

FalconStor Software, Inc. and Subsidiaries
CONDENSED CONSOLIDATED BALANCE SHEETS

	September 30, 2015	December 31, 2014
	(unaudited)	
Assets		
Current assets:		
Cash and cash equivalents	\$ 5,483,379	\$ 10,873,891
Marketable securities	10,582,030	10,900,722
Accounts receivable, net	5,051,870	8,898,680
Prepaid expenses and other current assets	1,644,379	1,596,916
Inventory	156,871	352,493
Deferred tax assets, net	300,343	316,586
Total current assets	<u>23,218,872</u>	<u>32,939,288</u>
Property and equipment, net	1,821,390	2,147,188
Deferred tax assets, net	7,503	7,503
Software development costs, net	1,128,553	1,508,517
Other assets, net	1,154,717	1,373,964
Goodwill	4,150,339	4,150,339
Other intangible assets, net	260,004	196,037
Total assets	<u>\$ 31,741,378</u>	<u>\$ 42,322,836</u>
Liabilities and Stockholders' Deficit		
Current liabilities:		
Accounts payable	\$ 1,387,493	\$ 1,266,504
Accrued expenses	7,418,471	6,939,198
Deferred tax liabilities, net	23,307	23,307
Deferred revenue, net	15,502,480	23,380,012
Total current liabilities	<u>24,331,751</u>	<u>31,609,021</u>
Other long-term liabilities	717,200	630,444
Deferred tax liabilities, net	252,298	226,443
Deferred revenue, net	9,260,148	13,097,215
Total liabilities	<u>34,561,397</u>	<u>45,563,123</u>
Commitments and contingencies		
Series A redeemable convertible preferred stock	7,661,884	7,230,941
Total stockholders' deficit	(10,481,903)	(10,471,228)
Total liabilities and stockholders' deficit	<u>\$ 31,741,378</u>	<u>\$ 42,322,836</u>

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Revenue:				
Product revenue	\$ 3,756,579	\$ 3,940,479	\$ 21,377,450	\$ 13,156,024
Support and services revenue	5,926,647	7,234,961	17,798,241	21,323,582
Total revenue	<u>9,683,226</u>	<u>11,175,440</u>	<u>39,175,691</u>	<u>34,479,606</u>
Cost of revenue:				
Product	510,861	834,628	1,619,142	2,107,974
Support and service	1,915,090	1,757,716	5,875,837	5,866,408
Total cost of revenue	<u>2,425,951</u>	<u>2,592,344</u>	<u>7,494,979</u>	<u>7,974,382</u>
Gross profit	\$ 7,257,275	\$ 8,583,096	\$ 31,680,712	\$ 26,505,224
Operating expenses:				
Research and development costs	3,454,128	2,995,150	9,727,727	9,487,169
Selling and marketing	4,128,814	5,776,558	13,805,689	18,016,971
General and administrative	2,132,665	2,140,460	7,209,499	6,896,250
Investigation, litigation, and settlement related (benefits) costs	—	(22,502)	8,842	(5,186,711)
Restructuring costs	15,024	259,078	172,995	1,045,564
Total operating expenses	<u>9,730,631</u>	<u>11,148,744</u>	<u>30,924,752</u>	<u>30,259,243</u>
Operating (loss) income	<u>(2,473,356)</u>	<u>(2,565,648)</u>	<u>755,960</u>	<u>(3,754,019)</u>
Interest and other income (loss), net	<u>25,697</u>	<u>(504,124)</u>	<u>(339,968)</u>	<u>(484,998)</u>
(Loss) income before income taxes	<u>(2,447,659)</u>	<u>(3,069,772)</u>	<u>415,992</u>	<u>(4,239,017)</u>
Provision for income taxes	134,280	162,627	403,736	464,233
Net (loss) income	<u>\$ (2,581,939)</u>	<u>\$ (3,232,399)</u>	<u>\$ 12,256</u>	<u>\$ (4,703,250)</u>
Less: Accrual of Series A redeemable convertible preferred stock dividends	190,786	186,904	568,476	560,712
Less: Accretion to redemption value of Series A redeemable convertible preferred stock	149,969	125,915	430,943	361,822
Net loss attributable to common stockholders	<u>\$ (2,922,694)</u>	<u>\$ (3,545,218)</u>	<u>\$ (987,163)</u>	<u>\$ (5,625,784)</u>
Basic net loss per share attributable to common stockholders	<u>\$ (0.07)</u>	<u>\$ (0.08)</u>	<u>\$ (0.02)</u>	<u>\$ (0.12)</u>
Diluted net loss per share attributable to common stockholders	<u>\$ (0.07)</u>	<u>\$ (0.08)</u>	<u>\$ (0.02)</u>	<u>\$ (0.12)</u>
Weighted average basic shares outstanding	<u>41,113,431</u>	<u>45,158,184</u>	<u>41,004,976</u>	<u>47,025,887</u>
Weighted average diluted shares outstanding	<u>41,113,431</u>	<u>45,158,184</u>	<u>41,004,976</u>	<u>47,025,887</u>

