FalconStor Software, Inc. and Subsidiaries CONDENSED CONSOLIDATED BALANCE SHEETS

	June 30, 2016	December 31, 2015
	(unaudited)	
Assets		
Current assets:		
Cash and cash equivalents	\$ 7,925,334	\$ 6,013,382
Marketable securities	1,500,235	7,420,042
Accounts receivable, net	4,641,500	6,635,262
Prepaid expenses and other current assets	1,396,389	1,742,668
Inventory	6,181	70,534
Deferred tax assets, net	526,391	205,816
Total current assets	15,996,030	22,087,704
Property and equipment, net	1,257,917	1,565,932
Deferred tax assets, net	127,015	110,060
Software development costs, net	736,453	1,116,816
Other assets, net	1,045,956	1,139,377
Goodwill	4,150,339	4,150,339
Other intangible assets, net	235,408	256,137
Total assets	\$ 23,549,118	\$ 30,426,365
Liabilities and Stockholders' Deficit		
Current liabilities:		
Accounts payable	\$ 973,739	\$ 1,005,944
Accrued expenses	6,186,181	6,783,514
Deferred tax liabilities, net	89,474	89,343
Deferred revenue, net	15,969,741	16,553,519
Total current liabilities	23,219,135	24,432,320
Other long-term liabilities	991,781	735,089
Deferred tax liabilities, net	40,637	27,069
Deferred revenue, net	9,462,032	9,122,289
Total liabilities	33,713,585	34,316,767
Commitments and contingencies		
Series A redeemable convertible preferred stock	8,153,204	7,818,554
Total stockholders' deficit	(18,317,671)	(11,708,956)
Total liabilities and stockholders' deficit	\$ 23,549,118	\$ 30,426,365

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

2016 2015 2016 2015 Revenue: Product revenue \$ 2,939,954 \$ 3,650,504 \$ 5,220,452 \$ 17,620,871 Support and services revenue 5,122,357 5,902,085 10,279,830 11,871,594 Total revenue 8,067,951 9,552,589 10,279,830 11,871,594 Cost of revenue: 1,999,125 1,940,729 3,761,345 3,900,747 Total cost of revenue 2,319,999 2,658,786 4,325,592 5,069,028 Gross profit 5,748,852 5 6,803,803 \$ 11,174,690 \$ 2,44,23,477 Operating expenses: 3,304,079 3,067,732 6,960,856 6,273,599 Selling and marketing 4,124,350 4,371,513 8,393,150 9,676,875 General and administrative 1,833,479 2,3483 3,539,404 5,076,834 Investigation, litigation, and settlement related (benefits) costs — (8,186) — 8,842 General and administrative 1,334,79 2,3495 17,7389 153,711 Total operating expenses:<		T	Three Months Ended June 30,				Six Months Ended June 30,			
Product revenue \$ 2,939,594 \$ 3,650,504 \$ 5,220,452 \$ 1,7620,871 Support and services revenue 5,128,357 5,902,085 10,279,830 11,871,594 Total revenue 8,067,951 9,552,589 15,500,282 29,492,465 Cost of revenue: 319,974 718,057 564,247 1,108,281 Support and service 1,999,125 1,940,729 3,761,345 3,960,747 Total cost of revenue 5,5748,852 5 6,893,803 \$ 11,174,690 \$ 24,423,437 Operating expenses: - - 6,806,856 6,273,599 \$ 24,723,7599 Selling and marketing 4,124,350 4,371,513 8,393,150 9,676,875 General and administrative 1,833,479 2,383,893 3,539,404 5,076,834 Investigation, litigation, and settlement related (benefits) costs - (8,186) - 8,842 Restructuring costs 93,405 23,495 17,389 15,773,89 3,229,316 Interest and other income (loss), net (23,664,611 (3,146,444 (7,896,10			2016	2015		2016		2015		
Support and services revenue $5,128,357$ $5,902,085$ $10,279,830$ $11,871,594$ Total revenue $8,067,951$ $9,552,589$ $15,500,282$ $29,492,465$ Cost of revenue: $11,997,125$ $11,940,729$ $3,761,345$ $3,960,747$ Total cost of revenue $2,319,099$ $2,658,786$ $4,325,592$ $5,069,028$ Gross profit\$ 5,748,852\$ 6,893,803\$ 11,174,600\$ 2,4423,437Operating expenses: $2,319,099$ $2,658,786$ $6,923,592$ $5,069,028$ Research and development costs $3,304,079$ $3,067,732$ $6,960,856$ $6,273,599$ Selling and marketing $4,124,350$ $4,371,513$ $8,393,150$ $9,676,875$ General and administrative $1,833,479$ $2,583,893$ $3,539,404$ $5,076,834$ Investigation, litigation, and settlement related (benefits) costs $ (8,186)$ $ 8,842$ Restructuring costs $93,405$ $23,495$ $177,389$ $157,971$ Total operating expenses $(3,506,461)$ $(3,144,464)$ $(7,896,109)$ $3,229,316$ Interest and other income (loss), net $237,251$ $98,411$ $355,434$ $(365,665)$ (Loss) income before income taxes $165,672$ $(378,049)$ $290,819$ $22,94,195$ Less: Accrueit of Fories A redeemable convertible preferred stock $195,366$ $186,904$ $387,974$ $377,690$ Less: Accrueit of to redemption value of Series A redeemable $10,098,1457$ $34,650$ $280,974$ Net (loss) income per share att	Revenue:									
