

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

	<b>December 31, 2014</b>	<b>December 31, 2013</b>
	<b>(unaudited)</b>	
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 10,873,891	\$ 19,288,340
Restricted cash	—	750,000
Marketable securities	10,900,722	8,073,108
Accounts receivable, net	8,898,680	11,150,323
Prepaid expenses and other current assets	1,596,916	1,636,891
Inventory	352,493	919,390
Deferred tax assets, net	316,586	358,092
Total current assets	32,939,288	42,176,144
Property and equipment, net	2,147,188	3,317,344
Deferred tax assets, net	7,503	49,651
Software development costs, net	1,508,517	1,796,075
Other assets, net	1,373,964	1,549,255
Goodwill	4,150,339	4,150,339
Other intangible assets, net	196,037	179,596
Total assets	\$ 42,322,836	\$ 53,218,404
<b>Liabilities and Stockholders' Equity</b>		
Current liabilities:		
Accounts payable	\$ 1,266,504	\$ 1,024,180
Accrued expenses	6,939,198	8,658,863
Deferred tax liabilities, net	23,307	18,005
Deferred revenue, net	23,380,012	18,148,268
Total current liabilities	31,609,021	27,849,316
Other long-term liabilities	630,444	617,300
Deferred tax liabilities, net	226,443	193,705
Deferred revenue, net	13,097,215	11,602,177
Total liabilities	45,563,123	40,262,498
Commitments and contingencies		
Series A redeemable convertible preferred stock	7,230,941	6,737,578
Total stockholders' (deficit) equity	(10,471,228)	6,218,328
Total liabilities and stockholders' (deficit) equity	\$ 42,322,836	\$ 53,218,404

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

	<b>Three Months Ended</b>		<b>Twelve Months Ended</b>	
	<b>December 31,</b>		<b>December 31,</b>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
Revenues:				
Product revenues	\$ 4,566,976	\$ 6,451,796	\$ 17,723,000	\$ 27,338,557
Support and services revenues	7,226,933	8,195,714	28,550,515	31,297,947
Total revenues	<u>11,793,909</u>	<u>14,647,510</u>	<u>46,273,515</u>	<u>58,636,504</u>
Cost of revenues:				
Product	683,976	690,168	2,791,950	4,155,413
Support and service	1,972,358	2,563,535	7,838,766	11,000,401
Total cost of revenues	<u>2,656,334</u>	<u>3,253,703</u>	<u>10,630,716</u>	<u>15,155,814</u>
Gross profit	\$ 9,137,575	\$ 11,393,807	\$ 35,642,799	\$ 43,480,690
Operating expenses:				
Research and development costs	2,965,359	2,923,828	12,452,528	15,613,543
Selling and marketing	6,409,467	5,432,371	24,426,438	25,222,954
General and administrative	2,209,295	2,637,999	9,105,545	12,265,038
Investigation, litigation, and settlement related costs	(231,214)	97,845	(5,417,925)	373,619
Restructuring costs	89,746	1,315,189	1,135,310	3,606,020
Total operating expenses	<u>11,442,653</u>	<u>12,407,232</u>	<u>41,701,896</u>	<u>57,081,174</u>
Operating loss	<u>(2,305,078)</u>	<u>(1,013,425)</u>	<u>(6,059,097)</u>	<u>(13,600,484)</u>
Interest and other (loss) income, net	<u>(157,635)</u>	<u>1,915,304</u>	<u>(642,633)</u>	<u>1,094,126</u>
(Loss) income before income taxes	<u>(2,462,713)</u>	<u>901,879</u>	<u>(6,701,730)</u>	<u>(12,506,358)</u>
Provision (benefit) for income taxes	45,858	27,068	510,091	(1,573,768)
Net (loss) income	<u>\$ (2,508,571)</u>	<u>\$ 874,811</u>	<u>\$ (7,211,821)</u>	<u>\$ (10,932,590)</u>
Less: Accrual of Series A redeemable convertible preferred stock dividends	186,904	187,504	747,616	216,379
Less: Accretion to redemption value of Series A redeemable convertible preferred stock	131,541	110,443	493,363	127,504
Net (loss) income attributable to common stockholders	<u>\$ (2,827,016)</u>	<u>\$ 576,864</u>	<u>\$ (8,452,800)</u>	<u>\$ (11,276,473)</u>
Basic net (loss) income per share attributable to common stockholders	<u>\$ (0.06)</u>	<u>\$ 0.01</u>	<u>\$ (0.18)</u>	<u>\$ (0.24)</u>
Diluted net (loss) income per share attributable to common stockholders	<u>\$ (0.06)</u>	<u>\$ 0.01</u>	<u>\$ (0.18)</u>	<u>\$ (0.24)</u>
Weighted average basic shares outstanding	<u>44,008,043</u>	<u>48,031,737</u>	<u>46,265,225</u>	<u>47,979,467</u>
Weighted average diluted shares outstanding	<u>44,008,043</u>	<u>48,224,082</u>	<u>46,265,225</u>	<u>47,979,467</u>

