

Consolidated Financial Statements

Tapinator, Inc.

Years Ended December 31, 2015 and 2014

Tapinator, Inc.
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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders
Tapinator, Inc.

We have audited the accompanying consolidated balance sheets of Tapinator, Inc. (the "Company") as of December 31, 2015 and 2014, and the related consolidated statement of operations, stockholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2015 and 2014, and the results of its operations and its cash flows for the years ended, in conformity with accounting principles generally accepted in the United States of America.

Liggett & Webb P.A.

New York, New York
March 28, 2016

Tapinator, Inc.
Consolidated Balance Sheets

	December 31,	
	2015	2014
Assets		
Current assets		
Cash and cash equivalents	\$ 1,487,196	\$ 121,740
Accounts receivable, net	429,565	130,681
Prepaid expenses	54,589	-
Total current assets	<u>1,971,350</u>	<u>252,421</u>
Property and equipment, net	13,714	17,500
Software development costs, net	746,936	1,260,865
Capitalized financing costs, net	71,959	-
Investments	19,086	19,086
Security deposits	14,052	19,840
Total assets	<u><u>\$ 2,837,097</u></u>	<u><u>\$ 1,569,712</u></u>
Liabilities and stockholders' equity		
Liabilities		
Current liabilities		
Accounts payable and accrued expenses	\$ 197,031	\$ 56,925
Due to related parties	100,640	129,327
Senior convertible debenture, net of debt discount	391,186	-
Total current liabilities	<u>688,857</u>	<u>186,252</u>
Notes payable to related parties, net of debt discount	-	203,954
Senior convertible debenture, net of debt discount	391,186	-
Total liabilities	<u>1,080,043</u>	<u>390,206</u>
Redeemable Preferred Stock of subsidiary, \$0.001 par value; zero and 1,000,000 shares authorized at December 31, 2015 and 2014, respectively; zero and 773,499 shares issued and outstanding at December 31, 2015 and 2014, respectively	<u>-</u>	<u>773,499</u>
Stockholders' equity		
Common Stock, \$0.001 par value; 150,000,000 and 74,000,000 shares authorized at December 31, 2015 and 2014, respectively; 57,109,303 and 55,031,871 shares issued and outstanding at December 31, 2015 and 2014, respectively	57,109	55,032
Series B Preferred Stock, \$0.001 par value; zero and 10,000 shares authorized, issued and outstanding at December 31, 2015 and 2014, respectively	-	10
Additional paid-in capital	3,633,868	360,880
Accumulated deficit	(1,933,923)	(9,915)
Total stockholders' equity	<u>1,757,054</u>	<u>406,007</u>
Total liabilities and stockholders' equity	<u><u>\$ 2,837,097</u></u>	<u><u>\$ 1,569,712</u></u>

(See accompanying notes to the consolidated financial statements)

Tapinator, Inc.
Consolidated Statements of Operations

	Year Ended December 31,	
	2015	2014
Revenue	\$ 2,448,051	\$ 943,449
Operating expenses		
Cost of revenue excluding depreciation and amortization	745,358	283,383
Research and development	135,659	302,744
Marketing and public relations	216,166	22,938
General and administrative	864,433	232,622
Impairment of capitalized software	584,479	-
Amortization of capitalized software development	753,882	38,421
Depreciation and amortization of other assets	41,792	1,395
Total expenses	3,341,769	881,503
Operating income (loss)	(893,718)	61,946
Other expenses		
Debt discount amortization	806,450	37,500
Interest expense	220,068	15,941
Total other expenses	1,026,518	53,441
Pretax income (loss)	(1,920,236)	8,505
Income taxes	3,772	613
Net income (loss)	\$ (1,924,008)	\$ 7,892
Net income (loss) per share:		
Basic	(\$0.03)	\$0.00
Diluted	(\$0.03)	\$0.00
Weighted average common shares outstanding:		
Basic	57,109,303	55,041,871
Diluted	57,109,303	55,641,871

(See accompanying notes to the consolidated financial statements)

