

FALCONSTOR SOFTWARE, INC.

111 Congress Avenue, Suite 500, Austin, TX 78701

(631) 777-5188

www.falconstor.com

www.falconstor.com/contact

SIC – 7372

Quarterly Report

For the period ended, June 30, 2024 (the “Reporting Period”)

Outstanding Shares

The number of shares outstanding of our Common Stock was:

7,134,504 as of June 30, 2024

7,133,089 as of December 31, 2023

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 June 30, 2024

Total shares authorized: 2,000,000 preferred stock as of June 30, 2024

Total shares outstanding: 7,134,504 common stock as of June 30, 2024

Total shares outstanding: 900,000 preferred stock as of June 30, 2024

Total number of shareholders of record: 37 common stock as of June 30, 2024

Total number of shareholders of record: 5 preferred stock as of June 30, 2024

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" or "FalconStor") 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 \$123.00 (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: December 31, 2021 Common: 7,082,276 Preferred: 900,000 | | | | | | | | | |
|--|--|--|---------------------|---|--|---|---|---|---|
| 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 | Unrestricted | Exemption – Section 4a2 of Securities Act |

| | | | | | | | | | |
|--------------------|--------------|-------|--------|--------|----|-------------------------|--|--------------|---|
| | | | | | | | vesting of 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 |
| February 17, 2024 | New Issuance | 1,415 | Common | \$1.33 | No | Vincent Sita | Executive Compensation - Shares issued pursuant to vesting of restricted stock units | Unrestricted | Exemption – Section 4a2 of Securities Act |
| Shares Outstanding on June 30, 2024 | Ending Balance: Common: <u>7,134,504</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 06/30/2024 (\$) | Principal Amount at Issuance (\$) | Interest Accrued as of 06/30/2024 (\$) | Maturity Date | Conversion Terms (e.g. pricing mechanism for determining conversion of instrument to shares) | Name of Noteholder. *You must disclose the control person(s) for any entities listed. | Reason for Issuance (e.g. Loan, Services, etc.) |
|-----------------------|---|-----------------------------------|--|---------------|--|--|---|
| February 23, 2018 | \$ 2,174,064 | \$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 June 30, 2024. 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 June 30, 2024, 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 7,134,504 shares of the Company's stock that were outstanding as of June 30, 2024. 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 ⁽¹⁾ | 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 ⁽²⁾ | 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 ⁽³⁾ | Director and Control Person | New York, NY | 3,653,377 | Common | 50.8% | Martin Hale |
| Nantahala Capital Management, LLC ⁽⁴⁾ | Control Person | Darien, CT | 638,151 | Common | 8.9% | Wilmot B. Harkey and Daniel Mack |
| ESW Capital, LLC ⁽⁵⁾ | Control Person | Austin, TX | 1,308,068 | Common | 18.3% | Joseph A. Liemandt |
| Bard Associates ⁽⁶⁾ | Control Person | Chicago, IL | 500,090 | Common | 7.0% | Timothy B. Johnson |
| Michael P. Kelly ⁽⁷⁾ | Director | Scottsdale, AZ | 18,851 | Common | * | |
| Barry Rudolph ⁽⁸⁾ | Director | Estes Park, CO | 18,796 | Common | * | |
| William Miller ⁽⁹⁾ | Director | Colorado Springs, CO | 10,289 | Common | * | |
| Todd Brooks ⁽¹⁰⁾ | Director and Executive Officer | Punta Gorda, FL | 87,146 | Common | 1.2% | |
| Vincent Sita ⁽¹¹⁾ | Executive Officer | Mont Royal, Quebec, Canada | 4,245 | Common | * | |
| Martin Hale, Hale Fund Management, LLC Hale Capital Management, LP, Hale Capital Partners, LP, HCP-FVA, LLC ⁽³⁾ | Director and Control Person | New York, NY | 558,000 | Preferred | 62.0% | Martin Hale |
| Nantahala Capital Management, LLC ⁽⁴⁾ | Control Person | Darien, CT | 99,807 | Preferred | 11.1% | Wilmot B. Harkey and Daniel Mack |
| ESW Capital, LLC ⁽⁵⁾ | Control Person | Austin, TX | 224,786 | Preferred | 25.0% | Joseph A. Liemandt |

| | | | | | | |
|---------------------------------|----------|----------------|-------|-----------|---|--|
| Michael P. Kelly ⁽⁷⁾ | Director | Scottsdale, AZ | 1,405 | Preferred | * | |
|---------------------------------|----------|----------------|-------|-----------|---|--|

* 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 June 30, 2024 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 June 30, 2024) 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 7,134,504 shares of common stock outstanding as of June 30, 2024.
- (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 June 30, 2024. 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 June 30, 2024. 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 January 4, 2024. Consists of 500,090 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 4,245 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

Auditor - Year Ended 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 Ended 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

Firm: Pope, Shamsie & Dooley LLP
Nature of Services: Tax Services
Address: 5332 Thunder Creek Road
Austin, Texas 78759
Phone: 512-836-5855

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 quarter ended June 30, 2024 and are hereby incorporated by reference:

