

**FalconStor Software, Inc. and Subsidiaries**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**

	<u>September 30,</u> <u>2017</u>	<u>December 31,</u> <u>2016</u>
	<u>(unaudited)</u>	
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 1,751,310	\$ 3,391,528
Accounts receivable, net	2,198,718	5,003,972
Prepaid expenses and other current assets	999,790	1,245,085
Inventory	6,181	6,181
Total current assets	<u>4,955,999</u>	<u>9,646,766</u>
Property and equipment, net	753,849	1,174,942
Deferred tax assets, net	577,934	577,735
Software development costs, net	338,022	547,558
Other assets, net	1,038,504	973,949
Goodwill	4,150,339	4,150,339
Other intangible assets, net	152,147	209,456
Total assets	<u>\$ 11,966,794</u>	<u>\$ 17,280,745</u>
<b>Liabilities and Stockholders' Deficit</b>		
Current liabilities:		
Accounts payable	\$ 1,156,193	\$ 419,877
Accrued expenses	4,114,109	4,471,010
Deferred revenue, net	12,334,255	15,236,123
Total current liabilities	<u>17,604,557</u>	<u>20,127,010</u>
Other long-term liabilities	1,114,496	1,170,844
Deferred tax liabilities, net	272,886	254,776
Deferred revenue, net	6,453,820	8,430,692
Total liabilities	<u>25,445,759</u>	<u>29,983,322</u>
Commitments and contingencies		
Series A redeemable convertible preferred stock	9,000,000	9,000,000
Total stockholders' deficit	<u>(22,478,965)</u>	<u>(21,702,577)</u>
Total liabilities and stockholders' deficit	<u>\$ 11,966,794</u>	<u>\$ 17,280,745</u>

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

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2017</b>	<b>2016</b>	<b>2017</b>	<b>2016</b>
Revenue:				
Product revenue	\$ 2,129,125	\$ 2,245,544	\$ 6,549,832	\$ 7,465,996
Support and services revenue	3,976,308	5,081,266	12,329,042	15,361,096
Total revenue	<u>6,105,433</u>	<u>7,326,810</u>	<u>18,878,874</u>	<u>22,827,092</u>
Cost of revenue:				
Product	118,880	145,986	669,564	710,233
Support and service	1,115,703	1,914,383	3,788,282	5,675,728
Total cost of revenue	<u>1,234,583</u>	<u>2,060,369</u>	<u>4,457,846</u>	<u>6,385,961</u>
Gross profit	\$ 4,870,850	\$ 5,266,441	\$ 14,421,028	\$ 16,441,131
Operating expenses:				
Research and development costs	1,216,663	2,514,822	5,536,658	9,475,678
Selling and marketing	1,128,850	2,991,901	5,288,991	11,385,051
General and administrative	1,163,676	1,561,335	4,130,570	5,100,739
Restructuring	76,705	—	(159,597)	177,389
Total operating expenses	<u>3,585,894</u>	<u>7,068,058</u>	<u>14,796,622</u>	<u>26,138,857</u>
Operating income (loss)	<u>1,284,956</u>	<u>(1,801,617)</u>	<u>(375,594)</u>	<u>(9,697,726)</u>
Interest and other (loss) income, net	134,321	(90,037)	260,121	265,397
Income (Loss) before income taxes	1,419,277	(1,891,654)	(115,473)	(9,432,329)
Provision for (benefit from) income taxes	(9,896)	84,519	207,352	375,338
Net income (loss)	<u>\$ 1,429,173</u>	<u>\$ (1,976,173)</u>	<u>\$ (322,825)</u>	<u>\$ (9,807,667)</u>
Less: Accrual of Series A redeemable convertible preferred stock dividends	215,000	194,012	634,664	581,986
Less: Accretion to redemption value of Series A redeemable convertible preferred stock	—	178,619	—	513,269
Net income (loss) attributable to common stockholders	<u>\$ 1,214,173</u>	<u>\$ (2,348,804)</u>	<u>\$ (957,489)</u>	<u>\$ (10,902,922)</u>
Basic net income (loss) per share attributable to common	<u>\$ 0.03</u>	<u>\$ (0.05)</u>	<u>\$ (0.02)</u>	<u>\$ (0.25)</u>
Diluted net income (loss) per share attributable to common	<u>\$ 0.02</u>	<u>\$ (0.05)</u>	<u>\$ (0.02)</u>	<u>\$ (0.25)</u>
Weighted average basic shares outstanding	<u>44,552,892</u>	<u>43,488,448</u>	<u>44,362,367</u>	<u>42,847,038</u>
Weighted average diluted shares outstanding	<u>54,235,876</u>	<u>43,488,448</u>	<u>44,362,367</u>	<u>42,847,038</u>

