

Condensed Consolidated Financial Statements

Tapinator, Inc.

Quarter Ended March 31, 2017

Tapinator, Inc.
Condensed Consolidated Financial Statements
Three months ended March 31, 2017
(Unaudited)

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Tapinator, Inc.
Condensed Consolidated Balance Sheets

	<u>March 31, 2017</u>	<u>December 31, 2016</u>
Assets		
Current assets:		
Cash and cash equivalents	\$ 479,565	\$ 590,461
Accounts receivable	339,423	326,607
Prepaid expenses	95,674	53,089
Total current assets	<u>914,662</u>	<u>970,157</u>
Property and equipment, net	21,839	20,429
Software development costs, net	1,256,765	1,174,377
Investments	5,000	5,000
Security deposits	22,698	22,698
Total assets	<u>\$ 2,220,964</u>	<u>\$ 2,192,661</u>
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable and accrued expenses	\$ 148,775	\$ 165,744
Due to related parties	37,042	89,697
Deferred Revenue	241,453	85,402
Accrued interest	143,640	95,760
Senior convertible debenture, net of debt discount	385,836	158,682
Total current liabilities	<u>956,746</u>	<u>595,285</u>
Senior convertible debenture, net of debt discount	<u>578,755</u>	<u>476,045</u>
Total Liabilities	<u>1,535,501</u>	<u>1,071,330</u>
Commitments and Contingencies		
Stockholders' equity:		
Preferred stock, \$0.001 par value; 1,532,500 shares authorized within any series of designation	-	-
Series A convertible preferred stock, \$0.001 par value; 840 and 0 shares designated at March 31, 2017 and December 31, 2016 respectively; 420 and 0 shares issued and outstanding at March 31, 2017 and December 31, 2016, respectively	1	1
Common stock, \$0.001 par value; 150,000,000 shares authorized; 57,292,637 and 56,959,303 shares issued and outstanding at March 31, 2017 and December 31, 2016, respectively	57,293	56,959
Additional paid-in capital	5,462,972	5,344,918
Accumulated deficit	(4,834,803)	(4,280,547)
Total stockholders' equity	<u>685,463</u>	<u>1,121,331</u>
Total liabilities and stockholders' equity	<u>\$ 2,220,964</u>	<u>\$ 2,192,661</u>

(See accompanying notes to the unaudited condensed consolidated financial statements)

Tapinator, Inc.
Condensed Consolidated Statements of Operations
(*unaudited*)

	Quarter Ended March 31,	
	2017	2016
Revenue	\$ 812,794	\$ 848,613
Operating expenses		
Cost of revenue excluding depreciation and amortization	256,369	263,738
Research and development	17,052	30,756
Marketing and public relations	178,525	30,701
General and administrative	337,898	308,453
Amortization of software development costs	195,412	188,910
Depreciation and amortization of other assets	5,878	19,162
Total expenses	991,135	841,720
Operating (loss)	(178,341)	6,893
Other expenses		
Amortization of debt discount	229,091	323,843
Interest expense, net	144,674	81,495
Total other expenses	373,765	405,338
(Loss) before income taxes	(552,106)	(398,445)
Income taxes	2,150	4,375
Net (loss)	\$ (554,256)	\$ (402,820)
Net (loss) income per share:		
Basic	(\$0.01)	(\$0.01)
Diluted	(\$0.01)	(\$0.01)
Weighted average common shares outstanding:		
Basic	57,100,044	57,081,281
Diluted	57,100,044	57,081,281

(See accompanying notes to the unaudited condensed consolidated financial statements)

Tapinator, Inc.
Condensed Statement of Stockholders' Equity
(*unaudited*)

