World Surveillance Group Inc.
Form 10-Q
November 14, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

Form 10-Q
(Mark one)
x QUARTERLY REPORT UNDER SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2014
or
¨ TRANSITION REPORT UNDER SECTION 13 OR 15 (d) OF THE EXCHANGE ACT

For the transition period from ____________ to _____________

Commission file number 001-32509

WORLD SURVEILLANCE GROUP INC.
(Exact name of registrant as specified in its charter)

Delaware	88-0292161
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

State Road 405, Building M6-306A, Room 1400
Kennedy Space Center, Florida 32815
(Address of principal executive offices)

(321) 452-3545
(Issuer's telephone number)

Indicate by check mark whether 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 x No ¨

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 x No ¨

Indicated by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer“ and “smaller reporting company” in Rule 12b-2 of the Exchange Act:

Large accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer ¨ (Do not check if a smaller reporting company) Smaller reporting company x

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

As of November 14, 2014, there were 737,844,377 shares of the registrant's Common Stock outstanding.

WORLD SURVEILLANCE GROUP INC. AND SUBSIDIARIES

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PART I - FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements.

WORLD SURVEILLANCE GROUP INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

ASSETS	September 30, 2014 (unaudited)	December 31, 2013
CURRENT ASSETS		
Cash	$ 5,021	$ 8,907
Accounts receivable	90,355	59,651
Accounts receivable from related party	63,165	59,833
Inventory	86,698	-
Prepaid expenses	38,940	38,940
Current assets – discontinued operations	-	194,407
TOTAL CURRENT ASSETS	284,179	361,738
PROPERTY AND EQUIPMENT		
Property and equipment, net of accumulated depreciation of $629,920 and $492,670, at September 30, 2014 and December 31, 2013, respectively.	2,132,716	2,269,966
OTHER NONCURRENT ASSETS		
Available-for-sale securities	3,720,000	-
Deferred financing costs	6,891	22,398
Other assets – discontinued operations	-	809,822
TOTAL NONCURRENT ASSETS	3,726,891	832,220
TOTAL ASSETS	$ 6,143,786	$ 3,463,924
LIABILITIES AND STOCKHOLDERS' DEFICIT		
CURRENT LIABILITIES		
Accounts payable	$ 4,533,506	$ 4,520,662
Notes payable	9,767,235	9,501,083
Other accrued liabilities	2,991,534	2,795,027
Current liabilities – discontinued operations	-	143,252
TOTAL CURRENT LIABILITIES	17,292,275	16,960,024
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' DEFICIT		
Common stock, $0.00001 par value, 1,000,000,000 shares authorized; 751,126,430 shares and 681,127,043 shares issued; and 739,126,430 shares and 669,127,043 shares outstanding at September 30, 2014 and December 31, 2013, respectively.	7,391	6,691
Additional paid-in capital	140,026,372	138,909,766
Accumulated other comprehensive income	3,641,000	-

Accumulated deficit		(154,823,252)		(152,412,557)
TOTAL STOCKHOLDERS' DEFICIT		(11,148,489)		(13,496,100)
TOTAL LIABILITIES AND STOCKHOLDERS’ DEFICIT	$	6,143,786	$	3,463,924

See accompanying notes to unaudited condensed consolidated financial statements

WORLD SURVEILLANCE GROUP INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

	Three-Months Ended September 30, 2014	2013	Nine-Months Ended September 30, 2014	2013
REVENUES				
Net sales	$ 370,063	333,027	968,325	800,504
Net sales to related party	106,918	95,641	338,061	391,646
Cost of sales	351,733	412,579	979,663	912,178
Gross profit	125,248	16,089	326,723	279,972
COSTS AND EXPENSES:				
General and administrative	238,632	682,550	1,405,463	1,508,341
Professional fees	127,517	135,916	394,074	363,706
Depreciation expense	45,750	45,750	137,250	137,250
TOTAL EXPENSES	411,899	864,216	1,936,787	2,009,297
LOSS FROM OPERATIONS	(286,651)	(848,127)	(1,610,064)	(1,729,325)
OTHER INCOME (EXPENSE)				
Loss on sale of discontinued operations	-	-	(443,183)	-
Loss from conversion agreement true-up	-	-	-	(233,381)
Change in fair value of derivative liabilities	-	-	-	363
Interest expense, net	(118,410)	(111,469)	(350,617)	(379,986)
NET OTHER INCOME (EXPENSE)	(118,410)	(111,469)	(793,800)	(613,004)
NET LOSS FROM CONTINUING OPERATIONS	(405,061)	(959,596)	(2,403,864)	(2,342,329)
Net income (loss) from discontinued operations	-	(86,065)	(6,831)	(60,785)
NET LOSS	(405,061)	(1,045,661)	(2,410,695)	(2,403,114)
Other comprehensive income (expense)	(5,280,000)	-	3,641,000	-
TOTAL COMPREHENSIVE INCOME (LOSS)	$ (5,685,061)	(1,045,661)	1,230,305	(2,403,114)
PER COMMON SHARE DATA				
NET LOSS PER SHARE:				
Basic and Diluted from continuing operations	$ (0.00)	(0.00)	(0.00)	(0.00)
Basic and Diluted from discontinued operations	$ (0.00)	(0.00)	(0.00)	(0.00)
Basic and Diluted from net loss	$ (0.00)	(0.00)	(0.00)	(0.00)
WEIGHTED AVERAGE SHARES:				
Basic and Diluted	739,126,430	519,340,666	715,897,618	597,936,763

See accompanying notes to unaudited condensed consolidated financial statements

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WORLD SURVEILLANCE GROUP INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF TOTAL STOCKHOLDERS' DEFICIT (UNAUDITED)
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2014

Description	COMMON STOCK SHARES	COMMON STOCK AMOUNT	ADDITIONAL PAID-IN CAPITAL
BALANCE, DECEMBER 31, 2013	669,127,043	$ 6,691	$ 138,909,766
Shares issued for cash	27,928,571	280	214,720
Shares issued for legal settlement	23,137,584	232	213,542
Shares issued for services	18,933,232	188	159,051
Fair value of vested shares issued as share-based compensation	-	-	95,200
Fair value of options issued for services	-	-	22,006
Fair value of vested options previously issued as share-based compensation	-	-	33,993
Fair value of vested options issued for employee and directors' compensation	-	-	378,094
Net loss	-	-	-
BALANCE, SEPTEMBER 30, 2014	739,126,430	$ 7,391	$ 140,026,372

See accompanying notes to unaudited condensed consolidated financial statements

WORLD SURVEILLANCE GROUP INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF TOTAL STOCKHOLDERS' DEFICIT (UNAUDITED)
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2014

Description		ACCUMULATED OTHER COMPREHENSIVE INCOME		ACCUMULATED DEFICIT		TOTAL STOCKHOLDERS' DEFICIT
BALANCE, DECEMBER 31, 2013	$	-	$	(152,412,557)	$	(13,496,100)
Shares issued for cash		-		-		215,000
Shares issued for legal settlement		-		-		213,774
Shares issued for services		-		-		159,239
Fair value of vested shares issued as share-based compensation		-		-		95,200
Fair value of options issued for services		-		-		22,006
Fair value of vested options previously issued as share-based compensation		-		-		33,993
Fair value of vested options issued for employee and directors' compensation		-		-		378,094
Net loss		-		(2,410,695)		(2,410,695)
Unrealized gain on Available-for-sale securities		3,641,000		-		3,641,000
BALANCE, SEPTEMBER 30, 2014	$	3,641,000	$	(154,823,252)	$	(11,148,489)

See accompanying notes to unaudited condensed consolidated financial statements

WORLD SURVEILLANCE GROUP INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Nine Months Ended September 30, 2014	2013
OPERATING ACTIVITIES IN CONTINUING OPERATIONS:		
Net loss	$ (2,410,695)	$ (2,403,114)
Loss From Discontinued Operations	6,831	60,785
Adjustments to reconcile net loss to net cash used by operating activities in continuing operations:		
Depreciation expense	137,250	137,250
Share-based compensation	507,287	358,072
Loss on sale of discontinued operations	443,183	-
Common stock issued for service	159,239	-
Fair Value of option issued for service	22,006	-
Loss on conversion of debt	-	233,382
Change in fair value of derivative liabilities	-	(363)
Loan interest capitalized to debt	316,152	339,984
Amortized deferred financing costs	15,507	10,338
Shares issued as inducement for loans	-	34,400
Change in operating assets and liabilities:		
Accounts receivable	(30,704)	(70,187)
Accounts receivable from related party	(3,332)	27,861
Inventories	(86,698)	-
Prepaid expenses	-	7,194
Deposits	-	50,000
Accounts payable	19,807	(202,768)
Other accrued liabilities	410,281	847,243
Deferred revenues	-	(7,500)
NET CASH USED BY OPERATING ACTIVITIES IN CONTINUING OPERATIONS	(493,866)	(577,423)
INVESTING ACTIVITIES		
Proceeds from sale of LTAS, net of professional fees	325,000	-
NET CASH PROVIDED BY INVESTING ACTIVITIES IN CONTINUING OPERATIONS	325,000	-
FINANCING ACTIVITIES:		
Payment on LTAS acquisition payable	-	(110,000)
Payment to LTAS shareholder	-	(140,000)
Proceeds from notes payable	-	150,000
Payoff of notes payable	(50,000)	-
Proceeds from sale of common stock	215,000	120,000
NET CASH PROVIDED BY FINANCING ACTIVITIES IN CONTINUING OPERATIONS	165,000	20,000
NET CASH USED BY CONTINUING OPERATIONS	(3,886)	(557,423)
CASH FLOW FROM DISCONTINUED OPERATIONS		
NET CASH PROVIDED BY DISCONTINUED OPERATIONS	-	516,558
CASH BALANCE, BEGINNING OF PERIOD	8,907	49,343
CASH BALANCE, END OF PERIOD	$ 5,021	$ 8,478

SUPPLEMENTAL INFORMATION:				
Interest paid	$	-	$	3,688
Income tax paid	$	-	$	-
SCHEDULE OF NON-CASH INVESTING AND FINANCING ACTIVITIES				
Reclassification of long-term convertible notes payable to current notes payable		-		267,000
Common stock issued for settlements		213,774		227,900
Unrealized gain on Available-for-sale securities		3,641,000		-
Common stock issued for convertible debt conversions		-		76,339
Common stock issued for acquisition		-		672,500
Common stock issued for accrued salary conversion		-		100,000
Fair value of vested options issued for accrued salary conversion		-		524,624
Due to LTAS selling shareholder		-		413,432
LTAS acquisition payable		-		140,000

See accompanying notes to unaudited condensed consolidated financial statements

WORLD SURVEILLANCE GROUP INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING PRINCIPLES

DESCRIPTION OF BUSINESS

World Surveillance Group Inc. (the “Company”) designs and develops autonomous lighter-than-air (LTA) unmanned aerial systems (UAS) designed to carry payloads that provide semi-persistent intelligence, surveillance and reconnaissance (ISR), security and/or wireless communications from air to ground solutions at low and mid altitudes. The Company’s business focuses primarily on the design and development of innovative UAS that are designed to provide situational awareness and other communications capabilities via the integration of wireless capabilities and customer payloads. The Company’s airships, when integrated with cameras, electronics systems and other high technology payloads, are designed for use by government-related and commercial entities that require real-time ISR or communications support for military, homeland defense, border control, drug interdiction, natural disaster relief, maritime and environmental missions.