Tapinator, Inc.
Consolidated Statements of Stockholders' Equity

	Common Stock		Series B Preferred Stock		Series C Preferred Stock		Series D Preferred Stock		Additional Paid-In-Capital	Subscription Receivable	Accumulated Deficit	TOTAL
	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount				
Balances at December 31, 2013	36,700,000	\$ 36,700	-	\$ -	-	\$ -	-	\$ -	\$ 117,800	\$ (115,000)	\$ (17,807)	\$ 21,693
Security exchange share issuances	9,174,372	9,175	10,000	10	461,100	461,100	885,500	885,500	(1,355,785)	115,000	-	115,000
Common shares issued related to software development costs	334,266	334	-	-	-	-	-	-	111,088	-	-	111,422
Common shares issued due to conversion of Series C preferred stock	3,074,000	3,074	-	-	(461,100)	(461,100)	-	-	458,026	-	-	-
Common shares issued due to conversion of Series D preferred stock	5,749,233	5,749	-	-	-	-	(885,500)	(885,500)	879,751	-	-	-
Beneficial conversion feature on convertible promissory notes	-	-	-	-	-	-	-	-	150,000	-	-	150,000
Net income											7,892	7,892
Balances at December 31, 2014	55,031,871	\$ 55,032	10,000	\$ 10	-	\$ -	-	\$ -	\$ 360,880	\$ -	\$ (9,915)	\$ 406,007
Common shares issued related to consulting agreements	345,000	345	-	-	-	-	-	-	70,155	-	-	70,500
Common shares issued due to conversion of Series B preferred stock	36,764	36	(10,000)	(10)	-	-	-	-	(26)	-	-	-
Common shares issued related to conversion of notes	1,537,835	1,538	-	-	-	-	-	-	392,018	-	-	393,556
Common shares issued due to conversion of series A redeemable preferred stock of subsidiary	257,833	258	-	-	-	-	-	-	773,241	-	-	773,499
Termination of royalty agreement	-	-	-	-	-	-	-	-	55,000	-	-	55,000
Debt discount related to conversion feature and warrants on convertible debenture	-	-	-	-	-	-	-	-	2,000,000	-	-	2,000,000
Common stock redemption and cancellation	(100,000)	(100)	-	-	-	-	-	-	(17,400)	-	-	(17,500)
Net loss	-	-	-	-	-	-	-	-	-	-	(1,924,008)	(1,924,008)
Balances at December 31, 2015	57,109,303	\$ 57,109	-	\$ -	-	\$ -	-	\$ -	\$ 3,633,868	\$ -	\$ (1,933,923)	\$ 1,757,054

(See accompanying notes to the consolidated financial statements)

Tapinator, Inc.
Consolidated Statements of Cash Flows

	Year Ended December 31,	
	2015	2014
Cash flows from operating activities		
Net (loss) income	\$ (1,924,008)	\$ 7,892
Adjustments to reconcile net (loss) income to net cash provided by		
Amortization of capitalized software development	753,882	38,421
Depreciation and amortization of other assets	41,792	1,395
Amortization of debt discount	806,450	37,500
Amortization of original issue discount	88,422	6,403
Stock based compensation	36,456	-
Impairment of capitalized software	584,479	-
Changes in operating assets and liabilities:		
Accounts receivable, net	(298,884)	(96,483)
Due from related parties	-	9,790
Prepaid expenses	(54,589)	-
Security deposits	5,788	(14,150)
Accounts payable and accrued expenses	140,106	32,469
Interest on promissory notes	148,644	9,538
Due to related parties	(28,687)	103,516
Net cash provided by operating activities	<u>299,851</u>	<u>136,291</u>
Cash flows from investing activities		
Capitalized software development costs	(824,429)	(422,568)
Purchase of property, plant and equipment	(10,272)	(16,737)
Reimbursement of leasehold improvements	10,800	-
Investments	-	(19,086)
Net cash (used in) investing activities	<u>(823,901)</u>	<u>(458,391)</u>
Cash flows from financing activities		
Issuance of promissory notes	2,000,000	205,000
Purchase of promissory notes	-	111,422
Stock subscriptions	-	115,000
Capitalized financing costs	(110,494)	-
Net cash provided by financing activities	<u>1,889,506</u>	<u>431,422</u>
Net change to cash and cash equivalents	1,365,456	109,322
Cash and cash equivalents at beginning of period	121,740	12,418
Cash and cash equivalents at end of period	<u>\$ 1,487,196</u>	<u>\$ 121,740</u>
Non-cash investing and financing activities		
Redeemable preferred stock conversion	<u>\$ -</u>	<u>\$ 876,718</u>
Common stock issued for convertible notes payable	<u>\$ 393,556</u>	<u>\$ -</u>
Supplemental disclosure of cash flow information:		
Cash paid for interest	<u>\$ 105,968</u>	<u>\$ -</u>
Cash paid for taxes	<u>\$ 1,222</u>	<u>\$ 613</u>

(See accompanying notes to the consolidated financial statements)

Tapinator, Inc.
Notes to Consolidated Financial Statements

NOTE 1 — ORGANIZATION AND DESCRIPTION OF BUSINESS

Tapinator, Inc. (“Tapinator” or the “Company”) designs, develops, and publishes mobile games on the iOS, Google Play, and Amazon platforms. Tapinator's owned and operated portfolio includes over 200 mobile gaming titles that have achieved over 190 cumulative million downloads, primarily within the Simulation, Arcade, Role Playing, Casino and Sports genres. A number of these titles have risen to the top of the mobile leaderboard charts and have been featured by the Apple, Google, and Amazon App Stores. Tapinator generates revenues through the sale of advertisements within its games, the sale of paid downloadable games, and the sale of additional in-game content within its games. Founded in 2013, Tapinator is headquartered in New York, with product development teams located in Denmark, Pakistan, Indonesia, Canada, and the United States.

The Company was originally incorporated on December 9, 2013 in the state of Delaware. On December 12, 2013, the Company merged with Tapinator, Inc., a Nevada Corporation. The Company was the surviving corporation from this merger. On June 16, 2014, the Company executed a securities exchange agreement with the members of Tapinator LLC, a New York limited liability company, whereby the Company issued 36,700,000 shares of its common stock (representing 80% of its then common stock outstanding after giving effect to the transaction) to the members of Tapinator LLC in exchange for 100% of the outstanding membership interests of Tapinator LLC. The transaction resulted in a business combination and a change of control within its business purpose.

