Apollo Enterprise Solutions, Ltd and Subsidiary

Financial Statements

December 31, 2016 and 2015

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APOLLO ENTERPRISE SOLUTIONS, LTD AND SUBSIDIARY
CONSOLIDATED FINANCIAL STATEMENTS

INDEX

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
Apollo Enterprise Solutions, Ltd. and Subsidiary

We have audited the accompanying consolidated balance sheets of **Apollo Enterprise Solutions, Ltd. and Subsidiary** (the "Company") as of December 31, 2016 and 2015, and the related consolidated statements of operations, stockholders' deficiency, and cash flows for years ended December 31, 2016 and 2015, and the related notes to the financial statements. The Company's management is responsible for these financial statements. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States) and in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. 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 audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of **Apollo Enterprise Solutions, Ltd. and Subsidiary** as of December 31, 2016 and 2015, and the results of its consolidated operations and cash flows for the years ended December 31, 2016 and 2015, and the related notes to the financial statements, in conformity with accounting principles generally accepted in the United States of America.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 2 to the consolidated financial statements, the Company has incurred recurring operating losses and is dependent on additional financing to fund operations. These conditions raise substantial doubt about the Company's ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 2 to the consolidated financial statements. The consolidated financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result from the outcome of this uncertainty.

Mayer Hoffman McCann P.C.

Orange County, California
March 31, 2017

APOLLO ENTERPRISE SOLUTIONS, LTD AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS

	December 31, 2016		December 31, 2015	
ASSETS				
Current assets:				
Cash	$	24,416	$	412,025
Accounts receivable, net of allowance for doubtful accounts of $346,500 and $0 at December 31, 2016 and 2015, respectively		474,919		-
Accounts receivable - related party		16,667		212,465
Prepaid expenses and other assets		36,842		55,711
Total current assets		552,844		680,201
Contract work in-progress		54,491		75,584
Patents, less accumulated amortization		998,624		1,104,479
Deferred debt costs associated with line of credit - related party		2,794,699		1,016,946
Deferred offering costs		25,000		-
Security deposit		100,000		100,000
Total Assets	**$**	**4,525,658**	**$**	**2,977,210**
LIABILITIES AND STOCKHOLDERS' DEFICIT				
Current liabilities:				
Accounts payable and accrued expenses	$	907,910	$	1,326,480
Accounts payable - related party		937,667		570,440
Accrued interest		28,791		-
Accrued interest - related party		1,174,729		679,954
Accrued payroll		24,306		20,677
Convertible notes - related party, net of debt discount		-		1,048,960
Warrant liability		-		7,527,108
Deferred revenue		1,259,509		1,290,562
Total current liabilities		4,332,912		12,464,181
Long-term liabilities:				
Notes payable - related party, net of debt discount		649,607		578,036
Line of credit - related party		5,952,100		2,339,000
Total long-term liabilities		6,601,707		2,917,036
Total liabilities		10,934,619		15,381,217
Commitments and contingencies (Note 6)				
Stockholders' deficit				
Class A preferred stock, $0.0001 par value, 4,000,000 shares authorized, 96 shares issued and outstanding as of December 31, 2016 and 2015. $2,838 and $2,768 aggregate liquidation preference at December 31, 2016 and 2015, respectively.		2,400		2,400
Class A-1 preferred stock, $0.0001 par value, 420,000 shares authorized, -0- shares issued and outstanding as of December 31, 2016 and 2015.		-		-
Class A-2 preferred stock, $0.0001 par value, 1,200,000 shares authorized, 401 shares issued and outstanding as of December 31, 2016 and 2015. $11,441 and $11,148 aggregate liquidation preference at December 31, 2016 and 2015, respectively.		10,030		10,030
Junior preferred stock, $0.0001 par value, 3,500,000 shares authorized, 117,762 shares issued and outstanding as of December 31, 2016 and 2015. $2,944,050 aggregate liquidation preference at December 31, 2016 and 2015.		2,929,044		2,929,044
Common stock, $0.0001 par value, 310,880,000 shares authorized, 72,739,393 shares issued; 43,204,690 and 42,786,813 shares outstanding as of December 31, 2016 and 2015, respectively		7,274		7,274
Additional paid-in capital		34,082,249		22,870,217
Accumulated deficit		(43,437,005)		(38,219,977)
Treasury stock, $0.0001 par value, 29,534,703 and 29,952,580 shares as of December 31, 2016 and 2015, respectively		(2,953)		(2,995)
Total stockholders' deficit		(6,408,961)		(12,404,007)
Total liabilities and stockholders' deficit	**$**	**4,525,658**	**$**	**2,977,210**

The accompanying notes are an integral part of these consolidated financial statements.

APOLLO ENTERPRISE SOLUTIONS, LTD AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF OPERATIONS

	For the years ended December 31,	
	2016	2015
Revenues	$ 1,040,549	$ 2,440,686
Cost of goods sold	231,449	443,483
Gross profit	809,100	1,997,203
Selling and general administrative expenses	4,248,810	3,565,966
Operating loss	(3,439,710)	(1,568,763)
Other income (expense):		
Change in warrant liability	(561,289)	2,936,954
Sublease income	396	56,153
Gain on foreign exchange transactions	138,900	35,500
Interest income	3	9,012
Interest expense	(1,355,328)	(1,474,864)
Total other income (expense)	(1,777,318)	1,562,755
Loss before income taxes	**(5,217,028)**	**(6,008)**
Provision for income taxes	-	-
Net loss	**$ (5,217,028)**	**$ (6,008)**
Basic and diluted net loss per ordinary share	$ (0.12)	$ (0.00)
Weighted average shares outstanding, basic and diluted	43,205,699	42,830,576

The accompanying notes are an integral part of these consolidated financial statements.

APOLLO ENTERPRISE SOLUTIONS, LTD AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' DEFICIT

	Class A Preferred Stock		Class A-2 Preferred Stock		Junior Preferred Stock		Common Stock		Additional Paid-in Capital	Accumulated Deficit	Treasury Stock		Total Stockholders' Deficit
	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount			Shares	Amount	
Balance at December 31, 2014, as restated	**96**	**$ 2,400**	**401**	**$ 10,030**	**117,762**	**$ 2,929,044**	**72,739,393**	**$ 7,274**	**$ 22,302,276**	**$ (38,213,969)**	**(29,959,607)**	**$ (2,996)**	**$ (12,965,941)**
Sale of treasury stock	-	-	-	-	-	-	-	-	12,590	-	24,091	3	12,593
Repurchased treasury stock	-	-	-	-	-	-	-	-	(68,181)	-	(107,973)	(11)	(68,192)
Warrants exercised	-	-	-	-	-	-	-	-	64,189	-	90,909	9	64,198
Issuance of options for services	-	-	-	-	-	-	-	-	559,343	-	-	-	559,343
Net loss	-	-	-	-	-	-	-	-	-	(6,008)	-	-	(6,008)
Balance at December 31, 2015	**96**	**$ 2,400**	**401**	**$ 10,030**	**117,762**	**$ 2,929,044**	**72,739,393**	**$ 7,274**	**$ 22,870,217**	**$ (38,219,977)**	**$ (29,952,580)**	**$ (2,995)**	**$ (12,404,007)**
Sale of treasury stock and warrants	-	-	-	-	-	-	-	-	218,811	-	500,300	50	218,861
Repurchased treasury stock	-	-	-	-	-	-	-	-	(44,167)	-	(82,423)	(8)	(44,175)
Reclassification of warrant liability to equity upon amendment of all outstanding warrant agreements	-	-	-	-	-	-	-	-	8,150,536	-	-	-	8,150,536
Issuance of warrants in connection with line of credit agreements	-	-	-	-	-	-	-	-	2,334,404	-	-	-	2,334,404
Issuance of options for services	-	-	-	-	-	-	-	-	552,448	-	-	-	552,448
Net loss	-	-	-	-	-	-	-	-	-	(5,217,028)	-	-	(5,217,028)
Balance at December 31, 2016	**96**	**$ 2,400**	**401**	**$ 10,030**	**117,762**	**$ 2,929,044**	**72,739,393**	**$ 7,274**	**$ 34,082,249**	**$ (43,437,005)**	**$ (29,534,703)**	**$ (2,953)**	**$ (6,408,961)**

The accompanying notes are an integral part of these consolidated financial statements.