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

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2017</b>	<b>2016</b>	<b>2017</b>	<b>2016</b>
GAAP loss from operations	\$ 1,284,956	\$ (1,801,617)	\$ (375,594)	\$ (9,697,726)
Non-cash stock option expense (1)	(260,577)	274,206	\$ 281,992	\$ 2,392,162
Restructuring costs (3)	76,705	—	(159,597)	177,389
Non-GAAP loss from operations	<u>\$ 1,101,084</u>	<u>\$ (1,527,411)</u>	<u>\$ (253,199)</u>	<u>\$ (7,128,175)</u>
GAAP net loss attributable to common stockholders	\$ 1,214,173	\$ (2,348,804)	\$ (957,489)	\$ (10,902,922)
Non-cash stock option expense, net of income taxes (2)	(260,577)	274,206	281,992	2,392,162
Restructuring costs (3)	76,705	—	(159,597)	177,389
Effects of Series A redeemable convertible preferred stock (4)	215,000	372,631	634,664	1,095,255
Non-GAAP net loss	<u>\$ 1,245,301</u>	<u>\$ (1,701,967)</u>	<u>\$ (200,430)</u>	<u>\$ (7,238,116)</u>
GAAP gross margin	80 %	72 %	76 %	72 %
Non-cash stock option expense (1)	0 %	0 %	0 %	0 %
Non-GAAP gross margin	<u>80 %</u>	<u>72 %</u>	<u>76 %</u>	<u>72 %</u>
GAAP gross margin - Product	94 %	93 %	90 %	90 %
Non-cash stock option expense (1)	0 %	0 %	0 %	0 %
Non-GAAP gross margin - Product	<u>94 %</u>	<u>93 %</u>	<u>90 %</u>	<u>90 %</u>
GAAP gross margin - Support and Service	72 %	62 %	69 %	63 %
Non-cash stock option expense (1)	0 %	0 %	0 %	1 %
Non-GAAP gross margin - Support and Service	<u>72 %</u>	<u>62 %</u>	<u>69 %</u>	<u>64 %</u>
GAAP operating margin	21%	(25%)	(2%)	(42%)
Non-cash stock option expense (1)	(4%)	4%	1%	10%
Restructuring costs (3)	1%	0%	(1%)	1%
Non-GAAP operating margin	<u>18%</u>	<u>(21%)</u>	<u>(2%)</u>	<u>(31%)</u>
GAAP Basic EPS	\$ 0.03	\$ (0.05)	\$ (0.02)	\$ (0.25)
Non-cash stock option expense, net of income taxes (2)	(0.01)	0.01	0.01	0.06
Restructuring costs (3)	0.00	0.00	0.00	0.00
Effects of Series A redeemable convertible preferred stock (4)	0.00	0.01	0.01	0.03
Non-GAAP Basic EPS	<u>\$ 0.03</u>	<u>\$ (0.04)</u>	<u>\$ 0.00</u>	<u>\$ (0.17)</u>
GAAP Diluted EPS	\$ 0.02	\$ (0.05)	\$ (0.02)	\$ (0.25)
Non-cash stock option expense, net of income taxes (2)	0.00	0.01	0.01	0.06
Restructuring costs (3)	0.00	0.00	0.00	0.00
Effects of Series A redeemable convertible preferred stock (4)	0.00	0.01	0.01	0.03
Non-GAAP Diluted EPS	<u>\$ 0.02</u>	<u>\$ (0.04)</u>	<u>\$ 0.00</u>	<u>\$ (0.17)</u>
Weighted average basic shares outstanding (GAAP and as adjusted)	<u>44,552,892</u>	<u>43,488,448</u>	<u>44,362,367</u>	<u>42,847,038</u>
Weighted average diluted shares outstanding (GAAP and as adjusted)	<u>54,235,876</u>	<u>43,488,448</u>	<u>44,362,367</u>	<u>42,847,038</u>

Footnotes:

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Cost of revenue - Product	\$ —	\$ —	\$ —	\$ —
Cost of revenue - Support and Service	(9,752)	16,684	55,533	85,521
Research and development costs	28,382	80,310	212,910	1,652,107
Selling and marketing	(23,560)	88,907	40,178	231,979
General and administrative	(255,647)	88,305	(26,629)	422,555
Total non-cash stock based compensation expense	<u>\$ (260,577)</u>	<u>\$ 274,206</u>	<u>\$ 281,992</u>	<u>\$ 2,392,162</u>

- (2) Represents the effects of non-cash stock-based compensation expense recognized, net of related income tax effects. For the three and nine months ended September 30, 2017 and 2016, the tax expense for both GAAP and Non-GAAP basis approximate the same amount. Included in share-based compensation expense for the three and nine months ended September 30, 2016, was \$0.0 million and \$1.5 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) 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 and accrual of Series A redeemable convertible preferred stock dividends.