Total revenue $8,067,951$ $9,552,589$ $15,500,282$ $29,492,465$ Cost of revenue: $319,974$ $718,057$ $564,247$ $1,108,281$ Support and service $1.999,125$ $1.940,729$ $3,761,345$ $3,960,747$ Total cost of revenue $2,319,099$ $2,658,786$ $4,325,592$ $5,069,028$ Gross profit $5,5748,852$ $8,6893,803$ $8,11,174,690$ $8,24423,437$ Operating expenses: $8,304,079$ $3,067,732$ $6,960,856$ $6,273,599$ Selling and marketing $4,124,350$ $4,371,513$ $8,393,150$ $9,676,875$ General and administrative $1,833,479$ $2,583,893$ $3,539,404$ $5,076,834$ Investigation, litigation, and settlement related (benefits) costs— $(8,186)$ — $8,842$ Restructuring costs $93,405$ $23,495$ $177,389$ $157,971$ Total operating expenses $9,355,313$ $10,038,447$ $19,070,799$ $21,194,121$ Operating (loss) income $(3,606,461)$ $(3,144,644)$ $(7,896,109)$ $3,229,316$ Interest and other income (loss), net $237,251$ $98,411$ $355,434$ $(365,665)$ (Loss) income taxes $165,672$ $(378,049)$ $290,819$ $269,456$ Net (loss) income 5 $(3,901,229)$ $$(2,668,184)$ $$(7,831,494)$ $$2,594,195$ Less: Accrual of Series A redeemable $156,672$ $(378,049)$ $290,819$ $269,456$ Convertible prefered stock $155,366$ $186,904$ $387,974$ $377,6$	Product revenue	\$	2,939,594	\$	3,650,504	\$	5,220,452	\$	17,620,871	
Cost of revenue:718,057564,2471,108,281Support and service1,999,1251,940,7293,761,3453,960,747Total cost of revenue2,319,0992,658,7864,325,5925,069,028Gross profit\$ 5,748,852\$ 6,893,803\$ 11,174,690\$ 2,4423,437Operating expenses: $4,124,350$ 4,371,5138,393,1509,676,875General and development costs3,304,0793,067,7326,960,8566,273,599Selling and marketing4,124,3504,371,5138,393,1509,676,875General and administrative1,833,4792,583,8933,539,4045,076,834Investigation, litigation, and settlement related (benefits) costs—(8,186)—8,842Restructuring costs93,40523,495177,389157,971Total operating expenses9,355,31310,038,44719,070,79921,194,121Operating (loss) income(3,606,461)(3,144,644)(7,896,109)3,229,316Interest and other income (loss), net237,25198,411355,434(365,665)(Loss) income before income taxes(3,692,110)(3,046,233)(7,540,675)2,863,651Provision (benefit) for income taxes165,672(378,049)20,819269,456Net (loss) income attributable to common stockholders\$ (3,901,229)\$ (2,998,645)\$ (8,554,118)\$ 1,935,531Basic net (loss) income per share attributable to common stockholders\$ (0,009)\$ (0,07)\$ (0,20)\$ 0,05Diluted	Support and services revenue		5,128,357		5,902,085		10,279,830		11,871,594	
Product $319,974$ $718,057$ $564,247$ $1,108,281$ Support and service $1,999,125$ $1,940,729$ $3,761,345$ $3,960,747$ Total cost of revenue $2,319,099$ $2,658,786$ $4,325,592$ $5,069,028$ Gross profit\$ $5,748,852$ \$ $6,893,803$ \$ $11,174,690$ \$ $2,4423,437$ Operating expenses: 8 $5,748,852$ \$ $6,893,803$ \$ $11,174,690$ \$ $2,4423,437$ Research and development costs $3,304,079$ $3,067,732$ $6,960,856$ $6,273,599$ Selling and marketing $4,124,350$ $4,371,513$ $8,933,150$ $9,676,875$ General and administrative $1,833,479$ $2,583,893$ $3,539,404$ $5,076,834$ Investigation, litigation, and settlement related (benefits) costs— $(8,186)$ — $8,842$ Restructuring costs $93,405$ $23,495$ $1177,389$ $157,971$ Total operating expenses $9,355,313$ $10,038,447$ $19,007,999$ $21,194,121$ Operating (loss) income $(3,369,210)$ $(3,144,644)$ $(7,896,109)$ $3,229,316$ Interest and other income (loss), net $237,251$ $98,411$ $355,434$ $(365,655)$ Net (loss) income before income taxes $165,672$ $(378,049)$ $290,819$ $269,456$ Net (loss) income attributable to common stockholders $$(3,391,229)$ $$(2,668,184)$ $$(7,831,494)$ $$2,594,195$ Less: Accrution for edemption value of Series A redeemable common stockholders $$(3,091,229)$ $$(2,998,645)$ $$(8,554,118)$ <td>Total revenue</td> <td></td> <td>8,067,951</td> <td></td> <td>9,552,589</td> <td></td> <td>15,500,282</td> <td></td> <td>29,492,465</td>	Total revenue		8,067,951		9,552,589		15,500,282		29,492,465	
