

# **Disclosure Statement Pursuant to the Pink Basic Disclosure Guidelines**

## **FALCONSTOR SOFTWARE, INC.**

111 Congress Avenue, Suite 500, Austin, TX 78701  
(631) 777-5188  
www.falconstor.com  
www.falconstor.com/contact  
SIC – 7372

## **Annual Report**

**For the Year Ended, December 31, 2023 (the “Reporting Period”)**

### **Outstanding Shares**

The number of shares outstanding of our Common Stock was:

7,133,089 as of December 31, 2023

7,118,609 as of December 31, 2022

### **Shell Status**

Indicate by check mark whether the company is a shell company (as defined in Rule 405 of the Securities Act of 1933, Rule 12b-2 of the Exchange Act of 1934 and Rule 15c2-11 of the Exchange Act of 1934):

Yes:  No:

Indicate by check mark whether the company’s shell status has changed since the previous reporting period:

Yes:  No:

### **Change in Control**

Indicate by check mark whether a Change in Control of the company has occurred over this reporting period:

Yes:  No:

### **1) Name and address of the issuer and its predecessors:**

The exact name of the issuer is FalconStor Software, Inc.

The issuer was incorporated in the State of Delaware in 1994 and is active and in good standing. The issuer was originally incorporated as Network Peripherals Inc. and changed its name to FalconStor Software, Inc. in 2001 through the completion of a reverse merger.

There have been no trading suspension orders issued by the SEC concerning the issuer since inception.

The issuer does not currently anticipate any stock split, stock dividend, recapitalization, merger, acquisition, spin-off, or reorganization and none have occurred in the past 12 months.

The address of the issuer's principal executive office:

111 Congress Avenue, Suite 500  
Austin, TX 78701

The address of the issuer's principal place of business:

Check if principal executive office and principal place of business are the same address:

Has the issuer or any of its predecessors been in bankruptcy, receivership, or any similar proceeding in the past five years?

No:  Yes:  If Yes, provide additional details below:

## 2) Security Information

### **Transfer Agent**

Name: Computershare Investor Services  
Address: 150 Royall Street, Canton MA 02021  
Email: danielle.mann@computershare.com  
Phone: (781) 575-2427

### **Publicly Quoted or Traded Securities:**

Trading symbol: FALC  
Exact title and class of securities outstanding: Common Stock and Series A redeemable convertible preferred stock  
CUSIP: 306137100  
Par or stated value: \$0.001 common stock and \$0.001 preferred stock

Total shares authorized: 30,000,000 common stock as of December 31, 2023  
Total shares authorized: 2,000,000 preferred stock as of December 31, 2023  
Total shares outstanding: 7,133,089 common stock as of December 31, 2023  
Total shares outstanding: 900,000 preferred stock as of December 31, 2023  
Total number of shareholders of record: 41 common stock as of December 31, 2023  
Total number of shareholders of record: 5 preferred stock as of December 31, 2023

### **Security Description:**

#### **1. For common equity, describe any dividend, voting and preemption rights.**

Subject to the Amended and Restated By-Laws (the "Bylaws") of FalconStor Software, Inc. (the "Company") holders of the Common Stock of the Company (the "Common Stock") are entitled to one vote for every share of such stock that is registered in his or her name on the record date of the applicable shareholders meeting.

#### **2. For preferred stock, describe the dividend, voting, conversion, and liquidation rights as well as redemption or sinking fund provisions.**

### **Dividend**

Subject to the Amended and Restated Certificate of Designations, Preferences and Rights of Series A Convertible Preferred Stock of the Company, dated as of June 24, 2021 (as amended, the "Certificate of Designations"), the holders of the Company's Series A Redeemable Convertible Preferred Stock (the "Series A Preferred Stock") are entitled to receive cumulative dividends at the rate (as a percentage of the stated value per share) equal to the lesser of (x) the prime corporate rate announced from time to time at the end of each calendar month by the Wall Street Journal plus 5% and (y) 10%, per annum, accruing on a daily basis and compounding monthly (collectively, "Series A Preferred

Dividends”), except that the Company is not permitted to pay such dividends in cash while any indebtedness under the Amended and Restated Term Loan Credit Agreement, dated as of February 23, 2018 (the “Amended and Restated Loan Agreement”), by and among the Company, the other loan parties thereto, as guarantors, the various financial institutions party thereto, as lenders, and HCP-FVA, LLC (“HCP-FVA”) remains outstanding without the consent of the Required Holders (as defined in the Amended and Restated Loan Agreement. In addition, the declaration and payment of dividends is subject to compliance with applicable law and unpaid dividends will accrue. A holder’s right to convert its shares of Series A Preferred Stock and receive dividends in the form of Common Stock is subject to certain limitations including, among other things, that the shares of Common Stock issuable upon conversion or as dividends will not, prior to receipt of stockholder approval, result in any holder beneficially owning greater than 9.99% of the Company’s currently outstanding shares of Common Stock.

### **Voting**

Each holder of Series A Preferred Stock has a vote equal to the number of shares of Common Stock into which its Series A Preferred Stock would be convertible as of the record date assuming a conversion price equal to \$1.23 (subject to adjustment from time to time for stock splits, stock dividends, stock combinations and similar events, as applicable, with respect to the Common Stock). In addition, the holders of a majority of the Series A Preferred Stock must approve certain actions, including any amendments to the Company’s Restated Certificate of Incorporation, as amended, or the Bylaws, in each case, that adversely affects the voting powers, preferences or other rights of the Series A Preferred Stock; payment of dividends or distributions; any liquidation, capitalization, reorganization or any other fundamental transaction of the Company; issuance of any equity security senior to or on parity with the Series A Preferred Stock as to dividend rights, redemption rights, liquidation preference and other rights; issuances of equity below the conversion price; any liens or borrowings other than non-convertible indebtedness from standard commercial lenders which does not exceed 80% of the Company’s accounts receivable; and the redemption or purchase of any of the capital stock of the Company.

### **Conversion**

Pursuant to the Certificate of Designations, each share of Series A Preferred Stock can be converted into shares of the Company’s Common Stock, at an initial conversion price of \$102.488 per share, subject to appropriate adjustments for any stock dividend, stock split, stock combination, reclassification or similar transaction, (i) at any time at the option of the holder or (ii) by the Company if, following the first anniversary of the issuance of the Series A Preferred Stock (subject to extension under certain circumstances), the volume weighted average trading price per share of the Company’s common stock for sixty (60) consecutive trading days exceeds 250% of the conversion price and continues to exceed 225% of the conversion price through the conversion date, subject at all times to the satisfaction of, and the limitations imposed by, the equity conditions set forth in the Certificate of Designations (including, without limitation, the volume limitations set forth therein).

### **Liquidation**

Upon the occurrence of any liquidation, dissolution or winding up of the Company, either voluntary or involuntary (“Liquidation Event”), the holders of Series A Preferred Stock are entitled to receive, prior and in preference to any distribution of any of the assets or funds of the Company to the holders of junior securities by reason of their ownership thereof, an amount per share in cash equal to the sum of (i) one hundred percent (100%) of the stated value per share of Series A Preferred Stock then held by them (as adjusted for any stock split, stock dividend, stock combination or other similar transactions with respect to the Series A Preferred Stock), plus (ii) 100% of all declared but unpaid dividends, and all accrued but unpaid dividends on each such share of Series A Preferred Stock (including, for the avoidance of doubt, any Series A Preferred Dividends applicable to such share of Series A Preferred Stock that the Company has elected to accrue pursuant to Section 3(b) of the Certificate of Designations and any Series A Preferred Dividends that have accrued thereon), in each case as of the date of such Liquidation Event (clauses (i) and (ii) together, the “Series A Preferred Stock Liquidation Preference”).

### **Redemption**

Upon certain triggering events, such as bankruptcy, insolvency or a material adverse effect or failure of the Company to issue shares of Common Stock upon conversion of the Series A Preferred Stock in accordance with its obligations, the holders of the Series A Preferred Stock may require the Company to redeem all or some of the Series A Preferred Stock at a price per share equal to the greater of (i) the Series A Preferred Stock Liquidation Preference, and (ii) the product of the number of shares of Common Stock underlying a share of Series A Preferred Stock (and accrued and unpaid dividends with respect thereto) and the closing price as of the occurrence of the triggering event. On February 12, 2024, the Company entered into letter agreement with Hale Capital to further extend the redemption date of the Series A Preferred Stock to June 30, 2025. On or after June 30, 2025, subject to the approval of HCP-FVA, each holder of Series A Preferred Stock can also require the Company to redeem its Series A Preferred Stock in cash at a per share price equal to 100% of the stated value of a share of Series A Preferred Stock plus accrued and unpaid dividends with respect thereto. Notwithstanding the forgoing, no holder of Series A Preferred Stock is permitted to exercise any rights or remedies upon a Breach Event (as defined in the Certificate of Designations) or to exercise any redemption rights under the

Certificate of Designations, unless approved by the holders of a majority of the then-outstanding shares of Series A Preferred Stock.

Upon consummation of a fundamental sale transaction, the Series A Preferred Stock will be redeemed at a per share redemption price equal to the greater of (y) 250% of the stated value of the Series A Preferred Stock and (z) the price payable in respect of such share of Series A Preferred Stock if such share of Series A Preferred Stock had been converted into such number of shares of common stock in accordance with the Certificate of Designations (but without giving effect to any limitations or restrictions contained therein) immediately prior to such fundamental sale transaction; provided however that the 250% threshold is changed to 100% if the fundamental sale transaction is approved by the two Series A Directors (as defined in the Certificate of Designations). In addition, if the Company consummates an equity or debt financing that results in more than \$5.0 million of net proceeds to the Company and/or its subsidiaries, the holders of Series A Preferred Stock will have the right, but not the obligation, to require the Company to use the net proceeds in excess of \$5.0 million to repurchase all or a portion of the Series A Preferred Stock at a per share price equal to the greater of (i) the sum of 100% of the stated value of such share of Series A Preferred Stock plus accrued and unpaid dividends with respect thereto, and (ii) the number of shares of common stock into which such share of Series A Preferred Stock is then convertible multiplied by the greater of (y) the closing price of the Common Stock on the date of announcement of such financing or (z) the closing price of the Common Stock on the date of consummation of such financing.

**3. Describe any other material rights of common or preferred stockholders.**

N/A

**4. Describe any material modifications to rights of holders of the company's securities that have occurred over the reporting period covered by this report.**

N/A

### 3) Issuance History

#### A. Changes to the Number of Outstanding Shares

Indicate by check mark whether there were any changes to the number of outstanding shares within the past two completed fiscal years

No:  Yes:  (If yes, you must complete the table below)

Shares Outstanding as of Second Most Recent Fiscal Year End: Opening Balance: Date: <u>December 31, 2021</u> Common: <u>7,082,276</u> Preferred: <u>900,000</u>									
Date of Transaction	Transaction type (e.g., new issuance, cancellation, shares returned to treasury)	Number of Shares Issued (or cancelled)	Class of Securities	Value of shares issued (\$/per share) at Issuance	Were the shares issued at a discount to market price at the time of issuance? (Yes/No)	Individual/ Entity Shares were issued to. *You must disclose the control person(s) for any entities listed.	Reason for share issuance (e.g. for cash or debt conversion) -OR- Nature of Services Provided	Restricted or Unrestricted as of this filing.	Exemption or Registration Type.
April 13, 2022	New Issuance	1,416	Common	\$1.15	No	Non-Executive Employee	Employee Compensation - Shares issued pursuant to vesting of restricted stock units	Unrestricted	Exemption – Section 4a2 of Securities Act
June 1, 2022	New Issuance	1,415	Common	\$0.65	No	Vincent Sita	Executive Compensation - Shares issued pursuant to vesting of restricted stock units	Unrestricted	Exemption – Section 4a2 of Securities Act
June 1, 2022	New Issuance	925	Common	\$0.65	No	Non-Executive Employee	Employee Compensation - Shares issued pursuant to vesting of restricted stock units	Unrestricted	Exemption – Section 4a2 of Securities Act
June 7, 2022	New Issuance	18,399	Common	\$1.10	No	Robert Brooks	Executive Compensation - Shares issued pursuant to vesting of restricted stock units	Unrestricted	Exemption – Section 4a2 of Securities Act
June 7, 2022	New Issuance	1,104	Common	\$1.10	No	Michael Kelly	Director Compensation - Shares issued pursuant to vesting of restricted stock units	Unrestricted	Exemption – Section 4a2 of Securities Act
June 7, 2022	New Issuance	1,104	Common	\$1.10	No	Barry Rudolph	Director Compensation - Shares issued pursuant to vesting of	Unrestricted	Exemption – Section 4a2 of Securities Act

							restricted stock units		
June 7, 2022	New Issuance	1,104	Common	\$1.10	No	William Miller	Director Compensation - Shares issued pursuant to vesting of restricted stock units	Unrestricted	Exemption – Section 4a2 of Securities Act
June 7, 2022	New Issuance	4,058	Common	\$1.10	No	Non-Executive Employees	Employee Compensation - Shares issued pursuant to vesting of restricted stock units	Unrestricted	Exemption – Section 4a2 of Securities Act
October 5, 2022	New Issuance	1,840	Common	\$1.43	No	Michael Kelly	Director Compensation - Shares issued pursuant to vesting of restricted stock units	Unrestricted	Exemption – Section 4a2 of Securities Act
October 5, 2022	New Issuance	1,840	Common	\$1.43	No	Barry Rudolph	Director Compensation - Shares issued pursuant to vesting of restricted stock units	Unrestricted	Exemption – Section 4a2 of Securities Act
October 5, 2022	New Issuance	1,840	Common	\$1.43	No	William Miller	Director Compensation - Shares issued pursuant to vesting of restricted stock units	Unrestricted	Exemption – Section 4a2 of Securities Act
October 5, 2022	New Issuance	1,288	Common	\$1.43	No	Non-Executive Employees	Employee Compensation - Shares issued pursuant to vesting of restricted stock units	Unrestricted	Exemption – Section 4a2 of Securities Act
February 17, 2023	New Issuance	1,415	Common	\$1.39	No	Vincent Sita	Executive Compensation - Shares issued pursuant to vesting of restricted stock units	Unrestricted	Exemption – Section 4a2 of Securities Act
March 6, 2023	New Issuance	925	Common	\$1.99	No	Non-Executive Employee	Employee Compensation - Shares issued pursuant to vesting of restricted stock units	Unrestricted	Exemption – Section 4a2 of Securities Act
March 16, 2023	New Issuance	1,250	Common	\$1.75	No	Non-Executive Employee	Employee Compensation - Shares issued pursuant to vesting of restricted stock units	Unrestricted	Exemption – Section 4a2 of Securities Act
September 22, 2023	New Issuance	2,832	Common	\$1.00	No	Non-Executive Employee	Employee Compensation - Shares issued	Unrestricted	Exemption – Section 4a2 of Securities Act

							pursuant to vesting of restricted stock units		
October 5, 2023	New Issuance	6,808	Common	\$1.00	No	Non-Executive Employee	Employee Compensation - Shares issued pursuant to vesting of restricted stock units	Unrestricted	Exemption – Section 4a2 of Securities Act
December 15, 2023	New Issuance	1,250	Common	\$1.50	No	Non-Executive Employee	Employee Compensation - Shares issued pursuant to vesting of restricted stock units	Unrestricted	Exemption – Section 4a2 of Securities Act
Shares Outstanding on December 31, 2023	<u>Ending Balance:</u> Common: <u>7,133,089</u> Preferred: <u>900,000</u>								

