

The following table displays by contributing factor the changes in the valuation allowance for deferred tax assets since October 1, 2015:

	<i>Year Ended September 30, 2016</i>
Balance - beginning of period	\$ -
Net operating loss generated/(utilization, expiration)	577,103
Deferred tax assets decrease/(increase)	<u>1,537,104</u>
Balance - end of period	<u>\$ 2,114,207</u>

The Company files income tax returns in the United States on federal basis and various states. The Company is not currently under any international or any United States federal, state and local income tax examinations for any taxable years. All of the Company's net operating losses are subject to tax authority adjustment upon examination.

18 - COMMITMENTS AND CONTINGENCIES

COMMITMENTS

In May 2016, the Company entered into a lease agreement for office space in New York, New York. The lease provides for base monthly rent of approximately \$5,000 per month with a rent-free period from May 1, 2016 through July 31, 2016. The lease term begins May 1, 2016 and expires April 30, 2017. A security deposit of \$10,000 required by this lease agreement is reported as a component of *prepaid expenses and other current assets* in the accompanying consolidated balance sheets. The Company entered into two additional leases for additional space with rent-free periods through November 1, 2016. Each lease has a term of one year beginning July 1, 2016 and September 1, 2016, requiring monthly lease payments after the rent-free period of approximately \$2,500 and \$3,500, respectively. An additional security deposit of \$6,000 was required for the additional space. At September 30, 2016, net minimum future rental payments pursuant to these leases for the 12 months ending September 30, 2017, is approximately \$90,000.

In connection with the acquisition of HowCo on September 9, 2016, the Company assumed a lease agreement for industrial space in Vancouver, Washington. The lease provides for base monthly rent of approximately \$4,600 per month. The lease term begins June 1, 2016 and expires May 31, 2017. At September 30, 2016, net minimum future rental payments pursuant to these leases for the 12 months ending September 30, 2017, is approximately \$36,800.

Continued

LEGAL MATTERS

In connection with the merger with Texas Wyoming Drilling, Inc., a vendor has a claim for unpaid bills of approximately \$75,000 against the company. The Company and its legal counsel believe the Company is indemnified by Texas Wyoming Drilling, Inc. for the claim pursuant to its indemnification clause in the merger agreement.

19 - CONCENTRATIONS

CONCENTRATIONS OF CREDIT RISK

The Company places its cash with high quality credit institutions. Cash in banks is insured by the Federal Deposit Insurance Corporation ("FDIC") up to \$250,000 per institution. At times, balances may be in excess of the FDIC insurance limit. At September 30, 2016 there were balances in bank of \$198,974 in excess of federally insured limits. The Company has not experienced any losses in such accounts and believes it is not exposed to any significant credit risk. Concentration of risk with respect to trade receivable are limited are to the larger concentration of sales to U.S. federal government and agencies who typically pay timely.

ECONOMIC CONCENTRATIONS

With respect to customer concentration, three customers accounted for approximately 51%, 20% and 12% of total sales for the period ended September 30, 2016.

With respect to accounts receivable concentration, two customers accounted for approximately 51% and 13% of total accounts receivable at September 30, 2016.

With respect to supplier concentration, two suppliers accounted for approximately 50% of total purchases at September 30, 2016.

With respect to accounts payable concentration, three suppliers accounted for approximately 76% of total accounts payable at September 30, 2016.

20 - SUBSEQUENT EVENTS

On October 1, 2016, the Company entered into employment agreements with two of its officers. The employment agreement with the company's President and CEO provides for annual base compensation of \$370,000 for a period of three years, which can, at the Company's election, be paid in cash or Common Stock or deferred if insufficient cash is available, and provides for other benefits, including a discretionary bonus and equity a provision for the equivalent of 12 months' base salary, and an additional one-time severance payment of \$2,500,000 upon termination under certain circumstances, as defined in the agreement. The employment agreement with the company's Treasurer and CFO provides for annual base compensation of \$250,000 for a period of three years, which can, at the Company's election, be paid in cash or Company Common Stock or deferred if insufficient cash is available, and provides for other benefits, including a discretionary bonus and equity a provision for the equivalent of 12 months' base salary and an additional one-time severance payment of \$1,500,000 upon termination under certain circumstances, as defined in the agreement.

