

FalconStor Software, Inc. and Subsidiaries
CONDENSED CONSOLIDATED BALANCE SHEETS

| | March 31, 2016 | December 31, 2015 |
|---|---------------------------|------------------------------|
| | (unaudited) | |
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 8,332,909 | \$ 6,013,382 |
| Marketable securities | 3,090,791 | 7,420,042 |
| Accounts receivable, net | 5,201,908 | 6,635,262 |
| Prepaid expenses and other current assets | 1,509,641 | 1,742,668 |
| Inventory | 30,029 | 70,534 |
| Deferred tax assets, net | 213,140 | 205,816 |
| Total current assets | 18,378,418 | 22,087,704 |
| Property and equipment, net | 1,456,242 | 1,565,932 |
| Deferred tax assets, net | 117,067 | 110,060 |
| Software development costs, net | 866,323 | 1,116,816 |
| Other assets, net | 1,030,568 | 1,139,377 |
| Goodwill | 4,150,339 | 4,150,339 |
| Other intangible assets, net | 235,339 | 256,137 |
| Total assets | <u>\$ 26,234,296</u> | <u>\$ 30,426,365</u> |
| Liabilities and Stockholders' Deficit | | |
| Current liabilities: | | |
| Accounts payable | \$ 1,104,108 | \$ 1,005,944 |
| Accrued expenses | 5,790,053 | 6,783,514 |
| Deferred tax liabilities, net | 89,491 | 89,343 |
| Deferred revenue, net | 16,747,873 | 16,553,519 |
| Total current liabilities | 23,731,525 | 24,432,320 |
| Other long-term liabilities | 895,208 | 735,089 |
| Deferred tax liabilities, net | 34,054 | 27,069 |
| Deferred revenue, net | 8,993,916 | 9,122,289 |
| Total liabilities | 33,654,703 | 34,316,767 |
| Commitments and contingencies | | |
| Series A redeemable convertible preferred stock | 7,982,223 | 7,818,554 |
| Total stockholders' deficit | (15,402,630) | (11,708,956) |
| Total liabilities and stockholders' deficit | <u>\$ 26,234,296</u> | <u>\$ 30,426,365</u> |

FalconStor Software, Inc. and Subsidiaries
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

| | Three Months Ended March 31, | |
|--|---|---------------------|
| | 2016 | 2015 |
| Revenue: | | |
| Product revenue | \$ 2,280,858 | \$ 13,970,367 |
| Support and services revenue | 5,151,473 | 5,969,509 |
| Total revenue | <u>7,432,331</u> | <u>19,939,876</u> |
| Cost of revenue: | | |
| Product | 244,273 | 390,224 |
| Support and service | 1,762,220 | 2,020,018 |
| Total cost of revenue | <u>2,006,493</u> | <u>2,410,242</u> |
| Gross profit | \$ 5,425,838 | \$ 17,529,634 |
| Operating expenses: | | |
| Research and development costs | 3,656,777 | 3,205,867 |
| Selling and marketing | 4,268,800 | 5,305,362 |
| General and administrative | 1,705,925 | 2,492,941 |
| Investigation, litigation, and settlement related costs | — | 17,028 |
| Restructuring costs | 83,984 | 134,476 |
| Total operating expenses | <u>9,715,486</u> | <u>11,155,674</u> |
| Operating (loss) income | <u>(4,289,648)</u> | <u>6,373,960</u> |
| Interest and other income (loss), net | 118,183 | (464,076) |
| (Loss) income before income taxes | (4,171,465) | 5,909,884 |
| Provision for income taxes | 125,147 | 647,505 |
| Net (loss) income | <u>\$ (4,296,612)</u> | <u>\$ 5,262,379</u> |
| Less: Accrual of Series A redeemable convertible preferred stock dividends | 192,608 | 190,786 |
| Less: Accretion to redemption value of Series A redeemable convertible preferred stock | 163,669 | 137,417 |
| Net (loss) income attributable to common stockholders | <u>\$ (4,652,889)</u> | <u>\$ 4,934,176</u> |
| Basic net (loss) income per share attributable to common stockholders | <u>\$ (0.11)</u> | <u>\$ 0.12</u> |
| Diluted net (loss) income per share attributable to common stockholders | <u>\$ (0.11)</u> | <u>\$ 0.10</u> |
| Weighted average basic shares outstanding | <u>41,882,232</u> | <u>40,935,380</u> |
| Weighted average diluted shares outstanding | <u>41,882,232</u> | <u>51,264,247</u> |