## B. Promissory and Convertible Notes

Indicate by check mark whether there are any outstanding promissory, convertible notes, convertible debentures, or any other debt instruments that may be converted into a class of the issuer’s equity securities:

No:  Yes:  (If yes, you must complete the table below)

Date of Note Issuance	Outstanding Balance as of 12/31/2023 (\$)	Principal Amount at Issuance (\$)	Interest Accrued as of 12/31/2023 (\$)	Maturity Date	Conversion Terms (e.g. pricing mechanism for determining conversion of instrument to shares)	Name of Noteholder. <small>*You must disclose the control person(s) for any entities listed.</small>	Reason for Issuance (e.g. Loan, Services, etc.)
February 23, 2018	\$ 2,172,382	\$3,000,000	—*	June 30, 2025	N/A	Hale Capital Partners, LP	Loan

\* Interest is paid monthly on the Loan; therefore Accrued Interest is \$0.

## 4) Business, Products and Services

### A. Business operations:

FalconStor is the trusted data protection software leader modernizing disaster recovery and backup operations for the hybrid cloud world. The Company enables enterprise customers and managed service providers to secure, migrate, and protect their data while reducing data storage and long-term retention costs by up to 95%. More than 1,000 organizations and managed service providers worldwide standardize on FalconStor as the foundation for their cloud first data protection future. Our products are offered through and supported by a worldwide network of leading original equipment manufacturers, managed service providers ("MSPs"), systems integrators, and resellers.

**B. Subsidiaries:**

**Domestic Subsidiaries:**

FalconStor, Inc. (Delaware)  
FalconStor AC, Inc. (Delaware)

**Foreign Subsidiaries:**

FalconStor Software, Inc. (Korea)  
FalconStor, Inc. (Taiwan)

**C. Principal products or services.**

Our products address the increasing demand for hybrid-cloud data protection for multiple devices, networks and platforms across enterprise on-premises data centers, and private and public clouds. Our products are utilized by enterprises and MSPs to address two key areas of enterprise data protection: (i) long-term data retention and recovery, and (ii) data replication to preserve business continuity. As enterprises increasingly look to focus their core IT staffs on application development and refresh, MSPs are increasingly assuming responsibility for cloud integration and data protection. Our integration with modern cloud-based data storage environments, such as IBM Cloud, Amazon Web Services and Microsoft Azure, enables our enterprise customers to significantly reduce costs and improve the portability, security and accessibility of their enterprise data and enables MSPs to serve their customers with their cloud of choice. We believe this accessibility is key in our modern world, where data must be protected and intelligently leveraged to facilitate learning, improve product design and drive competitive advantage. Our products can be used regardless of the underlying hardware, cloud, and source-data, which enables our enterprise customers to leverage their existing hardware and software investments.

**5) Facilities**

Since the Covid-19 pandemic, we have been essentially operating fully remotely. We maintain a mailing address and rent virtual office facilities at 111 Congress Avenue, Suite 500, Austin, Texas 78701. Our telephone number is (631) 777-5188. We also rent physical office space in Taiwan, and virtual offices in Germany, France, Malaysia, China, Korea, and Japan.

<u>Location</u>	<u>Own/Lease</u>	<u>Description</u>
Taiwan	Lease	Office Space



## 6) Officers, Directors, and Control Persons

The following tables show the number of shares of common stock beneficially owned by directors, executive officers, by directors and executive officers as a group, and by persons known to the Company to beneficially own more than five percent of the outstanding shares of common stock as of December 31, 2023. For the purposes of computing a person's beneficial ownership, shares of common stock issuable upon the exercise of securities exercisable within 60 days of December 31, 2023, are deemed outstanding for the purposes of computing the share ownership and percentage ownership of the person holding such securities, but are not deemed outstanding for the purposes of computing the percentage ownership of any other person.

Percentage of beneficial ownership is calculated assuming 7,133,089 shares of the Company's stock that were outstanding as of December 31, 2023. Except as otherwise indicated, known to the Company, the beneficial owners of common stock listed below have sole or shared investment and voting power with respect to such shares.

Names of All Officers, Directors and Control Persons <sup>(1)</sup>	Affiliation with Company (e.g. Officer Title /Director/Owner of more than 5%)	Residential Address (City / State Only)	Number of shares owned	Share type/class	Ownership Percentage of Class Outstanding <sup>(2)</sup>	Names of control person(s) if a corporate entity
Martin Hale, Hale Fund Management, LLC  Hale Capital Management, LP, Hale Capital Partners, LP, HCP-FVA, LLC <sup>(3)</sup>	Director and Control Person	New York, NY	3,653,377	Common	50.8%	Martin Hale
Nantahala Capital Management, LLC <sup>(4)</sup>	Control Person	Darien, CT	638,151	Common	8.9%	Wilmot B. Harkey and Daniel Mack
ESW Capital, LLC <sup>(5)</sup>	Control Person	Austin, TX	1,308,068	Common	18.3%	Joseph A. Liemandt
Bard Associates <sup>(6)</sup>	Control Person	Chicago, IL	531,190	Common	7.4%	Timothy B. Johnson
Michael P. Kelly <sup>(7)</sup>	Director	Scottsdale, AZ	18,851	Common	*	
Barry Rudolph <sup>(8)</sup>	Director	Estes Park, CO	18,796	Common	*	
William Miller <sup>(9)</sup>	Director	Colorado Springs, CO	10,289	Common	*	
Todd Brooks <sup>(10)</sup>	Director and Executive Officer	Punta Gorda, FL	87,146	Common	1.2%	
Vincent Sita <sup>(11)</sup>	Executive Officer	Mont Royal, Quebec, Canada	2,830	Common	*	
Martin Hale, Hale Fund Management, LLC  Hale Capital Management, LP, Hale Capital Partners, LP, HCP-FVA, LLC <sup>(3)</sup>	Director and Control Person	New York, NY	558,000	Preferred	62.0%	Martin Hale
Nantahala Capital Management, LLC <sup>(4)</sup>	Control Person	Darien, CT	99,807	Preferred	11.1%	Wilmot B. Harkey and Daniel Mack
ESW Capital, LLC <sup>(5)</sup>	Control Person	Austin, TX	224,786	Preferred	25.0%	Joseph A. Liemandt

Michael P. Kelly <sup>(7)</sup>	Director	Scottsdale, AZ	1,405	Preferred	*	
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\* Less than 1% of the Company's outstanding common stock.

- (1) A person is deemed to be the beneficial owner of voting securities over which the person has voting power or that can be acquired by such person within 60 days after December 31, 2023 upon the exercise of options or convertible securities, or upon the lapse or the removal of all restrictions on shares of restricted stock. Each beneficial owner's percentage ownership is determined by assuming that options or convertible securities that are held by such person (but not those held by any other person) and that are currently exercisable (i.e., that are exercisable within 60 days from December 31, 2023) have been exercised. Unless otherwise noted, we believe that all persons named in the table have sole voting and investment power with respect to all shares beneficially owned by them.
- (2) Based upon 7,133,089 shares of common stock outstanding as of December 31, 2023.
- (3) Based on information contained in Forms 4 and a report on Schedule 13D/A filed by Mr. Hale, Hale Fund Management, LLC ("Fund Management"), Hale Capital Management, LP ("Capital Management"), Hale Capital Partners, LP ("Hale Capital"), and HCP-FVA on May 22, 2019 and December 31, 2018. Consists of (i) 3,598,932 shares of common stock held by Hale Capital and HCP-FVA which includes 708 shares held by Mr. Hale for the benefit of Hale Capital, and (ii) 558,000 shares of Series A Preferred Stock held by HCP-FVA, which equates to 54,445 shares of common stock on an as-converted basis (without giving effect to the 9.99% blocker contained in the Certificate of Designations), held by HCP-FVA. Each of Mr. Hale, Fund Management, Capital Management and Hale Capital disclaims beneficial ownership of such shares of common stock except to the extent of his or its pecuniary interest.
- (4) Based on information contained in a report on Schedule 13G/A filed by Nantahala Capital Management, LLC ("Nantahala"), Wilmot B. Harkey and Daniel Mack on February 14, 2023. Consists of (i) 628,415 shares of common stock and (ii) 99,807 shares of Series A Preferred Stock that may be converted for 9,736 shares of common stock within 60 days of December 31, 2023. Messrs. Harkey and Mack are the managing members of Nantahala and disclaim beneficial ownership of such shares of common stock except to the extent of their pecuniary interest.
- (5) Based on information contained in a report on Schedule 13D/A filed by ESW Capital, LLC and Joseph A. Liemandt on December 31, 2018. Consists of (i) 1,286,135 shares of common stock and (ii) 224,786 shares of Series A Preferred Stock that may be converted for 21,933 shares of common stock within 60 days of December 31, 2023. ESW Capital, LLC and Mr. Liemandt disclaim Section 13(d) beneficial ownership with respect to 21,933 shares of common stock issuable upon conversion of Series A Preferred Stock as a result of the application of the 9.99% blocker contained in the Certificate of Designations. Mr. Liemandt is the sole voting member of ESW Capital, LLC and disclaims beneficial ownership of such shares of common stock except to the extent of his pecuniary interest.
- (6) Based on information contained in a report on Schedule 13G filed by Bard Associates, Inc. on February 6, 2023. Consists of 531,190 shares of common stock.
- (7) Based on information contained in Forms 3 and 4 filed by Mr. Kelly and certain other information. Consists of (i) 18,851 shares of common stock and (ii) 1,405 shares of Series A Preferred Stock held by Mr. Kelly, which equates to 137 shares of common stock on an as-converted basis (without giving effect to the 9.99% blocker contained in the Certificate of Designations) held by Mr. Kelly.
- (8) Based on information contained in Forms 3, 4 and 5 filed by Mr. Rudolph and certain other information. Consists of 18,796 shares of common stock held by Mr. Rudolph.
- (9) Based on information contained in Forms 3, 4 and 5 filed by Mr. Miller and certain other information. Consists of 10,289 shares of common stock held by Mr. Miller which includes 26 shares of common stock held by PV Strategies LLC, a hedge fund managed by Miller Investment Management LLC, a registered investment adviser of which Mr. Miller is a principal. Mr. Miller, as the principal of Miller Investment Management LLC, may be deemed the beneficial owner of shares owned by PV Strategies LLC. Mr. Miller disclaims beneficial ownership of such shares except to the extent of his pecuniary interest therein.

- (10) Based on information contained in Forms 3, 4 and 5 filed by Mr. Brooks and certain other information. Consists of 87,146 shares of common stock.
  
- (11) Based on information contained in Forms 3 and 4 filed by Mr. Sita and certain other information. Consists of 2,830 shares of common stock.

**7) Legal/Disciplinary History**

A. Identify whether any of the persons or entities listed above have, in the past 10 years, been the subject of:

- 1. Been the subject of an indictment or conviction in a criminal proceeding or plea agreement or named as a defendant in a pending criminal proceeding (excluding minor traffic violations);

N/A

- 2. Been the subject of the entry of an order, judgment, or decree, not subsequently reversed, suspended or vacated, by a court of competent jurisdiction that permanently or temporarily enjoined, barred, suspended or otherwise limited such person's involvement in any type of business, securities, commodities, financial- or investment-related, insurance or banking activities;

N/A

- 3. Been the subject of a finding, disciplinary order or judgment by a court of competent jurisdiction (in a civil action), the Securities and Exchange Commission, the Commodity Futures Trading Commission, a state securities regulator of a violation of federal or state securities or commodities law, or a foreign regulatory body or court, which finding or judgment has not been reversed, suspended, or vacated;

N/A

- 4. Named as a defendant or a respondent in a regulatory complaint or proceeding that could result in a "yes" answer to part 3 above; or

N/A

- 5. Been the subject of an order by a self-regulatory organization that permanently or temporarily barred, suspended, or otherwise limited such person's involvement in any type of business or securities activities.

N/A

- 6. Been the subject of a U.S Postal Service false representation order, or a temporary restraining order, or preliminary injunction with respect to conduct alleged to have violated the false representation statute that applies to U.S mail.