- a. Consolidated Balance Sheets at June 30, 2024 (unaudited), and December 31, 2023
- b. Consolidated Statements of Operations for the three and six months ended June 30, 2024, and 2023
- c. Consolidated Statements of Cash Flows for the three and six months ended June 30, 2024, and 2023
- d. Consolidated Statements of Comprehensive Income (Loss) for the three and six months ended June 30, 2024, and 2023
- e. Consolidated Statements of Stockholders' Deficit for the three and six months ended June 30, 2024, and 2023
- f. Notes to the Consolidated Financial Statements

10) Issuer Certification

I, Todd Brooks, certify that:

1. I have reviewed this Quarterly 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

August 07, 2024

Date

Principal Financial Officer:

I, Vincent Sita, certify that:

1. I have reviewed this Quarterly 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

August 07, 2024

Date

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FALCONSTOR SOFTWARE, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

| | <u>June 30, 2024</u> | <u>December 31, 2023</u> |
|--|------------------------|--------------------------|
| | <u>(unaudited)</u> | |
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 2,520,869 | \$ 3,409,120 |
| Accounts receivable, net | 1,769,258 | 2,333,816 |
| Prepaid expenses and other current assets | 818,204 | 1,032,125 |
| Contract assets, net | 405,838 | 509,201 |
| Total current assets | 5,514,169 | 7,284,262 |
| Property and equipment, net | 29,461 | 49,194 |
| Operating lease right-of-use assets, net | 66,307 | 104,566 |
| Deferred tax assets | (33,563) | — |
| Software development costs, net | 14,444 | 25,278 |
| Other assets | 15,247 | 15,946 |
| Goodwill | 4,150,339 | 4,150,339 |
| Other intangible assets, net | 837 | 2,489 |
| Long-term contract assets, net | 466,471 | 644,789 |
| Total assets | <u>\$ 10,223,712</u> | <u>\$ 12,276,863</u> |
| Liabilities and Stockholders' Deficit | | |
| Current liabilities: | | |
| Accounts payable | \$ 552,279 | \$ 522,976 |
| Accrued expenses | 1,258,117 | 1,972,593 |
| Current portion of lease liabilities | 66,307 | 69,143 |
| Short-term note payable | 13,079 | 91,557 |
| Deferred revenue | 3,000,974 | 3,736,200 |
| Total current liabilities | 4,890,756 | 6,392,469 |
| Other long-term liabilities | 939,458 | 1,021,605 |
| Notes payable, net of debt issuance costs and discounts | 2,174,064 | 2,172,382 |
| Operating lease liabilities, net of current portion | — | 35,422 |
| Deferred tax liabilities | 376,208 | 465,214 |
| Deferred revenue, net of current portion | 1,320,451 | 1,617,603 |
| Total liabilities | <u>\$ 9,700,937</u> | <u>\$ 11,704,695</u> |
| Commitments and contingencies (Note 10) | | |
| Series A redeemable convertible preferred stock, \$.001 par value, 2,000,000 shares authorized, 900,000 shares issued and outstanding, redemption value of \$18,460,241 and \$17,563,563, respectively | 18,446,195 | 17,543,521 |
| Stockholders' deficit: | | |
| Common stock, \$.001 par value, 30,000,000 shares authorized, 7,134,504 shares and 7,133,089 shares issued and outstanding, respectively | 7,134 | 7,133 |
| Additional paid-in capital | 108,342,020 | 109,240,183 |
| Accumulated deficit | (124,680,810) | (124,528,795) |
| Accumulated other comprehensive loss | (1,591,764) | (1,689,874) |
| Total stockholders' deficit | <u>\$ (17,923,420)</u> | <u>\$ (16,971,353)</u> |
| Total liabilities and stockholders' deficit | <u>\$ 10,223,712</u> | <u>\$ 12,276,863</u> |

See accompanying notes to unaudited consolidated financial statements.