Support and service $1,999,125$ $1,940,729$ $3,761,345$ $3,960,747$ Total cost of revenue $2,319,099$ $2,658,786$ $4,325,592$ $5,069,028$ Gross profit\$ 5,748,852\$ 6,893,803\$ 11,174,690\$ 24,423,437Operating expenses: $3,304,079$ $3,067,732$ $6,960,856$ $6,273,599$ Selling and marketing $4,124,350$ $4,371,513$ $8,393,150$ $9,676,875$ General and administrative $1,833,479$ $2,583,893$ $3,539,404$ $5,076,834$ Investigation, litigation, and settlement related (benefits) costs— $(8,186)$ — $8,842$ Restructuring costs $93,405$ $23,495$ $177,389$ $157,971$ Total operating expenses $9,355,313$ $10,038,447$ $19,070,799$ $21,194,121$ Operating (loss) income $(3,666,461)$ $(3,144,644)$ $(7,896,109)$ $3,229,316$ Interest and other income (loss), net $237,251$ $98,411$ $355,434$ $(365,665)$ (Loss) income before income taxes $165,672$ $(378,049)$ $290,819$ $269,456$ Net (loss) income\$ $(3,354,822)$ \$ $(2,668,184)$ \$ $(7,831,494)$ \$ $2,594,195$ Less: Accrual of Series A redeemable convertible preferred stock $195,366$ $186,904$ $387,974$ $377,690$ Less: Accrual of Series A redeemable convertible preferred stock $195,366$ $186,904$ $387,974$ $377,690$ Less: Accrual of Series A redeemable common stockholders\$ $(3,901,229)$ \$ $(2,998,645)$ \$ $(8,554,118)$ <	Cost of revenue:									
Total cost of revenue $2,319,099$ $2,658,786$ $4,325,592$ $5,069,028$ Gross profit\$ 5,748,852\$ 6,893,803\$ 11,174,690\$ 24,423,437Operating expenses: $3,304,079$ $3,067,732$ $6,960,856$ $6,273,599$ Selling and marketing $4,124,350$ $4,371,513$ $8,393,150$ $9,676,875$ General and administrative $1,833,479$ $2,583,893$ $3,539,404$ $5,076,834$ Investigation, litigation, and settlement related (benefits) costs— $(8,186)$ — $8,842$ Restructuring costs $93,405$ $23,495$ $177,389$ $157,971$ Total operating expenses $9,355,313$ $10,038,447$ $19,070,799$ $21,194,121$ Operating (loss) income $(3,606,461)$ $(3,144,644)$ $(7,896,109)$ $3,229,316$ Interest and other income (loss), net $237,251$ $98,411$ $355,434$ $(365,665)$ (Loss) income 5 $(3,369,210)$ $(3,046,233)$ $(7,540,675)$ $2,863,651$ Provision (benefit) for income taxes $165,672$ $(378,049)$ $290,819$ $269,456$ Net (loss) income\$ $(3,391,229)$ \$ $(2,998,645)$ \$ $(7,831,494)$ \$ $2,594,195$ Less: Accrual of Series A redeemable convertible preferred stock $195,366$ $186,904$ $387,974$ $377,690$ Less: Accrual of Series A redeemable convertible preferred stock $195,366$ $186,904$ $387,974$ $377,690$ Less: Accrual of Series A redeemable common stockholders\$ $(3,901,229)$ \$ $(2,998,645)$ \$ $(0,$	Product		319,974		718,057		564,247		1,108,281	
Gross profit \$ 5,748,852 \$ 6,893,803 \$ 11,174,690 \$ 24,423,437 Operating expenses: Research and development costs 3,304,079 3,067,732 6,960,856 6,273,599 Selling and marketing 4,124,350 4,371,513 8,393,150 9,676,875 General and administrative 1,833,479 2,583,893 3,539,404 5,076,834 Investigation, litigation, and settlement related (benefits) costs — (8,186) — 8,842 Restructuring costs 93,405 23,495 177,389 157,971 Total operating expenses 9,355,313 10,038,447 19,070,799 21,194,121 Operating (loss) income (3,366,461) (3,144,644) (7,896,109) 3,229,316 Interest and other income (loss), net 237,251 98,411 355,434 (365,665) (Loss) income taxes 165,672 (378,049) 290,819 269,456 Net (loss) income \$ (3,534,882) \$ (2,668,184) \$ (7,814,494) \$ 2,594,195 Less: Accrual of Series A redeemable convertible preferred stock 195,366 186,904 387,974 377,690 Less: Accruati of Seri	Support and service		1,999,125		1,940,729		3,761,345		3,960,747	