N/A

B. Material pending legal proceedings: None

## 8) Third Party Service Providers

### Securities Counsel:

Name: Olshan Frome Wolosky LLP  
Address: 1325 Avenue of the Americas  
New York, NY 10019  
Phone: (212)-451-2252  
Email: KSchlesinger@olshanlaw.com

Name: Campolo, Middleton & McCormick, LLP  
Address: 4175 Veterans Memorial Highway, Suite 400  
Ronkonkoma, New York 11779  
Phone: (631)-738-9100  
Email: contact@cmmllp.com

### Auditor - Year Ending December 31, 2022:

Name: Marcum LLP  
Address: 600 Anton Boulevard, Suite 1600  
Costa Mesa, CA 92626  
Phone: (949)-236.5600  
Email: info@marcumllp.com

### Auditor - Year Ending December 31, 2023:

Name: Weaver & Tidwell, LLP  
Address: 1601 South MoPac Expressway, Suite D250,  
Austin, TX 78746  
Phone: (512) 609-1900

### *All other means of Investor Communication:*

Website: <https://www.falconstor.com/investors/>  
X (Twitter): <https://twitter.com/FalconStor/status/1547135867600474112>  
LinkedIn: <https://www.linkedin.com/company/falconstor-software/>  
Facebook: <https://www.facebook.com/falconstorsoftwareinc/>

### Other Service Providers:

Firm: Bridgepoint Consulting  
Nature of Services: Financial Reporting  
Address: 8310 N. Capital of Texas Highway, Bldg. 1, Ste. 420  
Austin, Texas 78731  
Phone: 512-437-7900

## 9) Financial Statements

A. This Disclosure Statement was prepared by:

Name: Vincent Sita  
Title: CFO  
Relationship to Issuer: Employee and Officer

B. The following financial statements were prepared in accordance with:

- IFRS
- U.S. GAAP

C. The following financial statements were prepared by:

Name: Vincent Sita  
Title: CFO  
Relationship to Issuer: Employee and Officer  
Qualifications of the person who prepared the financial statements: CFO, Professional Accountant, 25+ years experience in financial management.

The following consolidated financial statements are attached for the year ending December 31, 2023 and are hereby incorporated by reference:

- a. Consolidated Balance Sheets at December 31, 2023 (unaudited) and December 31, 2022
- b. Consolidated Statements of Operations for the year ended December 31, 2023 (unaudited), and 2022
- c. Consolidated Statements of Cash Flows for the year ended December 31, 2023 (unaudited), and 2022
- d. Consolidated Statements of Comprehensive Income (Loss) for the year ended December 31, 2023 (unaudited), and 2022
- e. Consolidated Statements of Stockholders' Deficit for the year ended December 31, 2023 (unaudited), and 2022
- f. Notes to the Consolidated Financial Statements

## 10) Issuer Certification

I, Todd Brooks, certify that:

1. I have reviewed this Annual Disclosure Statement for FalconStor Software, Inc.;
2. Based on my knowledge, this disclosure statement does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this disclosure statement; and
3. Based on my knowledge, the financial statements, and other financial information included or incorporated by reference in this disclosure statement, fairly present in all material respects the financial condition, results of operations and cash flows of the issuer as of, and for, the periods presented in this disclosure statement.

/s/ Todd Brooks  
Todd Brooks  
Chief Executive Officer

February 22, 2024  
Date

*Principal Financial Officer:*

I, Vincent Sita, certify that:

1. I have reviewed this Annual Disclosure Statement for FalconStor Software, Inc.;
2. Based on my knowledge, this disclosure statement does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this disclosure statement; and
3. Based on my knowledge, the financial statements, and other financial information included or incorporated by reference in this disclosure statement, fairly present in all material respects the financial condition, results of operations and cash flows of the issuer as of, and for, the periods presented in this disclosure statement.

/s/ Vincent Sita  
Vincent Sita  
Chief Financial Officer

February 22, 2024  
Date

**FALCONSTOR SOFTWARE, INC. AND SUBSIDIARIES**  
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**FALCONSTOR SOFTWARE, INC. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**

	<u>December 31, 2023</u>	<u>December 31, 2022</u>
	(unaudited)	
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 3,409,120	\$ 2,011,062
Accounts receivable, net	2,333,816	2,278,802
Prepaid expenses and other current assets	1,032,125	897,493
Contract assets, net	509,201	181,933
Total current assets	<u>7,284,262</u>	<u>5,369,290</u>
Property and equipment, net	49,194	86,263
Operating lease right-of-use assets, net	104,566	34,416
Software development costs, net	25,278	53,057
Other assets	15,946	98,747
Goodwill	4,150,339	4,150,339
Other intangible assets, net	2,489	20,086
Long-term contract assets, net	644,789	357,914
Total assets	<u>\$ 12,276,863</u>	<u>\$ 10,170,112</u>
<b>Liabilities and Stockholders' Deficit</b>		
Current liabilities:		
Accounts payable	\$ 522,976	\$ 387,379
Accrued expenses	1,972,593	1,427,979
Current portion of lease liabilities	69,143	34,416
Short-term note payable	91,557	177,149
Deferred revenue	3,736,200	3,684,742
Total current liabilities	<u>6,392,469</u>	<u>5,711,665</u>
Other long-term liabilities	1,021,605	956,023
Notes payable, net of debt issuance costs and discounts	2,172,382	2,163,090
Operating lease liabilities, net of current portion	35,422	—
Deferred tax liabilities	465,214	537,651
Deferred revenue, net of current portion	1,617,603	1,281,107
Total liabilities	<u>\$ 11,704,695</u>	<u>\$ 10,649,536</u>
Commitments and contingencies (Note 12)		
Series A redeemable convertible preferred stock, \$.001 par value, 2,000,000 shares authorized, 900,000 shares issued and outstanding, redemption value of \$17,563,563 and \$15,984,331, respectively	17,543,521	15,928,018
Stockholders' deficit:		
Common stock, \$.001 par value, 30,000,000 shares authorized, 7,133,089 shares and 7,118,609 shares issued and outstanding, respectively	7,133	7,119
Additional paid-in capital	109,240,183	110,844,716
Accumulated deficit	(124,528,795)	(125,507,178)
Accumulated other comprehensive loss	(1,689,874)	(1,752,099)
Total stockholders' deficit	<u>\$ (16,971,353)</u>	<u>\$ (16,407,442)</u>
Total liabilities and stockholders' deficit	<u>\$ 12,276,863</u>	<u>\$ 10,170,112</u>

See accompanying notes to unaudited consolidated financial statements.



**FALCONSTOR SOFTWARE, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**

	Year Ended December 31,	
	2023	2022
	(unaudited)	
Revenue:		
Product revenue	\$ 6,366,899	\$ 4,246,177
Support and services revenue	5,231,844	5,806,071
Total revenue	<u>11,598,743</u>	<u>10,052,248</u>
Cost of revenue:		
Product	81,814	97,270
Support and service	1,564,650	1,467,611
Total cost of revenue	<u>1,646,464</u>	<u>1,564,881</u>
Gross profit	\$ 9,952,279	\$ 8,487,367
Operating expenses:		
Research and development costs	2,421,435	2,561,825
Selling and marketing	3,511,722	4,003,764
General and administrative	2,598,848	3,178,604
Restructuring costs	—	744
Total operating expenses	<u>8,532,005</u>	<u>9,744,937</u>
Operating income (loss)	1,420,274	(1,257,570)
Interest and other expense	(362,176)	(330,927)
Income (loss) before income taxes	1,058,098	(1,588,497)
Income tax expense (benefit)	79,715	210,458
Net income (loss)	<u>\$ 978,383</u>	<u>\$ (1,798,955)</u>
Less: Accrual of Series A redeemable convertible preferred stock dividends	1,579,232	1,494,057
Less: Accretion to redemption value of Series A redeemable convertible preferred stock	36,271	49,573
Net income (loss) attributable to common stockholders	<u>\$ (637,120)</u>	<u>\$ (3,342,585)</u>
Basic net income (loss) per share attributable to common stockholders	<u>\$ (0.09)</u>	<u>\$ (0.47)</u>
Diluted net income (loss) per share attributable to common stockholders	<u>\$ (0.09)</u>	<u>\$ (0.47)</u>
Weighted average basic shares outstanding	<u>7,124,045</u>	<u>7,100,929</u>
Weighted average diluted shares outstanding	<u>7,124,045</u>	<u>7,100,929</u>

See accompanying notes to unaudited consolidated financial statements.

**FALCONSTOR SOFTWARE, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**

	Year Ended December 31,	
	2023	2022
	(unaudited)	
Net income (loss)	\$ 978,383	\$ (1,798,955)
Other comprehensive income (loss), net of applicable taxes		
Foreign currency translation	61,959	138,788
Net minimum pension liability	266	(30,847)
Total other comprehensive income (loss), net of applicable taxes:	62,225	107,941
Total comprehensive income (loss)	\$ 1,040,608	\$ (1,691,014)
Less: Accrual of Series A redeemable convertible preferred stock dividends	1,579,232	1,494,057
Less: Accretion to redemption value of Series A redeemable convertible preferred stock	36,271	49,573
Total comprehensive income (loss) attributable to common stockholders	\$ (574,895)	\$ (3,234,644)

See accompanying notes to unaudited consolidated financial statements.

**FALCONSTOR SOFTWARE, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' DEFICIT**  
**(UNAUDITED)**

	Common Stock Outstanding	Common Stock	Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive Loss, Net	Total Stockholders' Deficit
Balance at December 31, 2021	7,082,276	\$ 7,082	\$ 112,349,613	\$ (123,708,223)	\$ (1,860,040)	\$ (13,211,568)
Net income (loss)				(1,798,955)		(1,798,955)
Share-based compensation to employees			38,770			38,770
Shares issued in connection with vesting of restricted stock	36,333	37	(37)			—
Accretion of Series A redeemable convertible preferred stock			(49,573)			(49,573)
Dividends on Series A redeemable convertible preferred stock			(1,494,057)			(1,494,057)
Foreign currency translation					138,788	138,788
Net minimum pension liability					(30,847)	(30,847)
Balance at December 31, 2022	7,118,609	7,119	110,844,716	(125,507,178)	(1,752,099)	(16,407,442)
Net income (loss)				978,383		978,383
Share-based compensation to employees			10,984			10,984
Shares issued in connection with vesting of restricted stock	14,480	14	(14)			—
Accretion of Series A redeemable convertible preferred stock			(36,271)			(36,271)
Dividends on Series A redeemable convertible preferred stock			(1,579,232)			(1,579,232)
Foreign currency translation					61,959	61,959
Net minimum pension liability					266	266
Balance at December 31, 2023	7,133,089	7,133	109,240,183	(124,528,795)	(1,689,874)	(16,971,353)

See accompanying notes to unaudited consolidated financial statements.

**FALCONSTOR SOFTWARE, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

	Year Ended December 31,	
	2023	2022
	(unaudited)	
Cash flows from operating activities:		
Net income (loss)	\$ 978,383	\$ (1,798,955)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	90,229	120,207
Amortization of debt discount on notes payable	9,292	8,992
Amortization of right of use assets	(70,150)	77,989
Share-based payment compensation	10,984	38,770
Recovery of returns and doubtful accounts	11,513	(54,044)
Deferred income taxes	(55,871)	67,342
Changes in operating assets and liabilities:		
Accounts receivable	(57,718)	633,998
Prepaid expenses and other current assets	(159,785)	130,979
Contract assets	(614,143)	362,801
Inventory	—	7,202
Other assets	64,120	77,919
Accounts payable	199,921	191,019
Accrued expenses and other long-term liabilities	633,402	409,812
Operating lease liabilities	70,150	(77,989)
Deferred revenue	396,310	(1,395,257)
Net cash provided by (used in) operating activities	<u>1,506,637</u>	<u>(1,199,215)</u>
Cash flows from investing activities:		
Purchases of property and equipment	(8,140)	—
Capitalized software development costs	—	(35,000)
Purchase of intangible assets	—	(3,078)
Net cash provided by (used in) investing activities	<u>(8,140)</u>	<u>(38,078)</u>
Cash flows from financing activities:		
Cash paid for payroll taxes on restricted stock unit release	(681)	—
Proceeds from short-term debt	130,796	253,069
Payments of short-term debt	(216,387)	(75,920)
Net cash provided by (used in) financing activities	<u>(86,272)</u>	<u>177,149</u>
Effect of exchange rate changes on cash and cash equivalents	(14,167)	(110,003)
Net increase (decrease) in cash and cash equivalents	1,398,058	(1,170,147)
Cash and cash equivalents, beginning of period	2,011,062	3,181,209
Cash and cash equivalents, end of period	<u>\$ 3,409,120</u>	<u>\$ 2,011,062</u>
Supplemental disclosures:		
Cash paid for interest	\$ 200,311	\$ 130,040
Non-cash investing and financing activities:		
Undistributed Series A redeemable convertible preferred stock dividends	\$ 1,579,232	\$ 1,494,057
Accretion of Series A redeemable convertible preferred stock	\$ 36,271	\$ 49,573

See accompanying notes to unaudited consolidated financial statements.

**FALCONSTOR SOFTWARE, INC. AND SUBSIDIARIES**  
**Notes to Unaudited Consolidated Financial Statements**

**(1) Summary of Significant Accounting Policies**

*The Company and Nature of Operations*

FalconStor Software, Inc., a Delaware corporation ("we", the "Company" or "FalconStor"), is a trusted data protection software leader modernizing disaster recovery and backup operations for the hybrid cloud world. The Company enables enterprise customers and managed service providers to secure, migrate, and protect their data while reducing data storage and long-term retention costs by up to 95%. More than 1,000 organizations and managed service providers worldwide standardize on FalconStor as the foundation for their cloud first data protection future.

