

ASX ANNOUNCEMENT

Appendix 4D: AirXpanders Half Year Financial Results

PALO ALTO, CA, United States, 25 August 2016: AirXpanders Inc. (ASX:AXP) a medical device company focused on the design, manufacture, sale and distribution of the AeroForm® tissue expander, today released its Appendix 4D – Half Year Financial Results report for the period ended 30 June 2016.

Key financial details

- Sales revenue of US\$217K from the Australian sales of AeroForm®
- Operating expenses of US\$7 million
- Net loss after tax of US\$9 million
- Cash balance of US\$23 million at 30 June 2016

Highlights for the period

- Successful placement of CHESS Depositary Interest raising US\$14.9 million
- Added the CFO/COO position to the senior management team
- Year on year revenue growth of 350%
- Submitted formal response to the U.S. Food and Drug Administration's (FDA) initial queries to the dossier submitted in 2015

Scott Dodson, President and CEO of AirXpanders said, "During the first half of 2016, we built upon the successful launch of AeroForm® in Australia by reaching more surgeons and bringing in new hospitals, as well as our continued manufacturing transfer to Costa Rica to ensure a strong inventory position in preparation for US launch."

"We also submitted our response to the FDA's initial queries and anticipate that a final decision from the regulatory authorities could be received in the final quarter of 2016, and expect U.S. commercialisation to commence shortly thereafter."

-ENDS-

For more information**AirXpanders**

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About AirXpanders

Founded in 2005, AirXpanders (ASX:AXP) is a medical device company focused on the design, manufacture, sale and distribution of its AeroForm® tissue expander used in patients undergoing breast reconstruction following mastectomy. AeroForm® uses controlled delivery of small amounts of gas (CO₂) to achieve tissue expansion prior to the placement of a permanent breast implant. AeroForm® successfully eliminates the need for needle-based expansion required by traditional saline tissue expanders and provides a faster and less painful breast reconstruction journey. AeroForm® has CE Mark and TGA approval and is covered by the Australian reimbursement regime. To date, AeroForm® has been successfully implanted more than 500 times in women in Australia and the United States. For more information, refer to the Company's website at www.airxpanders.com.



AIRXPANDERS, INC.

**HALF-YEAR INFORMATION
FOR THE SIX MONTHS ENDED 30 JUNE 2016**

PROVIDED TO THE ASX UNDER LISTING RULE 4.2A.3

This half-year financial report is to be read in conjunction with the financial report for the six months ended 30 June 2016.

AIRXPANDERS, INC.

APPENDIX 4D (RULE 4.2A.3)

HALF-YEAR REPORT FOR THE SIX MONTHS ENDED 30 JUNE 2016

REPORTING PERIOD

Report for the half-year ended 30 June 2016

All comparisons to half-year ended 30 June 2015

RESULTS FOR ANNOUNCEMENT TO THE MARKET

	\$USD	up/down	% movement
Revenue from ordinary activities	216,644	up	359%
Profit (loss) after tax from ordinary activities attributable to members	(\$8,840,919)	up	93%
Net profit (loss) attributable to members	(\$8,840,919)	up	93%

Dividend information

	Amount per security \$USD	Franked amount per security \$USD	Tax rate for franking credit
Interim dividend	Nil	Nil	N/A
Previous corresponding dividend	Nil	Nil	N/A

Net tangible asset backing

	30 June 2016 \$USD	30 June 2015 \$USD
Net tangible asset per share of common stock	\$0.28	\$0.33
Net tangible asset per CHES Depositary Instrument (CDI) (if all shares were converted to CDIs)	\$0.09	\$0.11

- **Independent Audit Review:** This report is based on the consolidated 2016 Half-Year Financial Statements which have been reviewed by SingerLewak with the Independent Auditor's Review Report included in the 2016 Half-Year Financial Statements.
- **Changes in control over entities:** There were no entities over which control was been gained or lost during the period.
- **Details of dividends and dividend reinvestment plans:** No dividends have been declared or proposed.
- **Details of associates or joint ventures:** Not applicable
- **Set of accounting standards use in compiling the report:** The unaudited consolidated financial statement have been prepared in accordance with accounting principles generally accepted in the United States (US GAAP).
- **Details of audit disputes or audit qualification:** Not applicable