Operating expenses: $3,304,079$ $3,067,732$ $6,960,856$ $6,273,599$ Selling and marketing $4,124,350$ $4,371,513$ $8,393,150$ $9,676,875$ General and administrative $1,833,479$ $2,583,893$ $3,539,404$ $5,076,834$ Investigation, litigation, and settlement related (benefits) costs $ (8,186)$ $ 8,842$ Restructuring costs $93,405$ $23,495$ $177,389$ $157,971$ Total operating expenses $9,355,313$ $10,038,447$ $19,070,799$ $21,194,121$ Operating (loss) income $(3,606,461)$ $(3,14,644)$ $(7,896,109)$ $3,229,316$ Interest and other income (loss), net $237,251$ $98,411$ $355,434$ $(365,665)$ (Loss) income before income taxes $165,672$ $(3,78,049)$ $290,819$ $269,456$ Net (loss) income \$ $(3,534,882)$ \$ $(2,668,184)$ \$ $(7,540,675)$ $2,863,651$ Less: Accretion to redemption value of Series A redeemable $170,981$ $143,557$ $334,650$ $280,974$ $377,690$ Less: Accretion to redemption value of Series A redeemable </td <td>Total cost of revenue</td> <td></td> <td>2,319,099</td> <td></td> <td>2,658,786</td> <td></td> <td>4,325,592</td> <td></td> <td>5,069,028</td>	Total cost of revenue		2,319,099		2,658,786		4,325,592		5,069,028	
Research and development costs $3,04,079$ $3,067,732$ $6,960,856$ $6,273,599$ Selling and marketing $4,124,350$ $4,371,513$ $8,393,150$ $9,676,875$ General and administrative $1,833,479$ $2,583,893$ $3,539,404$ $5,076,834$ Investigation, litigation, and settlement related (benefits) costs $ (8,186)$ $ 8,842$ Restructuring costs $93,405$ $23,495$ $177,389$ $157,971$ Total operating expenses $9,355,313$ $10,038,447$ $19,070,799$ $21,194,121$ Operating (loss) income $(3,606,461)$ $(3,144,644)$ $(7,896,109)$ $3,229,316$ Interest and other income (loss), net $237,251$ $98,411$ $355,434$ $(365,665)$ (Loss) income before income taxes $(3,369,210)$ $(3,046,233)$ $(7,540,675)$ $2,863,651$ Provision (benefit) for income taxes $165,672$ $(378,049)$ $290,819$ $269,456$ Net (loss) income\$ $(3,391,229)$ \$ $(2,668,184)$ \$ $(7,831,494)$ \$ $2,594,195$ Less: Accrual of Series A redeemable convertible preferred stock $195,366$ $186,904$ $387,974$ $377,690$ Less: Accrution to redemption value of Series A redeemable $170,981$ $143,557$ $334,650$ $280,974$ Net (loss) income per share attributable to common stockholders\$ $(0,09)$ \$ $(0,07)$ \$ $(0,20)$ \$Basic net (loss) income per share attributable to common stockholders\$ $(0,09)$ \$ $(0,07)$ <t< td=""><td>Gross profit</td><td>\$</td><td>5,748,852</td><td>\$</td><td>6,893,803</td><td>\$</td><td>11,174,690</td><td>\$</td><td>24,423,437</td></t<>	Gross profit	\$	5,748,852	\$	6,893,803	\$	11,174,690	\$	24,423,437	
Selling and marketing $4,124,350$ $4,371,513$ $8,393,150$ $9,676,875$ General and administrative $1,833,479$ $2,583,893$ $3,539,404$ $5,076,834$ Investigation, litigation, and settlement related (benefits) costs $ (8,186)$ $ 8,842$ Restructuring costs $93,405$ $23,495$ $177,389$ $157,971$ Total operating expenses $9,355,313$ $10,038,447$ $19,070,799$ $21,194,121$ Operating (loss) income $(3,606,461)$ $(3,144,644)$ $(7,896,109)$ $3,229,316$ Interest and other income (loss), net $237,251$ $98,411$ $355,434$ $(365,665)$ (Loss) income before income taxes $(3,369,210)$ $(3,046,233)$ $(7,540,675)$ $2,863,651$ Provision (benefit) for income taxes $165,672$ $(378,049)$ $290,819$ $269,456$ Net (loss) income\$ $(3,534,882)$ \$ $(2,668,184)$ \$ $(7,831,494)$ \$ $2,594,195$ Less: Accrual of Series A redeemable convertible preferred stock $195,366$ $186,904$ $387,974$ $377,690$ Less: Accrution to redemption value of Series A redeemable convertible preferred stock $195,366$ $186,904$ $387,974$ $377,690$ Less: here (loss) income per share attributable to common stockholders $$(0,09)$(0,07)$(0,20)$0.05Diluted net (loss) income per share attributable to commonstockholders$(0,09)$(0,07)$(0,20)$0.05<$	Operating expenses:									