For accounting and financial reporting purposes, Tapinator LLC was considered the acquirer and the transaction was treated as a reverse merger. All financial information presented for periods prior to the merger reflects only that of Tapinator LLC, and does not reflect the pre-merger Tapinator, Inc. assets, liabilities, or operating results. In addition, all share, per share and related Tapinator LLC information have been retrospectively adjusted to take into account the merger.

NOTE 2 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation and Consolidation

The accompanying consolidated financial statements and related notes have been prepared in conformity with United States generally accepted accounting principles (“GAAP”). The consolidated financial statements include the operations of the Company and its wholly-owned subsidiaries, Tapinator LLC and Tapinator IAF, LLC. All significant intercompany balances and transactions have been eliminated in consolidation.

Use of estimates

The preparation of financial statements in conformity with 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 as well as the reported amount of revenues and expenses during the reporting period. Actual results could differ from these estimates. Significant estimates include assumptions used in the fair value of revenue recognition, platform and advertising fees and related costs of revenue, long-lived assets, stock-based compensation, and the fair value of other equity and debt instruments.

Revenue Recognition

The Company derives revenue from the three gaming platforms on which it currently markets its mobile games in the form of paid downloads of its games and the sale of additional in-game content; and from various advertising networks in the form of advertising placements within its mobile games. The Company recognizes revenue when all of the following conditions are satisfied: there is persuasive evidence of an arrangement; the service is delivered to the player; the collection of fees is reasonably assured; and the amount of fees to be paid by the player is fixed or determinable.

The Company recognizes mobile game revenue based on the gross amount paid by the player because the Company is the primary obligor and has the contractual right to determine the price to be paid by the player. The Company records the related platform fees and advertising network revenue share as expenses in the period incurred.

Tapinator, Inc.
Notes to Consolidated Financial Statements

NOTE 2 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Revenue Recognition (continued)

In accordance with Accounting Standards Codification Topic (“ASC”) 605-45, *Revenue Recognition: Principal Agent Considerations*, the Company evaluates its agreements with the gaming platforms and ad networks in order to determine whether or not it is acting as the principal or as an agent when selling its games or when selling advertisements within its games, which it considers in determining if revenue should be reported gross or net. Key indicators that the Company evaluates to reach this determination include:

- the terms and conditions of the Company’s contracts with the gaming platforms and ad networks;
- the party responsible for determining the type, category and quantity of the methods to generate game revenue;
- whether the Company is paid a fixed percentage of the arrangement’s consideration or a fixed fee for each game, transaction, or advertisement;
- the party which sets the pricing with the end-user, and has the credit and inventory risk; and
- the party responsible for the fulfillment of the game or serving of advertisements and that determines the specifications of the game or advertisement.

Based on the evaluation of the above indicators, the Company has determined that it is generally acting as a principal and is the primary obligor to end-users for its games distributed on the gaming platforms and for advertisements served by the ad networks. Therefore, the Company recognizes revenue related to these arrangements on a gross basis, when the necessary information about the gross amounts or platform fees charged, before any adjustments, are made available by the gaming platforms and ad networks.

Accounts Receivable and Allowance for Doubtful Accounts

The Company monitors outstanding receivables based on factors surrounding the credit risk of specific customers, historical trends, and other information. The allowance for doubtful accounts is estimated based on an assessment of the Company’s ability to collect on customer accounts receivable. There is judgment involved with estimating the allowance for doubtful accounts and if the financial condition of the Company’s customers were to deteriorate, resulting in their inability to make the required payments, the Company may be required to record additional allowances or charges against revenues. The Company writes-off accounts receivable against the allowance when it determines a balance is uncollectible and no longer actively pursues its collection. As of December 31, 2015 and 2014, based upon the review of the outstanding accounts receivable, the Company has determined that an allowance for doubtful accounts is not required.

Cash Equivalents

For purposes of the Statements of Cash Flows, the Company considers all highly liquid investments purchased with an original maturity date of three months or less to be cash equivalents.

Concentrations of Credit Risk

Financial instruments and related items which potentially subject the Company to concentrations of credit risk consist primarily of cash, cash equivalents and trade receivables. The Company places its cash and temporary cash investments with credit quality institutions. At times, such investments may be in excess of the FDIC insurance limit. As of December 31 2015, the total amount exceeding was \$925,702.

The Company derives revenue from gaming platforms and advertising networks which individually may contribute 10% or more of the Company’s revenues in any given year. For the year ended December 31, 2015, revenue derived from four advertising networks comprised 72% of such period’s total revenue. For the year ended December 31, 2014 revenue derived from one gaming platform and two advertising networks comprised 77% of such period’s total revenue. As of December 31, 2015 and 2014, the receivable balances from two advertising networks comprised 69% and 79% of the Company’s total accounts receivable balances, respectively.

Tapinator, Inc.
Notes to Consolidated Financial Statements

NOTE 2 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Property and Equipment

Property and equipment are stated at cost. When retired or otherwise disposed, the related carrying value and accumulated depreciation are removed from the respective accounts and the net difference, less any amount realized from disposition, is reflected in earnings. Property and equipment are depreciated using the straight-line method over their estimated useful lives as follows:

Computer equipment	3 years
Furniture and fixtures	5 years
Leasehold improvements	remaining term of lease

Capitalized Software Development Costs

In accordance with ASC 985-20, "Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed," the Company capitalizes certain costs related to the development of new software products or the enhancement of existing software products for use in our product offerings. These costs are capitalized from the point in time that technological feasibility has been established, as evidenced by a working model or detailed working program design to the point in time that the product is available for general release to customers. Capitalized development costs are amortized on a straight-line basis over the estimated economic lives of the products, beginning when the product is placed into service.