FALCONSTOR SOFTWARE, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|------------------------------------|---------------------|----------------------------------|-----------------------|
| | 2024 | 2023 | 2024 | 2023 |
| Revenue: | | | | |
| Product revenue | \$ 1,016,006 | \$ 1,185,231 | \$ 1,813,363 | \$ 2,207,417 |
| Support and services revenue | 1,342,862 | 1,186,152 | 2,841,717 | 2,432,362 |
| Total revenue | <u>2,358,868</u> | <u>2,371,383</u> | <u>4,655,080</u> | <u>4,639,779</u> |
| Cost of revenue: | | | | |
| Product | 7,635 | 11,960 | 26,818 | 46,089 |
| Support and service | 388,874 | 374,884 | 788,964 | 716,072 |
| Total cost of revenue | <u>396,509</u> | <u>386,844</u> | <u>815,782</u> | <u>762,161</u> |
| Gross profit | \$ 1,962,359 | \$ 1,984,539 | \$ 3,839,298 | \$ 3,877,618 |
| Operating expenses: | | | | |
| Research and development costs | 553,498 | 619,830 | 1,124,035 | 1,238,357 |
| Selling and marketing | 835,632 | 778,339 | 1,560,688 | 1,580,905 |
| General and administrative | 569,674 | 774,189 | 1,142,556 | 1,666,843 |
| Total operating expenses | <u>1,958,804</u> | <u>2,172,358</u> | <u>3,827,279</u> | <u>4,486,105</u> |
| Operating income (loss) | 3,555 | (187,819) | 12,019 | (608,487) |
| Interest and other expense | (143,015) | (175,199) | (288,778) | (255,062) |
| Income (loss) before income taxes | (139,460) | (363,018) | (276,759) | (863,549) |
| Income tax expense (benefit) | (108,497) | 93,767 | (124,744) | 41,006 |
| Net income (loss) | <u>\$ (30,963)</u> | <u>\$ (456,785)</u> | <u>\$ (152,015)</u> | <u>\$ (904,555)</u> |
| Less: Accrual of Series A redeemable convertible preferred stock dividends | 453,920 | 410,894 | 896,678 | 726,109 |
| Less: Accretion to redemption value of Series A redeemable convertible preferred stock | <u>3,078</u> | <u>8,344</u> | <u>5,996</u> | <u>18,195</u> |
| Net income (loss) attributable to common stockholders | <u>\$ (487,961)</u> | <u>\$ (876,023)</u> | <u>\$ (1,054,689)</u> | <u>\$ (1,648,859)</u> |
| Basic net income (loss) per share attributable to common stockholders | <u>\$ (0.07)</u> | <u>\$ (0.12)</u> | <u>\$ (0.15)</u> | <u>\$ (0.23)</u> |
| Diluted net income (loss) per share attributable to common stockholders | <u>\$ (0.07)</u> | <u>\$ (0.12)</u> | <u>\$ (0.15)</u> | <u>\$ (0.23)</u> |
| Weighted average basic shares outstanding | <u>7,134,504</u> | <u>7,122,199</u> | <u>7,134,131</u> | <u>7,120,974</u> |
| Weighted average diluted shares outstanding | <u>7,134,504</u> | <u>7,122,199</u> | <u>7,134,131</u> | <u>7,120,974</u> |

See accompanying notes to unaudited consolidated financial statements.

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

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|------------------------------------|--------------|----------------------------------|----------------|
| | 2024 | 2023 | 2024 | 2023 |
| Net income (loss) | \$ (30,963) | \$ (456,785) | \$ (152,015) | \$ (904,555) |
| Other comprehensive income (loss), net of applicable taxes | | | | |
| Foreign currency translation | 37,487 | 73,526 | 98,110 | 85,312 |
| Total other comprehensive income (loss), net of applicable taxes: | 37,487 | 73,526 | 98,110 | 85,312 |
| Total comprehensive income (loss) | \$ 6,524 | \$ (383,259) | \$ (53,905) | \$ (819,243) |
| Less: Accrual of Series A redeemable convertible preferred stock dividends | 453,920 | 410,894 | 896,678 | 726,109 |
| Less: Accretion to redemption value of Series A redeemable convertible preferred stock | 3,078 | 8,344 | 5,996 | 18,195 |
| Total comprehensive income (loss) attributable to common stockholders | \$ (450,474) | \$ (802,497) | \$ (956,579) | \$ (1,563,547) |

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 January 1, 2024 | 7,133,089 | \$ 7,133 | \$ 109,240,183 | \$ (124,528,795) | \$ (1,689,874) | \$ (16,971,353) |
| Net income (loss) | | | | (121,052) | | (121,052) |
| Share-based compensation to employees | | | 2,361 | | | 2,361 |
| Shares issued in connection with vesting of restricted stock | 1,415 | 1 | (1) | | | — |
| Accretion of Series A redeemable convertible preferred stock | | | (2,918) | | | (2,918) |
| Dividends on Series A redeemable convertible preferred stock | | | (442,758) | | | (442,758) |
| Foreign currency translation | | | | | 60,623 | 60,623 |
| Balance at March 31, 2024 | 7,134,504 | 7,134 | 108,796,867 | (124,649,847) | (1,629,251) | (17,475,097) |
| Net income (loss) | | | | (30,963) | | (30,963) |
| Share-based compensation to employees | | | 2,151 | | | 2,151 |
| Accretion of Series A redeemable convertible preferred stock | | | (3,078) | | | (3,078) |
| Dividends on Series A redeemable convertible preferred stock | | | (453,920) | | | (453,920) |
| Foreign currency translation | | | | | 37,487 | 37,487 |
| Balance at June 30, 2024 | 7,134,504 | \$ 7,134 | \$ 108,342,020 | \$ (124,680,810) | \$ (1,591,764) | \$ (17,923,420) |

See accompanying notes to unaudited consolidated financial statements.