*Liquidity*

As of December 31, 2023, the Company had a working capital surplus of \$0.9 million, which is inclusive of current deferred revenue of \$3.7 million, and a stockholders' deficit of \$17.0 million. During the year ended December 31, 2023, the Company had a net income of \$1.0 million and positive cash flow from operations of \$1.5 million. The Company's total cash balance at December 31, 2023 was \$3.4 million, an increase of \$1.4 million compared to \$2.0 million on December 31, 2022.

The Company's principal sources of liquidity at December 31, 2023 consisted of cash and future cash anticipated to be generated from operations. The Company generated positive net income and positive cash flows from operations during the year ended December 31, 2023, and it reported positive working capital as of December 31, 2023.

The Company is currently party to an Amended and Restated Term Loan Credit Agreement, dated as of February 23, 2018, as amended December 27, 2019, by and between the Company and HCP-FVA, LLC ("HCP-FVA"), (the "Amended and Restated Loan Agreement"). In connection with the then-proposed public offering of the Company as described in the Company's Registration Statement on Form S-1, as amended, originally filed on June 3, 2021 (the "June Offering"), we entered into a letter agreement with Hale Capital Partners, LP ("Hale Capital"), dated June 2, 2021 (the "Loan Extension Letter Agreement"), that provided for an extension of the maturity date on Hale Capital's portion of the outstanding indebtedness owed under the Amended and Restated Loan Agreement to June 30, 2023. The remaining principal amount outstanding, which was owed to other lenders, was repaid in full. On July 19, 2022, we entered into a letter agreement with Hale Capital (the "Second Loan Extension Letter Agreement"), that provided for a subsequent extension of the maturity date on the outstanding indebtedness owed under the Amended and Restated Loan Agreement from June 30, 2023 to December 31, 2023. On February 10, 2023, the Company entered into a letter agreement with Hale Capital to further extend the maturity date of the senior secured debt to June 30, 2024 (the "Third Loan Extension Letter Agreement"). On February 12, 2024, the Company entered into a letter agreement with Hale Capital to further extend the maturity date of the senior secured debt to June 30, 2025 (the "Fourth Loan Extension Letter Agreement"). See Note (10) Notes Payable for more information.

Also, as described further in Note (13) *Series A Redeemable Convertible Preferred Stock*, the effective date of the mandatory redemption right of the Company's Series A Redeemable Convertible Preferred Stock (the "Series A Preferred Stock") held by HCP-FVA and Hale Capital was extended from July 30, 2021 to July 30, 2023 pursuant to that certain Amendment No. 1 to the Amended and Restated Certificate of Designations, Preferences and Rights of Series A Convertible Preferred Stock of the Company, dated as of June 24, 2021 (as amended, the "Certificate of Designations"). On July 19, 2022, the Company and Hale Capital entered into a letter agreement pursuant to which Hale Capital agreed not to exercise or permit the exercise of the mandatory redemption right of the Series A Preferred Stock on or prior to December 31, 2023 unless the redemption is in accordance with Section 8(e)(z) of the Certificate of Designations or in accordance with a Breach Event (as defined in the Certificate of Designations). On February 10, 2023, the Company entered into a letter agreement with Hale Capital to further extend the redemption date of the Series A Preferred Stock to June 30, 2024. On February 12, 2024, the Company entered into another letter agreement with Hale Capital to further extend the redemption date of the Series A Preferred Stock to June 30, 2025. If such Series A Preferred Stock was redeemed on December 31, 2023, the Company would have been required to pay the holders of the Series A Preferred Stock \$17.6 million.

The Company believes its current cash balances together with anticipated cash flows from operating activities will be sufficient to meet its working capital requirements for at least one year from the date the consolidated financial statements were issued.

#### *COVID-19 Pandemic, Geopolitical and Other Macroeconomic Impacts to our Operating Environment*

We are subject to risks and uncertainties arising from macroeconomic and geopolitical conditions, including, but not limited to, inflation, rising interest rates, foreign currency fluctuations, lower consumer spending, geopolitical conflicts, including the conflict in Ukraine, Middle East and continuing effects of the COVID-19 pandemic. We continuously monitor the direct and indirect impacts of these macroeconomic and geopolitical events and trends on our business and financial results.

The full extent to which these macroeconomic and geopolitical conditions impact our business is difficult to predict. Such impacts include, but are not limited to, supply chain and logistical challenges, reduced consumer demand for our products, and an industry-wide slowdown in advertising spending. The impact of COVID-19, for example, is fluid and uncertain, but it has caused and may continue to cause various negative effects, including an inability to meet with actual or potential customers, our end customers deciding to delay or abandon their planned purchases or failing to make payments, and delays or disruptions in our or our partners' supply chains. As a result, we may experience extended sales cycles, our ability to close transactions with new and existing customers and partners may be negatively impacted, our ability to recognize revenue from software transactions we do close may be negatively impacted, our demand generation activities, and the efficiency and effect of those activities, may be negatively affected. These uncertainties have, and may continue to, put pressure on global economic conditions and overall IT spending and may cause our end customers to modify spending priorities or delay or abandon purchasing decisions, thereby lengthening sales cycles and potentially lowering prices for our solutions, and may make it difficult for us to forecast our sales and operating results and to make decisions about future investments, any of which could materially harm our business, operating results and financial condition.

#### *Principles of Consolidation*

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

#### *Use of Estimates*

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America ("GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The Company's significant estimates include those related to revenue recognition, accounts receivable allowances, valuation of derivatives, valuation of goodwill and income taxes. Actual results could differ from those estimates.

The financial market volatility in many countries where the Company operates has impacted and may continue to impact the Company's business. Such conditions could have a material impact on the Company's significant accounting estimates discussed above.

#### *Derivative Financial Instruments*

The Company does not use derivative instruments to hedge exposures to cash flow, market or foreign currency risk. Terms of convertible preferred stock are reviewed to determine whether or not they contain embedded derivative instruments that are required under Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 815 "Derivatives and Hedging" ("ASC 815") to be accounted for separately from the host contract, and recorded on the balance sheet at fair value. The fair value of derivatives are required to be revalued at each reporting date, with corresponding changes in fair value recorded in current period operating results. See Note (11) *Fair Value Measurements* for additional information.

### *Revenue from Contracts with Customers and Associated Balances*

The Company derives its revenue from sales of its products, support and services. Product revenue consists of the Company's software integrated with industry standard hardware and sold as complete turn-key integrated solutions, as stand-alone software applications or sold on a subscription or consumption basis. Depending on the nature of the arrangement, revenue related to turn-key solutions and stand-alone software applications are generally recognized upon shipment and delivery of license keys. For certain arrangements revenue is recognized based on usage or ratably over the term of the arrangement. Support and services revenue consists of both maintenance revenues and professional services revenues. Revenue is recorded net of applicable sales taxes.

The Company recognizes revenue for the transfer of services or products to customers in an amount that reflects the consideration to which the Company expects to be entitled in exchange for those services or products. The principle is achieved through the following five-step approach:

- Identification of the contract, or contracts, with the customer
- Identification of the performance obligation in the contract
- Determination of the transaction price
- Allocation of the transaction price to the performance obligations in the contract
- Recognition of revenue when, or as, the Company satisfies a performance obligation

### *Nature of Products and Services*

Licenses for on-premises software provide the customer with a right to use the software as it exists when made available to the customer. Customers may purchase perpetual licenses or subscribe to licenses, which provide customers with the same functionality and differ mainly in the duration over which the customer benefits from the software. Revenue from distinct on-premises licenses is recognized upfront at the point in time when the software is made available to the customer. Revenue allocated to software maintenance and support services is recognized ratably over the contractual support period.

Hardware products consist primarily of servers and associated components and function independently of the software products and as such are accounted for as separate performance obligations. Revenue allocated to hardware maintenance and support services is recognized ratably over the contractual support period.

Professional services are primarily related to software implementation services and associated revenue is recognized upon customer acceptance.

### *Contract Balances*

The timing of revenue recognition may differ from the timing of invoicing to customers. The Company records a contract asset when revenue is recognized prior to invoicing, or unearned revenue when revenue is recognized subsequent to invoicing. For perpetual licenses with multi-year maintenance agreements, the Company invoices the license and generally one year of maintenance with future maintenance generally invoiced annually. For multi-year subscription licenses, the Company generally invoices customers annually at the beginning of each annual coverage period. The Company records a contract asset related to revenue recognized for multi-year on-premises licenses as its right to payment is conditioned upon providing product support and services in future years.

As of December 31, 2023 and December 31, 2022, accounts receivable, net of allowance for doubtful accounts, was \$2.3 million and \$2.3 million, respectively. A provision for expected credit losses for accounts receivables and contract assets that share similar risk characteristics is recorded based on an evaluation of historical loss experience, current conditions, and reasonable and supportable forecasts. Accounts are written off when it becomes apparent that such amounts will not be collected,

generally when amounts are past due by greater than nine months. Our provision for credit loss on accounts receivable was \$25,757 as of December 31, 2023 and \$25,720 as of December 31, 2022, respectively. As of December 31, 2023 and December 31, 2022, short and long-term contract assets, net of provision for credit loss, was \$1.2 million and \$0.5 million, respectively. Our provision for credit loss on contract assets was \$11,540 and zero as of December 31, 2023 and December 31, 2022, respectively.

Deferred revenue is comprised mainly of unearned revenue related to maintenance and technical support on term and perpetual licenses. Maintenance and technical support revenue is recognized ratably over the coverage period. Deferred revenue also includes contracts for professional services to be performed in the future which are recognized as revenue when the Company delivers the related service pursuant to the terms of the customer arrangement.

Changes in deferred revenue were as follows:

Balance at December 31, 2022	\$	4,965,849
Deferral of revenue		11,987,127
Recognition of revenue		(11,598,743)
Change in reserves		(430)
Balance at December 31, 2023	\$	<u>5,353,803</u>

During the twelve months ended December 31, 2023 and 2022, revenue of \$3.8 million and \$4.5 million, respectively, was recognized from the deferred revenue balance at the beginning of each period.

Deferred revenue includes invoiced revenue allocated to remaining performance obligations that has not yet been recognized and will be recognized as revenue in future periods. Deferred revenue was \$5.4 million as of December 31, 2023, of which the Company expects to recognize approximately 70% of such amount as revenue over the next 12 months and the remainder thereafter.

Payment terms and conditions vary by contract type, although terms generally include a requirement of payment within 30 to 90 days. In instances where the timing of revenue recognition differs from the timing of invoicing, the Company has determined that its contracts generally do not include a significant financing component. The primary purpose of the Company's invoicing terms is to provide customers with simplified and predictable ways of purchasing its products and services, and not to receive financing from our customers or to provide customers with financing. Examples include invoicing at the beginning of a subscription term with maintenance and support revenue recognized ratably over the contract period, and multi-year, on-premises licenses that are invoiced annually with product revenue recognized upon delivery.

#### *Significant Judgments*

The Company's contracts with customers often include promises to transfer multiple products and services to a customer. Determining whether products and services are considered distinct performance obligations that should be accounted for separately versus together may require significant judgment.

Judgment is required to determine the standalone selling price ("SSP") for each distinct performance obligation. For products and services aside from maintenance and support, the Company estimates SSP by adjusting the list price by historical discount percentages. SSP for software and hardware maintenance and support fees is based on the stated percentages of the fees charged for the respective products.

The Company's perpetual and term software licenses have significant standalone functionality and therefore revenue allocated to these performance obligations are recognized at a point in time upon electronic delivery of the download link and the license keys.

Product maintenance and support services are satisfied over time as they are stand-ready obligations throughout the support period. As a result, revenues associated with maintenance services are deferred and recognized as revenue ratably over the term of the contract.



Revenues associated with professional services are recognized at a point in time upon customer acceptance.

#### *Disaggregation of Revenue*

Please refer to the consolidated statements of operations and Note (16) *Segment Reporting and Concentrations* for discussion on revenue disaggregation by product type and by geography. The Company believes this level of disaggregation sufficiently depicts how the nature, amount, timing and uncertainty of our revenue and cash flows are affected by economic factors.

#### *Assets Recognized from Costs to Obtain a Contract with a Customer*

The Company recognizes an asset for the incremental costs of obtaining a contract with a customer if it expects the benefit of those costs to be longer than one year. The Company has determined that its sales commission program meets the requirements for cost capitalization. Total capitalized costs to obtain a contract were immaterial during the periods presented and are included in other current and long-term assets on our consolidated balance sheets. The Company applies a practical expedient to expense costs as incurred for costs to obtain a contract with a customer when the amortization period would have been one year or less.

#### *Leases*

We have entered into operating leases for our various facilities. We determine if an arrangement is a lease at inception. Operating leases are included in Right-of-Use ("ROU") assets, and lease liability obligations in our consolidated balance sheets. ROU assets represent our right to use an underlying asset for the lease term and lease liability obligations represent our obligation to make lease payments arising from the lease. ROU assets and liabilities are recognized at commencement date based on the present value of lease payments over the lease term. We have lease agreements with lease and non-lease components and account for such components as a single lease component. As most of our leases do not provide an implicit rate, we estimated our incremental borrowing rate based on the information available at commencement date in determining the present value of lease payments. We use the implicit rate when readily determinable. The ROU asset also includes any lease payments made and excludes lease incentives and lease direct costs. Our lease terms may include options to extend or terminate the lease. Such extended terms have been considered in determining the ROU assets and lease liability obligations when it is reasonably certain that we will exercise that option. Lease expense is recognized on a straight-line basis over the lease term.

#### *Right of Use Assets and Liabilities*

	Year Ended December 31,	
	2023	2022
Component of lease expense:		
Operating lease cost	\$ 149,910	\$ 142,388

During the year ended December 31, 2023, operating cash flows from operating leases were \$71,628.