The Company’s wholly owned subsidiary Global Telesat Corp. (GTC), provides mobile voice and data communications services globally via satellite to the U.S. government, defense industry and commercial users. GTC specializes in services related to the Globalstar satellite constellation, including satellite telecommunications voice airtime, tracking devices and services, and ground station construction. GTC has an e-commerce mobile satellite solutions portal and is an authorized reseller of satellite telecommunications equipment and services offered by other leading satellite network providers such as Inmarsat, Iridium, Globalstar and Thuraya. GTC also has a subscription based online tracking portal called GTCTrack, designed to attract new satellite and GSM tracking customers by offering an easy-to-use interface and compatibility with a wide range of devices. GTC’s equipment is installed in various ground stations across Africa, Asia, Australia, Europe and South America.

On May 5, 2014, the Company exchanged 100% of the outstanding stock of its wholly-owned subsidiary Lighter Than Air Systems Corp. (LTAS) for a cash payment of $335,000 and 10,000,000 shares of common stock of Drone Aviation Corp. (DAC), a privately-held company. For purposes of this Form 10-Q, the Company’s financial statements reflect the accounts and operations of LTAS as discontinued operations.

On June 3, 2014, 100% of the outstanding capital stock of Drone Aviation Corp. was exchanged for capital stock of Drone Aviation Holding Corp., a publicly-held entity, and the 10,000,000 common shares of DAC held by the Company were exchanged for 10,000,000 shares of Series D Convertible Preferred Shares of Drone Aviation Holding Corp.

BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements include the accounts of World Surveillance Group Inc. and its subsidiaries (“WSGI” or the “Company”) and have been prepared in accordance with generally accepted accounting principles in the United States of America (“U.S. GAAP”) for interim financial information and reports and pursuant to the requirements for reporting on Form 10-Q and Regulation S-X for scaled disclosures for smaller reporting companies. Accordingly, they do not include all, or include a condensed version of, the information and footnotes required by U.S. GAAP for complete financial statements. The Company believes, however, that the disclosures are adequate to make the information presented not misleading. Therefore, the Company’s condensed consolidated financial statements reflect all adjustments (consisting solely of normal recurring adjustments), which are, in the opinion of management, necessary for the fair presentation of the consolidated financial position and the consolidated results of operations of the Company for the periods shown. Results shown for interim periods are not necessarily indicative of the results to be obtained for a full fiscal year or for any future period. The preparation of financial statements in conformity with U.S. GAAP requires us to make estimates, judgments and assumptions that affect the amounts reported in the condensed consolidated financial statements. Actual results may differ from management's estimates.

The condensed consolidated balance sheet information as of December 31, 2013 was derived from the audited consolidated financial statements included in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission ("SEC") for the fiscal year ended December 31, 2013. These interim condensed consolidated financial statements should be read in conjunction with the Company's most recently audited financial statements and the notes thereto included in such above referenced Annual Report on Form 10-K.

RECLASSIFICATIONS

Certain 2013 amounts have been reclassified to conform to the 2014 presentation.

GOING CONCERN

The accompanying condensed consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the settlement of liabilities and commitments in the normal course of business. However, as reflected in the accompanying condensed consolidated financial statements, the Company incurred a loss from operations of $1,610,064 for the nine-months ended September 30, 2014. The Company also had a working capital deficit of $17,008,096 and total stockholders' deficit of $11,148,489, as well as an accumulated deficit of $154,823,252 at September 30, 2014. These factors raise substantial doubt about the Company's ability to continue as a going concern. The Company's ability to continue as a going concern is dependent upon its ability to raise additional funds either through investments or by generating revenue from the sale of the Company's products to continue its business operations and implement its strategic plan, which includes, among other things, continued development of its UAS, the pursuit or continued development of strategic relationships and expansion of the Company's subsidiary's business. The Company's business plan, which if successfully implemented, will allow it to sell UAS and other products for a profit, which in turn will reduce the Company's dependence on raising additional funds from outside sources. The condensed consolidated financial statements do not include any adjustments that might be necessary if the Company is unable to continue as a going concern. The Company anticipates a net loss to continue for at least the next several quarters.

Additional cash will be needed to support our ongoing operations until such time that operations provide sufficient cash flow to cover expenditures. We are currently pursuing both short and long-term financing options from private investors as well as through institutional investors. We are also working to commercialize our Argus One airship, and our subsidiary's products to generate revenues from customers. While we have not yet sold any of our Argus One airships, we are already generating revenue from our subsidiary's products. The costs associated with our strategic plan are variable and contingent on our ability to raise capital or generate revenue from customer contracts, but we expect to need funding of approximately $3 million over the next 12 months. We are currently in litigation with La Jolla Cove Investors and do not expect any future funding under those agreements. We continue to have discussions with various entities relating to funding, but there can be no assurance that such funding will be received in the amounts required, on a timely basis, or at all. While we believe we will be able to continue to raise capital from various funding sources in such amounts sufficient to sustain operations at our current levels through the next several quarters, if we are not able to do so and if we are not able to generate sufficient revenue through the sale of our products, we would likely need to modify our strategy or cut back or terminate some of our operations. If we are able to raise additional funds through the issuance of equity securities, substantial dilution to existing shareholders may result. However, if our plans are not achieved, if significant unanticipated damaging events occur, or if we are unable to obtain the necessary additional funding on favorable terms or at all, we will likely have to modify our business plan and reduce, delay or discontinue some or all of our operations to continue as a going concern or seek a buyer for all or a portion of our assets. As of the date hereof, we continue to raise capital to sustain our current operations.

REVENUE RECOGNITION

The Company recognizes revenue when all of the following criteria are met: 1) persuasive evidence of an arrangement exists; 2) delivery has occurred and title has transferred or services have been rendered; 3) our price to the buyer is fixed or determinable; and 4) collectability is reasonably assured. The Company records unearned contract revenues as deferred revenues and their associated costs of sales as prepaid expenses. Deferred revenues from contracts and their related costs are recognized upon completion and fulfillment of the contractual obligation using the completed contract method. The Company records unearned subscription fees as deferred revenues and their associated costs of sales as prepaid expenses. Deferred revenues from subscription fees and their related costs are amortized pro-ratable over the subscription term.

INVENTORY

Inventory consists of satellite phones, terminals, trackers and accessories, which are stated at the lower of cost or market. Cost is principally determined using the first-in, first-out (FIFO) method.

INCOME TAXES

The Company accounts for income taxes using the asset and liability approach. Under this approach, deferred income taxes are recognized based on the tax effects of temporary differences between the financial statement and tax bases of assets and liabilities, as measured by current enacted tax rates. Valuation allowances are recorded to reduce the deferred tax assets to an amount that will more likely than not be realized.

U.S. GAAP requires that, in applying the liability method, the financial statement effects of an uncertain tax position be recognized based on the outcome that is more likely than not to occur. Under this criterion the most likely resolution of an uncertain tax position should be analyzed based on technical merits and on the outcome that will likely be sustained under examination. There were no adjustments related to uncertain tax positions recognized during the nine months ended September 30, 2014 and 2013, respectively.

FAIR VALUE MEASUREMENTS

U.S. GAAP includes a framework for measuring fair value, which also addresses disclosure requirements for fair value measurements. Fair value is the price that would be received upon sale of an asset or paid upon transfer of a liability in an orderly transaction between market participants at the measurement date and in the principal or most advantageous market for that asset or liability. The fair value, in this context, should be calculated based on assumptions that market participants would use in pricing the asset or liability, not on assumptions specific to the entity. In addition, the fair value of liabilities should include consideration of non-performance risk, including the Company's own credit risk.

Under the measurement framework, a fair valuation hierarchy for disclosure of the inputs to valuation used to measure fair value has been established. This hierarchy prioritizes the inputs into three broad levels that reflect the degree of subjectivity necessary to determine fair value measurements, as follows. Level 1 inputs are based on unadjusted quoted prices in active markets for identical assets or liabilities. Level 2 inputs are based on quoted prices for similar assets and liabilities in active markets or inputs that are observable for the asset or liability, either directly or indirectly, through market corroboration, for substantially the full term of the asset or liability. Level 3 inputs are unobservable inputs and reflect the Company's estimates of assumptions that market participants would use to measure assets and liabilities at fair value. The fair values are therefore determined using model-based techniques that include option pricing models and discounted cash flow models. A financial asset or liability's classification within the hierarchy is determined based on the lowest level input that is significant to the fair value measurement.

DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS

The Company's financial instruments include cash, accounts receivable, accounts payable and notes payable. The carrying values for the current financial assets and liabilities approximate fair value due to their short maturity. The Company accounts for the 10,000,000 shares of Drone Aviation Corp. stock received as proceeds from the sale of LTAS, which was converted into 10,000,000 shares of Series D Convertible Preferred Stock of Drone Aviation Holding Corp. ("DAHC") on June 3, 2014, as available-for-sale securities. These shares are convertible on a one-for-one basis into shares of common stock of DAHC, but are subject to a contractual lock-up provision for 15 months beginning on June 3, 2014, although the Company will be able to sell a certain volume of shares in months 13 through 15. The Company uses fair value accounting to value these securities. The level 2 securities are not publicly traded, but rather they are convertible on a one-for-one basis into the publicly traded common stock. These securities were valued using observable inputs for the common stock based upon the closing quoted market price. The Company records changes in fair value of the available-for-sales securities as Other Comprehensive Income (Loss).

Fair Value Measurements at September 30, 2014 using:

	Total	(Level 1)	(Level 2)	(Level 3)
Available-for-sale securities	$ —$	—	$ 3,720,000	$ —
Totals	$ —$	—	$ 3,720,000	$ —

USE OF ESTIMATES

The process of preparing financial statements in conformity with U.S. GAAP requires the use of estimates, judgments and assumptions regarding certain types of assets, liabilities, revenues, and expenses. These estimates, judgments and assumptions are evaluated on an ongoing basis. The Company bases its estimates on historical experience and on various other assumptions that it believes are reasonable at that time, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Such estimates primarily relate to unsettled transactions and events as of the date of the financial statements. Accordingly, upon settlement, actual results may differ from the Company's estimated amounts. Other Comprehensive Income represents sources of income (loss) outside the control or operations of the Company.

BASIC AND DILUTED NET LOSS PER COMMON SHARE

Basic and diluted net loss per common share has been computed by dividing the net loss by the weighted average number of shares of common stock outstanding during each period. Whenever losses are reported, the weighted average number of common shares outstanding excludes common stock equivalents because their inclusion would result in a diluted loss per share less than the basic loss per share and therefore would be anti-dilutive. Whenever net income is reported, the weighted average number of common shares outstanding will include common stock equivalents that are in-the-money. If all outstanding options, warrants and convertible shares were converted or exercised on September 30, 2014, the shares outstanding would be 880,414,922.