APOLLO ENTERPRISE SOLUTIONS, LTD AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the years ended December 31, 2016	2015
Cash flows from operating activities		
Net loss	$ (5,217,028)	$ (6,008)
Adjustments to reconcile net loss to net cash used in operating activities:		
Amortization of patent costs	105,855	106,146
Amortization of debt discount	831,762	1,136,165
Depreciation expense	-	868
Stock-based compensation expense	552,448	559,343
Issuance of warrants for services	13,283	-
Change in warrant liability	561,289	(2,936,954)
Changes in operating assets and liabilities:		
Accounts receivable	(474,919)	-
Accounts receivable - related party	195,798	494,072
Prepaid expenses	18,869	(3,243)
Contract work in-progress	21,093	21,093
Security deposit	-	(100,000)
Accounts payable and accrued expenses	(418,570)	(221,743)
Accounts payable - related party	367,227	115,382
Accrued interest	28,791	-
Accrued interest - related party	494,775	335,551
Accrued payroll	3,629	(18,239)
Deferred rent	-	(38,645)
Deferred revenue	(31,053)	(172,947)
Net cash used in operating activities	(2,946,751)	(729,159)
Cash flows from financing activities		
Proceeds received from line of credit with related party	2,360,600	1,099,000
Proceeds received from issuance of treasury stock and warrants	267,717	12,593
Purchases of treasury stock	(44,175)	(68,192)
Proceeds received from exercise of warrants	-	47,520
Payment of deferred offering costs	(25,000)	-
Net cash provided by financing activities	2,559,142	1,090,921
Net increase (decrease) in cash	(387,609)	361,762
Cash at beginning of period	412,025	50,263
Cash at end of period	$ 24,416	$ 412,025
Supplemental Schedule of Non-cash Financing Activities:		
Reclassification of warrant liability to equity upon amendment of outstanding warrant agreements	$ 8,150,536	$ -
Issuance of warrants to amend notes payable and line of credit with related party	$ -	$ 1,298,910
Reclassification of warrant liability to additional paid-in capital upon exercise of warrants	$ -	$ 16,678
Issuance of warrants in connection with line of credit agreement	$ 2,334,404	$ -
Repayment of convertible note with line of credit	$ 1,252,500	$ -
Cash paid for interest	$ -	$ -
Cash paid for income taxes	$ -	$ -

The accompanying notes are an integral part of these consolidated financial statements.

NOTE 1 - NATURE OF OPERATIONS

Apollo Enterprise Solutions, Ltd ("AES, Ltd") was incorporated in Bermuda on September 27, 2012 for the purpose of effecting a reverse merger with its wholly-owned subsidiary, Apollo Enterprise Solutions, Inc. ("Apollo Inc.") (collectively, the "Company"). Once the merger was completed in October 2012, the Company pursued listing its shares on the Bermuda Stock Exchange ("BSX") and this was approved by the BSX on November 8, 2012.

AES' patented TruePay+™ System uses Agent Emulation® and Psychographic Persuasion™ technologies to advance the science of payment technologies for maximizing debt resolution. The TruePay+™ System assists creditors' agents and self-serve customers in resolving pre-delinquent and delinquent debt situations on an individualized basis according to customer profiles, using any device, at any time, from anywhere. The Company's customers access the proprietary AES TruePay+™ System as outsourced Software-as-a-Service ("SaaS"), to fully automate the origination of new debt products, modifications of existing debt arrangements, and collection of delinquent debt. The TruePay+™ System applies the customers' business rules to their own data and utilizes outside information such as credit bureau reports to formulate highly targeted origination, modification, and debt settlement offers to customers.

NOTE 2 – BASIS OF PRESENTATION

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("US GAAP") and include the accounts of AES, Ltd and its wholly-owned subsidiary, Apollo Inc. All intercompany balances and transactions have been eliminated in consolidation.

The functional currency of both AES, Ltd and its wholly-owned subsidiary is the U.S. Dollar. Monetary assets and liabilities denominated in non-U.S. currencies are translated at rates of exchange prevailing on the date of the consolidated balance sheets and revenues and expenses are translated at average rates of exchange for the period. Foreign currency remeasurement gains or losses on transactions in nonfunctional currencies are recognized within "Other (income) expenses" in the Consolidated Statements of Operations.

Going Concern

The accompanying financial statements have been prepared assuming the Company will continue as a going concern, which contemplates, among other things, the realization of assets and satisfaction of liabilities in the normal course of business. The Company had net loss of approximately $5.2 million and $6,000 for the years ended December 31, 2016 and 2015, respectively, and had net cash used in operating activities of approximately $2.9 million and $729,000 for the years ended December 31, 2016 and 2015, respectively. These matters, among others, raise substantial doubt about the Company's ability to continue as a going concern.

During the years ended December 31, 2016 and 2015, the operations of the Company have been funded through the sale of treasury shares on the Frankfurt Stock Exchange and issuance of notes payable, convertible notes payable and lines of credit provided by related party. The Company will attempt to secure additional equity or debt financing until such time as its operations are self sufficient. The Company cannot be certain that additional funding will be available on acceptable terms, or at all. To the extent that the Company raises additional funds by issuing equity securities, the Company's stockholders may experience significant dilution. Any debt financing, if available, may involve restrictive covenants that impact the Company's ability to conduct business. If the Company is not able to raise additional capital when required or on acceptable terms, the Company may have to significantly delay, scale back or discontinue the development and/or commercialization of one or more product candidates or relinquish or otherwise dispose of rights to technologies.

Management has determined that there is substantial doubt about the Company's ability to continue as a going concern within one year after the consolidated financial statements are issued. The accompanying consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts, or amounts and classification of liabilities that might result from this uncertainty.

NOTE 3 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Use of Estimates

The preparation of these consolidated financial statements in accordance with US GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and disclosed in the accompanying notes. Actual results may differ from those estimates and such differences may be material to the consolidated financial statements. The more significant estimates and assumptions by management include among others: revenue recognition, the allowance for doubtful accounts, the valuation allowance of deferred tax assets resulting from net operating losses, the recoverability and estimated useful life of patents, the valuation of the Company's common stock, and the valuation of warrants and options on the Company's common stock.

Concentration of Credit Risk

In the normal course of business, the Company is exposed to credit risk. Credit is generally granted to customers without collateral. Cash consists of checking accounts. While cash held by financial institutions may at times exceed federally insured limits, management believes that no material credit or market risk exposure exists due to the high quality of the institutions. The Company has not experienced any losses on such accounts.

In 2016 and 2015, 97.6% and 100.0%, respectively, of the Company's revenues were derived from Lantern Funding, LLC ("Lantern"), which was considered a related party through July 12, 2016 due to an individual serving on the boards of both the Company and Lantern. In 2016, Lantern notified management of their desire to amend their existing contract with the Company.

