

FalconStor Software, Inc. and Subsidiaries
Reconciliation of GAAP to Non-GAAP Financial Measures
(Unaudited)

	Three Months Ended March 31,	
	2018	2017
GAAP income (loss) from operations	\$ 558,986	\$ (1,144,170)
Non-cash stock option expense (1)	(22,895)	445,414
Restructuring costs (3)	(173,263)	(236,302)
Non-GAAP income (loss) from operations	<u>\$ 362,828</u>	<u>\$ (935,058)</u>
GAAP net loss attributable to common stockholders	\$ (2,043,437)	\$ (1,316,772)
Non-cash stock option expense, net of income taxes (2)	(22,895)	445,414
Restructuring costs (3)	(173,263)	(236,302)
Effects of Series A redeemable convertible preferred stock (4)	2,550,314	204,575
Non-GAAP net income (loss) attributable to common stockholders	<u>\$ 310,719</u>	<u>\$ (903,085)</u>
GAAP gross margin	85 %	76 %
Non-cash stock option expense (1)	0 %	1 %
Non-GAAP gross margin	<u>85 %</u>	<u>77 %</u>
GAAP gross margin - Product	99 %	90 %
Non-cash stock option expense (1)	0 %	0 %
Non-GAAP gross margin - Product	<u>99 %</u>	<u>90 %</u>
GAAP gross margin - Support and Service	76 %	70 %
Non-cash stock option expense (1)	0 %	1 %
Non-GAAP gross margin - Support and Service	<u>76 %</u>	<u>71 %</u>
GAAP operating margin	11%	(19%)
Non-cash stock option expense (1)	0%	7%
Restructuring costs (3)	(3%)	(4%)
Non-GAAP operating margin	<u>8%</u>	<u>(16%)</u>
GAAP Basic EPS	\$ (0.05)	\$ (0.03)
Non-cash stock option expense, net of income taxes (2)	0.00	0.01
Restructuring costs (3)	0.00	0.00
Effects of Series A redeemable convertible preferred stock (4)	0.06	0.00
Non-GAAP Basic EPS	<u>\$ 0.01</u>	<u>\$ (0.02)</u>
GAAP Diluted EPS	\$ (0.05)	\$ (0.03)
Non-cash stock option expense, net of income taxes (2)	0.00	0.01
Restructuring costs (3)	0.00	0.00
Effects of Series A redeemable convertible preferred stock (4)	0.05	0.00
Non-GAAP Diluted EPS	<u>\$ 0.00</u>	<u>\$ (0.02)</u>
Weighted average basic shares outstanding (GAAP and as adjusted)	44,564,094	44,088,352
Weighted average diluted shares outstanding (GAAP)	44,564,094	44,088,352
Weighted average diluted shares outstanding (Non-GAAP)	<u>261,370,198</u>	<u>44,088,352</u>

Footnotes:

- (1) Represents non-cash, stock-based compensation charges as follows:

	Three Months Ended March 31,	
	2018	2017
Cost of revenue - Product	\$ —	\$ —
Cost of revenue - Support and Service	8,700	56,451
Research and development costs	22,606	129,715
Selling and marketing	7,932	56,540
General and administrative	(62,133)	202,708
Total non-cash stock based compensation expense	<u>\$ (22,895)</u>	<u>\$ 445,414</u>

- (2) Represents the effects of non-cash stock-based compensation expense recognized, net of related income tax effects. For the three months ended March 31, 2018 and 2017, the tax expense for both GAAP and Non-GAAP basis approximate the same amount.
- (3) Represents restructuring costs which were incurred during each respective period presented.
- (4) Represents the effects of the accretion to redemption value of the Series A redeemable convertible preferred stock, accrual of Series A redeemable convertible preferred stock dividends and deemed dividend on Series A redeemable convertible preferred stock.