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

| | Three Months Ended March 31, | |
|--|-------------------------------------|---------------------|
| | 2016 | 2015 |
| GAAP (loss) income from operations | \$ (4,289,648) | \$ 6,373,960 |
| Non-cash stock option expense (1) | 990,610 | 374,806 |
| Legal related costs (3) | — | 17,028 |
| Restructuring costs (4) | 83,984 | 134,476 |
| Non-GAAP (loss) income from operations | <u>\$ (3,215,054)</u> | <u>\$ 6,900,270</u> |
| GAAP net (loss) income attributable to common stockholders | \$ (4,652,889) | \$ 4,934,176 |
| Non-cash stock option expense, net of income taxes (2) | 990,610 | 374,806 |
| Legal related costs (3) | — | 17,028 |
| Restructuring costs (4) | 83,984 | 134,476 |
| Effects of Series A redeemable convertible preferred stock (5) | 356,277 | 328,203 |
| Non-GAAP net (loss) income | <u>\$ (3,222,018)</u> | <u>\$ 5,788,689</u> |
| GAAP gross margin | 73 % | 88% |
| Non-cash stock option expense (1) | 0 % | 0% |
| Non-GAAP gross margin | <u>73 %</u> | <u>88%</u> |
| GAAP gross margin - Product | 89 % | 97% |
| Non-cash stock option expense (1) | 0 % | 0% |
| Non-GAAP gross margin - Product | <u>89 %</u> | <u>97%</u> |
| GAAP gross margin - Support and Service | 66 % | 66% |
| Non-cash stock option expense (1) | 0 % | 0% |
| Non-GAAP gross margin - Support and Service | <u>66 %</u> | <u>66%</u> |
| GAAP operating margin | (58%) | 32% |
| Non-cash stock option expense (1) | 13% | 2% |
| Legal related costs (3) | 0% | 0% |
| Restructuring costs (4) | 1% | 1% |
| Non-GAAP operating margin | <u>(43%)</u> | <u>35%</u> |
| GAAP Basic EPS | \$ (0.11) | \$ 0.12 |
| Non-cash stock option expense, net of income taxes (2) | 0.02 | 0.01 |
| Legal related costs (3) | 0.00 | 0.00 |
| Restructuring costs (4) | 0.00 | 0.00 |
| Effects of Series A redeemable convertible preferred stock (5) | 0.01 | 0.01 |
| Non-GAAP Basic EPS | <u>\$ (0.08)</u> | <u>\$ 0.14</u> |

| | | | | |
|--|----|------------|----|------------|
| GAAP Diluted EPS | \$ | (0.11) | \$ | 0.10 |
| Non-cash stock option expense, net of income taxes (2) | | 0.02 | | 0.01 |
| Legal related costs (3) | | 0.00 | | 0.00 |
| Restructuring costs (4) | | 0.00 | | 0.00 |
| Effects of Series A redeemable convertible preferred stock (5) | | 0.01 | | 0.01 |
| Non-GAAP Diluted EPS | \$ | (0.08) | \$ | 0.11 |
| Weighted average basic shares outstanding (GAAP and as adjusted) | | 41,882,232 | | 40,935,380 |
| Weighted average diluted shares outstanding (GAAP and as adjusted) | | 41,882,232 | | 51,264,247 |

Footnotes:

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

| | Three Months Ended March 31, | |
|---|------------------------------|------------|
| | 2016 | 2015 |
| Cost of revenue - Product | \$ — | \$ — |
| Cost of revenue - Support and Service | 24,771 | 18,810 |
| Research and development costs | 746,162 | 73,020 |
| Selling and marketing | 67,730 | 88,070 |
| General and administrative | 151,947 | 194,906 |
| Total non-cash stock based compensation expense | \$ 990,610 | \$ 374,806 |

- (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, 2016 and 2015, the tax expense for both GAAP and Non-GAAP basis approximate the same amount. Included in share-based compensation expense for the three months ended March 31, 2016 was \$0.7 million related to costs associated with our exclusive source code license and development agreement which were paid through the issuance of our common stock.
- (3) Legal related costs represent expenses in connection with the Company's investigations, litigation and settlement related costs for each respective period presented.
- (4) Represents restructuring costs which were incurred during each respective period presented.
- (5) Represents the effects of the accretion to redemption value of the Series A redeemable convertible preferred stock and accrual of Series A redeemable convertible preferred stock dividends.