#### *Property and Equipment*

Property and equipment are recorded at cost. Depreciation is recognized using the straight-line method over the estimated useful lives of the assets (3 to 7 years). Leasehold improvements are amortized on a straight-line basis over the terms of the respective leases or over their estimated useful lives, whichever is shorter.

#### *Goodwill and Other Intangible Assets*

Goodwill represents the excess of the purchase price over the estimated fair value of net tangible and identifiable intangible assets acquired in business combinations. The Company has not amortized goodwill related to its acquisitions, but instead tests the balance for impairment. The Company evaluates goodwill for impairment annually or more frequently when an event occurs or circumstances change that indicate that the carrying value may not be recoverable. The Company tests goodwill for impairment by first comparing the book value of net assets to the fair value of the reporting unit. If the fair value is determined to be less than the book value or qualitative factors indicate that it is more likely than not that goodwill is impaired, a second step is performed to compute the amount of impairment as the difference between the estimated fair value of goodwill and the carrying value.

The fair value of the Company's single reporting unit for purposes of its goodwill impairment test exceeded its carrying value as of December 31, 2023 and 2022 and thus the Company determined there was no impairment of goodwill.

Identifiable intangible assets include (i) assets acquired through business combinations, which include customer contracts and intellectual property, and (ii) patents amortized over three years using the straight-line method.

#### *Software Development Costs and Purchased Software Technology*

In accordance with the authoritative guidance issued by the FASB on costs of software to be sold, leased, or marketed, costs associated with the development of new software products and enhancements to existing software products are expensed as incurred until technological feasibility of the product has been established. Based on the Company's product development process, technological feasibility is established upon completion of a working model. Amortization of software development costs is recorded at the greater of the straight-line basis over the product's estimated life, or the ratio of current period revenue of the related products to total current and anticipated future revenue of these products.

#### *Income Taxes*

As discussed further in Note (8) Income Taxes, to our consolidated financial statements, in accordance with the authoritative guidance issued by the FASB on income taxes, we regularly evaluate our ability to recover deferred tax assets and report such deferred tax assets at the amount that is determined to be more-likely-than-not recoverable. The Company records income taxes under the asset and liability method. Deferred tax assets and liabilities are recognized for future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be realized or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. In determining the period in which related tax benefits are realized for financial reporting purposes, excess share-based compensation deductions included in net operating losses are realized after regular net operating losses are exhausted.

We account for uncertain tax positions in accordance with the authoritative guidance issued by the FASB on income taxes, which addresses the determination of whether tax benefits claimed or expected to be claimed on a tax return, should be recorded in the financial statements. Pursuant to the authoritative guidance, we may recognize the tax benefit from an uncertain tax position only if it meets the "more likely than not" threshold that the position will be sustained on examination by the taxing authority, based on the technical merits of the position or under statute expirations. The tax benefits recognized in the financial statements from such a position should be measured based on the largest benefit that has a greater than fifty percent likelihood of being realized upon ultimate settlement. In addition, the authoritative guidance addresses de-recognition, classification, interest and penalties on income taxes, accounting in interim periods, and requires increased disclosures.

#### *Long-Lived Assets*

The Company reviews its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. If the sum of the expected future cash flows, undiscounted and without interest, is less than the carrying amount of the asset, an impairment loss is recognized as the amount by which the carrying amount of the asset exceeds its fair value.

#### *Share-Based Payments*

The Company accounts for share-based payments in accordance with the authoritative guidance issued by the FASB on share-based compensation, which establishes the accounting for transactions in which an entity exchanges its equity instruments for goods or services. Under the provisions of the authoritative guidance, share-based compensation expense is measured at the

grant date, based on the fair value of the award, and is recognized as an expense over the requisite employee service period (generally the vesting period), net of actual forfeitures. For share-based payment awards that contain performance criteria share-based compensation, expense is recorded when the achievement of the performance condition is considered probable of achievement and is recorded on a straight-line basis over the requisite service period. If such performance criteria are not met, no compensation cost is recognized and any recognized compensation cost is reversed. The Company estimates the fair value of share-based payments using the Black-Scholes option-pricing model or the Monte Carlo simulation model if a market condition exists. Share-based compensation expense for a share-based payment award with a market condition is recorded on a straight-line basis over the longer of the explicit service period or the service period derived from the Monte Carlo simulation. All share-based awards are expected to be fulfilled with new shares of common stock.

### *Foreign Currency*

Assets and liabilities of foreign operations are translated at rates of exchange at the end of the period, while results of operations are translated at average exchange rates in effect for the period. Gains and losses from the translation of foreign assets and liabilities from the functional currency of the Company's subsidiaries into the U.S. dollar are classified as accumulated other comprehensive loss in stockholders' deficit. Gains and losses from foreign currency transactions are included in the consolidated statements of operations within interest and other expense, net. During the year ended December 31, 2023, foreign currency transactional losses totaled approximately \$57,576. During the year ended December 31, 2022, foreign currency transactional gains totaled approximately \$36,891.

### *Recently Issued Accounting Pronouncements*

In August 2020, the Financial Accounting Standards Board, or FASB, issued ASU 2020-06, regarding ASC Topic 470 "Debt" and ASC Topic 815 "Derivatives and Hedging," which reduces the number of accounting models for convertible instruments and amends the calculation of diluted earnings per share for convertible instruments, among other changes. The guidance is effective for smaller reporting companies as defined by the SEC, for annual reporting periods beginning after December 15, 2023, including interim periods within that reporting period. Early adoption is permitted. We are currently evaluating the impact of the adoption of this standard on our consolidated financial statements.

### *Recently Adopted Accounting Pronouncements*

In February 2020, the FASB issued ASU 2020-02, "Financial Instruments—Credit Losses (Topic 326) and Leases (Topic 842)", which delayed the effective date of Topic 326 for smaller reporting companies until fiscal years beginning after December 15, 2022. The Company adopted Topic 326 effective January 1, 2023. The impact of adoption of this standard was not material on the Company's consolidated financial statements.

## **(2) Earnings Per Share**

Basic earnings per share ("EPS") is computed based on the weighted average number of shares of common stock outstanding. Diluted EPS is computed based on the weighted average number of common shares outstanding increased by dilutive common stock equivalents, attributable to stock option awards, restricted stock, warrants and the Series A Preferred Stock outstanding.

The following represents the common stock equivalents that were excluded from the computation of diluted shares outstanding because their effect would have been anti-dilutive for the years ended December 31, 2023 and 2022:

	<u>Year Ended December 31,</u>	
	<u>2023</u>	<u>2022</u>
Stock options	2,825	4,965
Restricted stock	14,964	32,768
Series A redeemable convertible preferred stock	171,372	155,963
Total anti-dilutive common stock equivalents	<u>189,161</u>	<u>193,696</u>

The following represents a reconciliation of the numerators and denominators of the basic and diluted EPS computation:

	<u>Year Ended December 31,</u>	
	<u>2023</u>	<u>2022</u>
<u>Numerator</u>		
Net income (loss)	\$ 978,383	\$ (1,798,955)
Effects of Series A redeemable convertible preferred stock:		
Less: Series A redeemable convertible preferred stock dividends	1,579,232	1,494,057
Less: Deemed dividend on Series A redeemable convertible preferred stock	—	—
Less: Accretion to redemption value of Series A redeemable convertible preferred stock	36,271	49,573
Net income (loss) attributable to common stockholders	<u>\$ (637,120)</u>	<u>\$ (3,342,585)</u>
<u>Denominator</u>		
Weighted average basic shares outstanding	7,124,045	7,100,929
Effect of dilutive securities:		
Stock options, warrants and restricted stock	—	—
Series A redeemable convertible preferred stock	—	—
Weighted average diluted shares outstanding	<u>7,124,045</u>	<u>7,100,929</u>
<u>EPS</u>		
Basic net income (loss) per share attributable to common stockholders	<u>\$ (0.09)</u>	<u>\$ (0.47)</u>
Diluted net income (loss) per share attributable to common stockholders	<u>\$ (0.09)</u>	<u>\$ (0.47)</u>

### (3) Property and Equipment

The gross carrying amount and accumulated depreciation of property and equipment as of December 31, 2023 and 2022 are as follows:

	<u>December 31, 2023</u>	<u>December 31, 2022</u>
Gross carrying amount	\$ 15,517,615	\$ 15,505,431
Accumulated depreciation	(15,468,421)	(15,419,168)
Property and Equipment, net	<u>\$ 49,194</u>	<u>\$ 86,263</u>

For the year ended December 31, 2023 and 2022, depreciation expense was \$44,853 and \$61,215, respectively.

### (4) Software Development Costs

The gross carrying amount and accumulated amortization of software development costs as of December 31, 2023 and 2022 are as follows:

	<u>December 31, 2023</u>	<u>December 31, 2022</u>
Gross carrying amount	\$ 3,015,132	\$ 3,015,132
Accumulated amortization	(2,989,854)	(2,962,075)
Software development costs, net	<u>\$ 25,278</u>	<u>\$ 53,057</u>

During the year ended December 31, 2023 and 2022, the Company recorded \$27,779 and \$24,638, respectively, of amortization expense related to capitalized software costs.

### (5) Goodwill and Other Intangible Assets

The gross carrying amount and accumulated amortization of goodwill and other intangible assets as of December 31, 2023 and 2022 are as follows:

	<u>December 31, 2023</u>	<u>December 31, 2022</u>
Goodwill	\$ 4,150,339	\$ 4,150,339
Other intangible assets:		
Gross carrying amount	\$ 4,041,216	\$ 4,041,216
Accumulated amortization	(4,038,727)	(4,021,130)
Net carrying amount	<u>\$ 2,489</u>	<u>\$ 20,086</u>

For the year ended December 31, 2023 and 2022, amortization expense was \$17,597 and \$34,354, respectively.

### (6) Accrued Expenses

Accrued expenses are comprised of the following:

	<u>December 31, 2023</u>	<u>December 31, 2022</u>
Accrued compensation	\$ 182,014	\$ 106,882
Accrued consulting and professional fees	1,022,427	598,982
Accrued taxes	641,615	594,640
Accrued restructuring costs	126,537	127,475
	<u>\$ 1,972,593</u>	<u>\$ 1,427,979</u>

### (7) Share-Based Payment Arrangements

On June 22, 2018, the Company's stockholders adopted the FalconStor Software, Inc. 2018 Incentive Stock Plan (the "2018 Plan"). The 2018 Plan is administered by the Compensation Committee (the "Compensation Committee") of the Company's Board of Directors (the "Board") and initially provided for the issuance of up to 1,471,997 shares of the Company's common stock upon the grant of shares with such restrictions as determined by the Compensation Committee to the employees and directors of, and consultants providing services to, the Company or its affiliates. In June 2021, the Company's stockholders approved an amendment to increase the number of shares of our common stock authorized and reserved for issuance under the 2018 Plan by 220,800 shares to a total of 1,692,797 shares. Exercise prices of the options are determined by the Compensation Committee, subject to the consent of Hale Capital. The vesting terms are performance based and determined by the Compensation Committee, subject to the consent of Hale Capital, based on various factors, including (i) the return of capital to the holders of the Series A Preferred Stock and the Company's common stock in the event of a change of control, (ii) the repayment of the Company's obligations under its senior secured debt, and (iii) the Company's free cash flow.

The following table summarizes the 2018 Plan, which was the only plan under which the Company was able to grant equity compensation as of December 31, 2023:

<u>Name of Plan</u>	<u>Shares Authorized</u>	<u>Shares Available for Grant</u>	<u>Shares Outstanding</u>
FalconStor Software, Inc. 2018 Incentive Stock Plan	1,692,797	295,684	1,248,178

The following table summarizes the Company's equity plans that have terminated or expired but that still have equity awards outstanding as of December 31, 2023:

Name of Plan	Shares Available for Grant	Shares Outstanding
FalconStor Software, Inc., 2016 Incentive Stock Plan	—	2,000
FalconStor Software, Inc., 2006 Incentive Stock Plan	—	825

All outstanding options granted under the Company's equity plans have terms of ten years.

A summary of the Company's stock option activity for 2023 is as follows:

	Number of Options	Weighted Average Price	Weighted Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value
Options Outstanding at December 31, 2022	4,615	98.29	2.67	-
Granted	-	\$ -	-	-
Exercised	-	\$ -	-	-
Forfeited	(1,790)	\$ 136.00	-	-
Expired	-	\$ -	-	-
Options Outstanding at December 31, 2023	2,825	\$ 76.08	2.75	-
Options Exercisable at December 31, 2023	2,825	\$ 76.08	2.75	-
Options Expected to Vest after December 31, 2023	-	\$ -	-	-

Stock option exercises are fulfilled with new shares of common stock.

The Company has the ability to issue both restricted stock awards and restricted stock units. The restricted stock units are expensed at the fair value per share at date of vesting. A summary of the total stock-based compensation expense related to restricted stock units, which is included in the Company's total share-based compensation expense for each respective year, is as follows:

	Year Ended December 31,	
	2023	2022
Directors, officers and employees	\$ 10,984	\$ 38,770

A summary of the Company's restricted stock activity for the year ended December 31, 2023 is below. Such restricted stock did not bestow any voting or dispositive power and is not deemed outstanding until they vest.

	Number of Restricted Stock Awards
Non-Vested at December 31, 2022	1,316,933
Granted	—
Vested	(14,970)
Forfeited	(53,785)
Non-Vested at December 31, 2023	1,248,178

Restricted stock units are fulfilled with new shares of common stock. The total intrinsic value of restricted stock for which the restrictions lapsed during the years ended was \$15,014 and \$41,102 for the years ended December 31, 2023 and 2022, respectively.