	Common Stock		Series A Preferred Stock		Series B Preferred Stock		Additional	Accumulated	
	Shares	Amount	Shares	Amount	Shares	Amount	Paid-In-Capital	Deficit	TOTAL
Balances at December 31, 2016	56,959,303	\$ 56,959	420	\$ 1	-	-	\$ 5,344,918	\$ (4,280,547)	\$ 1,121,331
Common shares issued related to stock purchase agreement	333,334	334					99,667		100,001
Stock based compensation							18,388		18,388
Net loss								(554,256)	(554,256)
Balances at March 31, 2017	57,292,637	\$ 57,293	420	\$ 1	-	\$ -	\$ 5,462,973	\$ (4,834,803)	\$ 685,463

(See accompanying notes to the unaudited condensed consolidated financial statements)

Tapinator, Inc.
Condensed Consolidated Statements of Cash Flows
(unaudited)

	Three Months Ended March 31,	
	2017	2016
Cash flows from operating activities:		
Net (loss)	\$ (554,256)	\$ (402,820)
Adjustments to reconcile net (loss) to net cash provided by operating activities:		
Amortization of software development costs	195,412	188,910
Depreciation and amortization of other assets	5,878	19,162
Amortization of debt discount	229,091	323,843
Amortization of original issue discount	97,364	37,895
Stock based compensation	18,388	(28,500)
Accounts receivable	(12,815)	79,591
Prepaid expenses	(42,585)	36,750
Security deposits	-	-
Accounts payable and accrued expenses	30,911	(42,611)
Deferred Revenue	156,051	-
Due to related parties	(52,655)	27,734
Net cash provided by operating activities	<u>70,784</u>	<u>239,954</u>
Cash flows from investing activities:		
Capitalized software development costs	(277,800)	(232,383)
Purchase of property, plant and equipment	(3,880)	(4,998)
Net cash (used in) investing activities	<u>(281,680)</u>	<u>(237,381)</u>
Cash flows from financing activities:		
Proceeds from issuance of common stock	100,000	-
Net cash (used in) provided by financing activities	<u>100,000</u>	<u>-</u>
Net change to cash and cash equivalents	(110,896)	2,574
Cash and cash equivalents at beginning of period	590,461	1,487,196
Cash and cash equivalents at end of period	<u>\$ 479,565</u>	<u>\$ 1,489,770</u>
<i>Supplemental disclosure of cash flow information:</i>		
<i>Cash paid for interest</i>	<u>\$ -</u>	<u>\$ 44,800</u>
<i>Cash paid for taxes</i>	<u>\$ 2,150</u>	<u>\$ 4,375</u>

(See accompanying notes to the unaudited condensed consolidated financial statements)

Tapinator, Inc.
Notes to Condensed Consolidated Financial Statements
(*unaudited*)

NOTE 1 — ORGANIZATION AND DESCRIPTION OF BUSINESS

Tapinator, Inc. (“Tapinator” or the “Company”) develops and publishes mobile games on the iOS, Google Play, and Amazon platforms. Tapinator's portfolio includes over 300 mobile gaming titles that, collectively, have achieved over 400 million player downloads, including games such as ROCKY™, Combo Quest, Video Poker Classic, Solitaire Dash and Burn It Down. Tapinator generates revenues through the sale of branded advertisements, paid downloadable game and premium in-game content. Founded in 2013, Tapinator is headquartered in New York, with product development teams located in Germany, Canada, Russia, Pakistan, Indonesia and throughout 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.

The Company currently develops two types of games. Tapinator’s Rapid-Launch Games are developed and published in significant quantity. These titles that are built rapidly and economically based on a series of internally developed, expandable, and re-useable game engines. The Company’s Full-Featured Games are bespoke products developed and published selectively based on both original and licensed IP. These titles require significant development time and expense and have, in the opinion of management, the potential to become significant and long-lasting mobile game franchises.