AIRXPANDERS, INC.
FINANCIAL STATEMENTS
AS OF JUNE 30, 2016 AND 2015
AND FOR THE SIX MONTHS ENDED
JUNE 30, 2016 AND 2015

AIRXPANDERS, INC.
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June 30, 2016 and 2015

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INDEPENDENT ACCOUNTANT'S REPORT

To the Board of Directors
AirXpanders, Inc.
Palo Alto, California

We have reviewed the accompanying financial statements of AirXpanders, Inc. (the "Company"), which comprise the balance sheets as of June 30, 2016 and 2015, and the related statements of operations, stockholders' equity, and cash flows for the six-month periods then ended, and the related notes to the financial statements. A review includes primarily applying analytical procedures to management's financial data and making inquiries of management. A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, we do not express such an opinion.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial statements that are free from material misstatement whether due to fraud or error.

Accountant's Responsibility

Our responsibility is to conduct the review engagements in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. Those standards require us to perform procedures to obtain limited assurance as a basis for reporting whether we are aware of any material modifications that should be made to the financial statements for them to be in accordance with accounting principle generally accepted in the United States of America. We believe that the results of our procedures provide a reasonable basis for our conclusion.

Accountant's Conclusion

Based on our reviews, we are not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with accounting principles generally accepted in the United States of America.



SingerLewak LLP

August 24, 2016

AIRXPANDERS, INC.
BALANCE SHEETS
As of June 30, 2016 and 2015

ASSETS		
	2016	2015
Current assets		
Cash and cash equivalents	\$ 23,339,317	\$ 27,926,968
Accounts receivable	78,391	-
Inventory	684,317	444,347
Prepaid expenses and other current assets	638,324	184,289
Total current assets	24,740,349	28,555,604
Property and equipment, net	1,240,886	305,978
Other assets	136,997	114,529
Total assets	\$ 26,118,232	\$ 28,976,111
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Current portion of long-term debt, net of discount	\$ 1,500,000	\$ 1,555,200
Accounts payable	991,127	1,347,115
Accrued expenses	657,386	724,847
Total current liabilities	3,148,513	3,627,162
Long-term debt, less current portion, net of discount	428,843	1,763,376
Warrant liabilities	-	131,147
Total liabilities	\$ 3,577,356	\$ 5,521,685
Commitments (note 8)		
Stockholders' equity		
Common stock; par value \$0.001, 300,000,000 shares authorized; 79,199,125 and 70,424,230 shares issued and outstanding at June 30, 2016 and 2015, respectively	\$ 79,199	\$ 70,423
Additional paid-in capital	78,207,993	63,719,692
Accumulated deficit	(55,746,316)	(40,335,689)
Total stockholders' equity	22,540,876	23,454,426
Total liabilities and stockholders' equity	\$ 26,118,232	\$ 28,976,111

See accompanying notes to financial statements and independent accountant's review report.

AIRXPANDERS, INC.
STATEMENTS OF OPERATIONS
For the Six-Month Periods Ended June 30, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Revenue	\$ 216,644	\$ 47,202
Cost of goods sold	<u>1,909,484</u>	<u>480,854</u>
Gross loss	(1,692,840)	(433,652)
Operating expenses		
Research and development	2,307,055	1,459,564
Clinical trials and regulatory	1,011,017	1,451,088
Selling, general and administrative	<u>3,750,040</u>	<u>1,328,474</u>
Total operating expenses	<u>7,068,112</u>	<u>4,239,126</u>
Operating loss	(8,760,952)	(4,672,778)
Interest expense	119,461	220,067
Other income, net	<u>(39,494)</u>	<u>(301,208)</u>
Loss before income taxes	(8,840,919)	(4,591,637)
Income taxes	<u>-</u>	<u>-</u>
Net loss	<u><u>\$ (8,840,919)</u></u>	<u><u>\$ (4,591,637)</u></u>

See accompanying notes to financial statements and independent accountant's review report.

