

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
GAAP (loss) income from operations	\$ (3,144,644)	\$ 1,448,460	\$ 3,229,316	\$ (1,188,371)
Non-cash stock option expense (1)	425,968	422,054	800,774	834,715
Legal related (benefits) costs (3)	(8,186)	(5,275,920)	8,842	(5,164,209)
Restructuring costs (4)	23,495	562,913	157,971	786,486
Non-GAAP (loss) income from operations	<u>\$ (2,703,367)</u>	<u>\$ (2,842,493)</u>	<u>\$ 4,196,903</u>	<u>\$ (4,731,379)</u>
GAAP net (loss) income attributable to common stockholders	\$ (2,998,645)	\$ 1,023,512	\$ 1,935,531	\$ (2,080,566)
Non-cash stock option expense, net of income taxes (2)	425,968	422,054	800,774	834,715
Legal related (benefits) costs (3)	(8,186)	(5,275,920)	8,842	(5,164,209)
Restructuring costs (4)	23,495	562,913	157,971	786,486
Effects of Series A redeemable convertible preferred stock (5)	330,461	307,435	658,664	609,715
Non-GAAP net (loss) income	<u>\$ (2,226,907)</u>	<u>\$ (2,960,006)</u>	<u>\$ 3,561,782</u>	<u>\$ (5,013,859)</u>
GAAP gross margin	72 %	76 %	83%	77 %
Non-cash stock option expense (1)	0 %	0 %	0%	0 %
Non-GAAP gross margin	<u>73 %</u>	<u>76 %</u>	<u>83%</u>	<u>77 %</u>
GAAP gross margin - Product	80 %	84 %	94%	86 %
Non-cash stock option expense (1)	0 %	0 %	0%	0 %
Non-GAAP gross margin - Product	<u>80 %</u>	<u>84 %</u>	<u>94%</u>	<u>86 %</u>
GAAP gross margin - Support and Service	67 %	71 %	67%	71 %
Non-cash stock option expense (1)	1 %	0 %	0%	— %
Non-GAAP gross margin - Support and Service	<u>68 %</u>	<u>72 %</u>	<u>67%</u>	<u>71 %</u>
GAAP operating margin	(33%)	13%	11%	(5%)
Non-cash stock option expense (1)	4%	4%	3%	4%
Legal related (benefits) costs (3)	0%	(47%)	0%	(22%)
Restructuring costs (4)	0%	5%	1%	3%
Non-GAAP operating margin	<u>(28%)</u>	<u>(25%)</u>	<u>14%</u>	<u>(20%)</u>
GAAP Basic EPS	\$ (0.07)	\$ 0.02	\$ 0.05	\$ (0.04)
Non-cash stock option expense, net of income taxes (2)	0.01	0.01	0.02	0.02
Legal related (benefits) costs (3)	0.00	(0.11)	0.00	(0.11)
Restructuring costs (4)	0.00	0.01	0.00	0.02
Effects of Series A redeemable convertible preferred stock (5)	0.01	0.01	0.02	0.01
Non-GAAP Basic EPS	<u>\$ (0.05)</u>	<u>\$ (0.06)</u>	<u>\$ 0.09</u>	<u>\$ (0.10)</u>

GAAP Diluted EPS	\$ (0.07)	\$ 0.02	\$ 0.05	\$ (0.04)
Non-cash stock option expense, net of income taxes (2)	0.01	0.01	0.02	0.02
Legal related (benefits) costs (3)	0.00	(0.11)	0.00	(0.11)
Restructuring costs (4)	0.00	0.01	0.00	0.02
Effects of Series A redeemable convertible preferred stock (5)	0.01	0.01	0.02	0.01
Non-GAAP Diluted EPS	\$ (0.05)	\$ (0.06)	\$ 0.08	\$ (0.10)
Weighted average basic shares outstanding (GAAP and as adjusted)	40,964,160	47,919,318	40,949,849	47,975,217
Weighted average diluted shares outstanding (GAAP and as adjusted)	40,964,160	48,780,606	42,492,677	47,975,217

Footnotes:

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Cost of revenues - Product	\$ —	\$ —	\$ —	\$ —
Cost of revenues - Support and Service	34,894	32,454	53,704	54,337
Research and development costs	98,495	86,608	171,515	175,407
Selling and marketing	63,510	50,787	151,580	212,974
General and administrative	229,069	252,205	423,975	391,997
Total non-cash stock based compensation expense	\$ 425,968	\$ 422,054	\$ 800,774	\$ 834,715

(2) Represents the effects of non-cash stock-based compensation expense recognized in accordance with the FASB Accounting Standards Codification, Topic 718, net of related income tax effects. For the three and six months ended June 30, 2015 and 2014, the tax expense for both GAAP and Non-GAAP basis approximate the same amount.

(3) Legal related costs represent expenses/gains 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.