Accounts Receivable

The Company estimates the allowance for doubtful accounts using a specific identification method considering the age of the receivable balance, the customer's historical payment history and current credit worthiness as well as any known or expected collectability issues. Management's evaluation includes reviewing past due accounts on a case-by-case basis, and determining whether a customer account should be reserved, based on the facts and circumstances surrounding each potentially uncollectible account. Uncollectible accounts are written-off in the period management believes it has exhausted every opportunity to collect payment from the customer. Bad debt expense is recorded in selling and general administrative expenses when events or circumstances indicate an additional allowance is necessary based on the specific identification approach. The allowance for doubtful accounts totaled approximately $347,000 and $0 as of December 31, 2016 and 2015, respectively. Actual collections of trade receivables could differ from management's estimates due to changes in future economic or industry conditions or specific customers' financial conditions.

As of December 31, 2016 and 2015, 94.7% and 100%, respectively, of net accounts receivable is due from one customer, Lantern, a related party until July 12, 2016. As of December 31, 2016, the Company had an aggregate net receivable of approximately $450,000 from Lantern, net of an allowance for doubtful accounts of approximately $347,000. The Company had additional uncollected invoices to Lantern aggregating approximately $1.1 million at December 31, 2016, which are due from Lantern but which were not recognized in accounts receivable as the Company's revenue recognition policy had not been met as of December 31, 2016. On February 17, 2017, the Company filed a complaint against Lantern in Superior Court in the State of California for breach of contract and other causes. The Company is seeking payment from Lantern of approximately $2 million plus interest and reimbursement of associated legal fees and costs. The Company has included its best estimate of an appropriate amount in the allowance for doubtful accounts to cover any additional costs of collection. On March 24, 2017, Lantern petitioned the United States District Court for the Central District of California to move the Company's action to its jurisdiction and filed a counterclaim with the U.S. District Court for a declaration of patent invalidity and non-infringement, fraudulent inducement, unjust enrichment, breach of contract, and other causes. Management believes that Lantern's claims are without merit and the Company is aggressively pursuing all legal redress.

Revenue Recognition

The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable, and collectability is reasonably assured.

The Company derives its revenue from granting exclusive and non-exclusive licenses to its patents; designing, developing, and installing customized software solutions; providing software and hardware maintenance and support; and delivering software on a hosted basis as a service. The Company's fees primarily consist of license fees, software development and installation fees, software maintenance fees, data hosting fees, revenue sharing fees based on debt collection results of customers, per transaction fees and service usage fees. The Company's contracts have different terms based on the scope and deliverables of the arrangement, the terms of which frequently require the Company to make judgments and estimates in recognizing revenue.

Multiple-Element Patent License and Software Development Arrangement

The Company's multiple-element patent license and software development arrangement involves the delivery of more than one element, including an exclusive license to develop products using our intellectual property patents; designing, developing, and installing customized software; providing post contract customer support ("PCS") on the customized software; and developing other front-end software.

Upon the signing of the arrangement, the Company provides the licensee the exclusive right to use the Company's intellectual property patents to develop specific products using the patents, including the right to sublicense or sell those products. The Company's only obligation is to pay for the cost of maintaining the patents, including defense of the patents. In exchange for the exclusive right to the Company's intellectual property patents, the Company receives non-refundable license fees that are paid by the customer over the term of the license arrangement.

The Company evaluates the multiple elements in the arrangement to determine whether each element is a separate unit of accounting. This determination is based on whether the deliverable has "stand-alone value" to the customer. Because the patent and software licenses do not have standalone value to the customer and the Company does not have vendor specific objective evidence of fair value of the PCS, fees for the licenses and customized software services are deferred and recognized as revenue on a ratable basis over the period that the PCS services are provided.

The Company also provides front-end software development services under this arrangement with fees based on the time and materials expended. A contract with customized software may be segmented if the Company satisfies the segmenting criteria in ASC 605-35. Segmenting a contract may result in different interim rates of profitability for each scope of service than if the Company had recognized revenue without segmenting. The services to develop front-end software are a separate contract segment that meets the segmenting criteria in ASC 605-35. Revenues from the front-end software development services segment are recognized as the services are performed, which is measured based on the time incurred.

Multiple-Element Hosting Arrangement

The Company provides software and services on a hosted basis where the customer does not have the contractual right to take possession of the software. Under this arrangement, any upfront service and installation fees are recognized ratably over the hosting period. Data hosting and service usage fees are recognized when the data hosting and service usage occurs. Additionally, software maintenance fees are recognized ratably over the hosting period.

The Company's hosting arrangements include customer acceptance clauses that require the Company to test configuration services and deliverables and customer acceptance testing. If the configuration services and/or deliverables do not meet the customer acceptance testing, the Company has the right to correct any errors within 30 days of receipt of failure notice. In the event that the Company fails to correct or deliver the configuration services and/or deliverables in accordance with the arrangement, the customer has the option to terminate the agreement. Because the hosting period does not begin until after customer acceptance has occurred in our hosting arrangements, no revenue is recognized until after customer acceptance has occurred.

Fair Value Measurements

Fair value is defined as the price that would be received for sale of an asset or paid for transfer of a liability, in an orderly transaction between market participants at the measurement date. US GAAP establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). These tiers include:

- Level 1, defined as observable inputs such as quoted prices for identical instruments in active markets;
- Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable such as quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in markets that are not active; and
- Level 3, defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions, such as valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

Fair Value of Financial Instruments

ASC 820, *Fair Value Measurement and Disclosures*, requires all entities to disclose the fair value of financial instruments, both assets and liabilities for which it is practicable to estimate fair value, and defines fair value of a financial instrument as the amount at which the instrument could be exchanged in a current transaction between willing parties. As of December 31, 2016 and 2015, the recorded values of cash, accounts receivable, prepaid expenses, accounts payable, and accrued expenses approximate the fair values due to the short-term nature of the instruments.

Patent Asset

The Company capitalizes patent costs incurred when the costs provide probable future economic benefit to the Company. Such capitalized costs include external legal costs incurred in the defense of the Company's patents when it is believed that the future economic benefit of the patent will be increased and a successful defense is probable. All capitalized patent costs as of December 31, 2016 and 2015 result from capitalization of direct legal costs incurred to successfully defend the Company's 978 patent. Capitalized patent defense costs are amortized over 15 years, which is the estimated useful life of the related patent.

The patent asset is reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. If circumstances require that the patent asset be tested for possible impairment, the Company first compares the undiscounted cash flows expected to be generated by the asset to its carrying amount. If the carrying amount of the asset is not recoverable on an undiscounted cash flow basis, an impairment is recognized to the extent that the carrying amount exceeds its fair value. As of December 31, 2016, management expects the patent asset to be fully recoverable based upon projected cash flows from existing and potential customer contracts. Actual results may differ from management's estimates and such differences may result in changes to the carrying value of the patent asset.

Accrued Expenses

The Company incurs periodic expenses such as salaries, taxes, and professional fees. An entry to accrue expenses is necessary when expenses have been incurred by the Company prior to them being paid. When a vendor's invoice is not received, the Company is required to estimate its accrued expenses. This process involves reviewing quotations and contracts, identifying services that have been performed on the Company's behalf and estimating the level of service performed and the associated cost incurred for the service when the Company has not yet been invoiced or otherwise notified of the actual cost. The majority of the Company's service providers invoice monthly in arrears for services performed or when contractual milestones are met. The Company estimates accrued expenses as of each balance sheet date based on facts and circumstances known at that time. The Company periodically confirms the accuracy of its estimates with the service providers and makes adjustments if necessary.

Derivatives

The Company does not use derivative instruments to hedge exposures to cash flow, market, or foreign currency risks. The Company evaluates all of its financial instruments, including issued stock purchase warrants, to determine if such instruments are derivatives or contain features that qualify as embedded derivatives. For derivative financial instruments that are accounted for as liabilities, the derivative instrument is initially recorded at its fair value and is then re-valued at each reporting date, with changes in the fair value reported in the Statements of Operations. Depending on the features of the derivative financial instrument, the Company uses either the Black-Scholes option-pricing model or a Monte Carlo simulation to value the derivative instruments at inception and subsequent valuation dates. The classification of derivative instruments, including whether such instruments should be recorded as liabilities or as equity, is re-assessed at the end of each reporting period.