Research and development costs incurred prior to establishing technological feasibility are charged to expense as incurred. The Company periodically evaluates whether events or circumstances have occurred that indicate that the remaining useful lives of the capitalized software development costs should be revised or that the remaining balance of such assets may not be recoverable.

Impairment of Long-lived Assets

The Company regularly reviews property, equipment, software development costs and other long-lived assets for possible impairment. This review occurs annually or more frequently if events or changes in circumstances indicate the carrying amount of the asset may not be recoverable. The carrying amount of a long-lived asset is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset. Based upon management's assessment, there were no indicators of impairment of the Company's property, equipment and software development costs during the periods ended December 31, 2014. During the fourth quarter of 2015, the Company determined that its mini-game software development assets were substantially impaired, and that the remaining balance of such assets were likely unrecoverable. In accordance with ASC 985-20, the carrying value of these assets were reduced to zero as of December 31, 2015.

In general, investments in which the Company owns less than 20 percent of an entity's equity interest or does not hold significant influence over the investee are accounted for under the cost method. Under the cost method, these investments are carried at the lower of cost or fair value. The Company periodically assesses its cost method investments for impairment. If determination that a decline in fair value is other than temporary, the Company will write-down the investment and charge the impairment against operations. At December 31, 2015 and 2014, the carrying value of two investments totaling \$19,086 were recorded at their original cost.

Derivative Instrument Liability

The Company accounts for derivative instruments in accordance with ASC 815, *Derivatives and Hedging*, which establishes accounting and reporting standards for derivative instruments and hedging activities, including certain derivative instruments embedded in other financial instruments or contracts, and requires recognition of all derivatives on the balance sheet at fair value, regardless of hedging relationship designation. Accounting for changes in fair value of the derivative instruments depends on whether the derivatives qualify as hedge relationships and the types of relationships designated are based on the exposures hedged. At December 31, 2015 and 2014, the Company did not have any derivative instruments that were designated as hedges.

Tapinator, Inc.
Notes to Consolidated Financial Statements

NOTE 2 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Fair Value of Financial Instruments

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date. Assets and liabilities that are measured at fair value are reported using a three-level fair value hierarchy that prioritizes the inputs used to measure fair value. This hierarchy maximizes the use of observable inputs and minimizes the use of unobservable inputs. The three levels of inputs used to measure fair value are as follows:

- Level 1 – Unadjusted quoted prices in active markets that are accessible at the measurement date of identical, unrestricted assets or liabilities.
- Level 2 – Quoted prices in markets that are not active, or inputs that are observable, either directly or indirectly, for substantially the full term of the asset or liability; and
- Level 3 – Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (supported by little or no market activity).

As of December 31, 2015 and 2014, the Company did not identify any non-recurring assets and liabilities that are required to be presented in the balance sheets at fair value in accordance with ASC 825, *Financial Instruments*.

Cost of Revenue (excluding amortization of software development costs)

Cost of revenue includes primarily platform and advertising network fees, licensing costs and hosting fees. The Company, along with all mobile application publishers, is required to pay platform fees to Apple, Google and Amazon equal to approximately 30% of gross revenue. The Company is also required to pay a revenue share of approximately 30% to advertising networks and similar service providers.

Marketing and Public Relations

The Company follows the policy of charging the costs of marketing, and public relations to expense as incurred. Such costs were \$216,166 and \$22,938 for the years ended December 31, 2015 and 2014, respectively.

Income Taxes

The Company accounts for income taxes pursuant to the asset and liability method under ASC 740, *Income Taxes*, which requires deferred income tax assets and liabilities to be computed annually for temporary differences between the financial statement and tax bases of assets and liabilities that will result in taxable or deductible amounts in the future based on enacted laws and rates applicable to the periods in which the temporary differences are expected to affect taxable income. Valuation allowances are established when necessary to reduce deferred tax assets to the amounts expected to be realized.

Prior to June 2014, Tapinator LLC had elected to be treated under the Internal Revenue Code as a Limited Liability Company. As such, the Company's taxable income or loss was allocated to its members in accordance with their respective percentage ownership. In accordance with the share exchange agreement, the Company is treated under the Internal Revenue Code as a C-Corporation.

The Company recognizes a tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by taxing authorities, based on the technical merits of the position. The tax benefits recognized in the consolidated financial statements from such a position are measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. As of December 31, 2015 and 2014, the Company had not recorded any unrecognized tax benefits.

Tapinator, Inc.
Notes to Consolidated Financial Statements

NOTE 2 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Stock-Based Compensation

The Company measures the fair value of stock-based compensation issued to non-employees using the stock price observed in the arms-length private placement transaction nearest the measurement date (for stock transactions), or the fair value of the award (for non-stock transactions), which are considered to be more reliably determinable measures of fair value than the value of the services being rendered. The measurement date is the earlier of (1) the date at which commitment for performance by the counterparty to earn the equity instruments is reached, or (2) the date at which the counterparty's performance is complete.

