

FalconStor Software, Inc. and Subsidiaries
CONDENSED CONSOLIDATED BALANCE SHEETS

	December 31, 2015	December 31, 2014
	(unaudited)	
Assets		
Current assets:		
Cash and cash equivalents	\$ 6,013,382	\$ 10,873,891
Marketable securities	7,420,042	10,900,722
Accounts receivable, net	6,635,262	8,898,680
Prepaid expenses and other current assets	1,742,668	1,596,916
Inventory	70,534	352,493
Deferred tax assets, net	205,816	316,586
Total current assets	22,087,704	32,939,288
Property and equipment, net	1,565,932	2,147,188
Deferred tax assets, net	110,060	7,503
Software development costs, net	1,116,816	1,508,517
Other assets, net	1,139,377	1,373,964
Goodwill	4,150,339	4,150,339
Other intangible assets, net	256,137	196,037
Total assets	\$ 30,426,365	\$ 42,322,836
Liabilities and Stockholders' Deficit		
Current liabilities:		
Accounts payable	\$ 1,005,944	\$ 1,266,504
Accrued expenses	6,783,514	6,939,198
Deferred tax liabilities, net	89,343	23,307
Deferred revenue, net	16,553,519	23,380,012
Total current liabilities	24,432,320	31,609,021
Other long-term liabilities	735,089	630,444
Deferred tax liabilities, net	27,069	226,443
Deferred revenue, net	9,122,289	13,097,215
Total liabilities	34,316,767	45,563,123
Commitments and contingencies		
Series A redeemable convertible preferred stock	7,818,554	7,230,941
Total stockholders' deficit	(11,708,956)	(10,471,228)
Total liabilities and stockholders' deficit	\$ 30,426,365	\$ 42,322,836

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

	Three Months Ended December 31,		Twelve Months Ended December 31,	
	2015	2014	2015	2014
Revenue:				
Product revenue	\$ 3,470,274	\$ 4,566,976	\$ 24,847,724	\$ 17,723,000
Support and services revenue	5,925,026	7,226,933	23,723,267	28,550,515
Total revenue	9,395,300	11,793,909	48,570,991	46,273,515
Cost of revenue:				
Product	323,843	683,976	1,942,985	2,791,950
Support and service	1,863,312	1,972,358	7,739,149	7,838,766
Total cost of revenue	2,187,155	2,656,334	9,682,134	10,630,716
Gross profit	\$ 7,208,145	\$ 9,137,575	\$ 38,888,857	\$ 35,642,799
Operating expenses:				
Research and development costs	3,059,879	2,965,359	12,787,606	12,452,528
Selling and marketing	4,216,300	6,409,467	18,021,989	24,426,438
General and administrative	1,971,790	2,209,295	9,181,289	9,105,545
Investigation, litigation, and settlement related (benefits) costs	—	(231,214)	8,842	(5,417,925)
Restructuring costs	—	89,746	172,995	1,135,310
Total operating expenses	9,247,969	11,442,653	40,172,721	41,701,896
Operating loss	(2,039,824)	(2,305,078)	(1,283,864)	(6,059,097)
Interest and other income (loss), net	70,014	(157,635)	(269,954)	(642,633)
Loss before income taxes	(1,969,810)	(2,462,713)	(1,553,818)	(6,701,730)
(Benefit) provision for income taxes	(28,193)	45,858	375,543	510,091
Net loss	\$ (1,941,617)	\$ (2,508,571)	\$ (1,929,361)	\$ (7,211,821)
Less: Accrual of Series A redeemable convertible preferred stock dividends	196,727	186,904	765,203	747,616
Less: Accretion to redemption value of Series A redeemable convertible preferred stock	156,670	131,541	587,613	493,363
Net loss attributable to common stockholders	\$ (2,295,014)	\$ (2,827,016)	\$ (3,282,177)	\$ (8,452,800)
Basic net loss per share attributable to common stockholders	\$ (0.06)	\$ (0.06)	\$ (0.08)	\$ (0.18)
Diluted net loss per share attributable to common stockholders	\$ (0.06)	\$ (0.06)	\$ (0.08)	\$ (0.18)
Weighted average basic shares outstanding	41,356,757	44,008,043	41,093,644	46,265,225
Weighted average diluted shares outstanding	41,356,757	44,008,043	41,093,644	46,265,225

