

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

	<b>December 31, 2017</b>	<b>December 31, 2016</b>
	<b>(unaudited)</b>	
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 1,011,472	\$ 3,391,528
Accounts receivable, net	4,168,015	5,003,972
Prepaid expenses and other current assets	1,244,494	1,245,085
Inventory	—	6,181
Total current assets	<u>6,423,981</u>	<u>9,646,766</u>
Property and equipment, net	636,112	1,174,942
Deferred tax assets, net	590,977	577,735
Software development costs, net	279,414	547,558
Other assets, net	992,760	973,949
Goodwill	4,150,339	4,150,339
Other intangible assets, net	141,631	209,456
Total assets	<u>\$ 13,215,214</u>	<u>\$ 17,280,745</u>
<b>Liabilities and Stockholders' Deficit</b>		
Current liabilities:		
Accounts payable	\$ 1,092,864	\$ 419,877
Accrued expenses	4,376,235	4,471,010
Short-term loan, net of debt issuance costs and discounts	370,151	—
Deferred revenue, net	11,760,327	15,236,123
Total current liabilities	<u>17,599,577</u>	<u>20,127,010</u>
Other long-term liabilities	1,154,512	1,170,844
Deferred tax liabilities, net	85,559	254,776
Deferred revenue, net	6,600,363	8,430,692
Total liabilities	<u>25,440,011</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>(21,224,797)</u>	<u>(21,702,577)</u>
Total liabilities and stockholders' deficit	<u>\$ 13,215,214</u>	<u>\$ 17,280,745</u>

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

	Three Months Ended December 31,		Twelve Months Ended December 31,	
	2017	2016	2017	2016
Revenue:				
Product revenue	\$ 2,422,280	\$ 2,650,901	\$ 8,972,112	\$ 10,116,897
Support and services revenue	3,859,409	4,785,353	16,188,451	20,146,449
Total revenue	<u>6,281,689</u>	<u>7,436,254</u>	<u>25,160,563</u>	<u>30,263,346</u>
Cost of revenue:				
Product	115,971	222,213	785,535	932,446
Support and service	967,182	1,676,129	4,755,464	7,351,857
Total cost of revenue	<u>1,083,153</u>	<u>1,898,342</u>	<u>5,540,999</u>	<u>8,284,303</u>
Gross profit	\$ 5,198,536	\$ 5,537,912	\$ 19,619,564	\$ 21,979,043
Operating expenses:				
Research and development costs	980,392	2,227,278	6,517,050	11,702,956
Selling and marketing	831,664	2,533,442	6,120,655	13,918,493
General and administrative	1,988,943	1,369,840	6,119,513	6,470,579
Restructuring costs (benefit)	—	—	(159,597)	177,389
Total operating expenses	<u>3,800,999</u>	<u>6,130,560</u>	<u>18,597,621</u>	<u>32,269,417</u>
Operating income (loss)	<u>1,397,537</u>	<u>(592,648)</u>	<u>1,021,943</u>	<u>(10,290,374)</u>
Interest and other (loss) income, net	<u>(222,057)</u>	<u>(386,610)</u>	<u>38,064</u>	<u>(121,213)</u>
Income (loss) before income taxes	1,175,480	(979,258)	1,060,007	(10,411,587)
Provision (benefit) for income taxes	<u>(199,746)</u>	<u>211,869</u>	<u>7,606</u>	<u>587,207</u>
Net income (loss)	<u>\$ 1,375,226</u>	<u>\$ (1,191,127)</u>	<u>\$ 1,052,401</u>	<u>\$ (10,998,794)</u>
Less: Accrual of Series A redeemable convertible preferred stock dividends	238,379	195,904	873,043	777,890
Less: Accretion to redemption value of Series A redeemable convertible preferred stock	—	668,177	—	1,181,446
Net income (loss) attributable to common stockholders	<u>\$ 1,136,847</u>	<u>\$ (2,055,208)</u>	<u>\$ 179,358</u>	<u>\$ (12,958,130)</u>
Basic net income (loss) per share attributable to common stockholders	<u>\$ 0.03</u>	<u>\$ (0.05)</u>	<u>\$ —</u>	<u>\$ (0.30)</u>
Diluted net income (loss) per share attributable to common stockholders	<u>\$ 0.02</u>	<u>\$ (0.05)</u>	<u>\$ —</u>	<u>\$ (0.30)</u>
Weighted average basic shares outstanding	<u>44,563,490</u>	<u>43,818,413</u>	<u>44,413,061</u>	<u>43,091,878</u>
Weighted average diluted shares outstanding	<u>51,938,922</u>	<u>43,818,413</u>	<u>49,194,706</u>	<u>43,091,878</u>