Accounting for Income Taxes

Deferred tax assets and liabilities are recognized for the expected future consequences of events that have been reflected in the consolidated financial statements. Deferred tax assets and liabilities are determined based on the differences between the book and tax basis of assets and liabilities and operating loss carryforwards, using tax rates expected to be in effect for the years in which the differences are expected to reverse. The Company records a valuation allowance to reduce deferred income tax assets when it is more likely than not that some portion or all of the deferred tax asset will not be realized.

The Company applies a more-likely-than-not recognition threshold for all tax uncertainties. ASC Topic 740 only allows the recognition of those tax benefits that have a greater than fifty percent likelihood of being sustained upon examination by the taxing authorities. As of December 31, 2016, the Company reviewed its tax positions and determined there were no outstanding, or retroactive tax positions with less than a 50% likelihood of being sustained upon examination by the taxing authorities, therefore this standard has not had a material effect on the Company.

Employee Stock-based Compensation

Stock-based compensation issued to employees and members of the Company's Board of Directors is measured at the date of grant based on the estimated fair value of the award, net of estimated forfeitures. The grant date fair value of a stock-based award is recognized as an expense over the requisite service period of the award on a straight-line basis.

For purposes of determining the variables used in the calculation of stock-based compensation issued to employees, the Company performs an analysis of current market data and historical data to calculate an estimate of implied volatility, the expected term of the option and the expected forfeiture rate. With the exception of the expected forfeiture rate, which is not an input, the Company uses these estimates as variables in the Black-Scholes option pricing model. Depending upon the number of stock options granted, any fluctuations in these calculations could have a material effect on the results presented in the Company's Consolidated Statements of Operations. In addition, any differences between estimated forfeitures and actual forfeitures could also have a material impact on the Company's Consolidated Statements of Operations.

Stock-based Compensation Issued to Non-employees

Common stock issued to non-employees for acquiring goods or providing services is recognized at fair value when the goods are obtained or over the service period, which is generally the vesting period. If the award contains performance conditions, the measurement date of the award is the earlier of the date at which a commitment for performance by the non-employee is reached or the date at which performance is reached. A performance commitment is reached when performance by the non-employee is probable because of sufficiently large disincentives for nonperformance.

Treasury Stock

The Company accounts for treasury stock under the cost method and includes treasury stock as a component of stockholders' deficit.

Net loss per share

Basic net loss per share was calculated by dividing net loss by the weighted-average common shares outstanding during the period. Diluted net loss per share was calculated by dividing net loss by the weighted-average common shares outstanding during the period using the treasury stock method or the two-class method, whichever is more dilutive. The table below summarizes potentially dilutive securities that were not considered in the computation of diluted net loss per share because they would be anti-dilutive.

Potentially dilutive securities	December 31, 2016	December 31, 2015
Warrants (Note 8)	34,520,574	26,440,166
Options (Note 9)	10,089,550	10,210,541
Convertible debt (Note 5)	-	2,277,272
Convertible preferred stock (Note 7)	1,990,848	1,990,848

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-09, *Revenue from Contracts with Customers (Topic 606*). The new guidance will supersede and replace existing U.S. GAAP revenue recognition guidance. ASU 2014-09 provides new criteria for recognizing revenue to depict the transfer of goods or services to customers in amounts that reflect the consideration to which the company expects to be entitled in exchange for those goods or services. The new guidance requires expanded disclosures to provide greater insight into both revenue that has been recognized and revenue that is expected to be recognized in the future from existing contracts. Quantitative and qualitative information will be provided about the significant judgments and changes in those judgments that management made to determine the revenue that is recorded. The standard will be effective for the first interim period within annual reporting periods beginning after December 15, 2017. Early adoption is not permitted. The Company is currently assessing the provisions of the guidance and has not determined the impact of adoption on its Consolidated Financial Statements.

In August 2014, the FASB issued ASU No. 2014-15, *Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern* which requires management to evaluate whether there are conditions and events that raise substantial doubt about the Company's ability to continue as a going concern within one year after the financial statements are issued on both an interim and annual basis. Management will be required to provide certain footnote disclosures if it concludes that substantial doubt exists or when its plans alleviate substantial doubt about the Company's ability to continue as a going concern. The Company adopted ASU No. 2014-15 in the fourth quarter of 2016, and its adoption did not have a material impact on the Company's Consolidated Financial Statements.

In April 2015, the FASB issued ASU No. 2015-03, *Simplifying the Presentation of Debt Issuance Costs*, which requires debt issuance costs to be presented in the balance sheet as a direct deduction from the carrying value of the associated debt liability, consistent with the presentation of a debt discount. ASU No. 2015-03 is effective for the interim and annual periods ending after December 15, 2015. The Company has adopted this guidance and adoption did not have a material impact on the Company's Consolidated Financial Statements.

On February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*. Under the new guidance, lessees will be required to recognize all leases (with the exception of short-term leases) on the balance sheet as a lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis and a right-of-use asset, which is an asset that represents the lessee¹s right to use, or control the use of, a specified asset for the lease term. The new standard is effective for fiscal year beginning after December 15, 2018, including interim periods within those fiscal years. The Company is currently evaluating the effect the guidance will have on its Consolidated Financial Statements. The effect of adoption of this standard on the Company's consolidated financial statements will depend on the leases existing at January 1, 2018. Based on the Company's leases as of December 31, 2016, however, management expects that adoption of ASU 2016-02 will not have a material effect on the Company's results of operations, financial position and cash flows.

In April 2016, the FASB issued ASU No. 2016-09, *Share-Based Payment: Simplifying the Accounting for Share-Based Payments*. The standard addresses several aspects of the accounting for employee share-based payment transactions, including the accounting for income taxes, forfeitures and statutory tax withholding requirements, as well as classification in the statement of cash flows. The new standard is effective for fiscal years and interim periods within those fiscal years beginning after December 15, 2016. The Company adopted the standard as of January 1, 2017 and adoption did not have a material impact on the Company's Consolidated Financial Statements.

In March 2016, the FASB issued ASU No. 2016-06, *Derivatives and Hedging (Topic 815): Contingent Put and Call Options in Debt Instruments*. This new standard simplifies the embedded derivative analysis for debt instruments containing contingent call or put options by removing the requirement to assess whether a contingent event is related to interest rates or credit risks. This new standard will be in fiscal years beginning after December 15, 2016, and interim periods within those years. The adoption of this standard is not expected to have a material impact on the Company's financial position, results of operations, or cash flows.

In August 2016, the FASB issued ASU No. 2016-15, which addresses eight specific cash flow issues with the objective of reducing the existing diversity in practice in how certain cash receipts and cash payments are presented and classified in the statement of cash flows. The standard is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. Early adoption is permitted including adoption in an interim period. The Company is currently in the process of evaluating the impact of this new pronouncement on its Statements of Cash Flows.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments - Credit Losses*, which requires the measurement of expected credit losses for financial instruments held at the reporting date based on historical experience, current conditions and reasonable forecasts. The main objective of this ASU is to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date. The standard is effective for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. Early adoption is permitted for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. The Company is currently evaluating the effect the guidance will have on its Consolidated Financial Statements.