PROPERTY AND EQUIPMENT

Property and equipment are carried at cost less accumulated depreciation. Depreciation is based on the estimated service lives of the depreciable assets and is calculated using the straight-line method. Expenditures that increase the value or productive capacity of assets are capitalized. Fully depreciated assets are retained in property and accumulated depreciation accounts until they are removed from service. When property and equipment are retired, sold or otherwise disposed of, the asset's carrying amount and related accumulated depreciation are removed from the accounts and any gain or loss is included in operations. Repairs and maintenance are expensed as incurred.

The estimated useful lives of property and equipment are generally as follows:

Appliques	15 – 25 years
Machinery and equipment	3 – 12 years
Office furniture and fixtures	3 – 10 years
Computer hardware and software	3 – 7 years

MARKETABLE SECURITIES

The Company carries its investments in marketable equity securities at fair value, based on quoted market prices. Security transactions are recorded on a trade date basis. Unrealized gains and losses are reported as a component of accumulated other compre–hensive income.

Management determines the appropriate clas–sification of its investments at the time of purchase and reevaluates such determination at each balance sheet date. Marketable debt securities bought and held for short-term trading are classified as "trading securities." Marketable debt securities for which the Company does not have both the intent and ability to hold-to-maturity are classified as "available-for-sale". At September 30, 20, the Company had no trading securities, or investments that it plans to hold-to-maturity.

LONG-LIVED ASSETS

The Company evaluates the fair value of long-lived assets on an annual basis or whenever events or changes in circumstances indicate that its carrying amounts may not be recoverable. Accordingly, any impairment of value is recognized when the carrying amount of a long-lived asset exceeds its fair value. The Company's evaluations have not indicated any impairment of fair values.

SHARE-BASED COMPENSATION

The Company offers share-based compensation programs to its officers, directors and employees that consist of employee stock options, common stock and restricted stock awards. Common stock and restricted stock awards are issued at the closing price of the Company's common stock on the date of grant. The Company recognizes compensation expense ratably over the vesting periods for restricted stock awards using the fair value of the stock on the vest date. The Black-Scholes option pricing model is used to value stock options, and compensation expense is recognized ratably over the requisite service period. Stock options have contractual terms of three to seven years. Share-based compensation for employees and non-employees is included in general administrative expense. Share-based compensation incurred during the nine-months ended September 30, 2014 and 2013 was $507,287 and $358,072 respectively.

NOTE 2. ACQUISITIONS

On March 28, 2013, the Company consummated a Stock Purchase Agreement (the "Agreement") by and among the Company, Lighter Than Air Systems Corp. ("LTAS"), Felicia Hess (the "Shareholder") and Kevin Hess pursuant to which the Company acquired 100% of the outstanding shares of capital stock of LTAS, thereby making LTAS a wholly-owned subsidiary of the Company.

The purchase price paid by the Company for LTAS consisted of $250,000 in cash payable on or before the date that is 30 days after the closing of the acquisition (the "Closing"), 25,000,000 shares of the Company's common stock valued at the acquisition date based on the market price of $0.0269 per share, and an earn-out based on varying percentages of the gross revenues based on the level of revenue from contracts with an identified group of potential customers. No value was ascribed to the earn-out because future revenues, if any, cannot be reliably predicted. Pursuant to the Agreement and an Escrow Agreement, 7,500,000 shares of common stock out of the 25,000,000 shares issued by the Company have been placed in escrow for one year to satisfy possible indemnification claims of the Company. Felicia Hess, the President of LTAS, has entered into an employment agreement to continue in her role as President of LTAS. The Agreement also includes restrictions on the sale of the Company's securities issued as the purchase price by the Shareholder for a one-year period following the Closing.

On December 31, 2013, the Company entered into a First Amendment to the Agreement (the "First Amendment") by and among the Company, LTAS, the Shareholder and Kevin Hess, which amended and restated various terms and conditions of the Agreement and revised the purchase price from 25 million shares plus $250,000 cash payment to 45 million shares and no cash payment due the selling shareholder and deleted the earn-out payment provisions in their entirety.

The following table summarizes the allocation of the LTAS acquisition purchase price, which has been accounted at the fair values of the assets acquired and liabilities assumed under the acquisition method of accounting:

		Original Allocation		Allocation Adjustment		Revised Allocation
Current assets	$	703,220	$	7,195	$	710,415
Property and equipment		1,357		2,556		3,913
Goodwill		479,585		328,239		807,824
Due to selling shareholder		-		(350,000)		(350,000)
Current liabilities assumed		(261,662)		12,010		(249,652)
Total Purchase Price	$	922,500	$	-	$	922,500

NOTE 3. DISCONTINUED OPERATIONS

On May 5, 2014 (the "Closing Date"), the Company entered into a Securities Exchange Agreement (the "Agreement") by and among the Company, Lighter Than Air Systems Corp. ("LTAS"), and Drone Aviation Corp. ("Drone"), a privately-held company, pursuant to which the Company exchanged 100% of the outstanding shares of capital stock of LTAS for a cash payment of $335,000 and 10,000,000 shares of common stock, par value $0.0001 per share, of Drone (the "Shares"). The Shares were converted into 10,000,000 shares of Series D Convertible Stock (the "Preferred Shares") of Drone Aviation Holding Corp. (DAHC), a publicly-held company, and are convertible on a one-to-one basis into shares of common stock of DAHC. The Preferred Shares are currently valued at $3,720,000 based upon the closing price of the DAHC stock on September 30, 2014. The Company signed a Lock-Up Agreement that includes restrictions on the sale of the Shares by the Company for a fifteen-month period following the Closing Date, although the Company will be able to sell a certain volume of shares in the thirteenth through fifteenth month following the

Closing Date. Following the Closing Date, the Company will focus on its Argus airship program which is currently being developed by the Ohio Lighter Than Air UAS Consortium created by the Company and several other companies in August 2013 and growing the business of Global Telesat Corp. (“GTC”).

On the Closing Date, Felicia Hess, Kevin Hess and Dan Erdberg terminated their employment agreements with the Company. As part of the transaction, the Hesses waived certain bonuses, options and accrued wages owed to them from the Company. Effective on the Closing Date, Felicia Hess resigned as a director of WSGI.

The net assets of the LTAS discontinued operations sold on May 5th and at December 31, 2013, carried at fair value were as follows:

	May 5, 2014 (Unaudited)	December 31, 2013 (Audited)
Cash	$30,719	$109,825
Accounts receivable	135,050	8,085
Inventories	72,974	75,311
Prepaid expenses	1,382	1,186
Current assets of discontinued operations	$240,125	$194,407
Property and equipment, net	1,638	1,998
Goodwill	807,824	807,824
Other assets of discontinued operations	$809,462	$809,822
Accounts payable	117,746	72,985
Accounts payable due related party	24,824	50,691
Accrued liabilities	55,676	17,926
Deferred revenues	-	1,650
Current liabilities of discontinued operations	$198,246	$143,252
Net assets of discontinued operations	$851,341	$860,977

The operating results of LTAS since the acquisition date of March 28, 2013 are also reflected in the Company's Condensed Consolidated Statements of Comprehensive Income as discontinued operations through May 5, 2014.

	September 30, 2014 (Unaudited)	September 30, 2013 (Unaudited)
Net sales	250,000	$264,072
Cost of sales	152,513	141,487
General and administrative	90,984	176,653
Research and development	6,449	-
Professional fees	5,589	5,482
Depreciation	360	1,113
Interest expense	936	122
Net income (loss) from discontinued operations	(6,831)	$(60,785)

NOTE 4. RELATED PARTY TRANSACTIONS

The accounts receivable from related party at September 30, 2014 and December 31, 2013 reflects trade receivables due from Global Telesat Communications, Ltd. ("GTCL") of $63,165 and $59,833, respectively. GTCL is a related party based in the United Kingdom and controlled by a current officer of GTC. Total sales to GTCL for the three-months and nine-months ended September 30, 2014 were $106,918 and $338,061, and account for 22.4% and 25.9% of GTC's total sales for the respective periods. Total sales to GTCL for the three and nine-months ended September 30, 2013 were $95,641 and $391,646, respectively, and account for 47% and 33% of GTC's total sales for the respective periods.

NOTE 5. PROPERTY AND EQUIPMENT

Property and equipment consisted of the following:

	September 30, 2014 (Unaudited)	December 31, 2013
Appliques	$ 2,755,732	$ 2,755,732
Office furniture and fixtures	6,904	6,904
	2,762,636	2,762,636
Less: accumulated depreciation	(629,920)	(492,670)
	$ 2,132,716	$ 2,269,966

NOTE 6. OTHER ACCRUED LIABILITIES

Accrued liabilities consisted of the following:

	September 30, 2014 (Unaudited)	December 31, 2013
Payroll liabilities	$ 2,312,020	$ 1,890,245
Professional fees	10,000	10,000
Accrued legal claims payable	198,434	354,684
Accrued cash true-up from conversion	353,873	353,873
Accrued interest on debenture	40,619422	31,133
GTC acquisition payable	75,000	75,000
Other	1,588	80,092
OTHER ACCRUED LIABILITIES	$ 2,991,534	$ 2,795,027

NOTE 7. NOTES PAYABLE

Notes payable consisted of the following:

	September 30, 2014 (Unaudited)	December 31, 2013
Unsecured promissory notes	$ 5,997,030	$ 5,997,030
Unsecured short-term promissory notes	100,000	150,000
Convertible notes payable	267,000	267,000
Accrued interest on the unsecured promissory notes	3,403,205	3,087,053
NOTES PAYABLE	$ 9,767,235	$ 9,501,083

At September 30, 2014 and December 31, 2013, notes payable included two unsecured promissory notes aggregating $5,997,030 with no stated interest rate or terms of repayment. The Company has accrued interest at 7% per annum on both notes since their inception and includes the notes in current liabilities. Loan interest capitalized to debt related to these unsecured promissory notes for the nine months ended September 30, 2014 totaled $313,406.

On February 1, 2013, GTC issued a $100,000 75-day unsecured 10% promissory note to an individual investor for funds received. On March 18, 2013, GTC issued a $50,000 60-day unsecured 12% promissory note to the same investor for funds received. The Company issued 2 million common shares to the investor as an inducement for the loans, which was amortized as financing fees. On September 26, 2014, the parties amended the $100,000 note to extend its maturity date for six months and add the Company as a guarantor of the note. At September 30, 2014, the Company has repaid the $50,000 note with accrued interest. Loan interest capitalized to debt related to the $100,000 unsecured note for the nine months ended September 30, 2014 totaled $2,745.

On February 2, 2012, the Company closed on a Securities Purchase Agreement with a California-based institutional investor (the “Investor”) for an aggregate of $5.5 million. The $500,000 initial tranche was funded at the closing in connection with a Convertible Debenture due in February 2015 and an Equity Investment Agreement (the “EIA”). The Convertible Debenture was converted by the Investor into shares of common stock beginning on May 3, 2012.

The Convertible Debenture grants the Investor with a right of first refusal on future financings of the Company subject to certain terms and conditions and contains acceleration provisions requiring 120% of the principal amount, accrued and unpaid interest, to become immediately due and payable on certain events of default described therein.

Pursuant to the EIA, the Investor agreed to invest an additional $5.0 million in monthly tranches beginning on May 3, 2012. The Investor also has the right to purchase an additional $5.0 million of the Company’s common stock at an exercise price of $0.21 per share for a period of three years.