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

	<b>Three Months Ended December 31,</b>		<b>Twelve Months Ended December 31,</b>	
	<b>2017</b>	<b>2016</b>	<b>2017</b>	<b>2016</b>
GAAP income (loss) from operations	\$ 1,397,537	\$ (592,648)	\$ 1,021,943	\$(10,290,374)
Non-cash stock option expense (1)	140,961	(63,944)	422,953	2,328,218
Restructuring costs (3)	—	—	(159,597)	177,389
Non-GAAP (loss) income from operations	<u>\$ 1,538,498</u>	<u>\$ (656,592)</u>	<u>\$ 1,285,299</u>	<u>\$ (7,784,767)</u>
GAAP net loss attributable to common stockholders	\$ 1,136,847	\$ (2,055,208)	\$ 179,358	\$(12,958,130)
Non-cash stock option expense, net of income taxes (2)	140,961	(63,944)	422,953	2,328,218
Restructuring costs (3)	—	—	(159,597)	177,389
Effects of Series A redeemable convertible preferred stock (4)	238,379	864,081	873,043	1,959,336
Non-GAAP net (loss) income	<u>\$ 1,516,187</u>	<u>\$ (1,255,071)</u>	<u>\$ 1,315,757</u>	<u>\$ (8,493,187)</u>
GAAP gross margin	83 %	74 %	78 %	73 %
Non-cash stock option expense (1)	0 %	0 %	0 %	0 %
Non-GAAP gross margin	<u>83 %</u>	<u>74 %</u>	<u>78 %</u>	<u>73 %</u>
GAAP gross margin - Product	95 %	92 %	91 %	91 %
Non-cash stock option expense (1)	0 %	0 %	0 %	0 %
Non-GAAP gross margin - Product	<u>95 %</u>	<u>92 %</u>	<u>91 %</u>	<u>91 %</u>
GAAP gross margin - Support and Service	75 %	65 %	71 %	64 %
Non-cash stock option expense (1)	0 %	0 %	0 %	0 %
Non-GAAP gross margin - Support and Service	<u>75 %</u>	<u>65 %</u>	<u>71 %</u>	<u>64 %</u>
GAAP operating margin	(8%)	(8%)	4%	(34%)
Non-cash stock option expense (1)	2%	(1%)	2%	8%
Restructuring costs (3)	0%	0%	(1%)	1%
Non-GAAP operating margin	<u>(6%)</u>	<u>(9%)</u>	<u>5%</u>	<u>(26%)</u>
GAAP Basic EPS	\$ 0.03	\$ (0.05)	\$ 0.00	\$ (0.30)
Non-cash stock option expense, net of income taxes (2)	0.00	0.00	0.01	0.05
Restructuring costs (3)	0.00	0.00	0.00	0.00
Effects of Series A redeemable convertible preferred stock (4)	0.00	0.02	0.02	0.05
Non-GAAP Basic EPS	<u>\$ 0.03</u>	<u>\$ (0.03)</u>	<u>\$ 0.03</u>	<u>\$ (0.20)</u>
GAAP Diluted EPS	\$ 0.02	\$ (0.05)	\$ 0.00	\$ (0.30)
Non-cash stock option expense, net of income taxes (2)	0.00	0.00	0.01	0.05
Restructuring costs (3)	0.00	0.00	0.00	0.00
Effects of Series A redeemable convertible preferred stock (4)	0.01	0.02	0.02	0.05
Non-GAAP Diluted EPS	<u>\$ 0.03</u>	<u>\$ (0.03)</u>	<u>\$ 0.03</u>	<u>\$ (0.20)</u>
Weighted average basic shares outstanding (GAAP and as adjusted)	44,563,490	43,818,413	44,413,061	43,091,878
Weighted average diluted shares outstanding (GAAP and as adjusted)	51,938,922	43,818,413	49,194,706	43,091,878

Footnotes:

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

	Three Months Ended December 31,		Twelve Months Ended December 31,	
	2017	2016	2017	2016
Cost of revenues - Support and Service	8,894	(4,618)	64,427	80,903
Research and development costs	21,045	1,229	233,955	1,653,336
Selling and marketing	8,108	9,502	48,286	241,481
General and administrative	102,914	(70,057)	76,285	352,498
Total non-cash stock based compensation expense	\$ 140,961	\$ (63,944)	\$ 422,953	\$ 2,328,218

- (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, 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 twelve months ended December 31, 2017 and 2016 was \$0.0 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) 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.