In October 2016, the Company issued 115,000 shares of common stock to an entity as payment for acquisition-related services valued at \$57,500.

Continued

In October through November 2016, the Company issued 460,200 common shares upon conversion of the remaining settlement payable - vendor of \$48,998 and the remaining premium of \$26,384 was reclassified to equity.

Subsequent to September 30, 2016, the Company granted options to purchase 14,566,200 and 10,485,000 shares of its common stock at an exercise price ranging from \$0.20 to 0.24 per share valued at \$2,995,240 and \$2,350,290 at grant date, to employees and certain consultants, respectively. The options were valued using a Black-Scholes option pricing model with the following assumptions; risk-free interest rate of 1.46%, expected dividend yield of 0%, expected option life of 5.5 years for the shares that vested immediately and 5.75 to 6.5 years for those with vesting terms using the simplified method, and expected volatility of 841%. In addition, upon mutual agreement between management and one of the board members who resigned in March 2017, options to purchase 1,000,000 shares of common stock were canceled.

Subsequent to September 30, 2016, the Company entered into an agreement with a manufacturer in Pismo Beach, California. The agreement provides for certain services to be provided by the manufacturer as needed by the Company. The agreement has an initial term of three years with one year renewals. In connection with this agreement, the Company has agreed to sublease space based in San Luis Obispo, California from the manufacturer for the purposes of the development and manufacturing of unmanned aerial vehicles. The lease provides for base monthly rent of approximately \$15,000 for the initial term to be increased to \$16,500 per month upon extension. The lease term begins February 1, 2017 and expires January 31, 2019 with the option to extend the term an additional 24 months.

Effective February 17, 2017, the Company entered into an agreement with a company to receive consulting services, for a period of six months from the effective date. In connection with the agreement, the Company agreed to issue 400,000 vested shares of common stock on February 17, 2017 for a payment of \$200, and to pay consulting fees of \$10,000 per month. As the shares fee is considered contractually earned upon the execution of the agreement, the shares were valued on the February 17, 2017 measurement date at \$0.23 per share or a total of \$92,000 based on the quoted trading price which will be recognized over the 6 month service period.

On January 7, 2017, the Company entered into an agreement with a company to receive advisory services for a fee of \$22,500 payable over three months. In addition, at the Company's option, this company could, on an exclusive basis, act as the placement agent or underwriter for the Company in connection with a proposed institutional financing transaction.

On February 13, 2017, the Company entered into an agreement with a company to receive due diligence services for an initial term of 180 days from February 17, 2017. Total fees for these services are \$50,000, with \$15,000 payable upon signing and the remaining \$35,000 payable on May 10, 2017.

Subsequent to February 13, 2017, the Company defaulted on the monthly principal and interest payment of \$298,341, to a senior secured credit facility agreement, in March and April of 2017 (see Note 10). On April 13, 2017 we received a default notice from the lender and given a 10-day period to cure the default. The note became convertible upon expiration of the default cure period as the default was not cured. The Company is currently in discussion with the lender to restructure the debt.

On March 28, 2017, the Company entered into an agreement with the senior secured credit facility lender to receive a range of advisory services for a total of \$1,200,000 with no definitive term or length of service. If the Company is a quoted company on any listed exchange, the senior secured credit facility lender will accept a single preferred share convertible into common stock never to exceed 4.99%. The number of shares issued will be set at 100% of the amount due up to availability and subject to a make whole provision.

Subsequent to September 30, 2016, the Company received verbal and written demands for non-payment of three months of rent for its New York and California locations, non-payment of past due credit card balances and non-payment of past due amounts for services rendered by a consultant.

Subsequent Events have been evaluated through May 8, 2017, the date the consolidated financial statements were available to be issued.