The Company incurred customary closing costs including attorney’s fees, commissions and closing costs of $62,027, which are recorded as deferred financing costs to be amortized as additional interest expense on a straight-line basis over the 3-year term of the Debenture and EIA.

On July 25, 2013, the Company filed a lawsuit against the Investor in the United States District Court for the Northern District of California relating to the finance documents entered into by the Company and La Jolla in January 2012. In the lawsuit, the Company alleges breach of contract and other causes of action. The Investor has made counterclaims against the Company and is defending against the complaint. The Company has reclassified the convertible notes payable from long-term to current notes payable and continues to accrue interest at the stated interest rate and amortize the deferred financing costs.

NOTE 8. DERIVATIVE LIABILITIES

The Company accounts for derivative instruments at fair value. Gains and losses from changes in the fair value of derivatives are recognized in interest expense. The Company's derivative instruments consist of stock warrants that contained anti-dilution provisions that were issued with certain debt and equity financings. During 2013, all financial instruments that gave rise to the derivative liabilities expired.

NOTE 9. WARRANTS

The Company had entered into financing agreements for convertible promissory notes and stock purchase agreements, which included Class A and Class B warrants. Both Class A and Class B warrants contained anti-dilution rights and were considered to be derivative liabilities under U.S. GAAP. All of the Class A and Class B warrants expired during 2013. Beginning in 2010, the Company entered into new stock purchase agreements and issued an aggregate of 9,677,167 warrants under the 2010 and 2011 stock purchase agreements. Warrants issued under the 2010 and 2011 stock purchase agreements have no anti-dilution rights and are not considered derivative liabilities. All warrants and purchase rights have 3-year terms and are exercisable for a purchase price of $0.21 per share.

The following table summarizes certain information about the Company's warrants and purchase rights:

	Warrants & Purchase Rights	Average Exercise Price
Outstanding at December 31, 2013	18,628,235	$ 0.21
Warrants Granted	0	0
Warrants Expired	(2,583,334)	0.21
Outstanding at September 30, 2014	16,044,901	$ 0.21

All warrants and purchase rights were fully exercisable. The outstanding warrants and purchase rights had no intrinsic value at September 30, 2014 and December 31, 2013.

NOTE 10. LITIGATION AND CONTINGENCIES

In the ordinary conduct of business, we are subject to periodic lawsuits, investigations and litigation claims, which we account for where appropriate. We cannot predict with certainty the ultimate resolution of such lawsuits, investigations and claims asserted against us. As of the date hereof, we had the following material contingencies:

The DeCarlo Group

A lawsuit was filed by the DeCarlo Group on November 24, 2010 in Miami-Dade County Courthouse claiming damages in excess of $1.1 million, including $400,000 claimed in connection with CFO and accounting services rendered to the Company. It is our position that we were overcharged in connection with the services rendered and that no amounts are due. On July 2, 2014, without either party admitting liability, we and the DeCarlo Group entered into a confidential settlement agreement in the amount of $85,000 to be paid during the next twenty-four months. The Court will retain jurisdiction in the matter until the full amount of the settlement is paid in full. However, in the event we default on any payment or provision of the settlement agreement, the DeCarlo Group may, pursuant to the settlement agreement, pursue its litigation.

La Jolla Cove Investors, Inc.

On July 25, 2013, we filed a lawsuit against La Jolla Cove Investors, Inc. in the United States District Court for the Northern District of California relating to the finance documents entered into by us and La Jolla in January 2012. In the lawsuit, we allege breach of contract and other causes of action. Through stipulation during litigation, the parties agreed to refrain from enforcing, or attempting to enforce, any part or terms of the finance documents pending final resolution. We are seeking unspecified monetary damages as well as other relief. La Jolla has made counterclaims against us and is defending against our complaint. We intend to otherwise pursue this matter vigorously, but the outcome of the action cannot be predicted.

IRS

During 2010 and 2009, we, under our former name Sanswire Corp., incurred and reported to the Internal Revenue Service ("IRS") payroll tax liabilities (and deposited the appropriate withholding amounts) during the normal course of business at each payroll cycle. We reported payroll tax liabilities for all the tax periods in 2007 and 2008, however, we failed to deposit the appropriate withholding amounts for those periods. We recognized this issue and, accordingly, contacted the IRS to make arrangements to pay any taxes due. One such matter has been resolved with the IRS, and we currently estimate the amount involved in the second matter to be approximately $200,000. We may be subject to additional penalties and interest from the IRS in connection with these payroll tax matters. We are engaged in discussions and continue to cooperate with the IRS to resolve this matter.

NOTE 11. SHARE-BASED COMPENSATION

The Company issues stock-based compensation that consists of common stock, restricted stock and stock options to its directors, officers, employees and consultants. All common stock and restricted stock awards are subject to the securities law restrictions of Rule 144 as promulgated under the Securities Act of 1933, as amended, unless covered by a registration statement.

Common Stock

The Company recognizes the cost of the common stock issued to directors, officers, and employees as compensation expense at the closing market price on the grant date. All common stock awards are fully vested on the date of grant, therefore there is no unrecognized compensation associated with these awards. During the nine-months ended September 30, 2014, there were no share-based compensation awards of common stock. During the nine-months ended September 30, 2013, the Company awarded 900,000 shares for $13,890 for quarterly directors' fees, including 600,000 shares issued to the former Chairman of the Board of Directors pursuant to a settlement agreement.

Restricted Stock

Awards of restricted stock are generally subject to forfeiture if employment terminates prior to vesting. Prior to vesting, ownership of the restricted stock cannot be transferred. The restricted stock has the same voting rights as the common stock. The Company recognizes the grant date fair value of restricted stock awards ratably over the vesting period as compensation expense based upon the stock's closing market price on the vest date. Compensation expense for restricted stock that vested during the nine-months ended September 30, 2014 totaled $95,200. Compensation expense for performance-based restricted stock that vested during the nine-months ended September 30, 2013 totaled $9,312. During the first quarter of 2013, the Company awarded 12 million shares to certain officers as retention bonuses, which were originally slated to cliff vest on February 6, 2014 – all of these restricted shares were rescinded and exchanged for fully-vested options on December 31, 2013. Also during the first quarter of 2013, the Company awarded 4 million shares to certain employees as retention bonuses, which cliff vested on August 7, 2013 for $72,000. On July 29, 2013, the Company awarded 4 million shares for $95,200 with a six-month cliff vest as an employee retention bonus. On September 25, 2013, the Company issued 7,692,308 shares in lieu of $100,000 in accrued employee salaries. Unrecognized compensation relating to unvested restricted stock at September 30, 2014 and 2013 totaled approximately $23,450 and $469,215, respectively.

Stock Options

The Company has issued stock options at exercise prices equal to the Company's common stock market price on the date of grant with contractual terms of three to seven years. Historically, the stock options were fully vested and expensed as compensation on the grant date. During 2010, the Company began issuing stock options with vesting schedules and such stock options are generally subject to forfeiture if employment terminates prior to vesting. During the nine-months ended September 30, 2014, the Company awarded 41.2 million fully-vested options for $370,000 in retention bonuses; $8,095 in directors' fees; and $22,006 in consulting fees. The fair value of options issued in a previous period that vested during the nine-month period of 2014 totaled $33,993. At September 30, 2014, there is approximately $45,000 in unrecognized compensation expense relating to unvested stock options. During the nine-months ended September 30, 2013, the Company awarded 2 million options that cliff vest on February 6, 2014 in retention bonuses and issued 900,000 fully-vested options totaling $18,913 as directors' fees. On July 29, 2013, the Company awarded 12 million fully-vested options totaling approximately $285,600 as share-based compensation. On September 25, 2013, the Company issued 40,355,693 fully-vested options totaling approximately $524,624 for accrued employee salary conversions. Vested options during the nine-month period ended September 30, 2013 totaled $849,594. At September 30, 2014 and 2013, unrecognized compensation expense relating to unvested stock options totaled approximately $45,000 and $92,315, respectively.

The Company uses the Black-Scholes option pricing model to estimate the fair value of stock options. The principal assumptions utilized in valuing stock options include the expected stock price volatility based on the most recent historical period equal to the expected life of the option; an estimate of the expected option life based upon historical experience; no expected dividend yield; and the risk-free interest rate based upon on the yields of Treasury constant maturities for the remaining term of the option.

The following table summarizes information about stock options outstanding and exercisable at September 30, 2014:

	Options Outstanding and Exercisable		
Exercise prices	Number outstanding	Weighted average remaining contractual terms (years)	Weighted Average Exercise price
$.0042	400,000	2.83	$ .0042
.0083	3,400,000	2.50	.0083
.0096	12,000,000	6.25	.0096
.010	26,400,000	6.35	.010
.011	400,000	2.12	.011
.013	29,826,924	5.99	.013
.015	11,000,000	5.01	.015
.016	250,000	1.42	.016
.017	2,000,000	5.36	.017
.021	250,000	1.62	.021
.023	17,416,667	5.12	.023
.024	12,000,000	5.83	.024
.028	400,000	1.83	.028
.075	6,500,000	3.50	.075
	122,243,591	5.57	$ .018

No options were in-the-money on September 30, 2014.

NOTE 12. INCOME TAXES

The Company has federal and state net operating loss (NOL) carry-forwards, which can be used to offset future earnings. Accordingly, no provision for income taxes is recorded in these consolidated financial statements. A deferred tax asset for the future benefits of net operating losses and other differences is offset by a 100% valuation allowance due to the uncertainty of the Company's ability to realize future tax benefits from the losses. These net operating losses will expire in the years 2021 through 2031.

Certain income and expenses are recognized in different periods for tax and financial reporting purposes. The items that give rise to these temporary differences at the Company consist of its NOL carry-forwards and the related valuation allowances. The resulting deferred tax assets and liabilities consist of the tax effects (computed at 15%) of the temporary differences.

The Company also had net operating loss carry-forwards of its predecessor, related to its reincorporation and reorganization under the Internal Revenue Code, available to offset future taxable income. These NOL carry-forwards total approximately $81,429,083 and expire at various dates through 2022. The Company operated in multiple tax jurisdictions within the United States of America. Although management does not believe that the Company is currently under examination in any major tax jurisdiction in which it operates other than for the issues with the IRS as described in Note 9, the Company remains subject to examination in all of those tax jurisdictions until the applicable statute of limitations expire. At September 30, 2014, tax years subsequent to 2007 remain subject to examination by the Internal Revenue Service ("IRS") and in the Company's major state tax jurisdictions.

NOTE 13. PER SHARE INFORMATION

Basic earnings per share (“Basic EPS”) of common stock is computed by dividing the net loss by the weighted-average number of shares of common stock outstanding. Diluted earnings per share of common stock (“Diluted EPS”) is computed by dividing the net loss by the weighted-average number of shares of common stock, and dilutive common stock equivalents and convertible securities then outstanding. U.S. GAAP requires the presentation of both Basic EPS and Diluted EPS on the face of the Company’s Condensed Consolidated Statements of Comprehensive Income. There were no dilutive common stock equivalents.