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

	Three Months Ended December 31,		Twelve Months Ended December 31,	
	2014	2013	2014	2013
GAAP loss from operations	\$ (2,305,078)	\$ (1,013,425)	\$ (6,059,097)	\$ (13,600,484)
Non-cash stock option expense (1)	260,410	410,487	1,466,183	1,705,429
Legal related costs (3)	(231,214)	97,845	(5,417,925)	373,619
Restructuring costs (4)	89,746	1,315,189	1,135,310	3,606,020
Non-GAAP (loss) income from operations	<u>\$ (2,186,136)</u>	<u>\$ 810,096</u>	<u>\$ (8,875,529)</u>	<u>\$ (7,915,416)</u>
GAAP net (loss) income attributable to common stockholders	\$ (2,827,016)	\$ 576,864	\$ (8,452,800)	\$ (11,276,473)
Non-cash stock option expense, net of income taxes (2)	260,410	410,487	1,466,183	1,705,429
Legal related costs (3)	(231,214)	97,845	(5,417,925)	373,619
Restructuring costs (4)	89,746	1,315,189	1,135,310	3,606,020
Income Taxes (5)	—	(240,697)	—	(2,332,270)
Gain on Sale of cost method investment (6)	—	(1,886,728)	—	(1,886,728)
Effects of Series A redeemable convertible preferred stock (7)	318,445	297,947	1,240,979	343,883
Non-GAAP net (loss) income	<u>\$ (2,389,629)</u>	<u>\$ 570,907</u>	<u>\$ (10,028,253)</u>	<u>\$ (9,466,520)</u>
GAAP gross margin	77 %	78 %	77 %	74 %
Non-cash stock option expense (1)	0 %	0 %	0 %	0 %
Non-GAAP gross margin	<u>78 %</u>	<u>78 %</u>	<u>77 %</u>	<u>74 %</u>
GAAP gross margin - Product	85 %	89 %	84 %	85 %
Non-cash stock option expense (1)	0 %	0 %	0 %	0 %
Non-GAAP gross margin - Product	<u>85 %</u>	<u>89 %</u>	<u>84 %</u>	<u>85 %</u>
GAAP gross margin - Support and Service	73 %	69 %	73 %	65 %
Non-cash stock option expense (1)	0 %	0 %	0 %	— %
Non-GAAP gross margin - Support and Service	<u>73 %</u>	<u>69 %</u>	<u>73 %</u>	<u>65 %</u>
GAAP operating margin	(20%)	(7%)	(13%)	(23%)
Non-cash stock option expense (1)	2%	3%	3%	3%
Legal related costs (3)	(2%)	1%	(12%)	1%
Restructuring costs (4)	1%	9%	2%	6%
Non-GAAP operating margin	<u>(19%)</u>	<u>6%</u>	<u>(19%)</u>	<u>(13%)</u>
GAAP Basic EPS	\$ (0.06)	\$ 0.01	\$ (0.18)	\$ (0.24)
Non-cash stock option expense, net of income taxes (2)	0.01	0.01	0.03	0.04
Legal related costs (3)	(0.01)	0.00	(0.12)	0.01
Restructuring costs (4)	0.00	0.03	0.02	0.08
Income Taxes (5)	0.00	(0.01)	0.00	(0.05)
Gain on Sale of cost method investment (6)	0.00	(0.04)	0.00	(0.04)
Effects of Series A redeemable convertible preferred stock (6)	0.01	0.01	0.03	0.01
Non-GAAP Basic EPS	<u>\$ (0.05)</u>	<u>\$ 0.01</u>	<u>\$ (0.22)</u>	<u>\$ (0.20)</u>
GAAP Diluted EPS	\$ (0.06)	\$ 0.01	\$ (0.18)	\$ (0.24)
Non-cash stock option expense, net of income taxes (2)	0.01	0.01	0.03	0.04
Legal related costs (3)	(0.01)	0.00	(0.12)	0.01

Restructuring costs (4)	0.00	0.03	0.02	0.08
Income Taxes (5)	0.00	0.00	0.00	(0.05)
Gain on Sale of cost method investment (6)	0.00	(0.04)	0.00	(0.04)
Effects of Series A redeemable convertible preferred stock (6)	0.01	0.01	0.03	0.01
Non-GAAP Diluted EPS	\$ (0.05)	\$ 0.01	\$ (0.22)	\$ (0.20)
Weighted average basic shares outstanding (GAAP and as adjusted)	44,008,043	48,031,737	46,265,225	47,979,467
Weighted average diluted shares outstanding (GAAP)	44,008,043	48,224,082	46,265,225	47,979,467
Weighted average diluted shares outstanding (as adjusted) (8)	44,008,043	57,005,598	46,265,225	47,979,467

Footnotes:

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

	Three Months Ended December 31,		Twelve Months Ended December 31,	
	2014	2013	2014	2013
Cost of revenues - Product	\$ —	\$ —	\$ —	\$ 181
Cost of revenues - Support and Service	16,297	24,793	91,197	136,975
Research and development costs	59,924	71,816	282,416	363,296
Selling and marketing	47,506	182,615	327,694	397,967
General and administrative	136,683	131,263	764,876	807,010
Total non-cash stock based compensation expense	\$ 260,410	\$ 410,487	\$ 1,466,183	\$ 1,705,429

- (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 twelve months ended December 31, 2014 and 2013, 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 reversal of uncertain tax positions due to the expiration of applicable statutes of limitation.
- (6) Represents the gain recorded on the sale of our interest in Blue Whale, net of taxes.
- (7) 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.
- (8) Weighted average diluted shares outstanding as adjusted assumes conversion of the Series A preferred stock as of the beginning of the period.