NOTE 4 – PATENTS

Patents consist of the following:

	As of December 31,			
	2016		**2015**	
Cumulative successful patent defense costs	$	1,593,639	$	1,593,639
Less: Accumulated amortization		(595,015)		(489,160)
Total patents, net	**$**	**998,624**	**$**	**1,104,479**

Amortization expense was approximately $106,000 for both years ended December 31, 2016 and 2015, and is classified in selling and general administrative expenses in the accompanying Consolidated Statements of Operations. Estimated amortization expense for each of the succeeding five years from December 31, 2016 is approximately $106,000 per year.

NOTE 5 – DEBT

Short-term and long-term debt consists of the following:

	December 31,	
	2016	2015
Short-term debt:		
Convertible Note Payable - Related Party:		
Principal, 10% per annum, convertible at $0.55	$ -	$ 1,252,500
Debt discount	-	(203,540)
Carrying value of convertible note payable -	-	1,048,960
Total short-term debt	**$ -**	**$ 1,048,960**
Long-term debt:		
Notes Payable - Related Party:		
Principal, 10% per annum	860,000	860,000
Debt discount	(210,393)	(281,964)
Carrying value of notes payable - related party	649,607	578,036
Line of Credit - Related Party		
Outstanding balance, 10% per annum	5,952,100	2,339,000
Carrying value of line of credit - related party	5,952,100	2,339,000
Total long-term debt	**$ 6,601,707**	**$ 2,917,036**

The Company had unamortized deferred debt costs of approximately $2.8 million and $1 million associated with the line of credit at December 31, 2016 and 2015, respectively, which are being amortized to interest expense on a straight-line basis over the term of the line of credit.

Short-term Debt

Convertible note – related party

On December 1, 2014, the Company issued an unsecured convertible note with a principal balance of $1,252,000 to the Chief Executive Officer (“CEO”), who is a significant shareholder. Interest accrued on the unpaid principal balance at 10% per annum and, together with the outstanding principal, is due and payable in a single installment on December 1, 2016 (the “Maturity Date”). The holder may, at anytime, convert the outstanding principal balance of the note and accrued interest into shares of the Company’s common stock at a fixed conversion price of $0.55 per share by providing notice to the Company on or before the Maturity Date.

At the time of issuance, the conversion price was below the quoted market price of the Company’s common stock. As such, the Company recognized a beneficial conversion feature equal to the intrinsic value of the conversion price on the issuance date, resulting in a discount to the unsecured promissory note of approximately $367,000 with a corresponding credit to additional paid-in capital. The resulting debt discount is presented net of the related convertible note balance in the Consolidated Balance Sheets and is amortized to interest expense over the note’s term using the effective interest method. Borrowing capacity under the LOC was used to retire the outstanding principal balance of the convertible note on December 1, 2016. See description of the Third LOC, below.

Long-term Debt

Notes payable - related party

In June and August 2012, the Company issued unsecured promissory notes in the principal amount of $860,000 and ten-year warrants to purchase 781,818 shares of common stock, with an exercise price of $0.55 per share, for aggregate gross proceeds of $860,000 from existing shareholders and members of management. The notes accrued interest at 6% per annum. Notes with an aggregate principal balance of $535,000 were due and payable, along with accrued interest, prior to December 31, 2012. The remaining note with a principal balance of $325,000 was due, along with accrued but unpaid interest, on March 1, 2014. Upon the occurrence of an event of default, the note holder may demand immediate payment of the outstanding principal and all accrued but unpaid interest.

The warrants issued concurrent with the unsecured promissory notes were initially classified as liabilities and measured at fair value, pursuant to ASC 815-40. Upon amendment of the warrants at June 30, 2016 (see Note 8), these warrants are indexed to the Company's stock pursuant to ASC 815-40 and were reclassified to stockholders' deficit. At initial issuance, the gross proceeds of $860,000 were first allocated to the warrants with the remaining balance allocated to the notes, resulting in an initial carrying value of the notes of approximately $551,000. The resulting debt discount is presented net of the related notes payable balance in the Consolidated Balance Sheets and is amortized to interest expense over each note's term using the effective interest method.

As of March 1, 2014, all amounts due under the unsecured promissory notes were outstanding. On that date, the Company effectively issued new unsecured promissory notes to the holders, by amending the existing matured notes, to extend the maturity date of all notes to January 1, 2016 and to increase the interest rate of each note, beginning March 1, 2014, to 10% per annum. No additional amounts were loaned to the Company. In consideration for the amendments, the holders were issued ten-year warrants to purchase 781,818 shares of common stock at $0.55 per share. The initial fair value of the warrants of approximately $552,000 was recorded as a debt discount and presented net of the related notes payable balance in the Consolidated Balance Sheets. The Company amortized this debt discount to interest expense over each note's term using the effective interest method.

On December 31, 2015, the Company and the holders of the unsecured promissory notes amended the outstanding notes by extending the maturity date of all notes to December 31, 2018. No additional amounts were loaned to the Company and all other terms remain the same. In consideration for the amendments, the holders were issued ten-year warrants to purchase 781,818 shares of common stock at $0.55 per share. The initial fair value of the warrants of approximately $282,000 was recorded as a debt discount and presented net of the related notes payable balance in the Consolidated Balance Sheets. The debt discount will be amortized to interest expense over each note's term using the effective interest method.

Lines of credit – related party

On December 1, 2012, the Company executed a line of credit ("First LOC") with its CEO for up to $1,600,000. Outstanding amounts under the First LOC accrued interest at 6% per annum and were due and payable on December 1, 2013. The First LOC was not repaid when due. Concurrent with the issuance of the First LOC, the Company issued the lender ten-year warrants to purchase 1,500,000 shares of common stock at $0.55 per share. The initial fair value of the warrants of approximately $622,000 was amortized to interest expense on a straight-line basis over the First LOC's term.

On March 1, 2014, the Company amended the First LOC with the lender to increase the borrowing capacity from $1,600,000 to $3,200,000, increase the interest rate on all outstanding amounts to 10% per annum, effective March 1, 2014, and extending the maturity date to January 1, 2016. As of March 1, 2014, the Company had $1,240,000 outstanding under the First LOC. As consideration for amending the First LOC, the Company issued the lender ten-year warrants to purchase 1,500,000 shares of common stock at $0.55 per share. The initial fair value of the warrants of approximately $1.1 million is recognized as deferred debt costs in the Consolidated Balance Sheets and is amortized to interest expense on a straight-line basis over the amended First LOC's term.

On December 31, 2015, the Company amended the First LOC with the lender to extend the maturity date to December 31, 2018. As consideration for amending the First LOC, the Company issued the lender ten-year warrants to purchase 2,829,435 shares of common stock at $0.55 per share. The initial fair value of the warrants of approximately $1 million is recognized as deferred debt costs in the Consolidated Balance Sheets and is being amortized to interest expense on a straight-line basis over the amended First LOC's term.

On July 13, 2016, the Company executed a second line of credit ("Second LOC") with its CEO for up to $1,000,000. Outstanding amounts under the Second LOC accrue interest at 10% per annum and are due and payable on July 12, 2018. In connection with the issuance of the Second LOC, the Company issued the lender ten-year warrants to purchase 943,145 shares of common stock at $0.47 per share. The initial fair value of the warrants of approximately $368,000 is being amortized to interest expense on a straight-line basis over the Second LOC's term.

On November 9, 2016, the Company executed a third line of credit ("Third LOC") with its CEO for up to $3,252,500. An aggregate of $1,252,500 from the Third LOC was used to extinguish the outstanding principal of the convertible debt upon its maturity on December 1, 2016. Outstanding amounts under the Third LOC accrue interest at 10% per annum and are due and payable on December 31, 2018. In connection with the issuance of the Third LOC, the Company issued the lender ten-year warrants to purchase 7,283,619 shares of common stock at $0.24 per share. The initial fair value of the warrants of approximately $2 million is being amortized to interest expense on a straight-line basis over the Third LOC's term.