	Nine-Months Ended September 30,	
	2014	2013
Numerator:		
Net loss from continuing operations	$(2,403,864)	$(2,342,329)
Net income (loss) from discontinued operations	$(6,831)	$(60,785)
Denominator:		
Weighted-average common shares outstanding	715,897,618	597,936,763
Dilutive effect of stock warrants and stock options	0	0
Weighted-average common shares outstanding, assuming dilution	715,897,618	597,936,763
Net loss per share:		
Basic and diluted from continuing operations	$(0.00)	$(0.00)
Basic and diluted from discontinued operations	$(0.00)	$(0.00)

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

This Quarterly Report on Form 10-Q, including this Management’s Discussion and Analysis of Financial Condition and Results of Operations, contains forward-looking statements regarding future events and our future results. All statements other than statements of historical facts are statements that could be deemed forward-looking statements.

Certain statements in this Quarterly Report on Form 10-Q may contain words such as “anticipates,” “expects,” “intends,” “plans,” “believes,” “seeks,” “estimates,” “may,” “could,” “would” and other similar language and are considered forward l statements or information. In addition, any information or statements that refer to expectations, beliefs, plans, projections, objectives, performance or other characterizations of future events or circumstances, including any underlying assumptions, are forward-looking, and based on our current expectations, estimates, forecasts and projections about the operating environment, economies and markets in which we operate. Such forward-looking information or statements are subject to important assumptions, risks and uncertainties that are difficult to predict, and the actual outcome may be materially different. Our assumptions, although considered reasonable by us at the date of this Report, may prove to be inaccurate and consequently our actual results could differ materially from the expectations set out herein.

We undertake no obligation to revise or publicly release the results of any revisions to these forward-looking statements or information. You should carefully review documents we file from time to time with the Securities and Exchange Commission. A number of factors may materially affect our business, financial condition, operating results and prospects. These factors include but are not limited to those set forth in our Annual Report on Form 10-K and elsewhere in this Quarterly Report on Form 10-Q. Any one of these factors may cause our actual results to differ materially from recent results or from our anticipated future results. You should not rely too heavily on the forward-looking statements contained in this Quarterly Report on Form 10-Q, because these forward-looking statements are relevant only as of the date they were made.

The following MD&A is intended to help readers understand the results of our operation and financial condition, and is provided as a supplement to, and should be read in conjunction with, our condensed consolidated financial statements and the accompanying Notes to Condensed Consolidated Financial Statements under Part I, Item1 of this Quarterly Report on Form 10-Q.

Growth and percentage comparisons made herein generally refer to the three and nine months ended September 30, 2014 compared with the three and nine months ended September 30, 2013 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 are references to World Surveillance Group Inc. and, depending on the context, its subsidiaries.

General

We design and develop autonomous lighter-than-air (LTA) unmanned aerial systems (UAS) designed to carry payloads that provide semi-persistent intelligence, surveillance and reconnaissance (ISR), security and/or wireless communications from air to ground solutions at low and mid altitudes. Our business focuses primarily on the design and development of innovative UAS that are designed to provide situational awareness and other communications capabilities via the integration of wireless capabilities and customer payloads. Our airships when integrated with cameras, electronics systems and other high technology payloads, are designed for use by government-related and commercial entities that require real-time ISR or communications support for military, homeland defense, border control, drug interdiction, natural disaster relief, maritime and environmental missions.

Through our wholly owned subsidiary Global Telesat Corp. (GTC), we provide mobile voice and data communications services globally via satellite to the U.S. government, defense industry and commercial users. GTC specializes in services related to the Globalstar satellite constellation, including satellite telecommunications voice airtime, tracking devices and services, and ground station construction. GTC has an e-commerce mobile satellite solutions portal and is an authorized reseller of satellite telecommunications equipment and services offered by other leading satellite network providers such as Inmarsat, Iridium, Globalstar and Thuraya. GTC also has a subscription based online tracking portal called GTCTrack, designed to attract new satellite and GSM tracking customers by offering an easy-to-use interface and compatibility with a wide range of devices. GTC's equipment is installed in various ground stations across Africa, Asia, Australia, Europe and South America.

On September 22, 2008 we filed a Certificate of Merger with the Secretary of State of the State of Delaware pursuant to which our newly formed wholly-owned subsidiary, Sanswire Corp., a Delaware corporation, was merged into us and our corporate name was changed from GlobeTel Communications Corp. to Sanswire Corp. Effective April 19, 2011, we merged a newly created, wholly-owned Delaware subsidiary, World Surveillance Group Inc., with and into the Company, with the Company being the surviving corporation. Our Restated Certificate of Incorporation is the charter of the surviving corporation except that our name has been changed to World Surveillance Group Inc. In connection with the change of our corporate name, effective April 25th our stock ticker symbol, under which our common stock is now traded, was changed to "WSGI".

On May 25, 2011 we completed our acquisition of privately-held Global Telesat Corp. We acquired 100% of the issued and outstanding securities of GTC, making GTC a wholly owned subsidiary of the Company. GTC supplies satellite based tracking and communication solutions to government, defense and commercial customers.

On March 28, 2013 we completed our acquisition of privately-held Lighter Than Air Systems Corp. We acquired 100% of the issued and outstanding securities of LTAS, making LTAS a wholly owned subsidiary of the Company. On May 5, 2014, we exchanged 100% of the outstanding stock of LTAS for a cash payment of $335,000 and 10,000,000 shares of common stock of Drone Aviation Corp. (DAC). For purposes of this Form 10-Q, our financial statements reflect the accounts and operations of LTAS as discontinued operations. Following the LTAS sale, we intend to refocus our efforts on our Argus One program and GTC's business. The DAC shares were converted into 10,000,000 share of Series D Convertible Preferred stock (the "Preferred Shares") of Drone Aviation Holding Corp. (DAHC) on June 3, 2014. The Preferred Shares are convertible on a one-for-one basis into common shares of DAHC and are recorded as an asset of the Company. The Preferred Shares were valued at $9,000,000 based upon the closing price of DAHC common stock on June 30, 2014. As a result of the sale of LTAS, WSGI received cash for working capital and shares in DAHC, which will allow WSGI to hopefully benefit in the future success of the LTAS business.

Our current principal office is located at State Road 405, Building M6-306A, Room 1400, Kennedy Space Center, FL 32815, and our telephone number at that location is (321) 452-3545. Our internet address is www.wsgi.com. Information contained on our website is not a part of this report and the inclusion of our website address in this report is an inactive textual reference only.

Results of Operations

Comparison of Three Months Ended September 30, 2014 and 2013

Revenues. Revenues for the three-months ended September 30, 2014 were $476,981 compared to $428,668 for the three-months ended September 30, 2013 reflecting an increase of $48,313 or 11.3%. The increase in revenues during the 2014 period resulted primarily from an increase in the volume of GTC website and Amazon/eBay stores sales.

Cost of Sales. The cost of sales for the three-months ended September 30, 2014 was $351,733 compared to $412,579 for the three- months ended September 30, 2013 reflecting a decrease of $60,846 or 14.7%. The decrease in cost of sales during the third quarter of 2014 is attributed to the greater GTC website and Amazon/eBay stores sales volume and higher margin product mix.

Operating Expenses. Operating expenses consist primarily of compensation, professional fees, research and development, as well as expenses for executive and administrative personnel, insurance, facilities expenses, travel and related expenses, depreciation and amortization and other general corporate expenses. Operating expenses for the three-months ended September 30, 2014 were $411,899 compared to $864,216 for the three-months ended September 30, 2013. The decrease of $452,317, or 52.3%, resulted primarily from decreased general and administrative expenses of $443,918 compared to the third quarter of 2013. The decrease in general and administrative expenses is primarily attributable to reductions in vested share-based compensation and accrued salaries of approximately $437,000 during the third quarter of 2014.

Loss From Operations. The loss from operations of $286,651 for the three-months ended September 30, 2014 compares to a loss from operations of $848,127 for the three-months ended September 30, 2013. The decreased loss of $561,476, or 66.2%, is primarily attributable to the increased GTC sales and reductions in compensation described above.

Net Other Income (Expense). Interest expense totaled $118,410 for the three-months ended September 30, 2014 compared to interest expense of $111,469 for the three-months ended September 30, 2013, an increase of $6,941, or 6.2%.

Net Loss from Continuing Operations. The net loss from continuing operations of $405,061 for the three-months ended September 30, 2014 compared to net loss from continuing operations of $959,596 for the three-months ended September 30, 2013, a decreased loss of $554,535, or 57.8%. This decreased loss reflects the increase in GTC sales and the decrease in compensation during the quarter ended 2014 described above.

Other Comprehensive Income (Expense). We received 10,000,000 shares of Drone Aviation Corp. common stock as part of the proceeds from the sale of LTAS on May 5, 2014. These shares were converted into 10,000,000 shares of Series D Convertible Preferred Stock of Drone Aviation Holding Corp. (the “DAHC Stock”) on June 3, 2014, which are convertible into shares of DAHC common stock. We recorded the DAHC Stock as available-for-sale securities, although the shares are subject to a contractual 15-month lock-up provision, we will be able to sell a certain volume of shares in months 13 through 15. We have elected to value the DAHC Stock at fair value using the DAHC common stock closing price at the end of each reporting period. On September 30, 2014, the DAHC Stock held by the Company was valued at $3,720,000 and is recorded as an asset. We will record changes in fair value of the DAHC Stock as Other Comprehensive Income (Expense), which is reported separately from Net Loss as it represents income (expense) outside the control or influence of our operations.

Comparison of Nine-Months Ended September 30, 2014 and 2013

Revenues. Revenues for the nine-months ended September 30, 2014 were $1,306,386 compared to $1,192,150 for the nine-months ended September 30, 2013 reflecting an increase of $114,236 or 9.6%. The increase in revenues during the 2014 period resulted primarily from increased sales volume from the GTC website and Amazon/eBay stores. Revenues during the nine-months ended September 30, 2013 included the sale of a BiB aerostat system by GTC for $302,703. Sales generated by GTC's website and Amazon/eBay stores during the nine-months ended September 30, 2014 increased $416,939 or 46.9% over the same period of 2013.

Cost of Sales. The cost of sales for the nine-months ended September 30, 2014 was $979,663 compared to $912,178 for the nine-months ended September 30, 2013 reflecting an increase of $67,485 or 7.4%. The increase in cost of sales during the nine-months ended September 30, 2014 is attributed to the higher GTC website and Amazon/eBay store sales volume.

Operating Expenses. Operating expenses consist primarily of compensation, professional fees, research and development, as well as expenses for executive and administrative personnel, insurance, facilities expenses, travel and related expenses, depreciation and amortization and other general corporate expenses. Operating expenses for the nine-months ended September 30, 2014 were $1,936,787 compared to $2,009,297 for the nine-months ended September 30, 2013. The decrease of $72,510 or 3.6%, resulted primarily from decreased general and administrative expenses of $102,878, which reflects lower share-based compensation and accrued salaries during the nine-months ended September 30, 2014.

Loss From Operations. The loss from operations of $1,610,064 for the nine-months ended September 30, 2014 compares to a loss from operations of $1,729,325 for the nine-months ended September 30, 2013. The decreased loss of $119,261 or 6.9%, is primarily attributable to the lower share-based compensation awarded or vesting and salary expense during the nine-months ended 2014.