General and administrative $1,833,479$ $2,583,893$ $3,539,404$ $5,076,834$ Investigation, litigation, and settlement related (benefits) costs $ (8,186)$ $ 8,842$ Restructuring costs $93,405$ $23,495$ $177,389$ $157,971$ Total operating expenses $9,355,313$ $10,038,447$ $19,070,799$ $21,194,121$ Operating (loss) income $(3,606,461)$ $(3,144,644)$ $(7,896,109)$ $3,229,316$ Interest and other income (loss), net $237,251$ $98,411$ $355,434$ $(365,665)$ (Loss) income before income taxes $(3,369,210)$ $(3,046,233)$ $(7,540,675)$ $2,863,651$ Provision (benefit) for income taxes $165,672$ $(378,049)$ $290,819$ $269,456$ Net (loss) income\$ $(3,534,882)$ \$ $(7,831,494)$ \$ $2,594,195$ Less: Accrual of Series A redeemable convertible preferred stock $195,366$ $186,904$ $387,974$ $377,690$ Less: Accruat of Series A redeemable convertible preferred stock $170,981$ $143,557$ $334,650$ $280,974$ Net (loss) income attributable to common stockholders\$ $(3,991,229)$ \$ $(2,998,645)$ \$ $(8,554,118)$ $$1,935,531$ Basic net (loss) income per share attributable to common stockholders\$ $(0,09)$ \$ $(0,07)$ \$ $(0,20)$ \$ 0.05 Diluted net (loss) income per share attributable to common stockholders\$ $(0,99)$ $$(0,07)$ \$ $(0,20)$ \$ 0.05 Weighte	Research and development costs		3,304,079		3,067,732		6,960,856		6,273,599	
Investigation, litigation, and settlement related (benefits) costs— $(8,186)$ — $8,842$ Restructuring costs93,40523,495177,389157,971Total operating expenses9,355,31310,038,44719,070,79921,194,121Operating (loss) income(3,606,461)(3,144,644)(7,896,109)3,229,316Interest and other income (loss), net237,25198,411355,434(365,665)(Loss) income before income taxes(3,369,210)(3,046,233)(7,540,675)2,863,651Provision (benefit) for income taxes165,672(378,049)290,819269,456Net (loss) income\$(3,534,882)\$(2,668,184)\$(7,831,494)\$2,594,195Less: Accrual of Series A redeemable convertible preferred stock195,366186,904387,974377,690Less: Accruat of Series A redeemable convertible preferred stock170,981143,557334,650280,974Net (loss) income attributable to common stockholders\$(3,901,229)\$(2,998,645)\$(8,554,118)\$1,935,531Basic net (loss) income per share attributable to common stockholders\$(0,09)\$(0,07)\$(0,20)\$0.05Diluted net (loss) income per share attributable to common stockholders\$(0,09)\$(0,07)\$(0,20)\$0.05Weighted average basic shares outstanding43,159,28540,964,16042,521,01840,949,849	Selling and marketing		4,124,350		4,371,513		8,393,150		9,676,875	
Restructuring costs $93,405$ $23,495$ $177,389$ $157,971$ Total operating expenses $9,355,313$ $10,038,447$ $19,070,799$ $21,194,121$ Operating (loss) income $(3,606,461)$ $(3,144,644)$ $(7,896,109)$ $3,229,316$ Interest and other income (loss), net $237,251$ $98,411$ $355,434$ $(365,665)$ (Loss) income before income taxes $(3,369,210)$ $(3,046,233)$ $(7,540,675)$ $2,863,651$ Provision (benefit) for income taxes $165,672$ $(378,049)$ $290,819$ $269,456$ Net (loss) income\$ $(3,534,882)$ \$ $(2,668,184)$ \$ $(7,831,494)$ \$ $2,594,195$ Less: Accrual of Series A redeemable convertible preferred stock $195,366$ $186,904$ $387,974$ $377,690$ Less: Accruation to redemption value of Series A redeemable convertible preferred stock $170,981$ $143,557$ $334,650$ $280,974$ Net (loss) income attributable to common stockholders\$ (0.09) \$ (0.07) \$ (0.20) \$ 0.05 Diluted net (loss) income per share attributable to common stockholders\$ (0.09) \$ (0.07) \$ (0.20) \$ 0.05 Weighted average basic shares outstanding $43,159,285$ $40,964,160$ $42,521,018$ $40,949,849$	General and administrative		1,833,479		2,583,893		3,539,404		5,076,834	
Total operating expenses9,355,31310,038,44719,070,79921,194,121Operating (loss) income(3,606,461)(3,144,644)(7,896,109)3,229,316Interest and other income (loss), net237,25198,411355,434(365,665)(Loss) income before income taxes(3,369,210)(3,046,233)(7,540,675)2,863,651Provision (benefit) for income taxes165,672(378,049)290,819269,456Net (loss) income\$ (3,534,882)\$ (2,668,184)\$ (7,831,494)\$ 2,594,195Less: Accrual of Series A redeemable convertible preferred stock195,366186,904387,974377,690Less: Accretion to redemption value of Series A redeemable170,981143,557334,650280,974Net (loss) income per share attributable to common stockholders\$ (0.09)\$ (0.07)\$ (0.20)\$ 0.05Diluted net (loss) income per share attributable to common stockholders\$ (0.09)\$ (0.07)\$ (0.20)\$ 0.05Weighted average basic shares outstanding43,159,28540,964,16042,521,01840,949,849	Investigation, litigation, and settlement related (benefits) costs		_		(8,186)				8,842	