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 January 1, 2023 | 7,118,609 | \$ 7,119 | \$ 110,844,716 | \$ (125,507,178) | \$ (1,752,099) | \$ (16,407,442) |
| Net income (loss) | | | | (447,770) | | (447,770) |
| Share-based compensation to employees | | | 5,331 | | | 5,331 |
| Shares issued in connection with vesting of restricted stock | 3,590 | 3 | (3) | | | — |
| Accretion of Series A redeemable convertible preferred stock | | | (9,851) | | | (9,851) |
| Dividends on Series A redeemable convertible preferred stock | | | (315,215) | | | (315,215) |
| Foreign currency translation | | | | | 11,786 | 11,786 |
| Balance at March 31, 2023 | 7,122,199 | 7,122 | 110,524,978 | (125,954,948) | (1,740,313) | (17,163,161) |
| Net income (loss) | | | | (456,785) | | (456,785) |
| Share-based compensation to employees | | | 313 | | | 313 |
| Accretion of Series A redeemable convertible preferred stock | | | (8,344) | | | (8,344) |
| Dividends on Series A redeemable convertible preferred stock | | | (410,894) | | | (410,894) |
| Foreign currency translation | | | | | 73,526 | 73,526 |
| Balance at June 30, 2023 | 7,122,199 | \$ 7,122 | \$ 110,106,053 | \$ (126,411,733) | \$ (1,666,787) | \$ (17,965,345) |

See accompanying notes to unaudited consolidated financial statements.

FALCONSTOR SOFTWARE, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

| | Six Months Ended June 30, | |
|---|----------------------------------|--------------|
| | 2024 | 2023 |
| Cash flows from operating activities: | | |
| Net income (loss) | \$ (152,015) | \$ (904,555) |
| Adjustments to reconcile net loss to net cash provided by operating activities: | | |
| Depreciation and amortization | 31,301 | 49,261 |
| Amortization of debt discount on notes payable | 1,682 | 4,874 |
| Amortization of right of use assets | 38,259 | 34,416 |
| Share-based payment compensation | 4,512 | 5,644 |
| Provision for credit losses | 10,288 | 26,807 |
| Deferred income taxes | (56,737) | — |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 556,166 | 335,892 |
| Prepaid expenses and other current assets | 164,721 | 2,120 |
| Contract assets | 281,681 | (322,939) |
| Other assets | (15,866) | 57,568 |
| Accounts payable | 160,429 | 83,539 |
| Accrued expenses and other long-term liabilities | (729,482) | 42,947 |
| Operating lease liabilities | (38,258) | (34,416) |
| Deferred revenue | (1,021,926) | 60,559 |
| Net cash provided by (used in) operating activities | (765,245) | (558,283) |
| Cash flows from investing activities: | | |
| Purchases of property and equipment | — | (2,853) |
| Net cash provided by (used in) investing activities | — | (2,853) |
| Cash flows from financing activities: | | |
| Cash paid for payroll taxes on restricted stock unit release | — | (680) |
| Payments of short-term debt | (78,478) | (151,842) |
| Net cash provided by (used in) financing activities | (78,478) | (152,522) |
| Effect of exchange rate changes on cash and cash equivalents | (44,528) | (10,929) |
| Net increase (decrease) in cash and cash equivalents | (888,251) | (724,587) |
| Cash and cash equivalents, beginning of period | 3,409,120 | 2,011,062 |
| Cash and cash equivalents, end of period | \$ 2,520,869 | \$ 1,286,475 |
| Supplemental disclosures: | | |
| Cash paid for interest | \$ 104,681 | \$ 96,569 |
| Non-cash investing and financing activities: | | |
| Undistributed Series A redeemable convertible preferred stock dividends | \$ 896,678 | \$ 726,109 |
| Accretion of Series A redeemable convertible preferred stock | \$ 5,996 | \$ 18,195 |

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 June 30, 2024, the Company had a working capital surplus of \$0.6 million, which is inclusive of current deferred revenue of \$3.0 million, and a stockholders' deficit of \$17.9 million. During the six months ended June 30, 2024, the Company had a net loss of \$(0.2) million and negative cash flow from operations of \$(0.8) million. The Company's total cash balance at June 30, 2024 was \$2.5 million, a decrease of \$0.9 million compared to \$3.4 million on December 31, 2023.

The Company's principal sources of liquidity at June 30, 2024 consisted of cash and future cash anticipated to be generated from operations. The Company generated negative net income and negative cash flows from operations during the six months ended June 30, 2024, and it reported positive working capital as of June 30, 2024.

As described further in Note (8) Notes Payable, 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"). Subsequent amendments extended the maturity of the Amended and Restated Loan Agreement through December 31, 2023. On February 10, 2023, the Company entered into a letter agreement with Hale Capital to extend the maturity date of the senior secured debt to June 30, 2024. 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. See Note (8) Notes Payable for more information.

Also, as described further in Note (11) 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 is June 30, 2025 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") and subsequent letter agreements in 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 the mandatory redemption date 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 extend the redemption date of the Series A Preferred Stock to June 30, 2024. 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. In August 2024, the Company received a verbal agreement from Hale Capital to further extend the redemption date of the Series A Preferred Stock. If such Series A Preferred Stock was redeemed on June 30, 2024, the Company would have been required to pay the holders of the Series A Preferred Stock \$18.5 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

In March 2020, the World Health Organization declared the disease caused by the novel strain of coronavirus (“COVID-19”) a pandemic. In response to the public health crisis posed by COVID-19, we prioritized the health and safety of our employees and have since been operating remotely with the exception of office spaces leased in Taiwan. In response to the potential impacts and uncertainty about the duration of the COVID-19 pandemic, we took precautionary measures to increase and maintain our liquidity, which included reducing planned operating expenses and capital expenditures, and negotiating rent deferrals with landlords. We maintain a mailing address and rent virtual office facilities at 111 Congress Avenue, Suite 500, Austin, Texas 78701, along with virtual office facilities in Germany, France, Malaysia, China, Korea, and Japan, and use our business continuity plans to operate corporate support functions under remote work arrangements that currently remain in place.