NOTE 2 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation and Consolidation

The accompanying unaudited condensed 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, Tap2Play, LLC and Tapinator IAF, LLC. All significant intercompany balances and transactions have been eliminated in consolidation. Certain information and footnote disclosures normally included in audited consolidated financial statements prepared in accordance with GAAP have been condensed or omitted. Accordingly, these interim financial statements should be read in conjunction with the Company’s audited financial statements and related notes as contained in audited financial statements for the year ended December 31, 2016. In the opinion of management, the interim unaudited condensed consolidated financial statements reflect all adjustments, including normal recurring adjustments, necessary for fair presentation of the interim periods presented. The results of the operations for the three months ended March 31, 2017 are not necessarily indicative of the results of operations to be expected for the full year.

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.

Tapinator, Inc.
Notes to Condensed Consolidated Financial Statements
(*unaudited*)

NOTE 2 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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 premium in-game content; and from various advertising networks in the form of branded advertising placements within its mobile games.

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 advertising networks to determine whether it is acting as the principal or as an agent when selling its games or when selling premium in-game content or 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 advertising networks and has the contractual right to determine the price to be paid by the player. 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 advertising networks. The Company records the related platform fees and advertising network revenue share as expenses in the period incurred.

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. For purposes of determining when the service has been provided to the player, we have determined that an implied obligation exists to the paying player to continue displaying the purchased premium in-game content over its estimated life or until it is consumed. Accordingly, we categorize our premium in-game content as either consumable or durable virtual goods. Consumable virtual goods are items consumed at a predetermined time or otherwise have limitations on repeated use, while durable virtual goods are items, such as virtual currency, that remain in the game for as long as the player continues to play. Our revenues from consumable virtual goods have been insignificant since the Company’s formation.

Beginning with the period ended December 31, 2016, we recognize revenue, and the associated costs, from the sale of durable virtual goods ratably over the estimated average playing period of paying players for the applicable game, which represents our best estimate of the average life of durable virtual goods. For the sale of consumable virtual goods, we recognize revenue, and the associated costs, as the goods are consumed. If we do not have the ability to differentiate revenue attributable to durable virtual goods from consumable virtual goods for a specific game, we recognize revenue and the associated costs on the sale of durable and consumable virtual goods for that game ratably over the estimated average period that paying players typically play that game.

Tapinator, Inc.
Notes to Condensed Consolidated Financial Statements
(*unaudited*)

NOTE 2 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Prior to the period ended December 31, 2016, we recognized revenue, and the associated costs, from the sale of all virtual goods at the time of sale. For all fiscal years prior to 2016, we have analyzed the portion of durable virtual goods revenue, and the associated costs, that would have been otherwise deferred using the above revenue recognition policy. We have determined that the effect of such policy would have been immaterial to our reported revenue, net income, and earnings per share results.

On at least a semi-annual basis, we determine the estimated average playing period for paying players by genre across a sample of our games beginning at the time of a player's first purchase in that game and ending on a date when that paying player is no longer playing the game. To determine when paying players are no longer playing a given game, we measure the populations of paying players (the "daily cohort") from the date of their first installation of the game and track each daily cohort to understand the number of players from each daily cohort who played the game after their initial purchase. For titles where we have one or more years of paying players' historical usage data ("Tracked Titles"), we compute a weighted average playing period for paying users using this dataset.

For titles where we have less than one year of paying player data ("New/Untracked Titles"), we use a linear interpolation model on a representative sample of our games within each genre to estimate the average playing period of paying users. Using actual retention data for all players from these games for the period between game installation and up to 90 days thereafter, this data is inputted into a linear interpolation curve to estimate an average playing period for these titles. These calculated curves and their associated one-year average playing periods are mapped against the corresponding curves and associated average one-year playing periods for the Tracked Titles. Based on this mapping, the average playing period of paying users for Tracked Titles is then indexed up or down accordingly, and then applied against the New/Untracked Titles within the sample.