Operating (loss) income $(3,606,461)$ $(3,144,644)$ $(7,896,109)$ $3,229,316$ Interest and other income (loss), net $237,251$ $98,411$ $355,434$ $(365,665)$ (Loss) income before income taxes $(3,369,210)$ $(3,046,233)$ $(7,540,675)$ $2,863,651$ Provision (benefit) for income taxes $165,672$ $(378,049)$ $290,819$ $269,456$ Net (loss) income\$ $(3,534,882)$ \$ $(2,668,184)$ \$ $(7,831,494)$ \$ $2,594,195$ Less: Accrual of Series A redeemable convertible preferred stock $195,366$ $186,904$ $387,974$ $377,690$ Less: Accruic to redemption value of Series A redeemable convertible preferred stock $170,981$ $143,557$ $334,650$ $280,974$ Net (loss) income attributable to common stockholders\$ (0.09) \$ (0.07) \$ (0.20) \$ 0.05 Diluted net (loss) income per share attributable to common stockholders\$ (0.09) \$ (0.07) \$ (0.20) \$ 0.05 Weighted average basic shares outstanding $43,159,285$ $40,964,160$ $42,521,018$ $40,949,849$	Restructuring costs		93,405		23,495		177,389		157,971	
Interest and other income (loss), net $237,251$ $98,411$ $355,434$ $(365,665)$ (Loss) income before income taxes $(3,369,210)$ $(3,046,233)$ $(7,540,675)$ $2,863,651$ Provision (benefit) for income taxes $165,672$ $(378,049)$ $290,819$ $269,456$ Net (loss) income\$ $(3,534,882)$ \$ $(2,668,184)$ \$ $(7,831,494)$ \$ $2,594,195$ Less: Accrual of Series A redeemable convertible preferred stock $195,366$ $186,904$ $387,974$ $377,690$ Less: Accretion to redemption value of Series A redeemable convertible preferred stock $170,981$ $143,557$ $334,650$ $280,974$ Net (loss) income attributable to common stockholders\$ (0.09) \$ (0.07) \$ (0.20) \$ 0.05 Diluted net (loss) income per share attributable to common stockholders\$ (0.09) \$ (0.07) \$ (0.20) \$ 0.05 Weighted average basic shares outstanding $43,159,285$ $40,964,160$ $42,521,018$ $40,949,849$	Total operating expenses		9,355,313		10,038,447		19,070,799		21,194,121	
(Loss) income before income taxes $(3,369,210)$ $(3,046,233)$ $(7,540,675)$ $2,863,651$ Provision (benefit) for income taxes $165,672$ $(378,049)$ $290,819$ $269,456$ Net (loss) income\$ $(3,534,882)$ \$ $(2,668,184)$ \$ $(7,831,494)$ \$ $2,594,195$ Less: Accrual of Series A redeemable convertible preferred stock $195,366$ $186,904$ $387,974$ $377,690$ Less: Accruat of Series A redeemable convertible preferred stock $195,366$ $186,904$ $387,974$ $377,690$ Less: Accruation to redemption value of Series A redeemable $170,981$ $143,557$ $334,650$ $280,974$ Net (loss) income attributable to common stockholders\$ $(3,901,229)$ \$ $(2,998,645)$ \$ $(8,554,118)$ \$ $1,935,531$ Basic net (loss) income per share attributable to common stockholders\$ (0.09) \$ (0.07) \$ (0.20) \$ 0.05 Diluted net (loss) income per share attributable to common stockholders\$ (0.09) \$ (0.07) \$ (0.20) \$ 0.05 Weighted average basic shares outstanding $43,159,285$ $40,964,160$ $42,521,018$ $40,949,849$	Operating (loss) income		(3,606,461)		(3,144,644)		(7,896,109)		3,229,316	
Provision (benefit) for income taxes $165,672$ $(378,049)$ $290,819$ $269,456$ Net (loss) income\$ $(3,534,882)$ \$ $(2,668,184)$ \$ $(7,831,494)$ \$ $2,594,195$ Less: Accrual of Series A redeemable convertible preferred stock $195,366$ $186,904$ $387,974$ $377,690$ Less: Accretion to redemption value of Series A redeemable $170,981$ $143,557$ $334,650$ $280,974$ Net (loss) income attributable to common stockholders\$ $(3,901,229)$ \$ $(2,998,645)$ \$ $(8,554,118)$ \$ $1,935,531$ Basic net (loss) income per share attributable to common stockholders\$ (0.09) \$ (0.07) \$ (0.20) \$ 0.05 Diluted net (loss) income per share attributable to common stockholders\$ (0.09) \$ (0.07) \$ (0.20) \$ 0.05 Weighted average basic shares outstanding $43,159,285$ $40,964,160$ $42,521,018$ $40,949,849$	Interest and other income (loss), net		237,251		98,411		355,434		(365,665)	