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
GAAP (loss) income from operations	\$ (2,473,356)	\$ (2,565,648)	\$ 755,960	\$ (3,754,019)
Non-cash stock option expense (1)	372,173	371,058	1,172,947	1,205,773
Legal related (benefits) costs (3)	—	(22,502)	8,842	(5,186,711)
Restructuring costs (4)	15,024	259,078	172,995	1,045,564
Non-GAAP (loss) income from operations	<u>\$ (2,086,159)</u>	<u>\$ (1,958,014)</u>	<u>\$ 2,110,744</u>	<u>\$ (6,689,393)</u>
GAAP net loss attributable to common stockholders	\$ (2,922,694)	\$ (3,545,218)	\$ (987,163)	\$ (5,625,784)
Non-cash stock option expense, net of income taxes (2)	372,173	371,058	1,172,947	1,205,773
Legal related (benefits) costs (3)	—	(22,502)	8,842	(5,186,711)
Restructuring costs (4)	15,024	259,078	172,995	1,045,564
Effects of Series A redeemable convertible preferred stock (5)	340,755	312,819	999,419	922,534
Non-GAAP net (loss) income	<u>\$ (2,194,742)</u>	<u>\$ (2,624,765)</u>	<u>\$ 1,367,040</u>	<u>\$ (7,638,624)</u>
GAAP gross margin	75 %	77 %	81%	77 %
Non-cash stock option expense (1)	0 %	0 %	0%	0 %
Non-GAAP gross margin	<u>75 %</u>	<u>77 %</u>	<u>81%</u>	<u>77 %</u>
GAAP gross margin - Product	86 %	79 %	92%	84 %
Non-cash stock option expense (1)	0 %	0 %	0%	0 %
Non-GAAP gross margin - Product	<u>86 %</u>	<u>79 %</u>	<u>92%</u>	<u>84 %</u>
GAAP gross margin - Support and Service	68 %	76 %	67%	72 %
Non-cash stock option expense (1)	0 %	0 %	0%	0 %
Non-GAAP gross margin - Support and Service	<u>68 %</u>	<u>76 %</u>	<u>67%</u>	<u>73 %</u>
GAAP operating margin	(26%)	(23%)	2%	(11%)
Non-cash stock option expense (1)	4%	3%	3%	3%
Legal related (benefits) costs (3)	0%	0%	0%	(15%)
Restructuring costs (4)	0%	2%	0%	3%
Non-GAAP operating margin	<u>(22%)</u>	<u>(18%)</u>	<u>5%</u>	<u>(19%)</u>
GAAP Basic EPS	\$ (0.07)	\$ (0.08)	\$ (0.02)	\$ (0.12)
Non-cash stock option expense, net of income taxes (2)	0.01	0.01	0.03	0.03
Legal related (benefits) costs (3)	0.00	0.00	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	0.02
Non-GAAP Basic EPS	<u>\$ (0.05)</u>	<u>\$ (0.06)</u>	<u>\$ 0.03</u>	<u>\$ (0.16)</u>

GAAP Diluted EPS	\$ (0.07)	\$ (0.08)	\$ (0.02)	\$ (0.12)
Non-cash stock option expense, net of income taxes (2)	0.01	0.01	0.03	0.03
Legal related (benefits) costs (3)	0.00	0.00	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	0.02
Non-GAAP Diluted EPS	\$ (0.05)	\$ (0.06)	\$ 0.03	\$ (0.16)
Weighted average basic shares outstanding (GAAP and as adjusted)	41,113,431	45,158,184	41,004,976	47,025,887
Weighted average diluted shares outstanding (GAAP)	41,113,431	45,158,184	41,004,976	47,025,887
Weighted average diluted shares outstanding (as adjusted)	41,113,431	45,158,184	42,637,654	47,025,887

Footnotes:

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Cost of revenues - Product	\$ —	\$ —	\$ —	\$ —
Cost of revenues - Support and Service	26,653	20,563	80,357	74,900
Research and development costs	57,478	47,085	228,993	222,492
Selling and marketing	73,575	67,214	225,155	280,188
General and administrative	214,467	236,196	638,442	628,193
Total non-cash stock based compensation expense	\$ 372,173	\$ 371,058	\$ 1,172,947	\$ 1,205,773

(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 nine months ended September 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.