AIRXPANDERS, INC.
STATEMENTS OF STOCKHOLDERS' EQUITY
For the Six-Month Periods Ended June 30, 2016 and 2015

	Convertible Preferred Stock		Common Stock		Additional Paid-In	Accumulated	Total Stockholders'
	Shares	Amount	Shares	Amount	Capital	Deficit	Equity (Deficit)
Balance, January 1, 2015	130,509,868	\$ 130,510	901,665	\$ 902	\$ 33,425,263	\$ (35,744,052)	\$ (2,187,377)
Issuance of common stock for cash	-	-	-	-	-	-	-
(net of issuance costs of \$2,849,785)	-	-	25,217,180	25,217	25,077,466	-	25,102,683
Exercise of warrants to purchase common stock	-	-	9,780,489	9,780	39,122	-	48,902
Conversion of convertible bridge notes payable into common stock	-	-	4,412,474	4,412	5,025,808	-	5,030,220
Conversion of convertible preferred stock into common stock	(130,509,868)	(130,510)	30,112,422	30,112	100,398	-	-
Stock-based compensation	-	-	-	-	51,635	-	51,635
Net loss	-	-	-	-	-	(4,591,637)	(4,591,637)
Balance, June 30, 2015	-	\$ -	70,424,230	\$ 70,423	\$ 63,719,692	\$ (40,335,689)	\$ 23,454,426
	Convertible Preferred Stock		Common Stock		Additional Paid-In	Accumulated	Total Stockholders'
	Shares	Amount	Shares	Amount	Capital	Deficit	Equity
Balance, January 1, 2016	-	\$ -	70,427,195	\$ 70,427	\$ 63,880,185	\$ (46,905,397)	\$ 17,045,215
Issuance of common stock for cash	-	-	-	-	-	-	-
(net of issuance costs of \$731,489)	-	-	8,771,930	8,772	14,149,739	-	14,158,511
Stock-based compensation	-	-	-	-	178,069	-	178,069
Net loss	-	-	-	-	-	(8,840,919)	(8,840,919)
Balance, June 30, 2016	-	\$ -	79,199,125	\$ 79,199	\$ 78,207,993	\$ (55,746,316)	\$ 22,540,876

See accompanying notes to financial statements and independent accountant's review report.

AIRXPANDERS, INC.
STATEMENTS OF CASH FLOWS
For the Six-Month Periods Ended June 30, 2016 and 2015

	2016	2015
Cash flows from operating activities		
Net loss	\$ (8,840,919)	\$ (4,591,637)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	154,349	34,991
Amortization of debt discount	21,434	4,530
Interest on convertible bridge notes payable converted to common stock	-	70,233
Change in fair value of warrant liabilities	-	(32,991)
Inventory provision	412,607	403,959
Stock-based compensation	178,069	51,635
Changes in operating assets and liabilities		
Accounts receivable	(1,507)	-
Inventory	(569,904)	(676,638)
Prepaid expenses and other current assets	(443,731)	(137,246)
Other assets	(25,273)	-
Accounts payable	116,731	945,290
Accrued expenses	263,427	529,682
Net cash used in operating activities	<u>(8,734,717)</u>	<u>(3,398,192)</u>
Cash flows from investing activities		
Purchase of property and equipment	<u>(485,573)</u>	<u>(185,663)</u>
Cash used in investing activities	<u>(485,573)</u>	<u>(185,663)</u>
Cash flows from financing activities		
Proceeds from convertible bridge notes payable	-	4,959,987
Principal payments on notes payable	(711,706)	(250,000)
Proceeds from issuance of common stock, net of issuance costs	14,158,511	25,102,683
Proceeds from exercise of warrants for common stock	-	48,902
Debt issue costs	<u>-</u>	<u>(1,485)</u>
Net cash provided by financing activities	<u>13,446,805</u>	<u>29,860,087</u>
Increase in cash and cash equivalents	4,226,515	26,276,232
Cash and cash equivalents - beginning of period	<u>19,112,802</u>	<u>1,650,736</u>
Cash and cash equivalents - end of period	<u>\$ 23,339,317</u>	<u>\$ 27,926,968</u>
Supplemental disclosure		
Cash paid for interest	<u>\$ 81,734</u>	<u>\$ 129,087</u>
Cash paid for taxes	<u>\$ 800</u>	<u>\$ 800</u>
Supplemental schedule of noncash investing and financing activities:		
Conversion of preferred stock to common stock in connection with initial public offering	<u>\$ -</u>	<u>\$ 34,632,758</u>
Conversion of convertible bridge notes payable and accrued interest to common stock in connection with initial public offering	<u>\$ -</u>	<u>\$ 5,030,220</u>

See accompanying notes to financial statements and independent accountant's review report.