We then compute revenue-based weighted averages of the estimated playing period across all of the games in the sample, by genre, to arrive at the overall weighted average playing period of paying users for each of our major game genres, rounded to the nearest month. In the fourth quarter of 2016, the estimated weighted average life of our durable virtual goods was 14 months for our Casino / Card games, 2 months for our RPG / Arcade games and 2 months for our Rapid Launch / Simulation games. The estimated weighted average life of our durable virtual goods across all of our games was 7 months in the fourth quarter of 2016.

While we believe our estimates to be reasonable based on available game player information and based on the disclosed methodologies of larger publicly reporting mobile game companies, we may revise such estimates in the future based on changes in the operational lives of our games, and based on changes in our ability to make such estimates. Any future adjustments arising from changes in the estimates of the lives of these virtual goods would be applied to the then current quarter, and prospectively on the basis that such changes are caused by new information indicating a change in game player behavior patterns compared to historical titles. Any changes in our estimates of useful lives of these virtual goods may result in revenues being recognized on a basis different from prior periods' and may cause our operating results to fluctuate.

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 March 31, 2017 and December 31, 2016, based upon the review of the outstanding accounts receivable, the Company has determined that an allowance for doubtful accounts is not required.

Tapinator, Inc.
Notes to Condensed Consolidated Financial Statements
(unaudited)

NOTE 2 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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 March 31, 2017, the total amount exceeding was \$112,296.

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 March 31, 2017, revenue derived from four advertising networks comprised 47% of such period's total revenue. For the year ended December 31, 2016 revenue derived from four advertising networks comprised 72% of such period's total revenue.

As of March 31, 2017, and December 31, 2016, the receivable balances from two advertising networks comprised 47% and 46% of the Company's total accounts receivable balances, respectively.

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

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. Software 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.

Prior to March 31, 2016, the Company amortized its Rapid-Launch software development costs over 18-months. After an internal re-assessment of estimated economic lives, the Company discovered that the useful lives and expected revenue life of its Rapid-Launch software surpassed 18 months. Therefore, all new Rapid-Launch software development costs incurred after March 31, 2016 are amortized over 36 months. The software development costs incurred prior to March 31, 2016 will continue to amortize under an 18-month basis until they are fully amortized.

Prior to March 31, 2016, the Company generally amortized its Full-Featured Games software development costs over 18 months. After March 31, 2016, the amortization period of its Full-Featured Games software development costs have been determined based on the lesser of their expected revenue lives or the agreement terms with third party IP licensors, typically from 2 to 5 years. The software development costs incurred prior to March 31, 2016 will continue to amortize under an 18-month basis until they are fully amortized.

Tapinator, Inc.
Notes to Condensed Consolidated Financial Statements
(unaudited)

NOTE 2 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Software Development Costs (continued)

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

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 at December 31, 2016.

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 March 31, 2017 and December 31, 2016, the carrying value of its investments totaled \$5,000 and \$5,000, respectively.

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 March 31, 2017 and December 31, 2016, the Company did not have any derivative instruments that were designated as hedges.

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 March 31, 2017, and December 31, 2016, 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*.

Tapinator, Inc.
Notes to Condensed Consolidated Financial Statements
(unaudited)

NOTE 2 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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.

Stock-Based Compensation

The Company measures the fair value of stock-based compensation issued to employees and 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 outstanding during the period 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 quarter ended December 31, 2016, potentially dilutive securities excluded from the computation of basic and diluted net (loss) per share include 9,576,000 potentially convertible common shares related to the Company's Senior Secured Convertible Debenture, 1,680,000 potentially convertible common shares related to the Company's Series A Preferred Stock, 550,000 Common Stock Options and 11,260,162 Common Stock Warrants.