As of December 31, 2016, approximately $1.5 million remains available under the Third LOC.

NOTE 6 – COMMITMENTS AND CONTINGENCIES

Leases

The Company leases its office space located in Long Beach, California through July 2020. The Company provided a cash security deposit in the amount of $100,000, which was included in other non-current assets in the Company's Consolidated Balance Sheets as of December 31, 2016 and 2015.

As of December 31, 2016, the remaining contractual minimum lease payments on the lease were as follows:

	Operating leases
Years Ending December 31,	
2017	$ 90,864
2018	93,641
2019	96,448
2020	53,390
Total lease commitments	$ 334,343

The Company recognizes rent expense on a straight-line basis over the lease period. Any differences between rent expense and rent paid due to scheduled rent increases or rent abatements are included in deferred rent on the accompanying Consolidated Balance Sheets. Rent expense is classified within selling and general administrative expenses within the Company's Consolidated Statement of Operations and was approximately $82,000 and $159,000 for the years ended December 31, 2016 and 2015, respectively.

The Company subleased its excess office space through July 2015 to a company owned by one of the stockholders at the same lease rate it was charged. The Company recognized sublease income on a straight-line basis over the lease period.

Legal

In July 2014, the Company settled litigation with a vendor for an agreed amount of $412,500, with $100,000 payable up front and the remaining balance divided into 25 monthly installments of $12,500 each. During the years ended December 31, 2016 and 2015, the Company paid an aggregate of $100,000 and $150,000 pursuant to the settlement agreement. The remaining balance of $0 and $100,000 was included within Accounts Payable on the Company's Consolidated Balance Sheets as of December 31, 2016 and 2015, respectively.

In May 2016, a judgment was reached against the Company regarding litigation with a vendor for disputed past due amounts. The full amount of the judgment, including fees and interest, of approximately $158,000 is accrued in accounts payable in the Consolidated Balance Sheets as of December 31, 2016.

On February 17, 2017, the Company filed a complaint against Lantern in Superior Court in the State of California for breach of contract and other causes. The Company is seeking payment from Lantern of approximately $2 million plus interest and reimbursement of associated legal fees and costs. The Company has included its best estimate of an appropriate amount in the allowance for doubtful accounts to cover any additional costs of collection. On March 24, 2017, Lantern petitioned the United States District Court for the Central District of California to move the Company's action to its jurisdiction and filed a counterclaim with the U.S. District Court for a declaration of patent invalidity and non-infringement, fraudulent inducement, unjust enrichment, breach of contract, and other causes. Management believes that Lantern's claims are without merit and the Company is aggressively pursuing all legal redress. Management is unable to estimate a range of reasonably possible loss for Lantern's counterclaims given there are significant factual issues to be resolved and given the early stage of the matter.

Except as set forth above, there are no pending legal proceedings against the Company that are expected to have a material adverse effect on cash flows, financial condition or results of operations. From time to time, the Company could become involved in disputes and various litigation matters that arise in the normal course of business. These may include disputes and lawsuits related to intellectual property, licensing, contract law and employee relations matters. Periodically, the Company reviews the status of significant matters, if any exist, and assesses its potential financial exposure. If the potential loss from any claim or legal claim is considered probable and the amount can be estimated, the Company accrues a liability for the estimated loss. Legal proceedings are subject to uncertainties, and the outcomes are difficult to predict. Because of such uncertainties, accruals are based on the best information available at the time. As additional information becomes available, the Company reassesses the potential liability related to pending claims and litigation.

NOTE 7 – STOCKHOLDERS' DEFICIT

Common Stock

As of December 31, 2016, the Company is authorized to issue 310,880,000 shares of common stock each with the par value of $0.0001 per share. No dividends shall be paid upon common stock of the Company.

Preferred Stock

As of December 31, 2016 and 2015, the Company was authorized to issue 9,120,000 shares of preferred stock, each with the par value of $0.0001 per share, consisting of (a) 4,000,000 shares of Class A preferred stock, (b) 420,000 shares of Class A-1 preferred stock, (c) 1,200,000 shares of Class A-2 preferred stock, and (d) 3,500,000 shares of Junior preferred stock. All preferred stock are non-redeemable.

Conversion into Common Stock

Each share of preferred stock is convertible, at any time at the option of the holder or automatically upon the date specified in writing through the vote of at least a simple majority of the outstanding shares of the class to be converted, into such number of shares of fully paid and non-assessable shares of common stock as is determined by dividing the then-original issue price, as adjusted, ("Original Issue Price") for such share of preferred stock by the conversion price, as adjusted, in effect on the date the certificate is surrendered for conversion ("Conversion Price"). The Original Issue Prices of a share of the Class A, A-1, A-2 and the Junior preferred stock are $25.00. The initial Conversion Prices for Class A, A-1, and A-2 preferred stock are $0.3120099714, $0.1826287244, and $0.50 per share, respectively. The initial Junior preferred stock conversion ratio shall be such as is necessary to convert the outstanding Junior preferred stock into 1,963,096 shares of common stock.

Dividends

Dividends shall accrue cumulatively on each share of preferred stock at a rate per annum of 6% of the respective Original Issue Price of Class A, A-1, and A-2 preferred stock. Dividends shall accrue on each share of preferred stock in accordance with the foregoing on a daily basis from the date upon which such shares of Class A, A-1 and A-2 preferred stock were first issued (the "Initial Issuance Date"), and shall accrue whether or not declared and shall be payable after the Company has achieved three (3) consecutive quarters of positive net income or upon the occurrence of a liquidity event, whichever is first. Any such dividend payment shall be made ratably among the holders of Class A, A-1 and A-2 preferred stock in proportion to the amount of the shares of Class A, A-1 and A-2 preferred stock held by such holders, respectively. No dividends shall be paid upon the Junior preferred stock of the Company.

The Company has not achieved the above specified performance metric, which would trigger payment of dividends. As of December 31, 2016, the amount of dividends payable if the Company were to have achieved three consecutive quarters of positive net income, would be approximately $2.6 million. Declaration and payment of dividends is subject to approval of the AES, Ltd. Board of Directors.

Liquidation

Liquidation Rights of Class *A, A-1, and A-2 Preferred Stock Holders.*

Upon the occurrence of any liquidation event of the Company whether voluntary or involuntary, each holder of Class A, A-1, and A-2 preferred stock shall be entitled to receive, prior and in preference to any payment or distribution, or segregation for payment or distribution, of any assets of the Company to the holders of shares of common stock or the Junior preferred stock (or the holders of any other equity securities of the Company) by reason of their ownership thereof, for each share of Class A, A-1, and A- 2 preferred stock, an amount of cash equal to (i) $25.00 (as adjusted for stock splits, reverse stock splits, recapitalization and similar transactions), plus (ii) any accrued and unpaid dividends on such shares (the "Class A, A-1 and A-2 Liquidation Amount"). If upon the occurrence of liquidation event, the assets and funds available for distribution to shareholders are insufficient to permit the payment to the holders of the shares of Class A, A-1 and A-2 preferred stock of the full preferential amounts described above, then the entire assets and funds of the Company legally available for distribution to shareholders shall be distributed ratably among the holders of shares of Class A, A-1 and A-2 preferred stock in proportion to the then aggregate liquidation amounts of the shares of Class A, A-1 and A-2 preferred stock held by such holders.

Liquidation Rights of Junior Preferred Stock Holders.