Basic and Diluted Net Income (Loss) per Share Calculations

Net income (loss) per share is shown under two calculations -- basic and diluted. Basic net income (loss) per share is computed by dividing income available to common shareholders by the weighted-average number of common shares available. Diluted net income (loss) per share is computed similar to basic earnings per share except that the denominator is increased to include the number of additional common shares that would have been outstanding if the potential common shares had been issued and if the additional common shares were dilutive.

For the year ended December 31, 2015, potentially dilutive securities excluded from the computation of basic and diluted net income (loss) per share include 10,926,829 potentially convertible shares related to the senior secured debentures and 21,853,658 common stock warrants. For the year ended December 31, 2014, potentially dilutive securities excluded from the computation of basic and diluted net income (loss) per share include 668,750 potentially convertible shares related to the convertible promissory notes.

Reclassification

Certain reclassifications have been made to the prior years' data to conform to the current year presentation. These reclassifications had no effect on reported income (losses).

Recent Accounting Pronouncements

In April 2015, the Financial Accounting Standards Board ("FASB") issued ASU 2015-03, *Simplifying the Presentation of Debt Issuance Costs*, ("the Update") as part of its initiative to reduce complexity in accounting standards (the Simplification Initiative). The FASB received feedback that having different balance sheet presentation requirements for debt issuance costs and debt discount and premium creates unnecessary complexity. Recognizing debt issuance costs as a deferred charge (that is, an asset) also is different from the guidance in International Financial Reporting Standards, which requires that transaction costs be deducted from the carrying value of the financial liability and not recorded as separate assets. Additionally, the requirement to recognize debt issuance costs as deferred charges conflicts with the guidance in FASB Concepts Statement No. 6, *Elements of Financial Statements*, which states that debt issuance costs are similar to debt discounts and in effect reduce the proceeds of borrowing, thereby increasing the effective interest rate. Concepts Statement 6 further states that debt issuance costs cannot be an asset because they provide no future economic benefit. To simplify presentation of debt issuance costs, the amendments in the Update require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected by the amendments in the Update. For public business entities, the amendments in the Update are effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. The Company is currently evaluating the applicability of the Update.

In August 2014, FASB issued ASU 2014-15, *Presentation of Financial Statements Going Concern*, which provides guidance to reduce diversity in the timing and content of footnote disclosures. The amendment requires management to assess the Company's ability to continue as a going concern by incorporating and expanding upon certain principles that are currently in U.S. auditing standards. The Company has to define the term of substantial doubt, which has to be evaluated every reporting period including interim periods. Management has to provide principles for considering the mitigating effect of its plan, and disclose when substantial doubt is alleviated as well as when it is not alleviated. The

Tapinator, Inc.
Notes to Consolidated Financial Statements

NOTE 2 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Recent Accounting Pronouncements (continued)

Company is required to assess management's plan for a period of one year after the financial statements are issued (or available to be issued). The amendment is effective for annual periods ending after December 15, 2016. Early adoption is permitted. The Company is currently assessing the impact of implementing the new guidance. In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, which creates ASC 606, *Revenue from Contracts with Customers*, and supersedes the revenue recognition requirements in ASC 605, *Revenue Recognition*, including most industry-specific revenue recognition guidance throughout the Industry Topics of the Codification. In addition, ASU 2014-09 supersedes the cost guidance in Subtopic 605-35, *Revenue Recognition—Construction-Type and Production-Type Contracts*, and creates new Subtopic 340-40, *Other Assets and Deferred Costs—Contracts with Customers*. In summary, the core principle of ASC 606 is to recognize revenue when promised goods or services are transferred to customers in an amount that reflects the consideration that is expected to be received for those goods or services. The amendments in ASU 2014-09 are effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period, and early application is not permitted. Therefore, the amendments in ASU 2014-09 will become effective for the Company as of the beginning of the 2017 fiscal year. The Company is currently assessing the impact of adoption.

Management does not believe that any other recently issued, but not yet effective, accounting standards if currently adopted would have a material effect on the accompanying consolidated financial statements.

NOTE 3 — PROPERTY AND EQUIPMENT

Property and equipment consisted of the following as of December 31, 2015 and 2014:

	2015	2014
Leasehold improvements	\$ 1,144	\$ 11,944
Furniture and fixtures	7,338	4,793
Computer equipment	10,011	2,285
Property and equipment, cost	18,493	19,022
Less: accumulated depreciation	(4,779)	(1,522)
Property and equipment, net	<u>\$ 13,714</u>	<u>\$ 17,500</u>

During the years ended December 31, 2015 and December 31, 2014, depreciation and amortization expense was \$3,257 and \$1,395, respectively.