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 January 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update (ASU) 2016-01, which amends the guidance in U.S. GAAP on the classification and measurement of financial instruments. Changes to the current guidance primarily affect the accounting for equity investments, financial liabilities under the fair value option, and the presentation and disclosure requirements for financial instruments. In addition, the ASU clarifies guidance related to the valuation allowance assessment when recognizing deferred tax assets resulting from unrealized losses on available-for-sale debt securities. The new standard is effective for fiscal years and interim periods beginning after December 15, 2017, and upon adoption, an entity should apply the amendments by means of a cumulative-effect adjustment to the balance sheet at the beginning of the first reporting period in which the guidance is effective. Early adoption is not permitted except for the provision to record fair value changes for financial liabilities under the fair value option resulting from instrument-specific credit risk in other comprehensive income. The Company is currently evaluating the impact of adopting this guidance.

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 Condensed Consolidated Financial Statements
(unaudited)

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. The adoption of the standard did not have a material impact on the Company’s consolidated financial statements.

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 March 31, 2017 and December 31, 2016:

	<u>March 31, 2017</u>	<u>December 31, 2016</u>
Leasehold improvements	\$ 2,435	\$ 2,435
Furniture and fixtures	10,338	8,238
Computer equipment	24,185	22,406
Property and equipment cost	36,958	33,079
Less: accumulated depreciation	(15,119)	(12,650)
Property and equipment, net	<u>\$ 21,839</u>	<u>\$ 20,429</u>

During the three months ended March 31, 2017 and March 31, 2016, depreciation expense was \$2,469 and \$1,467, respectively.

NOTE 4—CAPITALIZED SOFTWARE DEVELOPMENT

Capitalized software development costs at March 31, 2017 and December 31, 2016 were as follows:

	<u>March 31, 2017</u>	<u>December 31, 2016</u>
Software development cost	\$ 2,719,425	\$ 2,441,625
Less: accumulated amortization (a)	(1,462,660)	(1,267,248)
Capitalized software development cost, net	<u>\$ 1,256,765</u>	<u>\$ 1,174,377</u>

(a) During the three months ended March 31, 2017 and March 31, 2016, amortization expense related to capitalized software was \$195,412 and \$188,910, respectively.

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NOTE 5 — RELATED PARTY TRANSACTIONS

The Company utilizes the services of an affiliated entity of a major shareholder for the development of certain of its mobile games. Amounts incurred by the Company for such development services, which were primarily attributed to capitalized software development costs, for the three months ended March 31, 2017 and March 31, 2016 were \$164,598 and \$171,752, respectively. As of March 31, 2017, and December 31, 2016, the Company had balances due to related parties related primarily to the software development services of \$37,043 and \$125,602, respectively

NOTE 6 — SENIOR SECURED CONVERTIBLE DEBENTURE

In July 2016, the Company and the holder of its Senior Secured Convertible Debenture entered into an agreement (the “Exchange Agreement”) to amend and refinance the terms of the \$2,240,000 8% Original Issue Discount Senior Secured Convertible Debenture (the “Original Debenture”) originally issued to the Holder in June, 2015.

In connection with the Original Debenture, the Company and Holder entered into that certain Securities Purchase Agreement, dated June 19, 2015 (the “Purchase Agreement”) pursuant to which the Company issued to the Holder the following (i) the Original Debenture which was convertible into shares of the Company’s common stock at a price per share of \$.205, (ii) Series A Common Stock purchase warrants (the “Series A Warrants”) to purchase up to 10,926,829 shares of common stock with an exercise price of \$.30 and (iii) Series B Common Stock purchase warrants (the “Series B Warrants”) to purchase up to 10,926,829 shares of common stock with an exercise price of \$.30 (collectively, the terms of which are referred to herein as the “Original Financing”). Immediately prior to the Exchange Agreement, the Company owed cash payments to the Holder of \$560,000 on October 1, 2016 and \$1,120,000 on January 1, 2017 under the Original Debenture.