Upon completion of the distributions to the Class A, A-1 and A-2 Preferred stock holders and the holders of any new series of preferred stock authorized by the Board of Directors, each holder of Junior preferred stock shall be entitled to receive, prior and in preference to any payment or distribution, or segregation for payment or distribution, of any assets of the Company to the holders of shares of common stock by reason of their ownership thereof, for each share of Junior preferred stock, an amount of cash equal to $25.00 (as adjusted for stock splits, reverse stock splits, recapitalizations and similar transactions). If upon the occurrence of liquidation event and after the distributions as required above to the holders of the preferred stock and to the holders of any new series of preferred stock authorized by the Board of Directors, the assets and funds available for distribution to shareholders are insufficient to permit the payment to the holders of the shares of the Junior preferred stock of the full preferential amounts described above, the entire assets and funds of the Company legally available for distribution to shareholders shall be distributed ratably among the holders of shares of Junior preferred stock in proportion to the then aggregate liquidation amounts of the shares Junior preferred stock held by such holders.

Significant Stock Transactions
In January 2016, the Company sold 500,000 shares of treasury stock and a two-year warrant to purchase 250,000 shares of common shares at €0.60 per share, for aggregate gross proceeds of €250,000. In connection with the issuance, the Company also issued a three-year warrant to purchase 50,000 shares of common shares at €0.50 per share to a vendor as offering costs. The warrants were initially classified as liabilities and measured at fair value, pursuant to ASC 815-40. Upon amendment of the warrants at June 30, 2016 (see Note 8), these warrants are indexed to the Company's stock pursuant to ASC 815-40 and were reclassified to stockholders' deficit. The initial fair value of the warrants of approximately $62,000 was recorded as a liability, with the difference in net proceeds and the initial warrant liability recorded in shareholders' deficit.

Treasury Stock

Subsequent to AES, Ltd being formed in November 2012 to April 2013, the Company sold an aggregate of 33,400,000 shares of common stock to a third party for par value and immediately repurchased those shares at par value, thereby increasing the total number of common stock issued and creating treasury stock available for trading on Bermuda and Frankfurt Stock Exchanges in compliance with rules promulgated by the BSX.

NOTE 8 — WARRANTS

Freestanding warrants are recognized and measured in accordance with ASC 480, *Distinguishing Liabilities from Equity,* and ASC 815-40, *Derivatives and Hedging: Contracts in Own Equity*. Under this guidance, prior to June 30, 2016, all of the Company's outstanding warrants to purchase the Company's common stock were classified as liabilities for one or both of the following reasons: i) the warrant agreement contains an exercise price that is denominated in a currency other than the Company's functional currency, and ii) the warrant agreement requires the Company to maintain applicable listing requirements with any exchange where its common shares are listed.

The warrant liability is measured at fair value at each reporting period with changes in fair value recorded as a gain or loss within other (income) expense in the Company's Consolidated Statements of Operations until the warrants are exercised, expire, or other facts and circumstances lead the warrant liability to be reclassified as an equity instrument.

In June 2016, the Company obtained the consent of a majority of the outstanding warrant holders, via a written resolution, to amend the warrant agreements, removing the requirement for the Company to maintain applicable listing requirements with any exchange where its common shares are listed and denominating the strike price of all warrants in USD. After obtaining such consent, the Company's Board of Directors approved the amendments to the warrant agreements on June 30, 2016. The amended terms are effective and binding on all warrant holders. On June 30, 2016, as a result of the amendments, all outstanding warrants are indexed to the Company's common shares pursuant to ASC 815-40. As such, the warrant liability was remeasured, with changes in fair value through that date recognized within other (income) expense in the Company's Consolidated Statements of Operations. The warrant liability balance of $8,150,536 on June 30, 2016, after being remeasured, was reclassified to additional paid-in capital within stockholders' deficit.

The warrant liability was a Level 3 fair value measurement, recognized on a recurring basis. Both observable and unobservable inputs may be used to determine the fair value of positions that the Company has classified within the Level 3 category. As a result, the unrealized gains and losses for liabilities within the Level 3 category may include changes in fair value that were attributable to both observable inputs (e.g., changes in market interest rates) and unobservable inputs (e.g., probabilities of the occurrence of an early termination event).

Changes in Level 3 liabilities measured at fair value:

Fair value of warrant liability at December 31, 2014	$	9,181,831
Fair value of warrant liability on dates of issuance		1,298,909
Change in fair value of warrant liability		(2,936,954)
Exercise of warrants		(16,678)
Fair value of warrant liability at December 31, 2015	$	7,527,108
Issuance of new warrant liability		62,139
Change in fair value of warrant liability		561,289
Reclassification of warrant liability to equity upon amendment of all outstanding warrant agreements		(8,150,536)
Fair value of warrant liability at December 31, 2016	$	-

There were no transfers between Levels 1, 2 or 3 during the years ended December 31, 2016 and 2015.

Management used a Monte Carlo Simulation, with one million trials, and Black-Scholes method to estimate the fair value of the warrant during the years ended December 31, 2016 and 2015, with the following key inputs:

	For the years ended December 31,	
	2016	**2015**
Expected dividend yield	0.00%	0.00%
Expected stock-price volatility	73.89% - 81.46%	73.65% - 84.36%
Risk-free interest rate	0.20% - 1.88%	0.07% - 2.27%
Term of warrants (years)	1 - 10	10

The following table represents a summary of the warrants outstanding at December 31, 2016 and 2015 and changes during the years then ended:

	Warrants		**Weighted Average Exercise Price**
Outstanding at December 31, 2014	23,686,987	$	0.98
Issued	3,611,253		0.55
Exercised/ Expired	(858,074)		0.89
Outstanding at December 31, 2015	26,440,166		0.88
Issued	8,526,764		0.28
Expired	(446,356)		0.72
Outstanding at December 31, 2016	34,520,574		0.72
Exercisable at December 31, 2016	34,520,574	$	0.72

NOTE 9 – STOCK-BASED COMPENSATION

Terms of the Company's share-based compensation are governed by the Company's Share Option/ Share Issuance Plan (the "Stock Plan".) The shares issuable under the Plan shall be authorized but unissued or reacquired Common Shares. The maximum number of common shares which may be issued over the term of the Stock Plan shall not exceed 10,000,000 shares, except that by authorization of the Board, the sanctioned number of shares subject to the plan shall automatically be increased by 2% of the number of fully diluted shares of the Company effective January 1 of each year, commencing on January 1, 2013. The Plans permit the Company to grant non-statutory stock options, incentive stock options and stock purchase rights to the Company's employees, outside directors and consultants. The exercise price for each option shall be equal to 100% of the fair market value of the common stock on the date of grant, as defined, and shall vest as determined by the Company's Board of Directors but shall not exceed a ten-year period.

Options Issued to Officers, Directors and Employees as Compensation

Pursuant to the terms of the Stock Plan, during the year ended December 31, 2015, the Company issued an aggregate of 1,505,000 options to its employees, directors and officers, with a weighted average grant date fair value of $0.49 per option. These option grants had a ten-year term and an exercise price of $0.56 per share, as determined by the Company's Board of Directors, and no intrinsic value at the date of grant. Of the 1,505,000 options granted, 100,000 options vest within one year, and the remaining vest over 4 years. The unvested shares are subject to repurchase by the Company at the lower of (i) the exercise price or (ii) the fair market value per share at the time of the optionee's cessation of service. Also during the year ended December 31, 2015, an aggregate of 900,000 options issued to its employees, directors and officers were forfeited, leaving an aggregate of 6,573,324 options remained outstanding.

During the year ended December 31, 2016, the Company issued an aggregate of 1,710,000 options to its employees, directors and officers, with a weighted average grant date fair value of $0.46 per option. These option grants had a ten-year term and exercise prices range from $0.29 to $0.66 per share, as determined by the Company's Board of Directors, and no intrinsic value at the date of grant. Of the 1,710,000 options granted, 110,000 options vest within one year, and the remaining vest over 4 years. The unvested shares are subject to repurchase by the Company at the lower of (i) the exercise price or (ii) the fair market value per share at the time of the optionee's cessation of service. Also during the year ended December 31, 2016, an aggregate of 1,271,324 options issued to its employees, directors and officers were forfeited, leaving an aggregate of 7,012,000 options outstanding.