We are also 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 the COVID-19 pandemic, 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. If the COVID-19 pandemic causes another period resulting in a change in customer behavior or any of the other aforementioned effects, such future events may have a material adverse impact on the Company’s results of operations, financial position and liquidity.

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.

Unaudited Interim Financial Information

The accompanying condensed consolidated financial statements have been prepared in accordance with GAAP for interim financial information and in accordance with the requirements of Quarterly Reporting of the OTC Markets. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. The interim financial information is unaudited, but reflects all normal adjustments and accruals which are, in the Company's opinion, considered necessary to provide a fair presentation for the interim periods presented. The consolidated financial statements included herein should be read in conjunction with the reported consolidated financial statements and the footnotes thereto included within the Company's latest OTC Markets Annual Reporting for the fiscal year ended December 31, 2023.

Revenue from Contracts with Customers and Associated Balances

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 June 30, 2024 and December 31, 2023, accounts receivable, net of allowance for doubtful accounts, was \$1.8 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 \$37,614 as of June 30, 2024 and \$25,757 as of December 31, 2023, respectively. As of June 30, 2024 and December 31, 2023, short and long-term contract assets, net of provision for credit loss, was \$0.9 million and \$1.2 million, respectively. Our provision for credit loss on contract assets was \$8,723 and \$11,540 as of June 30, 2024 and December 31, 2023, 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 January 1, 2024 | \$ | 5,353,803 |
| Deferral of revenue | | 3,623,581 |
| Recognition of revenue | | (4,655,080) |
| Change in reserves | | (879) |
| Balance at June 30, 2024 | \$ | <u>4,321,425</u> |

During the three months ended June 30, 2024 and 2023, revenue of \$1.0 million and \$2.4 million respectively, and the six months ended June 30, 2024 and 2023, revenue of \$2.2 million and \$3.7 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 \$4.3 million as of June 30, 2024, of which the Company expects to recognize approximately 69% of such amount as revenue over the next 12 months and the remainder thereafter.

Approximately \$1.9 million of revenue is expected to be recognized from remaining performance obligations for unbilled support and services as of June 30, 2024. We expect to recognize revenue on approximately 38% of these remaining performance obligations over the next twelve months, with the balance recognized 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 condensed consolidated statements of operations and Note (15) *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 condensed 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

We have various operating leases for office facilities that are expected to continue through 2024. Below is a summary of our ROU assets and liabilities as of June 30, 2024.

| | | |
|---|----|--------|
| Right of use assets | \$ | 66,307 |
| Lease liability obligations, current | | 66,307 |
| Lease liability obligations, less current portion | | — |
| Total lease liability obligations | \$ | 66,307 |
| Weighted-average remaining lease term | | 1.00 |
| Weighted-average discount rate | | 3.25 % |

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|------------------------------|-----------------------------|-----------|---------------------------|-----------|
| | 2024 | 2023 | 2024 | 2023 |
| Components of lease expense: | | | | |
| Operating lease cost | \$ 32,957 | \$ 36,264 | \$ 68,545 | \$ 69,382 |
| Sublease income | — | — | — | — |
| Net lease cost | \$ 32,957 | \$ 36,264 | \$ 68,545 | \$ 69,382 |

During the three months ended June 30, 2024 and 2023, operating cash flows from operating leases were approximately \$16,935 and \$17,467, respectively. During the six months ended June 30, 2024 and 2023 operating cash flows from operating leases were approximately \$33,871 and \$34,935, respectively.

Approximate future minimum lease payments for our ROU assets over the remaining lease periods as of June 30, 2024, are as follows:

| | | |
|------------------------------------|----|---------------|
| 2024 (remaining) | \$ | 33,871 |
| 2025 | | 31,048 |
| Total minimum lease payments | \$ | 64,919 |
| Less interest | | (1,388) |
| Present value of lease liabilities | \$ | <u>66,307</u> |

Recently Issued Accounting Pronouncements

In November 2023, the FASB issued Accounting Standards Update (ASU) 2023-07, Segment Reporting (Topic 280): Improvements to Reportable Segment Disclosures. The new standard requires enhanced disclosures about significant segment expenses and other segment items and requires companies to provide all annual disclosures about segments in interim periods. All disclosure requirements under ASU 2023-07 are also required for public entities with a single reportable segment. The ASU is effective for the Company's Annual Report for the fiscal year ending December 31, 2024, and subsequent interim periods, with early adoption permitted. We are currently evaluating the impact of adopting this ASU on our consolidated financial statements and related disclosures.

In December 2023, the FASB issued ASU 2023-09, "Income Taxes (Topic 740): Improvements to Income Tax Disclosures." The amendments in this update are intended to enhance the transparency and decision usefulness of income tax disclosures primarily through changes to the rate reconciliation and income taxes paid information. This update is effective for annual periods beginning after December 15, 2024, with early adoption permitted. We are currently evaluating the ASU to determine its impact on our consolidated financial statements and related disclosures.