Net Other Income (Expense). Net other expense totaled $793,800 for the nine-months ended September 30, 2014 compared to net other expense of $613,004 for the same period ended September 30, 2013, an increased loss of $180,796 or 29.5%. Net other expense for the nine-months ended September 30, 2013 included $233,381 in losses from conversion agreement true-up, which are no longer being incurred in 2014. Net other expense for the nine-months ended September 30, 2014 included $443,183 in losses from sale of discontinued operations, which didn't incur in 2013.

Net Loss from Continuing Operations. The net loss from continuing operations of $2,403,864 for the nine-months ended September 30, 2014 compared to net loss from continuing operations of $2,342,329 during the nine-months ended September 30, 2013, an increased loss of $61,535 or 2.6%, reflects the increase in GTC sales volume, the reduction in vested share-based compensation and salary expense, and the discontinuation of the loss from conversion agreement true-up, described above offset by the loss on sale of discontinued operations.

Other Comprehensive Income (Expense). We received 10,000,000 shares of Drone Aviation Corp. common stock as part of the proceeds from the sale of LTAS on May 5, 2014. These shares were converted into 10,000,000 shares of Series D Convertible Preferred Stock of Drone Aviation Holding Corp. (the "DAHC Stock") on June 3, 2014, which are convertible into shares of DAHC common stock. We recorded the DAHC Stock as available-for-sale securities, although the shares are subject to a contractual 15-month lock-up provision, we will be able to sell a certain volume of shares in months 13 through 15. We have elected to value the DAHC Stock at fair value using the DAHC common stock closing price at the end of each reporting period. On September 30, 2014, the DAHC Stock held by the Company was valued at $3,720,000 and is recorded as an asset. We will record changes in fair value of the DAHC Stock as Other Comprehensive Income (Expense), which is reported separately from Net Loss as it represents income (expense) outside the control or influence of our operations.

Liquidity and Capital Resources

Assets. Our cash balance was $5,021 at September 30, 2014 compared to $8,907 at December 31, 2013, reflecting a decrease of $3,886. Accounts receivable increased $34,036 at September 30, 2014 compared to September 30, 2013 reflecting a higher volume of credit sales from GTC's website. Total assets at September 30, 2014 excluding discontinued operations were $6,143,786 compared to $2,459,695 at December 31, 2013, reflecting an increase of $3,684,091 due principally to the fair value of the 10,000,000 shares of DAHC Stock. The DAHC Stock is subject to a 15-month lock-up provision, although we will be able to sell a certain volume of DAHC Stock in months 13 through 15. The Company has elected to record the DAHC Stock as available-for-sale securities and value them at fair value using the DAHC common stock's closing price at the end of each reporting period. On September 30, 2014, the DAHC Stock was valued at $3,720,000. Fair value adjustments are recorded as Other Comprehensive Income (Expense) in the Statements of Comprehensive Income and listed separately as a component of Stockholders' Deficit on the Consolidated Balance Sheets.

Liabilities. At September 30, 2014, the Company had total current liabilities excluding the discontinued operations of $17,292,275 compared to $16,816,772 at December 31, 2013, an increase of $475,503 or 2.8%. This increase is primarily attributable to the increases in accrued interest capitalized in notes payable of $266,152 and other accrued liabilities of $196,507.

Cash Flows. Net cash used by operating activities in continuing operations during the nine-months ended September 30, 2014 was $493,886 compared to net cash used by operating activities of $577,423 for the same period in 2013, a decrease of $83,537, primarily reflecting a reduction in net loss.

Net cash provided by investing activities in continuing operations for the nine-month period ended September 30, 2014 included the cash proceeds from the sale of LTAS of $335,000 less $10,000 paid in attorney fees. There were no cash flows from investing activities from continuing operations for the nine-months ended September 30, 2013.

Net cash provided by financing activities in continuing operations was $165,000 and $20,000 during the nine-months of 2014 and 2013, respectively. During the nine-months ended September 30, 2014, we received $215,000 in proceeds from the sale of common stock and paid-off a $50,000 unsecured promissory note with accrued interest. During the nine-months ended September 30, 2013, we received $120,000 from the sale of common stock, $150,000 in proceeds from the issuance of two short-term unsecured promissory notes and paid $110,000 against the LTAS acquisition payable and $140,000 to the LTAS shareholder.

Pursuant to a Stock Purchase Agreement relating to our acquisition of GTC in May 2011, the purchase price includes an earn-out equal to 5% of the gross revenues related to the construction by GTC of certain potential satellite ground stations. These earn-out payments are unlikely to materially impact our liquidity and capital resources since payments are required to be made to the former shareholder of GTC by us only upon the actual receipt of cash from a customer related to a ground station construction contract. The earn-out payments would have the effect of reducing our margin on any such contract. We are obligated to make these earn-out payments until the earlier of May 25, 2036 or the date on which GTC no longer has the right to construct ground stations under the applicable agreement with Globalstar.

The accompanying condensed consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the settlement of liabilities and commitments in the normal course of business. However, as reflected in the accompanying condensed consolidated financial statements, the Company incurred a loss from operations of $1,610,064 for the nine-months ended September 30, 2014. The Company also had a working capital deficit of $17,008,096 and total stockholders' deficit of $11,148,489, as well as an accumulated deficit of $154,823,252 at September 30, 2014. These factors raise substantial doubt about the Company's ability to continue as a going concern. The Company's ability to continue as a going concern is dependent upon its ability to raise additional funds either through investments or by generating revenue from the sale of the Company's products to continue its business operations and implement its strategic plan, which includes, among other things, continued development of its UAS, the pursuit or continued development of strategic relationships and expansion of the Company's subsidiary's business. The Company's business plan, which if successfully implemented, will allow it to sell UAS and other products for a profit, which in turn will reduce the Company's dependence on raising additional funds from outside sources. The condensed consolidated financial statements do not include any adjustments that might be necessary if the Company is unable to continue as a going concern. The Company anticipates a net loss to continue for at least the next several quarters.

Additional cash will be needed to support our ongoing operations until such time that operations provide sufficient cash flow to cover expenditures. We are currently pursuing both short and long-term financing options from private investors as well as through institutional investors. We are also working to commercialize our aerostats, Argus One airship, and our subsidiary's products to generate revenues from customers. While we have not sold any of our Argus One airships, we are already generating revenue from our subsidiary's products. The costs associated with our strategic plan are variable and contingent on our ability to raise capital or generate revenue from customer contracts, but we expect to need funding of approximately $3 million over the next 12 months. We are currently in litigation with La Jolla Cove Investors and do not expect any future funding under those agreements. We continue to have discussions with various entities relating to funding, but there can be no assurance that such funding will be received in the amounts required, on a timely basis, or at all. While we believe we will be able to continue to raise capital from various funding sources in such amounts sufficient to sustain operations at our current levels through at least the next several quarters, if we are not able to do so and if we are not able to generate sufficient revenue through the sale of our products, we would likely need to modify our strategy or cut back or terminate some of our operations. If we are able to raise additional funds through the issuance of equity securities, substantial dilution to existing shareholders may result. However, if our plans are not achieved, if significant unanticipated damaging events occur, or if we are unable to obtain the necessary additional funding on favorable terms or at all, we will likely have to modify our business plan and reduce, delay or discontinue some or all of our operations to continue as a going concern or seek a buyer for all or a portion of our assets. As of the date hereof, we continue to raise capital to sustain our current operations.

Off-Balance Sheet Arrangements

We do not enter into off-balance sheet financing as a matter of practice except for the use of operating leases for office space; none of which have, or potentially may have, a material effect on our financial condition, revenue, expenses, results of operations, liquidity, capital expenditures or capital resources. In accordance with U.S. GAAP, these leases do not meet the criteria for capitalization and are recorded as operating leases.

Critical Accounting Policies and Use of Estimates

Our Management's Discussion and Analysis of Financial Condition and Results of Operation is based upon our condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP). The preparation of our condensed consolidated financial statements in accordance with U.S. GAAP requires us to make certain estimates, judgments and assumptions that affect the reported amounts of assets and liabilities as of the date of the financial statements, the reported amounts and classification of revenues and expense during the periods presented, and the disclosure of contingent assets and liabilities. We evaluate our estimates and assumptions on an ongoing basis and material changes in these estimates or assumptions could occur in the future. Changes in estimates are recorded in the period in which they become known. We base our estimates on historical experience and various other assumptions that we believe to be reasonable under the circumstances and at that time, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ materially from these estimates if past experience or other assumptions do not turn out to be substantially accurate.

Please refer to our Note 1 of our condensed consolidated financial statements contained in this Quarterly Report on Form 10-Q, and our Management's Discussion and Analysis of Financial Condition and Results of Operation contained in Part II, Item 7 of our Annual Report on Form 10-K for our fiscal year ended December 31, 2013 and Note 1 of our consolidated financial statements contained therein for a more complete discussion of our critical accounting policies and use of estimates.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures (as that term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (Exchange Act)) that are designed to ensure that information required to be disclosed in our reports under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosures. Any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of September 30, 2014. Based upon that evaluation and subject to the foregoing, our Chief Executive Officer and Chief Financial Officer concluded that, as of September 30, 2014, the design and operation of our disclosure controls and procedures were effective to accomplish their objectives at the reasonable assurance level.

Changes in Internal Control Over Financial Reporting

There have been no changes in the Company's internal control over financial reporting during the third quarter of 2014, which were identified in connection with management's evaluation required by paragraph (d) of Rules 13a-15 and 15d-15 under the Exchange Act, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

In the ordinary conduct of business, we are subject to periodic lawsuits, investigations and litigation claims, which we account for where appropriate. We cannot predict with certainty the ultimate resolution of such lawsuits, investigations and claims asserted against us. As of the date hereof, we had the following material contingencies:

The DeCarlo Group

A lawsuit was filed by the DeCarlo Group on November 24, 2010 in Miami-Dade County Courthouse claiming damages in excess of $1.1 million, including $400,000 claimed in connection with CFO and accounting services rendered to the Company. It is our position that we were overcharged in connection with the services rendered and that no amounts are due. On July 2, 2014, without either party admitting liability, we and the DeCarlo Group entered into a confidential settlement agreement in the amount of $85,000 to be paid during the next twenty-four months. The Court will retain jurisdiction in the matter until the full amount of the settlement is paid in full. However, in the event we default on any payment or provision of the settlement agreement, the DeCarlo Group may, pursuant to the settlement agreement, pursue its litigation.

La Jolla Cove Investors, Inc.

On July 25, 2013, we filed a lawsuit against La Jolla Cove Investors, Inc. in the United States District Court for the Northern District of California relating to the finance documents entered into by us and La Jolla in January 2012. In the lawsuit, we allege breach of contract and other causes of action. Through stipulation during litigation, the parties agreed to refrain from enforcing, or attempting to enforce, any part or terms of the finance documents pending final resolution. We are seeking unspecified monetary damages as well as other relief. La Jolla has made counterclaims against us and is defending against our complaint. We intend to otherwise pursue this matter vigorously, but the outcome of the action cannot be predicted.