NOTE 4—CAPITALIZED SOFTWARE DEVELOPMENT

Capitalized software development costs at December 31, 2015 and 2014 were as follows:

	2015	2014
Mini-game software development assets (a)	\$ -	\$ 876,718
Other internally developed software (b)	1,246,997	422,568
Capitalized software development, cost	1,246,997	1,299,286
Less: accumulated amortization	(500,061)	(38,421)
Capitalized software development, net	<u>\$ 746,936</u>	<u>\$ 1,260,865</u>

- (a) In October 2014, the Company purchased the mini-game software development business from a related party (the "Minigame Acquisition"). The purchase consideration included the assumption of secured promissory notes in the aggregate amount of \$153,677 and the issuance of Tapinator IAF, LLC Series A Redeemable Preferred Stock with potential future redemption value of \$773,499 (see Note 9 below). For accounting purposes, the Minigame Acquisition was recorded as an asset acquisition as there was not sufficient continuity of the acquired entity's

Tapinator, Inc.
Notes to Consolidated Financial Statements

NOTE 4—CAPITALIZED SOFTWARE DEVELOPMENT (continued)

operations prior to and after the transaction to qualify as a business. During the fourth quarter of 2015, the Company determined that the mini-game software development assets were substantially impaired, and that the remaining balance of such assets were likely unrecoverable. In accordance with ASC 985-20, the carrying value of these assets were fully impaired as of December 31, 2015. The Company had previously recorded charges to operations related to the amortization of the mini-game software, prior to the impairment, of \$292,242 and recorded an impairment charge of \$584,479 during the quarter ended December 31, 2015. At December 31, 2015 and 2014, the carrying value of software under development but not yet released to customers totaled \$159,701 and \$222,675, respectively.

- (b) During the years ended December 31, 2015 and 2014, amortization expense was \$461,640 and \$38,421, respectively.

NOTE 5 — NOTES PAYABLE TO RELATED PARTIES

Related party notes payable as of December 31, 2015 and 2014 were comprised of the following:

	2015	2014
Convertible promissory note (a) (d)	\$ -	\$ 150,000
Secured promissory notes (b)	-	153,677
Royalty notes payable (c)	-	55,000
Accrued interest	-	17,818
Total notes payable	-	376,495
Less:		
Debt discount – beneficial conversion feature	-	(112,500)
Debt discount – original issue discount	-	(60,041)
Notes payable to related parties, net	<u>\$ -</u>	<u>\$ 203,954</u>

- (a) In September 2014, the Company issued a \$150,000 convertible promissory note bearing interest at 10% per year to a shareholder. This note was originally due and payable on October 1, 2015, at which time any outstanding unpaid balance would be converted into the Company's common stock at a conversion price equal to 80% of the volume weighted average closing price of the common stock during the ten trading days prior to the conversion date, with a minimum price of \$0.25, and a maximum price of \$1.00. The Company recognized an embedded beneficial conversion feature of \$150,000, which was recorded as a debt discount (to be amortized over the life of the note) and as an increase to additional paid-in capital as of the issuance date. In April 2015, pursuant to a letter of acknowledgement received by the Company from the holder, such note was restated into two separate convertible promissory notes of \$75,000 each, issued to both the original note holder and to another shareholder, with same terms as the original note. In June 2015, the two notes, after certain subsequent assignments, were each converted into 300,000 shares of the Company's common stock. On the conversion date, unamortized debt discount of \$46,250 was accelerated, \$11,028 of accrued interest was waived, and the notes were deemed paid in full.
- (b) In October 2014, as part of the consideration of the Minigame Acquisition, the Company assumed \$95,513 of promissory notes – representing face value of \$153,677, plus accrued interest of \$8,280, less unamortized original issuance discount of \$66,444 – bearing interest at the rate of 13% through maturity, and secured by substantially all of the acquired software minigame assets. In June 2015, pursuant to conversion agreements between the Company and the note holders, such notes were converted into 423,893 shares of Common Stock. The combined principal balance plus accrued interest of the notes on the date of conversion was \$127,168.
- (c) In December 2014, in exchange for \$110,000 of proceeds, the Company sold a 12.5% royalty interest in the net revenues, as defined in the royalty agreements, to be generated by one of its original, full-featured games to two separate investors (6.25% was sold to each investor at \$55,000), one of which is a shareholder, and the other a related entity of another shareholder. In March 2015, the royalty agreement of the entity related to a shareholder

Tapinator, Inc.
Notes to Consolidated Financial Statements

NOTE 5 — NOTES PAYABLE TO RELATED PARTIES (continued)

was cancelled. No royalties had been earned or paid prior to cancellation. The royalty purchase amounts made prior to cancellation of \$30,000 were reclassified as a convertible promissory note paying simple interest at the rate of 10% per year and maturing in March 2016. In June 2015, this note was converted into 149,146 shares of the Company's common stock. The principal balance plus accrued interest on the date of conversion was \$30,575. In June 2015, the royalty agreement of the shareholder was forgiven and cancelled. No royalties had been earned or paid prior to cancellation.

- (d) During 2015, the Company issued convertible promissory notes to a shareholder totaling a principal amount of \$23,950, paying simple interest at the rate of 10% per year and maturing in March 2016. In June 2015, these notes were converted into 117,981 shares of the Company's common stock. The principal balance plus accrued interest on the date of conversion was \$24,186.

NOTE 6 — RELATED PARTY TRANSACTIONS

The Company utilizes the services of two affiliated entities of an officer and major shareholder for the development of certain of its mobile games. Amounts incurred by the Company for such development services, which were primarily related to capitalized software development costs, for the years ended December 31, 2015 and 2014 were \$641,215 and \$333,731, respectively. As of December 31, 2015 and 2014, the Company had balances due to related parties related primarily to the software development services of \$104,605 and \$129,327, respectively.