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

	Three Months Ended December 31,		Twelve Months Ended December 31,	
	2015	2014	2015	2014
GAAP loss from operations	\$ (2,039,824)	\$ (2,305,078)	\$ (1,283,864)	\$ (6,059,097)
Non-cash stock option expense (1)	756,430	260,410	1,929,377	1,466,183
Legal related (benefits) costs (3)	—	(231,214)	8,842	(5,417,925)
Restructuring costs (4)	—	89,746	172,995	1,135,310
Non-GAAP (loss) income from operations	\$ (1,283,394)	\$ (2,186,136)	\$ 827,350	\$ (8,875,529)
GAAP net loss attributable to common stockholders	\$ (2,295,014)	\$ (2,827,016)	\$ (3,282,177)	\$ (8,452,800)
Non-cash stock option expense, net of income taxes (2)	756,430	260,410	1,929,377	1,466,183
Legal related (benefits) costs (3)	—	(231,214)	8,842	(5,417,925)
Restructuring costs (4)	—	89,746	172,995	1,135,310
Effects of Series A redeemable convertible preferred stock (5)	353,397	318,445	1,352,816	1,240,979
Non-GAAP net (loss) income	\$ (1,185,187)	\$ (2,389,629)	\$ 181,853	\$ (10,028,253)
GAAP gross margin	77 %	77 %	80 %	77 %
Non-cash stock option expense (1)	0 %	0 %	0 %	0 %
Non-GAAP gross margin	77 %	78 %	80 %	77 %
GAAP gross margin - Product	91 %	85 %	92 %	84 %
Non-cash stock option expense (1)	0 %	0 %	0 %	0 %
Non-GAAP gross margin - Product	91 %	85 %	92 %	84 %
GAAP gross margin - Support and Service	69 %	73 %	67 %	73 %
Non-cash stock option expense (1)	0 %	0 %	0 %	0 %
Non-GAAP gross margin - Support and Service	69 %	73 %	68 %	73 %
GAAP operating margin	(22%)	(20%)	(3%)	(13%)
Non-cash stock option expense (1)	8%	2%	4%	3%
Legal related (benefits) costs (3)	0%	(2%)	0%	(12%)
Restructuring costs (4)	0%	1%	0%	2%
Non-GAAP operating margin	(14%)	(19%)	2%	(19%)
GAAP Basic EPS	\$ (0.06)	\$ (0.06)	\$ (0.08)	\$ (0.18)
Non-cash stock option expense, net of income taxes (2)	0.02	0.01	0.05	0.03
Legal related (benefits) costs (3)	0.00	(0.01)	0.00	(0.12)
Restructuring costs (4)	0.00	0.00	0.00	0.02
Effects of Series A redeemable convertible preferred stock (5)	0.01	0.01	0.03	0.03
Non-GAAP Basic EPS	\$ (0.03)	\$ (0.05)	\$ 0.00	\$ (0.22)

GAAP Diluted EPS	\$ (0.06)	\$ (0.06)	\$ (0.08)	\$ (0.18)
Non-cash stock option expense, net of income taxes (2)	0.02	0.01	0.04	0.03
Legal related (benefits) costs (3)	0.00	(0.01)	0.00	(0.12)
Restructuring costs (4)	0.00	0.00	0.00	0.02
Effects of Series A redeemable convertible preferred stock (5)	0.01	0.01	0.03	0.03
Non-GAAP Diluted EPS	<u>\$ (0.03)</u>	<u>\$ (0.05)</u>	<u>\$ 0.00</u>	<u>\$ (0.22)</u>
Weighted average basic shares outstanding (GAAP and as adjusted)	<u>41,356,757</u>	<u>44,008,043</u>	<u>41,093,644</u>	<u>46,265,225</u>
Weighted average diluted shares outstanding (GAAP)	<u>41,356,757</u>	<u>44,008,043</u>	<u>41,093,644</u>	<u>46,265,225</u>
Weighted average diluted shares outstanding (as adjusted)	<u>41,356,757</u>	<u>44,008,043</u>	<u>42,906,072</u>	<u>46,265,225</u>

Footnotes:

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

	Three Months Ended December 31,		Twelve Months Ended December 31,	
	2015	2014	2015	2014
Cost of revenues - Product	\$ —	\$ —	\$ —	\$ —
Cost of revenues - Support and Service	18,419	16,297	98,776	91,197
Research and development costs	577,355	59,924	806,348	282,416
Selling and marketing	60,632	47,506	285,787	327,694
General and administrative	100,024	136,683	738,466	764,876
Total non-cash stock based compensation expense	<u>\$ 756,430</u>	<u>\$ 260,410</u>	<u>\$ 1,929,377</u>	<u>\$ 1,466,183</u>

(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, 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.