As of December 31, 2023, total unrecognized compensation costs for unvested restricted stock unit awards was \$951,196 including \$942,045 relating to performance-based awards. The performance condition for such awards was not deemed probable at grant dates or at December 31, 2023 and the cost related to such awards will begin to be recognized once the performance condition is deemed probable. The remaining amount of \$9,151 relating to time-based awards is expected to be recognized over a weighted-average period of 0.8 years as of December 31, 2023.

As of December 31, 2023, the Company had 1,546,687 shares of common stock reserved for issuance upon the exercise or vesting of stock options and restricted stock.

The following table summarizes the share-based compensation expense for all awards issued under the Company's stock equity plans in the following line items in the consolidated statements of operations for the years ended December 31, 2023 and 2022:

	<b>Year Ended December 31,</b>	
	<b>2023</b>	<b>2022</b>
Cost of revenue - Support and Service	61	242
Research and development costs	3,453	6,607
Selling and marketing	1,511	19,226
General and administrative	5,959	12,695
	<u>\$ 10,984</u>	<u>\$ 38,770</u>

The Company did not recognize any tax benefits related to share-based compensation expense during the years ended December 31, 2023 and 2022.

## (8) Income Taxes

Information pertaining to the Company's income (loss) before income taxes and the applicable provision for income taxes is as follows:

	Year Ended December 31,	
	2023	2022
Income (loss) before income taxes:		
Domestic income (loss)	\$ 1,030,520	\$ (1,698,610)
Foreign income (loss)	27,578	110,113
Total income (loss) before income taxes:	1,058,098	(1,588,497)
Provision (benefit) for income taxes:		
Current:		
Federal	-	-
State and local	11,103	4,841
Foreign	141,048	138,275
Total Current	152,152	143,116
Deferred:		
Federal	893	1,785
State and local	(5,260)	1,022
Foreign	(68,069)	64,535
Total Deferred	(72,437)	67,342
Total Provision (Benefit) for income taxes:	\$ 79,715	\$ 210,458

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting and tax purposes. Significant components of the Company's deferred tax assets and liabilities are as follows:

	Year Ended December 31,	
	2023	2022
Deferred tax assets:		
Allowance for receivables	\$ 8,615	\$ 6,190
Deferred revenue	235,291	340,933
Share-based compensation	47,199	49,091
Accrued expense and other	136,300	37,912
Domestic net operating loss carryforwards	19,158,883	19,388,081
Foreign net operating loss carryforwards	284,225	400,302
Tax Credit carryforwards	2,889,077	3,106,022
Fixed assets	9,667	8,628
Intangibles	23,592	54,278
Sec. 174 Capitalized Costs	391,302	433,448
Deferred tax assets before valuation allowance	23,184,151	23,824,885
Less valuation allowance	(22,844,659)	(23,438,852)
Total deferred tax asset	339,492	386,033
Deferred tax liabilities:		
Prepaid commissions and other	\$ (32,922)	\$ (27,010)
Deferred State Income Tax	(343,697)	(365,240)
Foreign Withholding Taxes	(428,088)	(434,720)
Unrealized Foreign Exchange Gains	-	(96,714)
Total deferred tax liabilities	(804,707)	(923,684)
Net deferred tax assets (liabilities)	\$ (465,214)	\$ (537,651)

As of each reporting date, the Company considers new evidence, both positive and negative, that could affect its view of the future realization of deferred tax assets. In assessing the Company's ability to recover its deferred tax assets, the Company evaluated whether it is more likely than not that some portion or the entire deferred tax asset will be realized. The ultimate



realization of deferred tax assets is dependent upon the generation of future taxable income in those periods in which temporary differences become deductible and/or net operating losses can be utilized. The Company considered all positive and negative evidence when determining the amount of the net deferred tax assets that are more likely than not to be realized. This evidence includes, but is not limited to, historical earnings, scheduled reversal of taxable temporary differences, tax planning strategies and projected future taxable income. Based on these factors the Company determined that its U.S. deferred tax assets are not realizable on a more-likely-than-not basis and has recorded a full valuation allowance against such net deferred tax assets. The Company's valuation allowance decreased by \$0.6 million due to operations.

As of December 31, 2023, the Company had approximately \$83.8 million of federal net operating loss carryforwards, of which \$78.7 million will begin to expire beginning in 2030, if not utilized, and the remaining \$5.1 million of which can be carried forward indefinitely subject to 80% of taxable income. As of December 31, 2023, the Company had approximately \$2.9 million of research and development tax credit carryforwards which expire at various dates beginning in 2023, if not utilized. Utilization of the net operating losses and credit carryforwards may be subject to a substantial annual limitation due to the "change in ownership" provisions of the Internal Revenue Code of 1986. The annual limitation may result in the expiration of net operating losses and credit carryforwards before utilization.

The effective tax rate before income taxes varies from the current statutory federal income tax rate as follows:

	<b>Year Ended December 31,</b>	
	<b>2023</b>	<b>2022</b>
At federal statutory rate	\$ 222,201	\$ (333,585)
Increase (reduction) in income taxes resulting from:		
State and local taxes	60,198	79,182
Non-deductible expenses	18,913	18,374
Net effect of foreign operations	155,121	120,806
Uncertain tax positions	(17,971)	(9,768)
Change in valuation allowance	(594,193)	129,634
Foreign Withholding Taxes	78,474	63,941
Prior Period True-ups	(52,698)	147,363
Expired R&D Credits	216,945	-
Other	(7,274)	(5,489)
Total	<u>\$ 79,715</u>	<u>\$ 210,458</u>

Due to the change in U.S. federal tax law, the Company does not intend to indefinitely reinvest any of its unremitted foreign earnings. As of December 31, 2023, the Company has provided for additional foreign withholding taxes totaling approximately \$0.4 million on approximately \$3.9 million of undistributed earnings of its subsidiaries operating outside of the United States for which withholding tax applies.

A reconciliation of the beginning and ending amount of unrecognized tax benefits, excluding interest and penalties, is as follows:

	<b>2023</b>	<b>2022</b>
Beginning balance at January 1,	\$ 71,297	\$ 79,518
Expiration of statutes of limitation	(19,744)	(8,221)
Ending balance at December 31,	<u>\$ 51,554</u>	<u>\$ 71,297</u>

At December 31, 2023, unrecognized tax benefits of \$51,554, if recognized, would reduce the Company's annual effective tax rate. As of December 31, 2023, the Company had approximately \$43,646 of accrued interest. The Company believes it is reasonably possible that the remaining balance of its unrecognized tax benefits will reverse within the next 12 months due to expiring statute of limitations. The Company records any interest and penalties related to unrecognized tax benefits in income tax expense.

The Company files federal, state, and foreign income tax returns in jurisdictions with varying statutes of limitations. The 2021 through 2023 tax years generally remain subject to examination by federal and most state tax authorities. In addition to the U.S., the Company's major taxing jurisdictions include Taiwan, Japan, and Germany. The exam of tax year 2021 in Taiwan was cleared during the year without any adjustment.

## (9) Accumulated Other Comprehensive Loss

The changes in Accumulated Other Comprehensive Loss, net of tax, for the year ended December 31, 2023 are as follows:

	<u>Foreign Currency Translation</u>	<u>Net Minimum Pension Liability</u>	<u>Total</u>
Accumulated other comprehensive income (loss) at January 1, 2023	\$ (1,742,217)	\$ (9,882)	\$ (1,752,099)
Other comprehensive income (loss)			
Other comprehensive income (loss) before reclassifications	61,959	179	62,138
Amounts reclassified from accumulated other comprehensive income	—	87	87
Total other comprehensive income (loss)	<u>61,959</u>	<u>266</u>	<u>62,225</u>
Accumulated other comprehensive income (loss) at December 31, 2023	<u>\$ (1,680,258)</u>	<u>\$ (9,616)</u>	<u>\$ (1,689,874)</u>

The changes in Accumulated Other Comprehensive Loss, net of tax, for the year ended December 31, 2022 are as follows:

	<u>Foreign Currency Translation</u>	<u>Net Minimum Pension Liability</u>	<u>Total</u>
Accumulated other comprehensive income (loss) at January 1, 2022	\$ (1,881,005)	\$ 20,965	\$ (1,860,040)
Other comprehensive income (loss)			
Other comprehensive income (loss) before reclassifications	138,788	(30,963)	107,825
Amounts reclassified from accumulated other comprehensive income	—	116	116
Total other comprehensive income (loss)	<u>138,788</u>	<u>(30,847)</u>	<u>107,941</u>
Accumulated other comprehensive income (loss) at December 31, 2022	<u>\$ (1,742,217)</u>	<u>\$ (9,882)</u>	<u>\$ (1,752,099)</u>

For the year ended December 31, 2023 and 2022, the amounts reclassified to net income (loss) related to the Company's defined benefit plan. These amounts are included within "Operating income (loss)" within the consolidated statement of operations.

## (10) Notes Payable

The long-term note payable balance consists of the following:

Long-term note payable, net at December 31, 2021	\$ 2,154,098
Accretion of discount	8,992
Long-term note payable, net at December 31, 2022	\$ 2,163,090
Accretion of discount	9,292
Long-term note payable, net at December 31, 2023	<u>\$ 2,172,382</u>

### Senior Secured Debt

The Company is currently a party to the Amended and Restated Loan Agreement. The senior secured debt bears interest at prime plus 0.75%. In connection with the June Offering, we entered into the Loan Extension Letter Agreement with Hale Capital, which provided for an extension of the maturity date on Hale Capital's portion of the outstanding indebtedness owed under the Amended and Restated Loan Agreement to June 30, 2023. The remaining principal amount outstanding, which was owed to other lenders, was repaid in full. On July 19, 2022, we entered into the Second Loan Extension Letter Agreement with Hale Capital, which provided for a subsequent extension of the maturity date on the outstanding indebtedness owed under the Amended and Restated Loan Agreement from June 30, 2023 to December 31, 2023. On February 10, 2023, the Company entered into the Third Loan Extension Letter Agreement with Hale Capital to further extend the maturity date of the senior secured debt to June 30, 2024. On February 12, 2024, the Company entered into the Fourth Loan Extension Letter Agreement with Hale Capital to further extend the maturity date of the senior secured debt to June 30, 2025. The Company concluded these extensions under the Loan Extension Letter Agreements, resulted in a debt modification under ASC 470-50, Modifications and Extinguishments, and therefore no gain or loss was required to be recognized. The changes were accounted for prospectively using the new effective interest rate of the loan.

In the event the term notes issued pursuant to the Amended and Restated Loan Agreement (the "Term Loan") are prepaid for any reason, such prepayment will be subject to the payment of a premium in an amount equal to 5% of the principal amount prepaid. The Term Loan is required to be prepaid upon the occurrence of certain events, including but not limited to certain asset dispositions, the incurrence of additional indebtedness, the receipt of insurance proceeds, and a change of control, subject to certain exceptions.

The Amended and Restated Loan Agreement has customary representations, warranties and affirmative and negative covenants. The negative covenants include financial covenants relating to in-force annual contract value. The Amended and Restated Loan Agreement also contains customary events of default, including but not limited to payment defaults, cross defaults with certain other indebtedness, breaches of covenants, bankruptcy events and a change of control. In the case of an event of default, as administrative agent under the Amended and Restated Loan Agreement, HCP-FVA, an affiliate of Hale Capital may (and upon the written request of lenders holding in excess of 50% of the term loans, which must include HCP-FVA, is required to) accelerate payment of all obligations under the Amended and Restated Loan Agreement, and seek other available remedies.

As of December 31, 2023, the Company was in compliance with the financial covenants contained in the Amended and Restated Loan Agreement.

### Other Financing Arrangements

On September 18, 2023, the Company entered into a financing arrangement with AFCO Premium Credit LLC ("AFCO"), for the renewal of its corporate insurance policies with Watkins Insurance Group in the amount of \$153,877. The terms of the arrangement include a down payment of \$23,082 and a \$13,794 monthly payment to be made over a ten month period at a 11.75% annual interest rate through August 15, 2024.

The short-term note payable balance consists of the following:

Proceeds from issuance of AFCO financing		253,069
Repayment of AFCO financing		(75,920)
Total short-term note payable, at December 31, 2022	\$	177,149
Proceeds from issuance of AFCO financing		130,795
Repayment of AFCO financing		(216,387)
Total short-term note payable, at December 31, 2023	\$	<u>91,557</u>

## (11) Fair Value Measurements

The Company measures its cash equivalents and derivative instruments at fair value. Fair value is an exit price, representing the amount that would be received on the sale of an asset or that would be paid to transfer a liability in an orderly transaction between market participants. As a basis for considering such assumptions, the Company utilizes a three-tier fair value hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value.

### *Fair Value Hierarchy*

The methodology for measuring fair value specifies a hierarchy of valuation techniques based upon whether the inputs to those valuation techniques reflect assumptions other market participants would use based upon market data obtained from independent sources (observable inputs) or reflect the Company's own assumptions of market participant valuation (unobservable inputs). As a result, observable and unobservable inputs have created the following fair value hierarchy:

- *Level 1* – Quoted prices in active markets that are unadjusted and accessible at the measurement date for identical, unrestricted assets or liabilities. The Company had no Level 1 securities at December 31, 2023 and 2022.
- *Level 2* – Quoted prices for identical assets and liabilities in markets that are not active, quoted prices for similar assets and liabilities in active markets or financial instruments for which significant inputs are observable, either directly or indirectly. At December 31, 2023 and 2022, the Company did not have any Level 2 category assets included in the consolidated balance sheets.
- *Level 3* – Prices or valuations that require inputs that are both significant to the fair value measurement and unobservable. At December 31, 2023 and 2022, the Level 3 category included derivatives. The Company did not hold any cash and cash equivalents categorized as Level 3 as of December 31, 2023 or December 31, 2022.