Recently Adopted 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. We adopted the standard on January 1, 2024 and there was no impact on our 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 awards, 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 three and six months ended June 30, 2024 and 2023:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|-----------------------------|----------------|---------------------------|----------------|
| | 2024 | 2023 | 2024 | 2023 |
| Stock options | 2,825 | 3,425 | 2,825 | 3,425 |
| Restricted stock | 13,549 | 28,685 | 13,549 | 28,685 |
| Series A redeemable convertible preferred stock | 180,121 | 163,048 | 180,121 | 163,048 |
| Total anti-dilutive common stock equivalents | <u>196,495</u> | <u>195,158</u> | <u>196,495</u> | <u>195,158</u> |

(3) Property and Equipment

The gross carrying amount and accumulated depreciation of property and equipment as of June 30, 2024 and December 31, 2023 are as follows:

| | June 30, 2024 | December 31, 2023 |
|-----------------------------|------------------|-------------------|
| Gross carrying amount | \$ 15,496,714 | \$ 15,517,615 |
| Accumulated depreciation | (15,467,253) | (15,468,421) |
| Property and Equipment, net | <u>\$ 29,461</u> | <u>\$ 49,194</u> |

For the three months ended June 30, 2024 and 2023, depreciation expense was \$7,507 and \$11,200, respectively. For the six months ended June 30, 2024 and 2023, depreciation expense was \$18,815 and \$22,444, respectively.

(4) Software Development Costs

The gross carrying amount and accumulated amortization of software development costs as of June 30, 2024 and December 31, 2023 are as follows:

| | June 30, 2024 | December 31, 2023 |
|---------------------------------|------------------|-------------------|
| Gross carrying amount | \$ 3,015,132 | \$ 3,015,132 |
| Accumulated amortization | (3,000,688) | (2,989,854) |
| Software development costs, net | <u>\$ 14,444</u> | <u>\$ 25,278</u> |

During the three months ended June 30, 2024 and 2023, the Company recorded \$5,417 and \$7,061, respectively, of amortization expense related to capitalized software costs. During the six months ended June 30, 2024 and 2023, the Company recorded \$10,834 and \$14,117, 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 June 30, 2024 and December 31, 2023 are as follows:

| | June 30, 2024 | December 31, 2023 |
|--------------------------|---------------------|---------------------|
| Goodwill | <u>\$ 4,150,339</u> | <u>\$ 4,150,339</u> |
| Other intangible assets: | | |
| Gross carrying amount | \$ 4,041,216 | \$ 4,041,216 |
| Accumulated amortization | (4,040,379) | (4,038,727) |
| Net carrying amount | <u>\$ 837</u> | <u>\$ 2,489</u> |

For the three months ended June 30, 2024 and 2023, amortization expense was \$547 and \$5,899, respectively. For the six months ended June 30, 2024 and 2023, amortization expense was \$1,652 and \$12,700, respectively.

(6) 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 June 30, 2024:

| Name of Plan | Shares Authorized | Shares Available for Grant | Shares Outstanding |
|---|--------------------------|-----------------------------------|---------------------------|
| FalconStor Software, Inc. 2018 Incentive Stock Plan | 1,692,797 | 295,684 | 1,246,763 |

The following table summarizes the Company's equity plans that have terminated or expired but that still have equity awards outstanding as of June 30, 2024:

| 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 |

A summary of the Company's restricted stock activity for the six months ended June 30, 2024 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 January 1, 2024 | 1,248,178 |
| Granted | — |
| Vested | (1,415) |
| Forfeited | — |
| Non-Vested at June 30, 2024 | 1,246,763 |

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 condensed consolidated statements of operations for the three and six months ended June 30, 2024 and 2023:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---------------------------------------|------------------------------------|---------------|----------------------------------|-----------------|
| | 2024 | 2023 | 2024 | 2023 |
| Cost of revenue - support and service | 80 | 126 | 160 | 251 |
| Research and development costs | 531 | 987 | 1,062 | 1,963 |
| Selling and marketing | 549 | (2,292) | 1,098 | 42 |
| General and administrative | 991 | 1,492 | 2,192 | 3,388 |
| | <u>\$ 2,151</u> | <u>\$ 313</u> | <u>\$ 4,512</u> | <u>\$ 5,644</u> |

(7) Income Taxes

The Company's provision for income taxes consists principally of state and local, and foreign taxes, as applicable, in amounts necessary to align the Company's year-to-date tax provision with the effective rate that it expects to achieve for the full year.

For the six months ended June 30, 2024, the Company recorded an income tax benefit of \$124,744, including a benefit of \$96,511 from the release of unrecognized tax benefits due to statute of limitations related to transfer pricing adjustments. The effective tax rate for the six months ended June 30, 2024 was 45.1%. The effective tax rate differs from the statutory rate of 21% due to the mix of foreign and domestic earnings, foreign withholding taxes, the application of valuation allowances, and the above unrecognized tax benefits. As of June 30, 2024, the Company's conclusion did not change with respect to the realizability of its domestic deferred tax assets and therefore, the Company has not recorded any income tax benefit as such amounts are fully offset with a valuation allowance.