IRS

During 2010 and 2009, we, under our former name Sanswire Corp., incurred and reported to the Internal Revenue Service (“IRS”) payroll tax liabilities (and deposited the appropriate withholding amounts) during the normal course of business at each payroll cycle. We reported payroll tax liabilities for all the tax periods in 2007 and 2008, however, we failed to deposit the appropriate withholding amounts for those periods. We recognized this issue and, accordingly, contacted the IRS to make arrangements to pay any taxes due. One such matter has been resolved with the IRS, and we currently estimate the amount involved in the second matter to be approximately $200,000. We may be subject to additional penalties and interest from the IRS in connection with these payroll tax matters. We are engaged in discussions and continue to cooperate with the IRS to resolve this matter.

The Company provides indemnification, to the extent permitted by law, to its’ officers, directors, employees and agents for liabilities arising from certain events or occurrences while the officer, director, employee, or agent is or was serving at the Company’s request in such capacity.

Item 1A. Risk Factors

Investing in or purchasing shares of our common stock involves a high degree of risk. You should carefully consider the risks and uncertainties described below, together with all of the other information in this prospectus, including our consolidated financial statements and related notes, before deciding whether to purchase or invest in shares of our common stock. If any of the following risks are realized, our business, financial condition, operating results and prospects could be materially and adversely affected. In that event, the price of our common stock would likely decline, and you could lose part or all of your investment in our common stock.

Risks Related to Our Business and Industry

We need to raise a significant amount of additional capital to continue our operations which capital may be costly and difficult to obtain, and if we are unable to raise additional capital, we would likely have to delay, curtail, scale back or terminate some or all of our operations, prematurely sell some or all of our assets, merge with or be acquired by another company, or possibly shut down our operations.

We need to raise significant additional capital in order to meet our cash requirements to fully implement our business plan and continue our operations during the next twelve months. At September 30, 2014, we had $5,021 in cash and negative working capital of $17,008,096 and for the nine-months ended September 30, 2014, we had a net loss of $2,410,695. We expect to use the funds raised, if any, to expand and accelerate our sales capabilities and research and development efforts, acquire complimentary technology, companies or personnel, hire additional personnel, implement additional corporate governance measures, attract independent board members and for other operating activities. We will, as we deem necessary and prudent, continue to seek to raise additional capital through various financing alternatives, including the private or public sale of equity or debt securities, bank financing or corporate partnering arrangements. We are currently in litigation with La Jolla Cove Investors and do not expect any future financing under those agreements. We do not have any firm commitments for additional capital from third parties or from our officers, directors or shareholders. Although our officers and directors or their affiliates have in the past provided us with or helped us obtain capital, they are not legally bound to do so. We may not be able to raise additional capital on terms acceptable to us or at all. In order to attract new investors and raise additional capital, we may be forced to provide rights and preferences to new investors that are not available to current stockholders and that may be adverse to existing investors. If we do not receive adequate additional financing on terms satisfactory to us on a timely basis, or at all, we would not be able to meet our cash payment obligations or fully implement our business plan. We would likely also have to delay, curtail, scale back or terminate some or all of our operations that could hurt our future performance, prematurely sell some or all of our assets on undesirable terms, merge with or be acquired by another company on unsatisfactory terms, or possibly shut down our operations.

We have a history of operating losses that we anticipate will continue for the foreseeable future.

We have a history of losses from operations and we anticipate that for the foreseeable future, we will continue to experience losses from operations. Those losses have resulted principally from costs incurred from general and administrative expenses, settlements and professional fees associated with our business. We had losses from operations of $1,610,064 for the nine-months ended September 30, 2014; $2,733,084 for the year ended December 31, 2013; and $4,541,587 during 2012. Our accumulated deficit at September 30, 2014 was $154,823,252. We expect to continue to incur net losses from operations for at least the next several quarters as we continue to develop and commercialize our products.

We have incurred substantial indebtedness and may be unable to service our debt.

Our total indebtedness at September 30, 2014 was $17,292,275. A portion of such indebtedness reflects judicial judgments against us that could result in liens being placed on our bank accounts or assets. We are continuing to review our ability to reduce this debt level due to the age and/or settlement of certain payables but we may not be able to do so. This level of indebtedness could, among other things:

- make it difficult for us to make payments on this debt and other obligations;
- make it difficult for us to obtain future financing;
- require us to redirect significant amounts of cash from operations to servicing the debt;
- require us to take measures such as the reduction in scale of our operations that might hurt our future performance in order to satisfy our debt obligations; and
- make us more vulnerable to bankruptcy or an unwanted acquisition on terms unsatisfactory to us.

Our independent auditors have issued a report stating that there is substantial doubt relating to our ability to continue as a going concern, which may impair our ability to raise additional financing.

The report of our independent auditors contained in our consolidated financial statements for the years ended December 31, 2013 and 2012 explains that we have incurred substantial operating losses and raises substantial doubt about our ability to continue as a going concern. Analysts and investors view reports of independent auditors questioning a company's ability to continue as a going concern unfavorably. This report may make it difficult for us to raise additional debt or equity financing necessary to continue our business operations and the development of our airships. Potential investors should review this report before making a decision to invest in the Company.

Product development is a long, expensive and uncertain process.

The development of LTA UAS is a costly, complex and time-consuming process, and the investment in product development often involves a long wait until a return, if any, is achieved on such investment. Investments in new technology and processes are inherently speculative. We also now rely on the UAS Ohio Consortium for the development of our Argus One airship. We have experienced numerous setbacks and delays in our research and development efforts and may encounter further obstacles in the course of the development of additional technologies and products. We may not be able to overcome these obstacles or may have to expend significant additional funds and time. Technical obstacles and challenges we encounter in our research and development process may result in delays in or abandonment of product commercialization, may substantially increase the costs of development, and may negatively affect our results of operations.

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

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

- failure to obtain the required regulatory approvals for their use;
- prohibitive production costs;
- competing products;
- lack of innovation of the product;
- ineffective distribution and marketing;
- lack of sufficient cooperation from our partners; and
- demonstrations of the products not aligning with or meeting customer needs.

Although we have sold our GTC products, we have not yet sold any of our Argus One airships in the commercial marketplace. Our success in the market for the products we develop will depend largely on our ability to prove our products' capabilities. Upon demonstration, our airships and other products may not have the capabilities they were designed to have or that we believed they would have. Furthermore, even if we do successfully demonstrate our products' capabilities, potential customers may be more comfortable doing business with a larger, more established, more proven company than us. Moreover, competing products may prevent us from gaining wide market acceptance of our products. Significant revenue from new product investments may not be achieved for a number of years, if at all.

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

We anticipate that the majority of our revenue (for our airships and GTC products other than GTC website and Amazon/eBay storefront sales) at least in the foreseeable future will come from U.S. government and government-related entities, including both the Department of Defense and other departments and agencies. Government programs that we may seek to participate in and contracts for LTA UAS or the construction of satellite ground stations must compete with other programs for consideration during Congress' budget and appropriations hearings, and may be affected by changes not only in political power and appointments but also general economic conditions and other factors beyond our control. Reductions, extensions or terminations in a program that we are seeking to participate in or overall defense or other spending could adversely affect our ability to generate revenues and realize any profits. We cannot predict whether potential changes in security, defense, communications and intelligence priorities will afford opportunities for our business in terms of research and development or product contracts, but any reduction in government spending on such programs could negatively impact our ability to generate revenues.

Some of our products are subject to significant governmental regulation including FAA regulations that currently prohibit us from performing any untethered flight testing of our UAS in commercial airspace until we receive a clearance certification from the FAA or a FAA Certificate of Waiver or Authorization which are difficult and time-consuming to obtain, and such regulations could significantly increase our research and development costs and could limit our ability to generate revenues.

Some of our products are subject to regulation by the FAA, which currently does not allow any untethered flights by UAS in commercial airspace in the U.S. without prior FAA clearance certifications or a FAA Certificate of Waiver or Authorization (COA) that are difficult and time-consuming to obtain. Federal, state and local government entities must obtain an FAA COA before flying UAS in the Nation Air Space (NAS). The status of regulations regarding the testing, operations and safety of UAS is in flux. Depending on the ultimate rules adopted by the FAA, the cost to test and fly our products and our ability to generate revenues may be significantly adversely affected. International sales of our products may also be subject to U.S. laws, regulations and policies like the International Traffic in Arms Regulations (ITAR) and other export laws and regulations and may be subject to first obtaining licenses, clearances or authorizations from various regulatory entities. If we are not allowed to export our products or the clearance process is burdensome, our ability to generate revenue would be adversely affected. The failure to comply with any of these regulations could adversely affect our ability to conduct our business and generate revenues as well as increasing our operating costs.

We compete with companies that have significantly more resources than us and already have received government contracts for the development of UAS.

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

We are subject to a number of lawsuits that could result in material judgments against us.

We are defendants in a number of litigation matters and are subject to various other claims and demands. These matters are likely to divert financial and management resources that would otherwise be used to benefit our operations. We intend to aggressively defend ourselves in these proceedings but no assurances can be given that the results of these matters will be favorable to us. An adverse resolution or outcome of any of these lawsuits, claims or demands that cannot be predicted with certainty or potential settlements of such matters could adversely affect our business and financial condition, or could result in us having to issue freely tradable shares which could hurt our share price. Any claims and litigation, even if fully reserved or insured for, could negatively impact our reputation among our customers and the public and make it more difficult for us to raise capital, secure contracts or to compete effectively.

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

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

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

Our intellectual property and proprietary rights are important to our ability to remain competitive and for the success of our products and our business. Patent protection can be limited and not all intellectual property is or can be patented. We rely on a combination of patent, trademark, copyright, and trade secret laws as well as confidentiality agreements and procedures, non-compete agreements and other contractual provisions to protect our intellectual property, other proprietary rights and our brand. We have little protection when we must rely on trade secrets and nondisclosure agreements. We filed a provisional patent application on our Argus One airship in February 2011. In February 2012 we filed both a U.S. utility patent application and a patent application under the Patent Cooperation Treaty for an airship design and method of controlling the airship based on our Argus One UAS. In May 2012 we filed a provisional patent, and in May 2013 we filed a U.S. utility patent application, for a self-powered releasable aerostat and for a method for releasing and controlling the aerostat. There is no assurance that a patent will issue from such applications. We intend to continue to expand the patent protection for our airships and other products as we deem appropriate, but there can be no assurance that we will be able to secure any such patent protection. Our intellectual property rights may be challenged, invalidated or circumvented by third parties. We may not be able to prevent the unauthorized disclosure or use of our technical knowledge or other trade secrets by employees or competitors. Furthermore, our competitors may independently develop technologies and products that are substantially equivalent or superior to our technologies and/or products, which could result in decreased revenues. Moreover, the laws of foreign countries may not protect our intellectual property rights to the same extent as the laws of the U.S. Litigation may be necessary to enforce our intellectual property rights which could result in substantial costs to us and substantial diversion of management attention. If we do not adequately protect our intellectual property, our competitors could use it to enhance their products. Our inability to adequately protect our intellectual property rights could adversely affect our business and financial condition, and the value of our brand and other intangible assets.

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

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

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

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

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

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

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

For our business to be successful, we need to attract and retain highly qualified technical, management and sales personnel. As of October 31, 2014, we together with our subsidiary employed four employees and we rely heavily on outside partners and contractors in certain areas. The failure to recruit additional key personnel when needed with specific qualifications and on acceptable terms or to retain good relationships with our partners might impede our ability to continue to develop, commercialize and sell our products. To the extent the demand for skilled personnel exceeds supply, we could experience higher labor, recruiting and training costs in order to attract and retain such employees. The loss of any members of our management team may also delay or impair achievement of our business objectives and result in business disruptions due to the time needed for their replacements to be recruited and become familiar with our business. We face competition for qualified personnel from other companies with significantly more resources available to them and thus may not be able to attract the level of personnel needed for our business to succeed.