### *Measurement of Fair Value*

The Company measures fair value as an exit price using the procedures described below for all assets and liabilities measured at fair value. When available, the Company uses unadjusted quoted market prices to measure fair value and classifies such items within Level 1. If quoted market prices are not available, fair value is based upon financial models that use, when possible, current market-based or independently-sourced market parameters such as interest rates and currency rates. Items valued using financial generated models are classified according to the lowest level input or value driver that is significant to the valuation. Thus, an item may be classified in Level 3 even though there may be inputs that are readily observable. If quoted market prices are not available, the valuation model used generally depends on the specific asset or liability being valued. The determination of fair value considers various factors including interest rate yield curves and time value underlying the financial instruments.

The fair value of the Company's derivatives were valued using the Black-Scholes pricing model adjusted for probability assumptions, with all significant inputs, except for the probability and volatility assumptions, derived from or corroborated by observable market data such as stock price and interest rates. The probability and volatility assumptions are both significant to the fair value measurement and unobservable. These embedded derivatives are included in Level 3 of the fair value hierarchy. The derivatives are included in other long-term liabilities on our consolidated balance sheets.

The Company's Series A Preferred Stock and notes payable are measured at amortized cost using an effective interest rate of 10.2% and 9.7% yield, respectively.

The following table presents the Company's assets and liabilities that are measured at fair value on a recurring basis at December 31, 2023:

	<b>Fair Value Measurements at Reporting Date Using</b>			
	<b>Total</b>	<b>Quoted Prices in Active Markets for Identical Assets (Level 1)</b>	<b>Significant other Inputs (Level 2)</b>	<b>Significant Unobservable Inputs (Level 3)</b>
Derivative liabilities:				
<i>Derivative Instruments</i>	\$ 907,074	\$ —	\$ —	\$ 907,074
Total derivative liabilities	907,074	—	—	907,074
Total assets and liabilities measured at fair value	\$ 907,074	\$ —	\$ —	\$ 907,074

The following table presents the Company's assets and liabilities that are measured at fair value on a recurring basis at December 31, 2022:

	<b>Fair Value Measurements at Reporting Date Using</b>			
	<b>Total</b>	<b>Quoted Prices in Active Markets for Identical Assets (Level 1)</b>	<b>Significant other Inputs (Level 2)</b>	<b>Significant Unobservable Inputs (Level 3)</b>
Derivative liabilities:				
<i>Derivative Instruments</i>	\$ 821,726	\$ —	\$ —	\$ 821,726
Total derivative liabilities	821,726	—	—	821,726
Total assets and liabilities measured at fair value	\$ 821,726	\$ —	\$ —	\$ 821,726

The fair value of the Company's derivatives were valued using the Black-Scholes pricing model adjusted for probability assumptions, with all significant inputs, except for the probability and volatility assumptions, derived from or corroborated by observable market data such as stock price and interest rates. The probability and volatility assumptions are both significant to the fair value measurement and unobservable. These embedded derivatives are included in Level 3 of the fair value hierarchy. The probability and volatility assumptions are as follows:

Probability of redemption as part of a fundamental sale transaction	0.5 %
Probability of redemption absent a fundamental sale transaction	4.75 %
Annual volatility	65 %

The following table presents a reconciliation of the beginning and ending balances of the Company's liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the years ended December 31, 2023 and 2022:

	<b>Year Ended December 31,</b>	
	<b>2023</b>	<b>2022</b>
Beginning Balance	\$ 821,726	\$ 776,623
Total loss recognized in earnings	85,348	45,103
Ending Balance	\$ 907,074	\$ 821,726

Earnings and losses resulting from changes in the fair value of the derivative instruments above are recorded as a component of interest and other expense.

## (12) Commitments and Contingencies

The Company typically provides its customers a warranty on its software products for a period of no more than 90 days. Such warranties are accounted for in accordance with the authoritative guidance issued by the FASB on contingencies. For the year ended December 31, 2023, the Company has not incurred any costs related to warranty obligations.

Under the terms of substantially all of its software license agreements, the Company indemnifies its customers for all costs and damages arising from claims against such customers based on, among other things, allegations that the Company's software infringes on the intellectual property rights of a third party. In most cases, in the event of an infringement claim, the Company retains the right to (i) procure for the customer the right to continue using the software; (ii) replace or modify the software to eliminate the infringement while providing substantially equivalent functionality; or (iii) if neither (i) nor (ii) can be reasonably achieved, the Company may terminate the license agreement and refund to the customer a pro-rata portion of the license fee paid to the Company. Such indemnification provisions are accounted for in accordance with the authoritative guidance issued by the FASB on guarantees. From time to time, in the ordinary course of business, the Company receives claims for indemnification, typically from original equipment manufacturers. The Company is not currently aware of any material claims for indemnification.

As described under Note (13) *Series A Redeemable Convertible Preferred Stock* the holders of the Series A Preferred Stock have redemption rights upon certain triggering events. As of December 31, 2023, the Company did not fail any non-financial covenants related to the Company's Series A Preferred Stock.

In connection with the appointment of Todd Brooks as Chief Executive Officer, the Board approved an offer letter to Mr. Brooks (the "Brooks Agreement"), which was executed on August 14, 2017. The Brooks Agreement provides that Mr. Brooks is entitled to receive an annualized base salary of \$350,000, payable in regular installments in accordance with the Company's general payroll practices. Mr. Brooks will also be eligible for a cash bonus of \$17,500 for any quarter that is free cash flow positive on an operating basis and additional incentive compensation of an annual bonus of up to \$200,000, subject to attainment of performance objectives to be mutually agreed upon and established. Mr. Brooks' employment can be terminated at will. Pursuant to the Brooks Agreement and the 2018 Plan, Mr. Brooks received 735,973 shares of restricted stock. If Mr. Brooks' employment is terminated by the Company other than for cause, he is entitled to receive severance equal to 12 months of his base salary if (i) he has been employed by the Company for at least 12 months at the time of termination or (ii) a change of control has occurred within six months of Mr. Brooks' employment. Except as set forth in the preceding sentence, Mr. Brooks is entitled to receive severance equal to six months of his base salary if he has been employed by the Company for less than six months and his employment was terminated by the Company without cause. Mr. Brooks is also entitled to vacation and other employee benefits in accordance with the Company's policies as well as reimbursement for an apartment.

In connection with Mr. Sita's appointment as Chief Financial Officer, the Board approved an Independent Contractor Services Agreement with Alucris Consulting, Inc. ("Alucris"), an entity owned by Mr. Sita (the "Sita Agreement"), which was executed on February 11, 2022. The Sita Agreement provides that Alucris is entitled to receive a fee of \$20,000 per month. Alucris will also be eligible for an additional payment of up to \$60,000 annually, based upon the achievement of goals determined by the Company, to be paid quarterly in accordance with standard Company policies. The agreement also provided that Mr. Sita received a grant of shares of the Company's common stock, to be governed by the Company's 2018 Stock Incentive Plan and subject to specific vesting conditions.

The Sita Agreement expired on July 1, 2023 and automatically renewed for additional one year term pursuant to the terms set forth therein.

As described under Note (17) *Restructuring Costs*, the Company incurred certain restructuring costs in connection with restructuring plans adopted in 2017 and 2019.

In addition, as of December 31, 2023, the Company's liability for uncertain tax positions totaled \$95,198. At this time, the settlement period for this liability, including related accrued interest, cannot be determined.

### **(13) Series A Redeemable Convertible Preferred Stock**

The Company has 900,000 shares of Series A Preferred Stock outstanding with a par value \$0.001 per share and a stated value of \$10 per share. Pursuant to the Certificate of Designations, each share of Series A Preferred Stock can be converted into shares of the Company's common stock, at an initial conversion price of \$102.488 per share, subject to appropriate adjustments for any stock dividend, stock split, stock combination, reclassification or similar transaction, (i) at any time at the option of the holder or (ii) by the Company if, following the first anniversary of the issuance of the Series A Preferred Stock (subject to extension under certain circumstances), the volume weighted average trading price per share of the Company's common stock for sixty (60) consecutive trading days exceeds 250% of the conversion price and continues to exceed 225% of the conversion price through the conversion date, subject at all times to the satisfaction of, and the limitations imposed by, the equity conditions set forth in the Certificate of Designations (including, without limitation, the volume limitations set forth therein).

Pursuant to the Certificate of Designations, the holders of the Series A Preferred Stock are entitled to receive quarterly dividends at the prime rate (provided in the Wall Street Journal Eastern Edition) plus 5% (up to a maximum dividend rate of 10%), payable in cash or in kind (i.e., through the issuance of additional shares of Series A Preferred Stock), except that the Company is not permitted to pay such dividends in cash while any indebtedness under the Amended and Restated Loan Agreement remains outstanding without the consent of the holders of the Series A Preferred Stock. In addition, the declaration and payment of dividends is subject to compliance with applicable law and unpaid dividends will accrue. A holder's right to convert its shares of Series A Preferred Stock and receive dividends in the form of common stock is subject to certain limitations including, among other things, that the shares of common stock issuable upon conversion or as dividends will not, prior to receipt of stockholder approval, result in any holder beneficially owning greater than 9.99% of the Company's currently outstanding shares of common stock.

The Series A Preferred Stock dividends shall accrue whether or not the declaration or payment of such Series A Preferred Stock dividends are prohibited by applicable law, whether or not the Company has earnings, whether or not there are funds legally available for the payment of such dividends and whether or not such dividends are authorized or declared.

Upon certain triggering events, such as bankruptcy, insolvency or a material adverse effect or failure of the Company to issue shares of common stock upon conversion of the Series A Preferred Stock in accordance with its obligations, the holders may require the Company to redeem all or some of the Series A Preferred Stock at a price per share equal to the greater of (i) the sum of 100% of the stated value of a share of Series A Preferred Stock plus accrued and unpaid dividends with respect thereto, and (ii) the product of the number of shares of common stock underlying a share of Series A Preferred Stock (and accrued and unpaid dividends with respect thereto) and the closing price as of the occurrence of the triggering event. On or after December 31, 2023, subject to the approval of HCP-FVA, each holder of Series A Preferred Stock can also require the Company to redeem its Series A Preferred Stock in cash at a per share price equal to 100% of the stated value of a share of Series A Preferred Stock plus accrued and unpaid dividends with respect thereto. Notwithstanding the forgoing, no holder of Series A Preferred Stock is permitted to exercise any rights or remedies upon a Breach Event (as defined in the Certificate of Designations) or to exercise any redemption rights under the Certificate of Designations, unless approved by the holders of a majority of the then-outstanding shares of Series A Preferred Stock.

Upon consummation of a fundamental sale transaction, the Series A Preferred Stock will be redeemed at a per share redemption price equal to the greater of (y) 250% of the stated value of Series A Preferred Stock and (z) the price payable in respect of such share of Series A Preferred Stock if such share of Series A Preferred Stock had been converted into such number of shares of common stock in accordance with the Certificate of Designations (but without giving effect to any limitations or restrictions contained therein) immediately prior to such fundamental sale transaction; provided however that the 250% threshold is changed to 100% if the fundamental sale transaction is approved by the two Series A Directors (as defined in the Certificate of Designations). In addition, if the Company consummates an equity or debt financing that results in more than \$5.0 million of net proceeds to the Company and/or its subsidiaries, the holders of Series A Preferred Stock will have the right, but not the obligation, to require the Company to use the net proceeds in excess of \$5.0 million to repurchase all or a portion of the Series A Preferred Stock at a per share price equal to the greater of (i) the sum of 100% of the stated value of such share of Series A Preferred Stock plus accrued and unpaid dividends with respect thereto, and (ii) the number of shares of common stock into which such share of Series A Preferred Stock is then convertible multiplied by the greater of (y) the closing price of the common stock on the date of announcement of such financing or (z) the closing price of the common stock on the date of consummation of such financing.

Each holder of Series A Preferred Stock has a vote equal to the number of shares of common stock into which its Series A Preferred Stock would be convertible as of the record date. In addition, the holders of a majority of the Series A Preferred Stock must approve certain actions, including approving any amendments to the Company's Restated Certificate of Incorporation as amended or Amended and Restated Bylaws that adversely affects the voting powers, preferences or other rights of the Series A Preferred Stock; payment of dividends or distributions; any liquidation, capitalization, reorganization or any other fundamental transaction of the Company; issuance of any equity security senior to or on parity with the Series A Preferred Stock as to dividend rights, redemption rights, liquidation preference and other rights; issuances of equity below the conversion price; any liens or borrowings other than non-convertible indebtedness from standard commercial lenders which does not exceed 80% of the Company's accounts receivable; and the redemption or purchase of any of the capital stock of the Company.

The holders of our outstanding Series A Preferred Stock have a mandatory redemption right that may be exercised only with the approval of Hale Capital and HCP-FVA. In connection with the June Offering, the effective date of such redemption right was extended from July 30, 2021 to July 30, 2023 pursuant to an amendment to the Certificate of Designations, dated as of June 24, 2021. On July 19, 2022, the Company and Hale Capital entered into a letter agreement pursuant to which Hale Capital agreed not to exercise or to permit the exercise of the mandatory redemption right of the Series A Preferred Stock on or prior to December 31, 2023 unless the redemption is in accordance with Section 8(e)(z) of the Certificate of Designations or in accordance with a Breach Event (as defined in the Certificate of Designations). On February 10, 2023, the Company entered into a letter agreement with Hale Capital to further extend the redemption date of the Series A Preferred Stock to June 30, 2024. On February 12, 2024, the Company entered into a letter agreement with Hale Capital to further extend the redemption date of the Series A Preferred Stock to June 30, 2025. The Company concluded the extensions resulted in a debt modification under ASC 470-50, Modifications and Extinguishments, and therefore no gain or loss was required to be recognized. The change is accounted for prospectively using the new effective interest rate of the preferred stock.