For the six months ended June 30, 2023, the Company recorded an income tax provision of \$41,006. The effective tax rate for the six months ended June 30, 2023 was 4.7%. The effective tax rate differs from the statutory rate of 21% due to the mix of foreign and domestic earnings, foreign withholding taxes and the application of valuation allowances that are applicable with respect to the Company. As of June 30, 2023, the Company's conclusion did not change with respect to the realizability of its domestic deferred tax assets and therefore, the Company had not recorded any income tax benefit as such amounts are fully offset with a valuation allowance.

The Company's total unrecognized tax benefits, excluding interest, June 30, 2024 and June 30, 2023 were none and \$62,306, respectively. As of June 30, 2024 and June 30, 2023, the Company had none and \$39,280, respectively, of accrued interest reflected in accrued expenses. The Company released all of its remaining unrecognized tax benefits during the quarter ended June 30, 2024 due to statute of limitations.

(8) Notes Payable

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

| | | |
|--|----|------------------|
| Long-term note payable, net at January 1, 2024 | \$ | 2,172,382 |
| Accretion of discount | | 1,682 |
| Long-term note payable, net at June 30, 2024 | \$ | <u>2,174,064</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%. Subsequent amendments extended the maturity of the Amended and Restated Loan Agreement through December 31, 2023. On February 10, 2023, the Company entered into a letter agreement with Hale Capital to extend the maturity date of the senior secured debt to June 30, 2024. 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 ("February 2024 Loan Extension Letter Agreement"). The Company concluded the extensions under the February 2024 Loan Extension Letter Agreement 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 June 30, 2024, 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:

| | | |
|--|----|---------------|
| Short-term note payable (AFCO), net at January 1, 2024 | \$ | 91,557 |
| Repayment of AFCO financing | | (78,478) |
| Total short-term note payable (AFCO), at June 30, 2024 | \$ | <u>13,079</u> |

(9) 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 June 30, 2024 and December 31, 2023.
- *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 June 30, 2024 and December 31, 2023, the Company did not have any Level 2 category assets included in the condensed consolidated balance sheets.
- *Level 3* – Prices or valuations that require inputs that are both significant to the fair value measurement and unobservable. At June 30, 2024 and December 31, 2023, the Level 3 category included derivatives. The Company did not hold any cash and cash equivalents categorized as Level 3 as of June 30, 2024 or December 31, 2023.

The following table presents the Company's assets and liabilities that are measured at fair value on a recurring basis at June 30, 2024:

| | Total | Fair Value Measurements at Reporting Date Using | | |
|---|------------|--|--|--|
| | | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant other Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Derivative liabilities: | | | | |
| <i>Derivative Instruments</i> | \$ 921,219 | \$ — | \$ — | \$ 921,219 |
| Total derivative liabilities | 921,219 | — | — | 921,219 |
| Total assets and liabilities measured at fair value | \$ 921,219 | \$ — | \$ — | \$ 921,219 |

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

| | Total | Fair Value Measurements at Reporting Date Using | | |
|---|------------|--|--|--|
| | | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant other Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| 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 |

Measurement of Fair Value

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 10.1% and 9.4% yield, respectively.

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 three and six months ended June 30, 2024 and 2023:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|-----------------------------------|-----------------------------|------------|---------------------------|------------|
| | 2024 | 2023 | 2024 | 2023 |
| Beginning Balance | \$ 889,346 | \$ 821,640 | \$ 907,074 | \$ 821,726 |
| Total loss recognized in earnings | 31,873 | 24,401 | 14,145 | 24,315 |
| Ending Balance | \$ 921,219 | \$ 846,041 | \$ 921,219 | \$ 846,041 |

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 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 % |

(10) 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 three and six months ended June 30, 2024, 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 (11) *Series A Redeemable Convertible Preferred Stock* the holders of the Series A Preferred Stock have redemption rights upon certain triggering events. As of June 30, 2024, 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 Vincent Sita's appointment as Chief Financial Officer, the Board approved an Independent Contractor Services Agreement with Alucria Consulting, Inc. ("Alucria"), an entity owned by Mr. Sita (the "Sita Agreement"), which was executed on February 11, 2022. The Sita Agreement provides that Alucria is entitled to receive a fee of \$20,000 per month. Alucria 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 an additional one-year term pursuant to the terms set forth therein.

(11) 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 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 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 HCP-FVA and Hale Capital. The effective date of such redemption right is June 30, 2025 pursuant to an amendment to the Certificate of Designations, dated as of June 24, 2021 and subsequent letter agreements in 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 the mandatory redemption date 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 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 changes were accounted for prospectively using the new effective interest rate of the preferred stock. In August 2024, the Company received a verbal agreement from Hale Capital to further extend the redemption date of the Series A 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 June 30, 2024 and December 31, 2023, 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 six months ended June 30, 2024 and 2023 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 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, 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 loss attributable to common stockholders on the statement of operations and in determining loss per share for the three and six months ended June 30, 2024 and 2023, respectively.