The control deficiencies in our internal control over financial reporting may until remedied cause errors in our financial statements or cause our filings with the SEC to not be timely.

We have identified control deficiencies in our internal control over financial reporting as of the evaluation done by management as of September 30, 2014, including those related to (i) an ineffective global control environment such that control deficiencies in various other components of internal control could lead the auditor to conclude that a significant deficiency or material weakness exists in the control environment, (ii) absent or inadequate segregation of duties within a significant account or process, (iii) inadequate documentation of the components of internal control, and (iv) inadequate design of information technology general and application controls that prevent the information system from providing complete and accurate information consistent with financial reporting objectives and current needs. If our internal control over financial reporting or disclosure controls and procedures are not effective, there may be errors in our financial statements that could require a restatement or our filings may not be timely made with the SEC. Based on the work undertaken and performed by us, however, we believe the consolidated financial statements contained in our reports filed with the SEC are fairly stated in all material respects in accordance with GAAP for each of the periods presented. We intend to implement additional corporate governance and control measures to strengthen our control environment as we are able, but we may not achieve our desired objectives. Moreover, no control environment, no matter how well designed and operated, can prevent or detect all errors or fraud. We may identify material weaknesses and control deficiencies in our internal control over financial reporting in the future that may require remediation and could lead investors losing confidence in our reported financial information, which could lead to a decline in our stock price.

Risks Related To Ownership of Our Common Stock

Market volatility and fluctuations in our stock price and trading volume may cause sudden decreases in the value of an investment in our common stock.

The market for our common stock is illiquid and subject to wide fluctuations in response to a number of factors, including, but not limited to:

- limited numbers of buyers and sellers in the market;
- investors wanting to place large sale or buy orders in a particular day;
- actual or anticipated variations in our results of operations;
- our ability or inability to generate new revenues;
- the development of our products; and
- increased competition or technological innovations or new products by competitors.

The market price of our common stock has historically been, and we expect it to continue to be, volatile. The price of our common stock has ranged from between $0.0033 to $0.32 from January 1, 2010 to September 30, 2014. In addition to the extremely volatile nature of the stock market, our stock price has been affected by our own public announcements regarding such things as acquisitions or sales, financings and product development. Furthermore, our stock price may be impacted by factors that are unrelated or disproportionate to our operating performance which include among others individual stockholder market transactions, stock market fluctuations, general economic, political and overall global market conditions, such as recessions, interest rates or international currency fluctuations, in addition to market conditions in our industry. Consequently, events both within and beyond our control may adversely affect the market price and liquidity of our common stock.

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

The sale of a substantial number of shares of our common stock by stockholders could adversely affect the market price of our shares. As of March 21, 2014, we had 710 registered stockholders and many more beneficial holders, most of whom have held their shares for the required holding periods under Rule 144 promulgated pursuant to the Securities Act and thus would hold freely tradable shares. The shares that were issued pursuant to conversions under the convertible debenture are freely tradable; 50 million shares were registered with the SEC and any additional shares are freely tradable pursuant to Rule 144 promulgated pursuant to the Securities Act, and such selling stockholder is not subject to a lock-up agreement. If such shares are sold, or if it is perceived they will be sold, the trading price of our common stock could decline. Because investors may be more reluctant to purchase shares of our common stock following substantial sales or issuances, the resale of these shares of common stock could impair our ability to raise capital in the near term.

There are a large number of shares underlying our convertible debenture and equity investment agreement and issuance of shares upon conversion of the convertible debenture and exercise of the rights in the equity investment agreement may cause immediate and substantial dilution to our existing stockholders.

There are a large number of shares that may be issued pursuant to our convertible debenture and equity investment agreement. The issuance of shares upon conversion of the convertible debenture and purchase of shares under the equity investment agreement may result in substantial dilution to the interests of other stockholders since the selling stockholder may ultimately convert and sell the full amount issuable on conversion. Although the selling stockholder may not convert its convertible debenture if such conversion would cause them to own more than 4.99% of our outstanding common stock, this restriction does not prevent the selling stockholder from converting some of their holdings and then converting the rest of their holdings. In this way, the selling stockholder could sell more than this limit while never holding more than this limit. While the status of these agreements and the issuance of any additional shares remains uncertain pending our litigation with La Jolla Cove Investors, any outcome of such litigation negative to our interests could result in additional dilution to our shareholders.

If we are required for any reason to repay our outstanding convertible debenture, we would be required to deplete our working capital, if available, or raise additional funds. Our failure to repay the convertible debenture for any reason, if required, could result in legal action against us, which could require the sale of substantial assets or the curtailment of some or all of our operations.

In February 2012, we issued a convertible debenture that is due and payable, with 4 3/4% interest, three years from the date of issuance, unless sooner converted into shares of our common stock. In addition, any event of default could require the early repayment of the convertible debenture at a price equal to 110% of the amount due under the debenture. If we were required to repay the convertible debenture for any reason, whether as a result of the current litigation with La Jolla Cove Investors or otherwise, we would be required to use our limited working capital and raise additional funds. If we were unable to repay the debenture, the debenture holder could commence legal action against us and foreclose on our assets to recover the amounts due. Any such action would likely require us to curtail some or all of our operations. While the status of these agreements and the repayment of the debenture remains uncertain pending our litigation with La Jolla Cove Investors, any outcome of such litigation negative to our interests could result in additional dilution to our shareholders.

Future equity or convertible debenture financings will result in additional dilution of the ownership interest of our existing investors and may have an adverse impact on the price of our common stock.

We expect that we will need to raise additional capital in the future to continue our operations. Historically the primary source of the additional capital we have raised has been equity and convertible debentures, and we expect that equity-related instruments will continue to be a source of additional capital. Any future equity or convertible debenture financings will dilute the ownership interest of our existing investors and may have an adverse impact on the price of our common stock.

We have authorized preferred stock that can be designated by our board of directors without shareholder approval.

We have authorized 10,000,000 shares of preferred stock. The shares of preferred stock may be issued from time to time in one or more series, each of which shall have distinctive designation or title as shall be determined by our board of directors prior to the issuance of any shares thereof. The preferred stock shall have such voting powers, full or limited, or no voting powers, and such preferences and relative, participating, optional or other special rights and such qualifications, limitations or restrictions thereof as adopted by our board of directors. Because our board of directors is able to designate the powers and preferences of the preferred stock without the vote of the holders of our common stock, the holders of our common stock will have no control over what designations and preferences our preferred stock will have. As a result of this, our board of directors could designate one or more series of preferred stock with superior rights to the rights of the holders of our common stock.

Provisions in our charter documents and Delaware law may inhibit a takeover of us, which could limit the price investors might be willing to pay in the future for our common stock and could entrench management.

Our restated certificate of incorporation and bylaws contain provisions that may discourage unsolicited takeover proposals that stockholders may consider to be in their best interests. These provisions include:

- the ability of the board of directors to designate the terms of, and to issue new, series of preferred stock;
- advance notice requirements for nominations for election to the board of directors;
- the ability of the board of directors to fix the number of directors and fill any vacancies or newly created directorships;
- a classified board of directors;
- Limitations on the removal of directors;
- limitations on stockholders’ ability to call a special meeting of stockholders; and
- special voting requirements for the amendment of certain provisions of our bylaws.

We are also subject to anti-takeover provisions under Delaware law, which could delay or prevent a change of control. Together, certain provisions of our certificate of incorporation and bylaws, and certain provisions of Delaware law, may singularly and/or collectively make the removal of management more difficult and may discourage transactions that otherwise could involve payment of a premium over prevailing market prices for our common stock.

Since we have not paid dividends on our common stock, you may not receive income from your investment.

We have not paid dividends on our common stock and do not contemplate or anticipate paying any dividends on our common stock in the foreseeable future. Earnings, if any, will be used to finance the development and expansion of our business.

Investors may face significant restrictions on the resale of our common stock due to federal regulations of penny stock.

Our common stock is subject to the requirements of Rule 15g-9, promulgated under the Exchange Act, as long as the price of our common stock is below $5.00 per share. Under such rule, broker-dealers who recommend low-priced securities to persons other than established customers and accredited investors must satisfy special sales practice requirements, including a requirement that they make an individualized written suitability determination for the purchaser and receive the purchaser's consent prior to the transaction. The Securities Enforcement Remedies and Penny Stock Reform Act of 1990, also requires additional disclosure in connection with any trades involving a stock defined as a penny stock. Generally, the SEC defines a penny stock as any equity security not traded on an exchange or quoted on NASDAQ that has a market price of less than $5.00 per share. The required penny stock disclosures include the delivery, prior to any transaction, of a disclosure schedule explaining the penny stock market and the risks associated with it. In addition, various state securities laws impose restrictions on transferring penny stocks. Furthermore, certain brokers or on-line trading houses may not accept our common stock for brokerage accounts at their firms. Such requirements could severely limit the market liquidity of our securities and the ability of purchasers to sell our securities in the secondary market.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

During the nine-months ended September 30, 2014, we issued an aggregate of 69,999,387 shares of Common Stock for cash, legal settlements and services rendered by consultants and partners. Of the aggregate shares issued, 5,000,000 shares, or 7.1% were issued to insiders and affiliates, as restricted securities under an exemption provided by Section 4(2) of the Securities Act of 1933 and/or Regulation D, Rule 506, promulgated under the Securities Act of 1933. Common Stock issuances were valued at prices based on the closing market prices on the date the Board of Directors authorized the issuances.

Item 6. Exhibits

Exhibits	Description
10.1*	Share Exchange Agreement by and among Drone Aviation Holding Corp., Drone Aviation Corp. and the shareholders of Drone Aviation Corp. dated June 3, 2014.
31.1*	Certification of the Chief Executive Officer pursuant to Rule 13a-14(a) of the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2*	Certification of the Chief Financial Officer pursuant to Rule 13a-14(a) of the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1*	Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2*	Certification of 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
101.INS*	XBRL Instance Document**
101.SCH*	XBRL Taxonomy Extension Schema Document**
101.CAL*	XBRL Taxonomy Calculation Linkbase Document**
101.PRE*	XBRL Taxonomy Presentation Linkbase Document**
101.LAB*	XBRL Taxonomy Label Linkbase Document**
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document**

* Filed herewith.
\+ Indicates management contract relating to compensatory plans or arrangements

** Pursuant to Rule 406T of Regulation S-T, these interactive data files shall not be deemed to be “filed” for purposes of Section

18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to liability under that section, and shall not be
incorporated by reference into any registration statement or other document filed under the Securities Act of 1933, as amended,
except as expressly set forth by specific reference in such filing.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this Quarterly Report on Form 10-Q to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated: November 14, 2014

WORLD SURVEILLANCE GROUP INC.

By: /s/ W. Jeffrey Sawyers
Name: W. Jeffrey Sawyers
Title: Chief Financial Officer and Treasurer
(Principal Financial and Accounting Officer)

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