Pursuant to the Exchange Agreement, the following material terms of the Original Financing were amended, altered and/or ratified (collectively, the terms of which are referred to herein as the “New Financing”): (i) the Original Debenture was exchanged in its entirety for the issuance of a new 8% Original Issue Discount Senior Secured Convertible Debenture with an original principal amount of \$2,394,000 and an increased conversion price of \$0.25 (the “New Debenture”), (ii) the issuance of 420 shares of Series A Convertible Preferred Stock (the “Preferred Stock”) as further described by the Certificate of Designation of Preferences, Rights and Limitations of Series A Convertible Preferred Stock which may be converted into 1,680,000 shares of Company’s common stock, (iii) the extension of the maturity date of the Series A Warrants from June 22, 2020 until July 28, 2021, (iv) the cancellation of the Series B Warrants in their entirety, (v) the ratification of the Security Agreement executed by the Company with respect to all of its assets (as required by the initial Purchase Agreement and Original Debenture) as continued collateral for the New Debenture as well as the ratification of the Subsidiary Guarantee and Pledge and Security Agreement as such agreements are referenced in the Purchase Agreement and Exchange Agreement, and (vi) the creation of a new right for the Holder, subject to the written consent of the Company, for a \$2,100,000 cash investment in the Company with identical terms to the New Financing.

The New Debenture requires periodic redemption amounts of \$598,500 due on both November 1, 2017 and February 1, 2018, with the remaining principal balance of \$1,197,000 due on May 1, 2018. Additionally, both the New Debenture and the Preferred Stock contain anti-dilution protection such that the conversion and exercise price, respectively, will be adjusted for any subsequent equity transactions with an effective price per share lower than the conversion price, but not lower than \$0.10 per share.

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NOTE 6 — SENIOR SECURED CONVERTIBLE DEBENTURE (continued)

Senior secured convertible debenture payable as of March 31, 2017 and December 31, 2016 were comprised of the following:

	<u>March 31, 2017</u>	<u>December 31, 2016</u>
Principal balance outstanding	\$ 2,394,000	\$ 2,394,000
Less:		
Debt discount – beneficial conversion feature	(992,727)	(1,221,818)
Debt discount – original issue discount	(421,909)	(519,273)
Debt discount – financing costs	(14,772)	(18,182)
Principal balance outstanding, net	<u>964,592</u>	<u>634,727</u>
Less current portion	<u>385,836</u>	<u>158,682</u>
Long term portion	<u><u>578,755</u></u>	<u><u>476,045</u></u>

NOTE 7 — STOCKHOLDERS' EQUITY

On February 24, 2017, the Company entered into a Stock Purchase Agreement with an individual investor for the purchase of 500,000 shares of the Company's common stock for an aggregate purchase price of \$150,000, or \$0.30 per share, which will be payable in two tranches. In connection with the financing, the Company also issued to the investor two warrants. Each warrant has a term of three years and each warrant shall enable the investor to purchase up to an additional 500,000 shares of the Company's common stock at an exercise price of \$.30 and \$.36, respectively.

At December 31, 2016, 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, par value \$0.001 per share.

In July 2016, the Company and the holder of its Senior Secured Convertible Debenture entered into an agreement to amend and refinance the terms of the \$2.4 million 8% Original Issue Discount Senior Secured Convertible Debenture originally issued in June, 2015.

Pursuant to the Exchange Agreement, the following material terms of the Original Financing were amended, altered and/or ratified: (i) the Original Debenture was exchanged in its entirety for the issuance of a new 8% Original Issue Discount Senior Secured Convertible Debenture with an original principal amount of \$2,394,000 and an increased conversion price of \$0.25, (ii) the issuance of 420 shares of Series A Convertible Stock as further described by the Certificate of Designation of Preferences, Rights and Limitations of Series A Convertible Preferred Stock which may be exercised for up to 1,680,000 shares of Company's common stock, (iii) the extension of the maturity date of the Series A Warrant from June 22, 2020 until July 28, 2021, (iv) the cancellation of the Series B Warrants in their entirety, (v) the ratification of the Security Agreement executed by the Company with respect to all of its assets (as required by the initial Purchase Agreement and Original Debenture) as continued collateral for the New Debenture as well as the ratification of the Subsidiary Guarantee and Pledge and Security Agreement as such agreements are referenced in the Purchase Agreement and Exchange Agreement, and (vi) the creation of a new right for the Holder, subject to the written consent of the Company, for a \$2,100,000 cash investment in the Company with identical terms to the New Financing.