AIRXPANDERS, INC.
NOTES TO FINANCIAL STATEMENTS
June 30, 2016 and 2015

NOTE 1 – DESCRIPTION OF BUSINESS

AirXpanders, Inc. ("AirXpanders" or the "Company") is a Delaware corporation formed on March 17, 2005, and is headquartered in Palo Alto, California. The Company has been primarily engaged in developing initial product technology, recruiting personnel and raising capital.

As a medical device company, AirXpanders is focusing in the field of tissue expansion after mastectomy, with an emphasis on breast reconstruction. The Company is designing the novel AeroForm patient controlled tissue expander. The AeroForm system consists of a self-contained expander (which is implanted in a similar manner to traditional saline expanders following a mastectomy), and a small hand-held wireless remote control unit. The lipstick-sized carbon dioxide (CO₂) reservoir in the expander gradually releases a predetermined amount of CO₂ through a small internal valve, eliminating the need for frequent saline injections at doctors' offices typically associated with current on-market expanders.

NOTE 2 – LIQUIDITY

The accompanying financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the settlement of liabilities and commitments in the normal course of business for the foreseeable future. The Company has incurred net losses from operations since its inception and has an accumulated deficit of \$55,746,316 at June 30, 2016. The Company recorded net losses of \$8,840,919 and \$4,591,637 for the six-month periods ended June 30, 2016 and 2015, respectively. The Company also recorded negative cash flows from operating activities for the six-month periods ended June 30, 2016 and 2015 of \$8,734,717 and \$3,398,192, respectively. To date, the Company's product candidates have been approved for marketing and sales in Australia and Europe, the Company started selling its product in Australia in January 2015. Management expects operating losses and cash flow deficits to continue for the foreseeable future. The Company's ability to achieve profitability is dependent primarily on its ability to successfully gain market share in Australia and Europe, obtain regulatory approvals in the U.S. by the U.S. Food and Drug Administration (FDA), reduce its manufacturing costs and gain market share in the U.S. The regulatory approval process is expensive, time-consuming, and uncertain, and any denial or delay of approval could have a material adverse effect on the Company. The accompanying financial statements do not include any adjustments that may be needed if the Company were unable to continue as a going concern.

In June 2016, the Company issued 8,771,930 shares of common stock in connection with a secondary public offering ("Secondary Offering") on the Australian Securities Exchange (ASX). The Company raised a total of \$14,158,511(AU\$19,017,476), net of issuance costs of \$731,489.

NOTE 2 – LIQUIDITY (Continued)

In June 2015, the Company issued 29,629,654 shares of common stock in connection with an initial public offering ("IPO") on the ASX. The Company raised a total of \$30,089,162, net of issuance costs of \$2,872,649. Of this amount \$28,001,824 (AU\$36.5 million) were proceeds received directly from the IPO; \$4,959,987 were proceeds received from the private placement of convertible bridge notes payable.

NOTE 3 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (US GAAP).

Use of Estimates

The preparation of financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of expenses during the reporting period. Actual results could differ materially from those estimates. The Company's most significant estimates relate to the valuation of its common stock prior to the IPO, options and warrant liabilities and valuation of its inventory at lower of cost or market.

Certain Significant Risks and Uncertainties

The Company operates in a dynamic, highly competitive industry and believes that changes in any of the following areas could have a material adverse effect on the Company's future financial position, results of operations, or cash flows; ability to obtain future financing; advances and trends in new technologies and industry standards; regulatory approval and market acceptance of the Company's products; development of sales channels; certain strategic relationships; litigation or claims against the Company based on intellectual property, patent, product, regulatory, or other factors; and the Company's ability to attract and retain employees necessary to support its growth.

Concentrations of Credit Risk

Financial instruments that potentially subject the Company to credit risk consist primarily of cash and cash equivalents. The Company maintains all of its U.S. cash balances at one financial institution, which at times may exceed the Federal Deposit Insurance Corporation (FDIC) limits of \$250,000 for interest-bearing accounts. At June 30, 2016 and 2015, the Company had cash balances of approximately \$21,893,532 and \$24,738,299 that were in excess of the FDIC limits. The Company also maintains all of its Australian cash balance at one financial institution, which at times may exceed the Australian government guaranteed limit of \$186,000 (AU\$ 250,000). At June 30, 2016 and 2015, the Company had a cash balance of approximately \$1,034,785 and \$3,188,669 that was in excess of the guaranteed limit.