In July 2014, the Company purchased promissory notes with a principal amount of \$91,000 plus accrued interest of \$20,422 with a related party in exchange for 334,266 shares of the Company's common stock. Concurrent with this transaction, the Company entered into a services agreement with this related party whereby the Company received mobile game development services in exchange for (i) waiving of interest payments on the purchased notes, and (ii) a development fee of \$180,000. Such development fee was offset against the outstanding balance on the notes and other loans extended to this related party. At December 31, 2014, the development fee was fully paid and the outstanding balance on the notes was zero.

NOTE 7 — COMMITMENTS AND CONTINGENCIES

In November 2014, the Company entered into a lease for office space which expires in November 2017. Future minimum lease payments under this lease are as follows:

Year ended December 31,	
2016	\$ 61,769
2017	58,080
Total	<u>119,849</u>

For the years ended December 31, 2015 and 2014, rent expense totaled \$56,160 and \$36,446 and respectively.

NOTE 8 — SENIOR SECURED CONVERTIBLE DEBENTURE

In June 2015, the Company raised \$2.0 million through the sale of a \$2.24 million 8% senior secured convertible debenture due January 1, 2017 with an initial conversion price of \$0.205 per share. The conversion price is adjustable for any subsequent equity transactions with an effective price per share lower than the conversion price, but not lower than \$0.10 per share. The secured convertible debenture has periodic redemption amounts of \$560,000 on July 1, 2016 and October 1, 2016, respectively with the remainder due on January 1, 2017. In addition, five-year Series A warrants were issued to purchase 10.9 million shares at an exercise price of \$0.30 per share, and five-year Series B callable warrants were issued to purchase 10.9 million shares at an exercise price of \$0.30 per share, which are exercisable only upon a payment default. The conversion price is adjustable for any subsequent equity transactions with an effective price per share lower than the conversion price, but not lower than \$0.10 per share. The debenture is collateralized by a first security interest in all assets of the Company and its subsidiaries. Additionally, certain officers, directors and other affiliates of the Company have pledged 29 million shares as security for the debenture.

Tapinator, Inc.
Notes to Consolidated Financial Statements

NOTE 8 — SENIOR SECURED CONVERTIBLE DEBENTURE (continued)

The Company recognized an embedded beneficial conversion feature of \$2.0 million, which was recorded as a debt discount to be amortized over the life of the note. During the year ended December 31, 2015, \$693,950 was charged to interest expense as amortization of the debt discount related to the senior secured convertible debenture. During the year ended December 31, 2015 the company capitalized \$110,494 in finance fees related to convertible debenture. The related amortization expense charge for the year was \$38,535.

We evaluated the financing transactions in accordance with ASC 470, *Debt with Conversion and Other Options*, and determined that the conversion feature of the convertible promissory note was afforded the exemption for a conventional convertible instrument due to the floor on its conversion rate. The note has an explicit limit on the number of shares issuable so it meets the conditions set forth in current accounting standards for equity classification. The debt was issued with non-detachable conversion options that are beneficial to the investors at inception, because the conversion option has an effective strike price that is less than the market price of the underlying stock at the commitment date. The accounting for the beneficial conversion feature requires that the beneficial conversion feature be recognized by allocating the intrinsic value of the conversion option to additional paid-in-capital, resulting in a discount on the convertible notes, which will be amortized and recognized as interest expense.

Senior secured convertible debenture payable as of December 31, 2015 and December 31, 2014 were comprised of the following:

	<u>2015</u>	<u>2014</u>
Principal balance outstanding	\$ 2,240,000	\$ -
Less:		
Debt discount – beneficial conversion feature	(1,306,050)	-
Debt discount – original issue discount	(151,578)	-
Principal balance outstanding, net	<u>\$ 782,372</u>	<u>\$ -</u>

NOTE 9 — REDEEMABLE PREFERRED STOCK

In October 2014, as part of the consideration of the Minigame Acquisition previously discussed in Note 4 above, the Company issued Series A Redeemable Preferred Stock with a par value of \$1.00 per share and a potential future redemption value of \$773,499 (the “TapIAF Preferred Stock”) in Tapinator IAF, LLC, a newly created subsidiary, to the equity holders of the selling company, a related party. In June 2015, pursuant to conversion agreements between the Company and the shareholders of the TapIAF Preferred Stock, all TapIAF Preferred Stock was exchanged for 257,833 shares of the Company’s common stock. Accordingly, as of December 31, 2015, there was no TapIAF preferred stock outstanding.

Prior to such conversion, since there was limited trading volume of the Company’s common stock, the Company determined that the variable conversion provisions embedded in the Redeemable Series A Preferred Stock did not meet the defined criteria of a derivative in such that the net settlement requirement of delivery of common shares does not meet the “readily convertible to cash” requirement as described in ASC 815 and therefore bifurcation is not required.

NOTE 10 — STOCKHOLDERS’ EQUITY

At December 31, 2015, the authorized capital of the Company consisted of 150,000,000 shares of common stock, par value \$0.001 per share, and 1,532,500 shares of blank check preferred stock.

In August 2015, the Company retained the services of a consultant whose compensation included a restricted stock grant of 300,000 shares of the Company’s common stock valued at \$57,000 on the date of grant which was partially amortized over the twelve-month term of the service agreement during 2015.