Net (loss) income \$ (3,534,882) \$ (2,668,184) \$ (7,831,494) \$ 2,594,195 Less: Accrual of Series A redeemable convertible preferred stock 195,366 186,904 387,974 377,690 Less: Accretion to redemption value of Series A redeemable 170,981 143,557 334,650 280,974 Net (loss) income attributable to common stockholders \$ (3,901,229) \$ (2,998,645) \$ (8,554,118) \$ 1,935,531 Basic net (loss) income per share attributable to common stockholders \$ (0.09) \$ (0.07) \$ (0.20) \$ 0.05 Diluted net (loss) income per share attributable to common stockholders \$ (0.09) \$ (0.07) \$ (0.20) \$ 0.05 Weighted average basic shares outstanding 43,159,285 40,964,160 42,521,018 40,949,849	(Loss) income before income taxes		(3,369,210)		(3,046,233)		(7,540,675)		2,863,651	
Less: Accrual of Series A redeemable convertible preferred stock dividends195,366186,904 $387,974$ $377,690$ Less: Accretion to redemption value of Series A redeemable convertible preferred stock170,981143,557 $334,650$ $280,974$ Net (loss) income attributable to common stockholders\$ (3,901,229)\$ (2,998,645)\$ (8,554,118)\$ 1,935,531Basic net (loss) income per share attributable to common stockholders\$ (0.09)\$ (0.07)\$ (0.20)\$ 0.05Diluted net (loss) income per share attributable to common stockholders\$ (0.09)\$ (0.07)\$ (0.20)\$ 0.05Weighted average basic shares outstanding43,159,28540,964,16042,521,01840,949,849	Provision (benefit) for income taxes		165,672		(378,049)		290,819		269,456	
dividends $195,366$ $186,904$ $387,974$ $377,690$ Less: Accretion to redemption value of Series A redeemable convertible preferred stock $170,981$ $143,557$ $334,650$ $280,974$ Net (loss) income attributable to common stockholders\$ (3,901,229)\$ (2,998,645)\$ (8,554,118)\$ 1,935,531Basic net (loss) income per share attributable to common stockholders\$ (0.09)\$ (0.07)\$ (0.20)\$ 0.05Diluted net (loss) income per share attributable to common stockholders\$ (0.09)\$ (0.07)\$ (0.20)\$ 0.05Weighted average basic shares outstanding $43,159,285$ $40,964,160$ $42,521,018$ $40,949,849$	Net (loss) income	\$	(3,534,882)	\$	(2,668,184)	\$	(7,831,494)	\$	2,594,195	
convertible preferred stock $170,981$ $143,557$ $334,650$ $280,974$ Net (loss) income attributable to common stockholders\$ (3,901,229)\$ (2,998,645)\$ (8,554,118)\$ 1,935,531Basic net (loss) income per share attributable to common stockholders\$ (0.09)\$ (0.07)\$ (0.20)\$ 0.05Diluted net (loss) income per share attributable to common stockholders\$ (0.09)\$ (0.07)\$ (0.20)\$ 0.05Weighted average basic shares outstanding $43,159,285$ $40,964,160$ $42,521,018$ $40,949,849$	dividends		195,366		186,904		387,974		377,690	
Basic net (loss) income per share attributable to common stockholders\$ (0.09)\$ (0.07)\$ (0.20)\$ 0.05Diluted net (loss) income per share attributable to common stockholders\$ (0.09)\$ (0.07)\$ (0.20)\$ 0.05Weighted average basic shares outstanding43,159,28540,964,16042,521,01840,949,849	Less: Accretion to redemption value of Series A redeemable convertible preferred stock		170,981		143,557		334,650		280,974	
stockholders\$ (0.09) \$ (0.07) \$ (0.20) \$ 0.05 Diluted net (loss) income per share attributable to common stockholders\$ (0.09) \$ (0.07) \$ (0.20) \$ 0.05 Weighted average basic shares outstanding $43,159,285$ $40,964,160$ $42,521,018$ $40,949,849$	Net (loss) income attributable to common stockholders	\$	(3,901,229)	\$	(2,998,645)	\$	(8,554,118)	\$	1,935,531	
stockholders \$ (0.09) \$ (0.07) \$ (0.20) \$ 0.05 Weighted average basic shares outstanding $43,159,285$ $40,964,160$ $42,521,018$ $40,949,849$	stockholders	\$	(0.09)	\$	(0.07)	\$	(0.20)	\$	0.05	