NOTE 3 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Cash and Cash Equivalents

The Company considers all highly liquid investments with an original maturity of three months or less to be cash equivalents. At June 30, 2016, the Company maintained a balance of \$22,143,532 with one U.S. financial institution and the equivalent of approximately U.S. \$1,220,785 with one Australian financial institution. Restricted cash of \$25,000 at June 30, 2016 and 2015, which serves as collateral for corporate credit cards, is included in other assets in the balance sheet.

Inventory

Inventory is valued at the lower of cost or market, with cost determined by the first-in, first-out method. When needed, the Company provides reserves for excess or obsolete inventory.

Property and Equipment

Property and equipment are stated at cost, net of accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally three to five years. Leasehold improvements and property and equipment under capital leases are depreciated over the shorter of the estimated useful lives of the assets or the lease terms.

Expenditures for repairs and maintenance are charged to expense as incurred. Upon disposition of an asset, the cost and related accumulated depreciation are removed from the accounts and the resulting gain or loss is reflected in the statement of operations.

Impairment of Long-Lived Assets

The Company's long-lived assets and other assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. Recoverability of an asset to be held and used is measured by a comparison of the carrying amount of an asset to the future undiscounted cash flows expected to be generated by the asset. If such asset is considered to be impaired, the impairment to be recognized is measured as the amount by which the carrying amount of the asset exceeds its fair value. Through June 30, 2016, the Company had not experienced impairment losses on its long-lived assets.

Fair Value of Financial Instruments

The Company follows Financial Accounting Standards Board ("FASB") Accounting Standards Codification Topic No. 820, *Fair Value Measurement* ("ASC 820"), which clarifies fair value as an exit price, establishes a hierarchical disclosure framework for measuring fair value, and requires extended disclosures about fair value measurements. The provisions of ASC 820 apply to all financial assets and liabilities measured at fair value.

AIRXPANDERS, INC.
NOTES TO FINANCIAL STATEMENTS
June 30, 2016 and 2015

NOTE 3 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

As defined in ASC 820, fair value represents the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As a result, fair value is a market-based approach that should be determined based on assumptions that market participants would use in pricing an asset or a liability. As a basis for considering these assumptions, ASC 820 defines a three-tier value hierarchy that prioritizes the inputs used in the valuation methodologies in measuring fair value.

Fair Value of Financial Instruments (Continued)

Level 1 – Quoted prices in active markets for identical assets or liabilities.

Level 2 – Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The fair value hierarchy also requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

The following table sets forth by level, within the fair value hierarchy, the Company's assets measured at fair value in the balance sheet as of June 30, 2016:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Cash and cash equivalents	\$ 23,339,317	\$ -	\$ -	\$ 23,339,317
Total assets at fair value	\$ 23,339,317	\$ -	\$ -	\$ 23,339,317

The following table sets forth by level, within the fair value hierarchy, the Company's assets and liabilities measured at fair value in the balance sheet as of June 30, 2015:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Cash and cash equivalents	\$ 27,926,968	\$ -	\$ -	\$ 27,926,968
Total assets at fair value	\$ 27,926,968	\$ -	\$ -	\$ 27,926,968
Warrant liabilities	\$ -	\$ -	\$ 131,147	\$ 131,147
Total liabilities at fair value	\$ -	\$ -	\$ 131,147	\$ 131,147

NOTE 3 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

See Note 11 for discussion of the valuation methodology and inputs for the warrant liabilities.

At June 30, 2016 and 2015, the Company had the following financial instruments for which disclosure only of fair value is required:

Long-term debt – Valued at carrying value which is considered to be representative of its fair value based on current market rates available to the Company for comparable borrowing facilities.

Revenue Recognition

The Company recognizes revenue from sales of its products in accordance with the Revenue Recognition Topic ASC 605. The Company recognizes revenue from product sales upon delivery, provided there are no uncertainties regarding customer acceptance, there is persuasive evidence of an arrangement, the fee is fixed or determinable, and collectability of the related receivable is reasonably assured. This generally occurs after a device has been implanted in a patient.

Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable are stated at cost, net of allowance for doubtful accounts. Credit is extended to customers based on an evaluation of their financial condition and other factors and the Company does not charge interest on past due balances. The Company generally does not require collateral or other security to support accounts receivable. The Company performs ongoing credit evaluations of its customers and maintains an allowance for doubtful accounts.