In July 2015, the Company received a majority written consent of the shareholders to amend the Company’s Certificate of Incorporation to delete the previously approved series of preferred stock designations of the Company, none of

Tapinator, Inc.
Notes to Consolidated Financial Statements

NOTE 10 — STOCKHOLDERS' EQUITY (continued)

which had any shares issued or outstanding as of June 30, 2015. In July 2015, the Company filed a Restated Certificate of Incorporation thereby deleting the previously approved series of preferred stock designations.

In June 2015, the Company issued 246,815 shares of common stock pursuant to the conversion terms of a convertible promissory note. The principal balance plus accrued interest on the date of conversion was \$50,597.

In June 2015, the Company issued 1,291,020 shares of common stock pursuant to the conversion terms of related party convertible promissory notes. The principal balance plus accrued interest on the date of conversion was \$342,959. See Note 5 for additional disclosures.

In June 2015, all 10,000 shares of Series B preferred stock, \$0.001 par value, were converted into 36,764 shares of the Company's common stock.

In April 2015, the Company retained the services of a consultant in exchange for 45,000 restricted shares of the Company's common stock valued at \$13,500 on the date of grant which was fully amortized over the six-month term of the service agreement during 2015.

In August through December 2014, all 885,500 shares of Series D preferred stock, \$1.00 par value, were converted into 5,749,233 shares of restricted common stock.

In July 2014, all 461,100 shares of Series C preferred stock, \$1.00 par value, were converted into 3,074,000 shares of restricted common stock.

In July 2014, the Company issued 334,266 shares of restricted common stock to purchase the debt obligations owed to the note holders of a related party.

NOTE 11— INCOME TAXES

As of December 31, 2015, the Company has federal net operating loss carryforwards ("NOL's") of approximately \$1,600,000 that will be available to reduce future taxable income, if any. These NOL's begin to expire in 2034. Sections 382 and 383 of the Internal Revenue Code of 1986, as amended, provide for annual limitations on the utilization of net operating loss and credit carryforwards if the Company were to undergo an ownership change, as defined in Section 382 of the Code. In general, an ownership change occurs whenever the percentage of the shares of a corporation owned, directly or indirectly, by 5-percent shareholders, as defined in Section 382 of the Code, increases by more than 50 percentage points over the lowest percentage of the shares of such corporation owned, directly or indirectly, by such 5-percent shareholders at any time over the preceding three years. In the event such ownership change occurs, the annual limitation may result in the expiration of the net operating losses prior to full utilization.

The Company performs an analysis each year to determine whether the expected future income will more likely than not be sufficient to realize the deferred tax assets. No tax benefit has been reported in the financial statements, since the potential tax benefit is offset by a valuation allowance of the same amount.

As of December 31, 2015, open tax years include the period from July 1, 2013 (inception) through December 31, 2015.

The Company applies the standard relating to accounting (ASC 740-10) for uncertainty in income taxes, which prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The Company is required to recognize in the financial statements the impact of a tax position, if that position is more likely than not of being sustained on audit, based on the technical merits of the position. There were no significant unrecognized tax benefits recorded as of December 31, 2015 and 2014.

Tapinator, Inc.
Notes to Consolidated Financial Statements

NOTE 12 — WARRANTS

During the year ended December 31, 2015, the Company granted warrants in connection with the senior secured convertible debentures as disclosed in Note 8. The warrant terms are 5 years expiring on June 19, 2020.

	2015		2014	
	Number of Warrants	Weighted average exercise price	Number of Warrants	Weighted average exercise price
Outstanding, January 1,	-	\$ -	-	\$ -
Granted (a)	21,853,658	0.30	-	-
Exercised	-	-	-	-
Expired	-	-	-	-
Outstanding, December 31,	<u>21,853,658</u>	<u>\$ 0.30</u>	<u>-</u>	<u>\$ -</u>
Exercisable at the end of period (a)	<u>10,926,829</u>	<u>\$ 0.30</u>	<u>-</u>	<u>-</u>

(a) 10,926,829 warrants are exercisable only upon a payment default of the convertible debenture described in Note 8.

NOTE 13 – EQUITY INCENTIVE PLAN

In December 2015, the Company approved the 2015 Equity Incentive Plan (the “Plan”). The Plan provides for the grant of incentive stock options, non-statutory stock options, restricted stock awards, restricted stock unit awards, performance stock awards and other stock-based awards (collectively, “Stock Awards”). Under the Plan, the Company may grant Stock Awards to its employees, directors and consultants of up to 6,000,000 shares of common stock.

The Board or a duly appointed committee thereof may suspend or terminate the Plan at any time. No rights may be granted under the Plan while it is suspended or after it is terminated. The Board or a duly appointed committee thereof may amend or modify the Plan at any time, subject to any required stockholder approval.

NOTE 14—SUBSEQUENT EVENTS

Management has evaluated subsequent events in accordance with the requirements of ASC 855, *Subsequent Events*, and has determined that there are the following subsequent events that require disclosure:

In January 2016 and pursuant to the 2015 Equity Incentive Plan, the Company granted a member of the Company’s Board of Directors an option to purchase 300,000 shares of the Company’s common stock at an exercise price equal to \$0.33 per share. Such option shall vest in eight quarterly installments of 37,500 shares at the end of each quarterly anniversary of the grant date, contingent upon the continual service as a member of the Board of Directors as of each vesting installment date.