	Diluted net (loss) income per share attributable to common stockholders	\$	(0.09)	\$	(0.07)	\$	(0.20)	\$	0.05	
Weighted average diluted shares outstanding 43,159,285 40,964,160 42,521,018 42,492,677	Weighted average basic shares outstanding		43,159,285	_	40,964,160		42,521,018	_	40,949,849	
	Weighted average diluted shares outstanding		43,159,285		40,964,160		42,521,018		42,492,677	

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

	Three Months	Six Months Ended June 30,			
	2016	2015	2016		2015
GAAP (loss) income from operations	\$ (3,606,461)	\$ (3,144,644)	\$ (7,896,109)	\$	3,229,316
Non-cash stock option expense (1)	1,127,346	425,968	2,117,956		800,774
Legal related costs (3)	_	(8,186)	_		8,842
Restructuring costs (4)	93,405	23,495	177,389		157,971
Non-GAAP (loss) income from operations	\$ (2,385,710)	\$ (2,703,367)	\$ (5,600,764)	\$	4,196,903
GAAP net (loss) income attributable to common stockholders	\$ (3,901,229)	\$ (2,998,645)	\$ (8,554,118)	\$	1,935,531
Non-cash stock option expense, net of income taxes (2)	1,127,346	425,968	2,117,956		800,774
Legal related costs (3)	_	(8,186)	_		8,842
Restructuring costs (4)	93,405	23,495	177,389		157,971
Effects of Series A redeemable convertible preferred stock (5)	366,347	330,461	722,624		658,664
Non-GAAP net (loss) income	\$ (2,314,131)	\$ (2,226,907)	\$ (5,536,149)	\$	3,561,782
GAAP gross margin	71 %	72 %	72 %		83%
Non-cash stock option expense (1)	1 %	0 %	0 %		0%
Non-GAAP gross margin	72 %		73 %		83%
GAAP gross margin - Product	89 %	80 %	89 %		94%
Non-cash stock option expense (1)	0 %		0 %		0%
Non-GAAP gross margin - Product	89 %	80 %	89 %	_	94%
GAAP gross margin - Support and Service	61 %	67 %	63 %		67%
Non-cash stock option expense (1)	1 %	1 %	1 %		0%
Non-GAAP gross margin - Support and Service	62 %	68 %	64 %	_	67%
GAAP operating margin	(45%)	(33%)	(51%)		11%
Non-cash stock option expense (1)	14%	4%	14%		3%
Legal related costs (3)	0%	0%	0%		0%
Restructuring costs (4)	1%	0%	1%		1%
Non-GAAP operating margin	(30%)	(28%)	(36%)	_	14%
GAAP Basic EPS	\$ (0.09)	\$ (0.07)	\$ (0.20)	\$	0.05
Non-cash stock option expense, net of income taxes (2)	0.03	0.01	0.05		0.02
Legal related costs (3)	0.00	0.00	0.00		0.00
Restructuring costs (4)	0.00	0.00	0.00		0.00
Effects of Series A redeemable convertible preferred stock (5)	0.01	0.01	0.02		0.02
Non-GAAP Basic EPS	\$ (0.05)	\$ (0.05)	\$ (0.13)	\$	0.09

GAAP Diluted EPS	\$	(0.09)	\$	(0.07)	\$	(0.20)	\$	0.05		
Non-cash stock option expense, net of income taxes (2)		0.03		0.01		0.05		0.02		
Legal related costs (3)		0.00		0.00		0.00		0.00		
Restructuring costs (4)		0.00		0.00		0.00		0.00		
Effects of Series A redeemable convertible preferred stock (5)		0.01		0.01		0.02		0.02		
Non-GAAP Diluted EPS	\$	(0.05)	\$	(0.05)	\$	(0.13)	\$	0.08		
Weighted average basic shares outstanding (GAAP and as adjusted)	43,	43,159,285		43,159,285 40,964		40,964,160		42,521,018		,949,849
Weighted average diluted shares outstanding (GAAP and as adjusted)	43,	43,159,285		43,159,285 40,964,160		42,521,018		42,492,677		

Footnotes:

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

	Three Months Ended June 30,				Six Months Ended June 30			
		2016		2015	2015			2015
Cost of revenue - Product	\$	_	\$	—	\$	_	\$	—
Cost of revenue - Support and Service		44,066		34,894		68,837		53,704
Research and development costs		825,635		98,495		1,571,797		171,515
Selling and marketing		75,342		63,510		143,072		151,580
General and administrative		182,303		229,069		334,250		423,975
Total non-cash stock based compensation expense	\$	1,127,346	\$	425,968	\$	2,117,956	\$	800,774

- (2) Represents the effects of non-cash stock-based compensation expense recognized, net of related income tax effects. For the three and six months ended June 30, 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 and six months ended June 30, 2016, was \$0.8 million and \$1.5 million, respectively, 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.