The Company estimates its allowance for doubtful accounts by evaluating specific accounts where information indicates that customers may have an inability to meet their financial obligations and receivable amounts are outstanding for an extended period beyond the invoice terms. In these cases, the Company uses assumptions and judgment, based on the best available facts and circumstances, to either record a specific allowance against these customer balances or to write the balances off. The accounts receivable aging is reviewed on a regular basis and write-offs are recorded on a case-by-case basis net of any amounts that may be collected. Allowance charges are recorded as operating expenses. The Company did not have an allowance for doubtful accounts at June 30, 2016 and 2015.

Concentration

64% of the Company's revenue for the six-month period ended June 30, 2016 was from four customers and four customers accounted for 70% of the accounts receivable balance at June 30, 2016.

NOTE 3 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Reverse Stock Split

In May 2015 the Company's shareholders approved a 5-for-1 reverse stock split of all outstanding common stock and all securities exercisable into common stock. All amounts for common stock, preferred stock conversion ratios, stock options and warrants in the financial statements have been retroactively adjusted to reflect the effect of the reverse stock split.

Stock-Based Compensation

Stock-based compensation is measured at the grant date based on the fair value of the award. The fair value of the award that is ultimately expected to vest is recognized as expense on a straight-line basis over the requisite service period, which is generally the vesting period. The expense recognized for the portion of the award that is expected to vest has been reduced by an estimated forfeiture rate. The forfeiture rate is determined at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

The Company uses the Black-Scholes option-pricing model (the "Black-Scholes model") as the method for determining the estimated fair value of stock options.

Expected Term

The Company's expected term represents the period that the Company's stock-based awards are expected to be outstanding and is determined using the simplified method, which essentially equates to a weighted average of the vesting periods and total term of the award.

Expected Volatility

Expected volatility is estimated using comparable public companies volatility for similar terms. As the Company does not have long enough period as a public company to estimate its own volatility.

Expected Dividend

The Black-Scholes model calls for a single expected dividend yield as an input. The Company has never paid dividends and has no current plans to pay dividends on its common stock.

Risk-Free Interest Rate

The risk-free interest rate used in the Black-Scholes model is based on the U.S. Treasury zero coupon issues in effect at the time of grant for periods corresponding with the expected term of the option.

The Company recognizes the fair value of stock options granted to nonemployees as stock-based compensation expense over the period in which the related services are received.

Research and Development

Costs incurred in research and development activities (including clinical trials) are expensed as incurred. Research and development costs include, but are not limited to, payroll and personnel expenses, laboratory supplies, consulting costs, travel, parts and materials, equipment expenses, and equipment depreciation.

NOTE 3 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Income Taxes

The Company accounts for income taxes using the asset and liability method. Under this method, deferred income tax assets and liabilities are recorded based on the estimated future tax effects of differences between the financial statement and income tax basis of assets and liabilities. In addition, deferred tax assets are recorded for the future benefit of utilizing net operating loss and tax credit carryovers. Deferred tax assets and liabilities are measured using the enacted tax rates applied to taxable income. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is provided against the Company's deferred income tax assets when it is more likely than not that the asset will not be realized.

Significant judgment is required in determining any valuation allowance recorded against deferred tax assets. In assessing the need for a valuation allowance, the Company considers all available evidence, including past operating results, estimates of future taxable income and the feasibility of tax planning strategies. In the event that the Company changes its determination as to the amount of deferred tax assets that are more likely than not to be realized, the Company will adjust its valuation allowance with a corresponding impact to the provision for income taxes in the period in which such determination is made.

The Company follows authoritative guidance regarding uncertain tax positions. This guidance requires that realization of an uncertain income tax position must be more likely than not (i.e. greater than 50% likelihood of receiving a benefit) before it can be recognized in the financial statements. The guidance further prescribes the benefit to be realized assumes a review by tax authorities having all relevant information and applying current conventions. The interpretation also clarifies the financial statement classification of tax related penalties and interest and sets forth disclosures regarding unrecognized tax benefits. The Company recognizes potential accrued interest and penalties related to unrecognized tax benefits as income tax expense.

Foreign Currency Transactions

The Company's primary functional and reporting currency is the U.S. dollar. Foreign currency transactions are recorded in the functional currency of the Company by use of the exchange rate in effect at that date. Monetary assets and liabilities are translated at the exchange rate in effect at the balance sheet date. Other assets and liabilities are translated at the exchange rate in effect at the transaction date. Items appearing in the current year's income statement, except for the cost of inventories and depreciation translated at historic rate, are translated at average year rates. Exchange gains and losses are included in the income statement.