In May 2016 and pursuant to the 2015 Equity Incentive Plan, the Company granted an executive officer an option to purchase 250,000 shares of the Company's common stock at an exercise price equal to \$0.1925 per share. Such option shall vest in eight quarterly installments of 31,250 shares at the end of each quarterly anniversary commencing on August 31, 2016, contingent upon the grantee's continual employment by the Company as of each vesting installment date. Total stock-based compensation related to this option agreement was \$6,016 during the quarter-ended March 31, 2017.

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NOTE 7 — STOCKHOLDERS' EQUITY (continued)

The Company issued 300,000 shares of restricted Common Stock, valued at \$57,000, pursuant to an investor relations consulting agreement dated August 6, 2015. On March 14, 2016, the agreement was cancelled and 150,000 shares of the Company's common stock valued at \$28,500 were returned to the Company at which time the shares were cancelled.

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 commencing on March 31, 2016, contingent upon the grantee's continual service as a member of the Board of Directors as of each vesting installment date. Total stock-based compensation related to this option agreement was \$12,372 during the quarter-ended March 31, 2017.

NOTE 8 — COMMON STOCK WARRANTS

During the three months ended March, 2017, the company granted warrants in connection with the Stock Purchase Agreement described in Note 7. The warrant terms are 3 years expiring on February 21, 2020.

	2017	
	Number of Common Stock Warrants	Weighted average exercise price
Outstanding, January 1, 2017	10,926,829	\$ 0.30
Granted	1,000,000	0.33
Exercised	-	-
Expired	-	-
Outstanding, March 31, 2017	11,926,829	\$ 0.30
Exercisable, March 31, 2017	10,926,829	\$ 0.30

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NOTE 9—OPTIONS

In January 2016 and pursuant to the 2015 Equity Incentive Plan, the Company granted a non-executive 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 commencing on March 31, 2016, contingent upon the grantee's continual service as a member of the Board of Directors as of each vesting installment date. Total stock-based compensation related to this option grant was \$45,365 during the three months ended March 31, 2017.

In May 2016 and pursuant to the 2015 Equity Incentive Plan, the Company granted an executive officer an option to purchase 250,000 shares of the Company's common stock at an exercise price equal to \$0.1925 per share. Such option shall vest in eight quarterly installments of 31,250 shares at the end of each quarterly anniversary commencing on August 31, 2016, contingent upon the grantee's continual employment by the Company as of each vesting installment date. Total stock-based compensation related to this option grant was \$18,388 during the year ended March 31, 2017.

The fair value of the stock options was determined using the Black Scholes option pricing model with the following assumption: dividend yield: 0%; volatility: 232.41%-333.7%; risk free rate: .87%-1.78%; term 10 years.

	2017	
	Number of Options	Weighted average exercise price
Outstanding, January 1, 2017	-	\$ -
Granted	550,000	0.27
Exercised	-	-
Expired	-	-
Outstanding, March 31, 2017	550,000	\$ 0.27
Exercisable, March 31, 2017	281,520	\$ 0.29

NOTE 10—SUBSEQUENT EVENTS

On May 11, 2017 and pursuant to the 2015 Equity Incentive Plan, the Company granted executive officers, directors and employees options to purchase 4,500,000 shares of the Company's common stock at an exercise price equal to \$0.11 per share. Such option shall vest in twelve quarterly installments of 375,000 shares at the end of each quarterly anniversary commencing on June 30, 2017, contingent upon the grantee's continual employment or service with the Company as of each vesting installment date.