The Company recognized an expense for these option awards of approximately $550,000 and $560,000 for the years ended December 31, 2016 and 2015, respectively, within general and administrative expenses in the Consolidated Statements of Operations.

Options Issued to Nonemployees for Services Received

During the year ended December 31, 2015, there were no grants or forfeitures, and the total outstanding options were 3,637,217 at December 31, 2015.

During the year ended December 31, 2016, the Company issued an aggregate of 100,000 options to a consultant, with a weighted average grant date fair value of $0.38 per share. These option grants had a ten-year term, vest over four years, had an exercise price of $0.38 per share, and no intrinsic value at the date of grant. During the year ended December 31, 2016, an aggregate of 659,667 options issued to its consultants were forfeited, leaving an aggregate of 3,077,550 options outstanding at December 31, 2016.The Company recognized an expense for these option awards of approximately $3,000 and $0 for the years ended December 31, 2016 and 2015, respectively, within general and administrative expenses in the Consolidated Statements of Operations.

Options Valuation

The Company calculates the fair value of stock-based compensation awards granted to employees and nonemployees using the Black-Scholes option-pricing method. If the Company determines that other methods are more reasonable, or other methods for calculating these assumptions are prescribed by regulators, the fair value calculated for the Company's stock options could change significantly. Higher volatility and longer expected lives would result in an increase to stock-based compensation expense to non-employees determined at the date of grant. Stock-based compensation expense affects the Company's selling, general and administrative expenses.

The Black-Scholes option-pricing model requires the use of highly subjective and complex assumptions, which determine the fair value of stock-based awards. The assumptions used in the Black-Scholes option-pricing method for the years ended December 31, 2016 and 2015 is set forth below:

	For the years ended December 31,	
	2016	2015
Expected dividend yield	0.00%	0.00%
Expected stock-price volatility	72.9% - 79.9%	77.0% - 88.4%
Risk-free interest rate	1.3% - 2.4%	1.65% - 2.05%
Stock price	$0.26 - $0.72	$0.60 - $0.67
Expected term (years)	6.50	6.19

- *Expected dividend.* The expected dividend is assumed to be zero as the Company has never paid dividends and have no current plans to pay any dividends on the Company's common stock.
- *Expected volatility.* As the Company's common stock has been thinly traded since being listed in Bermuda and Frankfurt, the expected volatility is derived from the average historical volatilities of publicly traded companies within the Company's industry that the Company considers to be comparable to the Company's business over a period approximately equal to the expected term.
- *Risk-free interest rate.* The risk-free interest rate is based on the U.S. Treasury yield in effect at the time of grant for zero coupon U.S. Treasury notes with maturities approximately equal to the expected term.
- *Expected term.* The expected term represents the period that the stock-based awards are expected to be outstanding. The Company's historical share option exercise experience does not provide a reasonable basis upon which to estimate an expected term because of a lack of sufficient data. Therefore, the Company estimates the expected term by using the simplified method provided by the SEC. The simplified method calculates the expected term as the average of the time-to-vesting and the contractual life of the options.

In addition to the assumptions used in the Black-Scholes option-pricing model, the Company also estimates a forfeiture rate to calculate the stock-based compensation for the Company's equity awards. The Company will continue to use judgment in evaluating the expected volatility, expected terms and forfeiture rates utilized for the Company's stock-based compensation calculations on a prospective basis.

The following table represents a summary of the options granted to employees and non-employees outstanding at December 31, 2016 and 2015, and changes during the period then ended:

	Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (years)
Outstanding at December 31, 2014	9,605,541	$ 0.47	6.2
Granted	1,505,000	0.56	9.0
Expired/ Forfeited	(900,000)	0.56	
Outstanding at December 31, 2015	10,210,541	0.48	5.8
Granted	1,810,000	0.59	8.9
Expired/ Forfeited	(1,930,991)	0.47	-
Outstanding at December 31, 2016	10,089,550	$ 0.50	5.7
Exercisable at December 31, 2016	6,857,050	$ 0.45	4.3
Expected to be vested	3,232,500	$ 0.61	8.7

Total unrecognized stock-based compensation cost related to unvested stock options as of December 31, 2016 was approximately $1.5 million and is expected to be recognized over a weighted-average period of approximately 1.6 years.

NOTE 10 – RELATED PARTY TRANSACTIONS

The Company entered into several consulting agreements with certain management personnel and stockholders. Consulting expenses from such agreements were approximately $300,000 for each of the year ended December 31, 2016 and 2015, included within selling and general administrative expenses in the accompanying Consolidated Statements of Operations.

Other than as disclosed herein and in Notes 3, 5, 7 and 10, the Company has not entered into or been a participant in any transaction in which a related party had or will have a direct or indirect material interest.

NOTE 11 – INCOME TAXES

As of December 31, 2016, the Company has net operating loss carryforwards of approximately $25.2 million available to reduce future taxable income, if any, for Federal and state income tax purposes. The U.S. federal and state net operating loss carryforwards will begin to expire in 2034 for federal purposes and 2024 for state purposes.

Under the Internal Revenue Code ("IRC") Section 382, annual use of the Company's net operating loss carryforwards to offset taxable income may be limited based on cumulative changes in ownership. The Company has not completed an analysis to determine whether any such limitations have been triggered as of December 31, 2016. The Company has no income tax affect due to the recognition of a full valuation allowance on the expected tax benefits of future loss carry forwards based on uncertainty surrounding realization of such assets.

The Company's actual income tax expense for the years 2016 and 2015 differ from the expected amount computed by applying the statutory federal income tax rate of 34% to loss before income taxes as follows:

	For the years ended December 31,	
	2016	**2015**
Statutory federal income tax benefit	$ 1,773,790	$ 2,043
State taxes, net of federal tax benefit	304,382	351
Non-U.S. operations	(601,384)	396,128
Amortization of debt discount	(331,327)	(452,585)
Change in warrant liabilty	(120,807)	464,794
Meals and entertainment	(6,651)	(10,925)
Change in valuation allowance	(1,018,003)	(399,806)
Income taxes provision (benefit)	$ -	$ -

The tax effects of the temporary differences and carry forwards that give rise to deferred tax assets consist of the following:

	For the years ended December 31,	
	2016	2015
Statutory Federal Income Tax Rate	(34.0) %	(34.0) %
State Taxes, Net of Federal Tax Benefit	(5.8) %	(5.8) %
Non-U.S. operations	11.5 %	(6,592.4) %
Amortization of debt discount	6.4 %	7,532.0 %
Change in warrant liabilty	2.3 %	(7,735.2) %
Meals and entertainment	0.1 %	181.8 %
Change in Valuation Allowance	19.5 %	6,653.6 %
Income Taxes Provision (Benefit)	- %	- %

The Company applies the accounting guidance for uncertainty in income taxes pursuant to ASC 740-10. The Company did not record any accruals for income tax accounting uncertainties for the year ended December 31, 2016 and 2015, respectively.

The Company's policy is to recognize interest and penalties that would be assessed in relation to the settlement value of unrecognized tax benefits as a component of income tax expense. The Company did not accrue either interest or penalties from inception through December 31, 2016.

The Company does not have any unrecognized tax benefits that will significantly decrease or increase within 12 months of December 31, 2016.

The Company's major tax jurisdictions are the United States, California, and Bermuda. All of the Company's tax years will remain open three and four years for examination by the Federal and state tax authorities, respectively, from the date of utilization of the net operating loss. The Company does not have any tax audits pending.