The Series A Preferred Stock consists of the following:

| | | |
|---|----|-------------------|
| Total Series A redeemable convertible preferred stock, net at January 1, 2024 | \$ | 17,543,521 |
| Accrued dividends | | 442,758 |
| Accretion of preferred stock | | 2,918 |
| Total Series A redeemable convertible preferred stock, net at March 31, 2024 | \$ | 17,989,197 |
| Accrued dividends | | 453,920 |
| Accretion of preferred stock | | 3,078 |
| Total Series A redeemable convertible preferred stock, net at June 30, 2023 | \$ | <u>18,446,195</u> |

(12) Accumulated Other Comprehensive Loss

The changes in Accumulated Other Comprehensive Loss, net of tax, for the three months ended June 30, 2024 are as follows:

| | Foreign Currency Translation | Net Minimum Pension Liability | Total |
|--|------------------------------------|----------------------------------|----------------|
| Accumulated other comprehensive income (loss) at April 1, 2024 | \$ (1,619,635) | \$ (9,616) | \$ (1,629,251) |
| Other comprehensive income (loss) | | | |
| Other comprehensive income (loss) before reclassifications | 37,487 | — | 37,487 |
| Total other comprehensive income (loss) | 37,487 | — | 37,487 |
| Accumulated other comprehensive income (loss) at June 30, 2024 | \$ (1,582,148) | \$ (9,616) | \$ (1,591,764) |

The changes in Accumulated Other Comprehensive Loss, net of tax, for the three months ended June 30, 2023 are as follows:

| | Foreign Currency Translation | Net Minimum Pension Liability | Total |
|--|------------------------------------|----------------------------------|----------------|
| Accumulated other comprehensive income (loss) at April 1, 2023 | \$ (1,730,431) | \$ (9,882) | \$ (1,740,313) |
| Other comprehensive income (loss) | | | |
| Other comprehensive income (loss) before reclassifications | 73,526 | — | 73,526 |
| Total other comprehensive income (loss) | 73,526 | — | 73,526 |
| Accumulated other comprehensive income (loss) at June 30, 2023 | \$ (1,656,905) | \$ (9,882) | \$ (1,666,787) |

The changes in Accumulated Other Comprehensive Loss, net of tax, for the six months ended June 30, 2024 are as follows:

| | Foreign Currency Translation | Net Minimum Pension Liability | Total |
|--|------------------------------------|----------------------------------|----------------|
| Accumulated other comprehensive income (loss) at January 1, 2024 | \$ (1,680,258) | \$ (9,616) | \$ (1,689,874) |
| Other comprehensive income (loss) | | | |
| Other comprehensive income (loss) before reclassifications | 98,110 | — | 98,110 |
| Total other comprehensive income (loss) | 98,110 | — | 98,110 |
| Accumulated other comprehensive income (loss) at June 30, 2024 | \$ (1,582,148) | \$ (9,616) | \$ (1,591,764) |

The changes in Accumulated Other Comprehensive Loss, net of tax, for the six months ended June 30, 2023 are as follows:

| | Foreign Currency Translation | Net Minimum Pension Liability | Total |
|--|------------------------------------|----------------------------------|----------------|
| 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 | 85,312 | — | 85,312 |
| Total other comprehensive income (loss) | 85,312 | — | 85,312 |
| Accumulated other comprehensive income (loss) at June 30, 2023 | \$ (1,656,905) | \$ (9,882) | \$ (1,666,787) |

(13) Stockholders' Equity

Stock Repurchase Activity

During the three and six months ended June 30, 2024 and 2023, the Company did not repurchase any shares of its common stock. As of June 30, 2024, the Company had the authorization to repurchase 49,078 shares of its common stock based upon its judgment and market conditions.

(14) 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.

(15) 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 for the three and six months ended June 30, 2024 and 2023, and the location of long-lived assets as of June 30, 2024 and December 31, 2023, are summarized as follows:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---------------------------------------|-----------------------------|---------------------|---------------------------|---------------------|
| | 2024 | 2023 | 2024 | 2023 |
| Revenue: | | | | |
| Americas | \$ 1,336,116 | \$ 1,348,921 | \$ 2,685,211 | \$ 2,285,767 |
| Europe, Middle East, Africa and Other | 716,183 | 724,165 | 1,312,019 | 1,718,879 |
| Asia Pacific | 306,569 | 298,297 | 657,850 | 635,133 |
| Total Revenue | <u>\$ 2,358,868</u> | <u>\$ 2,371,383</u> | <u>\$ 4,655,080</u> | <u>\$ 4,639,779</u> |
| | | | | |
| | June 30, 2024 | | December 31, 2023 | |
| Long-lived assets: | | | | |
| Americas | \$ | 485,859 | \$ | 683,781 |
| Asia Pacific | | 71,478 | | 154,776 |
| Europe, Middle East, Africa and Other | | 1,030 | | 1,216 |
| Total long-lived assets | <u>\$</u> | <u>558,367</u> | <u>\$</u> | <u>839,773</u> |

For the three and six months ended June 30, 2024, the Company had one customer that accounted for 10% or more of total revenue. For the three and six months ended June 30, 2023, the Company had one customer that accounted for 10% or more of total revenue.

As of June 30, 2024, the Company had three customers that accounted for 10% or more of the gross accounts receivable balance. As of December 31, 2023, the Company had two customers that accounted for 10% or more of the gross accounts receivable balance.