The Company has classified the Series A Preferred Stock as temporary equity in the financial statements as it is subject to redemption at the option of the holder under certain circumstances. As a result of the Company's analysis of all the embedded conversion and put features within the Series A Preferred Stock, the contingent redemption put options in the Series A Preferred Stock were determined to not be clearly and closely related to the debt-type host and also did not meet any other scope exceptions for derivative accounting. Therefore, the contingent redemption put options are being accounted for as derivative instruments and the fair value of these derivative instruments was bifurcated from the Series A Preferred Stock and recorded as a liability.

As of December 31, 2023 and 2022, the fair value of these derivative instruments were included in other long-term liabilities within the consolidated balance sheets. The loss on the change in fair value of these derivative instruments for the years ended December 31, 2023 and 2022 was included in interest and other expense within the consolidated statement of operations.



At the time of issuance, the Company recorded transaction costs, a beneficial conversion feature and the fair value allocated to the embedded derivatives as discounts to the Series A Preferred Stock. These costs were being accreted to the Series A Preferred Stock using the effective interest method through the stated redemption date of August 5, 2017, which represents the earliest redemption date of the instrument. This accretion was accelerated as of December 31, 2016 due to the failure of the financial covenants and the redemption right of the holders at that time. In connection with the June Offering, Hale Capital Partners, which was the sole holder of the Series A Preferred Stock, agreed to the extension of the mandatory redemption right and waived prior breaches of the terms of the Series A Preferred Stock. The Company included deductions for accretion, deemed and accrued dividends on the Series A Preferred Stock as adjustments to net income (loss) attributable to common stockholders on the statement of operations and in determining income (loss) per share for the years ended December 31, 2023 and 2022, respectively. The following represents a reconciliation of net loss attributable to common stockholders for the years ended December 31, 2023 and 2022, respectively:

	<u>Year Ended December 31,</u>	
	<u>2023</u>	<u>2022</u>
Net income (loss)	\$ 978,383	\$ (1,798,955)
Effects of Series A redeemable convertible preferred stock:		
Less: Accrual of Series A redeemable convertible preferred stock dividends	1,579,232	1,494,057
Less: Accretion to redemption value of Series A redeemable convertible preferred stock	36,271	49,573
Net income (loss) attributable to common stockholders	<u>\$ (637,120)</u>	<u>\$ (3,342,585)</u>

The Series A Preferred Stock consists of the following:

Total Series A redeemable convertible preferred stock, net at December 31, 2021	\$ 14,384,388
Accrued dividends	1,494,057
Accretion of preferred stock	49,573
Total Series A redeemable convertible preferred stock, net at December 31, 2022	\$ 15,928,018
Accrued dividends	1,579,232
Accretion of preferred stock	36,271
Total Series A redeemable convertible preferred stock, net at December 31, 2023	<u>\$ 17,543,521</u>

#### **(14) Stockholders' Equity**

##### *Stock Repurchase Activity*

During the years ended December 31, 2023 and 2022, the Company did not repurchase any shares of its common stock. As of December 31, 2023, the Company had the authorization to repurchase 49,078 shares of its common stock based upon its judgment and market conditions.

## (15) Litigation

In view of the inherent difficulty of predicting the outcome of litigation, particularly where the claimants seek very large or indeterminate damages, the Company generally cannot predict what the eventual outcome of the pending matters will be, what the timing of the ultimate resolution of these matters will be, or what the eventual loss, fines or penalties related to each pending matter may be.

In accordance with the authoritative guidance issued by the FASB on contingencies, the Company accrues anticipated costs of settlement, damages and losses for claims to the extent specific losses are probable and estimable. The Company records a receivable for insurance recoveries when such amounts are probable and collectable. In such cases, there may be an exposure to loss in excess of any amounts accrued. If, at the time of evaluation, the loss contingency related to a litigation is not both probable and estimable, the matter will continue to be monitored for further developments that would make such loss contingency both probable and estimable and, the Company will expense these costs as incurred. If the estimate of a probable loss is a range and no amount within the range is more likely, the Company will accrue the minimum amount of the range.

The Company is subject to various legal proceedings and claims, asserted or unasserted, which arise in the ordinary course of business. While the outcome of any such matters cannot be predicted with certainty, such matters are not expected to have a material adverse effect on the Company's financial condition or operating results.

The Company continues to assess certain litigation and claims to determine the amounts, if any, that the Company believes may be paid as a result of such claims and litigation and, therefore, additional losses may be accrued and paid in the future, which could materially adversely impact the Company's financial results, its cash flows and its cash reserves.

## (16) Segment Reporting and Concentrations

The Company is organized in a single operating segment for purposes of making operating decisions and assessing performance. Revenue from the United States to customers in the following geographical areas, and the location of long-lived assets as of December 31, 2023 and 2022, are summarized as follows:

	Year Ended December 31,	
	2023	2022
<b>Revenue:</b>		
Americas	\$ 6,118,293	\$ 4,372,411
Europe, Middle East, Africa and Other	3,736,876	3,695,054
Asia Pacific	1,743,574	1,984,783
<b>Total Revenue</b>	<b>\$ 11,598,743</b>	<b>\$ 10,052,248</b>
	2023	2022
<b>Long-lived assets:</b>		
Americas	\$ 683,781	\$ 504,545
Asia Pacific	193,681	112,301
Europe, Middle East, Africa and Other	1,216	13,551
<b>Total long-lived assets</b>	<b>\$ 878,678</b>	<b>\$ 630,397</b>

For the years ended December 31, 2023 and 2022, the Company had one customer that accounted for 10% or more of total revenue.

As of December 31, 2023 and 2022, the Company had two customers that accounted for 10% or more of the gross accounts receivable balance.

## (17) Restructuring Costs

In June 2017, the Board approved a comprehensive plan to increase operating performance (the “2017 Plan”). The 2017 Plan was substantially completed by the end of the Company’s fiscal year ended December 31, 2017, and when combined with previous workforce reductions in the second quarter of fiscal 2017 reduced the Company’s workforce to approximately 86 employees at December 31, 2018. In making these changes, the Company prioritized customer support and development while consolidating operations and streamlining direct sales resources, allowing the Company to focus on the install base and develop alternate channels to the market. As part of this consolidation effort, the Company vacated a portion of its former Melville, NY office space during the three months ended June 30, 2018. During the fiscal year ended December 31, 2021, the Company incurred lease disposal-related costs for this property of \$833,313. The Melville, NY lease which ended on April 30, 2021 with a gross annualized rental cost of \$1.5 million, will not be replaced. The Company expects the remaining accrued severance-related costs of \$126,537 as of December 31, 2023 to be paid once final settlement litigation is completed. Such litigation stems from termination of employees in France and office closure.

The following table summarizes the activity during 2022 and 2023 related to restructuring liabilities recorded in connection with the 2017, 2019 and 2020 Plans:

	<b>Severance Related Costs</b>	<b>Facility and Other Costs</b>	<b>Total</b>
Balance at December 31, 2021	\$ 134,663	\$ —	\$ 134,663
Provisions/Additions	—	744	744
Payments	—	(744)	(744)
Translation Adjustment	(7,188)	—	(7,188)
Balance at December 31, 2022	\$ 127,475	\$ —	\$ 127,475
Provisions/Additions	70,000	—	70,000
Payments	(72,639)	—	(72,639)
Translation Adjustment	1,701	—	1,701
Balance at December 31, 2023	\$ 126,537	\$ —	\$ 126,537

The severance and facility related liabilities are included within accrued expenses in the accompanying consolidated balance sheets. The expenses under the 2017 Plan are included within restructuring costs in the accompanying consolidated statements of operations.

## (18) Employee Benefit Plans

### *Defined Contribution Plan*

Effective July 2002, the Company established a voluntary savings and defined contribution plan (the “Plan”) under Section 401(k) of the Internal Revenue Code. This Plan covers all U.S. employees meeting certain eligibility requirements and allows participants to contribute a portion of their annual compensation. Employees are 100% vested in their own contributions. For the years ended December 31, 2023 and 2022, the Company did not make any contributions to the Plan.

Effective July 1, 2007, the Company, in accordance with the labor pension system in Taiwan, contributes 6% of salaries to individual pension accounts managed by the Bureau of Labor Insurance. The plan covers all Taiwan employees that elect the new pension system and all employees hired after July 1, 2005. For the years ended December 31, 2023 and 2022, the Company contributed approximately \$2,000 and \$2,000, respectively.

### *Defined Benefit Plan*

The Company has a defined benefit plan covering employees in Taiwan. The Company accounts for its defined benefit plan in accordance with the authoritative guidance issued by the FASB on retirement benefits, which requires the Company to

recognize the funded status of its defined benefit plan in the accompanying consolidated balance sheet, with the corresponding adjustment to accumulated other comprehensive income, net of tax.

At December 31, 2023 and 2022, \$29,092 and \$31,873, respectively, is included in accumulated other comprehensive (loss) income for amounts that have not yet been recognized in net periodic pension cost. These amounts include unrecognized actuarial gains at December 31, 2023 and 2022, respectively.

Pension information for the years ended December 31, 2023 and 2022, is as follows:

	Year Ended December 31,	
	2023	2022
Accumulated benefit obligation	\$ 61,317	\$ 60,592
Changes in projected benefit obligation:		
Projected benefit obligation at beginning of year	\$ 70,748	\$ 85,961
Interest cost	969	618
Actuarial gain	(133)	(7,760)
Currency translation	(36)	(8,071)
Projected benefit obligation at end of year	\$ 71,548	\$ 70,748
Changes in plan assets:		
Fair value of plan assets at beginning of year	\$ 59,423	\$ 49,097
Actual return on plan assets	815	3,605
Employer contributions	1,779	1,801
Currency translation	(9,836)	4,920
Fair value of plan assets at end of year	\$ 52,181	\$ 59,423
Funded status	\$ 19,367	\$ (11,325)

The underfunded status of the Company's defined benefit plan has been recorded as a component of other long-term liabilities as of December 31, 2022.

Components of net periodic pension cost:		
Interest cost	\$ 969	\$ 618
Expected return on plan assets	679	354
Amortization of net (gain) loss	(1,561)	(856)
Net periodic pension (benefit) cost	\$ 87	\$ 116

The Company makes contributions to the plan so that minimum contribution requirements, as determined by government regulations, are met. Company contributions of approximately \$2,000 are expected to be made during 2023. Benefit payments of \$69,000 are expected to be paid through 2030.

The Company utilized the following assumptions in computing the benefit obligation at December 31, 2023 and 2022 as follows:

	2023	2022
Discount rate	1.26%	1.39%
Rate of increase in compensation levels	2.00%	2.00%
Expected long-term rate of return on plan assets	1.75%	1.39%

## **(19) Related Party Transactions**

The Company is currently a party to the Amended and Restated Loan Agreement. In connection with the then-proposed June offering, we entered into the Loan Extension Letter Agreement with Hale Capital, that provided for an extension of the maturity date on Hale Capital's portion of the outstanding indebtedness owed under the Amended and Restated Loan Agreement to June 30, 2023. The remaining principal amount outstanding, which was owed to other lenders, was repaid in full. On July 19, 2022, we entered into the Second Loan Extension Letter Agreement, that provided for a subsequent extension of the maturity date on the outstanding indebtedness owed under the Amended and Restated Loan Agreement from June 30, 2023 to December 31, 2023. On February 10, 2023, the Company entered into the Third Loan Extension Letter Agreement to further extend the maturity date of the senior secured debt to June 30, 2024. On February 12, 2024, the Company entered into the Fourth Loan Extension Letter Agreement to further extend the maturity date of the senior secured debt to June 30, 2025. See Note (10) Notes Payable for more information. Also, as described further in Note (13) Series A Redeemable Convertible Preferred Stock, the effective date of the mandatory redemption right of the Company's Series A Redeemable Convertible Preferred Stock (the "Series A Preferred Stock") held by HCP-FVA and Hale Capital was extended from July 30, 2021 to July 30, 2023 pursuant to that certain Amendment No. 1 to the Amended and Restated Certificate of Designations, Preferences and Rights of Series A Convertible Preferred Stock of the Company, dated as of June 24, 2021 (as amended, the "Certificate of Designations"). On July 19, 2022, the Company and Hale Capital entered into a letter agreement pursuant to which Hale Capital agreed not to exercise or permit the exercise of the mandatory redemption right of the Series A Preferred Stock on or prior to December 31, 2023 unless the redemption is in accordance with Section 8(e)(z) of the Certificate of Designations or in accordance with a Breach Event (as defined in the Certificate of Designations). If such Series A Preferred Stock was redeemed on March 31, 2023, the Company would have been required to pay the holders of the Series A Preferred Stock \$16.3 million. On February 10, 2023, the Company entered into a letter agreement with Hale Capital to further extend the redemption date of the Series A Preferred Stock to June 30, 2024. On February 12, 2024, the Company entered into another letter agreement with Hale Capital to further extend the redemption date of the Series A Preferred Stock to June 30, 2025. The Company believes its current cash balances together with anticipated cash flows from operating activities will be sufficient to meet its working capital requirements for at least one year from the date the consolidated financial statements were issued.

## **(20) Subsequent Events**

### *Senior Secured Debt*

On February 12, 2024, we entered into a letter agreement with Hale Capital that provided for a subsequent extension of the maturity date on the outstanding indebtedness owed under the Amended and Restated Loan Agreement from June 30, 2024 to June 30, 2025.

### *Series A Redeemable Convertible Preferred Stock*

On February 12, 2024, the Company and Hale Capital entered into a letter agreement pursuant to which Hale Capital agreed not to exercise or to permit the exercise of the mandatory redemption right of the Series A Preferred Stock on or prior to June 30, 2025 unless the redemption is in accordance with Section 8(e)(z) of the Certificate of Designations or in accordance with a Breach Event (as defined in the Certificate of Designations).