NOTE 3 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Recent Accounting Pronouncements

In March 2016, the FASB issued ASU 2016-09, Improvements to Employee Share-Based Payment Accounting, which amends ASC Topic 718, Compensation—Stock Compensation. The new guidance simplifies several aspects of the accounting for employee share-based payment transactions for both public and nonpublic entities, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification in the statement of cash flows. The new guidance is effective for public business entities for annual reporting periods beginning after December 15, 2016, and interim periods within that reporting period. The Company is currently evaluating the impact of this guidance on its financial statements.

In February 2016, the FASB issued a new standard, Leases, ASC 842. Lessees will need to recognize all lease arrangements with terms longer than twelve months on their balance sheet as a right-of-use asset and a corresponding lease liability. For income statement purposes, the FASB retained a dual model, requiring leases to be classified as either operating or finance. Lessor accounting is similar to the current model. Existing sale-leaseback guidance, including guidance for real estate, is replaced with a new model applicable to both lessees and lessors. The new guidance is effective for public business entities in fiscal years beginning after December 15, 2018. The Company is currently evaluating the impact of this guidance on its financial statements.

In November 2015, the FASB issued ASU 2015-17, "Income Taxes". The new guidance requires that all deferred tax assets and liabilities, along with any related valuation allowance for each tax-paying jurisdiction within each tax-paying component, be classified as noncurrent on the balance sheet. The new guidance will be effective for public business entities in fiscal years beginning after December 15, 2016, including interim periods within those years. Early adoption is permitted for all entities as of the beginning of an interim or annual reporting period. The Company does not expect this guidance to have significant impact on its financial statements.

In July 2015, the FASB issued ASU 2015-11, "Inventory (Topic 330): Simplifying the Measurement of Inventory". ASU 2015-11 more closely aligns the measurement of inventory in U.S. GAAP with the measurement of inventory in International Financial Reporting Standards by requiring companies using any methods of inventory valuation other than last-in, first-out or the retail inventory methods to measure inventory using the lower of cost and net realizable value, where net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. For public business entities, ASU 2015-11 is effective for annual reporting periods beginning after December 15, 2016 including interim periods within those fiscal years. ASU 2015-11 should be applied prospectively with earlier application permitted as of the beginning of an interim or annual reporting period. The Company is currently evaluating the impact of this ASU on its financial statements.

NOTE 3 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Recent Accounting Pronouncements (Continued)

In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers (Topic 606)". The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve that core principle, an entity should 1) identify the contract(s) with a customer, 2) identify the performance obligations in the contract, 3) determine the transaction price, 4) allocate the transaction price to the performance obligations in the contract, and 5) recognize revenue when (or as) the entity satisfies a performance obligation. In July 2015, the FASB deferred for one year the effective date of the new revenue standard, but early adoption will be permitted. The new standard will be effective for the Company on January 1, 2018. The Company is currently evaluating the impact of this ASU on its financial statements.

In April 2015, the FASB issued ASU No. 2015-03, "Interest – Imputation of Interest (Topic 835): Simplifying the Presentation of Debt Issuance Costs". This ASU simplifies the accounting for debt issuance costs by requiring such costs to be presented as a direct deduction from the related debt liability rather than as an asset. Debt disclosures will include the face amount of the debt liability and the effective interest rate. The ASU requires retrospective application and represents a change in accounting principle. The update is effective for fiscal years beginning after December 15, 2015. Early adoption is permitted for financial statements that have not been previously issued. The Company is currently evaluating the impact of this ASU on its 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 that management of public and private companies (rather than the independent auditor) to evaluate and disclose whether there are conditions and events that raise substantial doubt about the entity's ability to continue as a going concern within one year after the financial statements are issued (or available to be issued.) Management will be required to make this evaluation for both annual and interim reporting periods, if applicable. Management also is required to evaluate and disclose whether its plans alleviate that doubt. The new standard is effective for annual periods ending after December 15, 2015 and for annual and interim periods thereafter. Early adoption is permitted for annual or interim reporting periods for which the financial statements have not previously been issued. The Company is currently evaluating the impact of this ASU on its financial statements.

AIRXPANDERS, INC.
NOTES TO FINANCIAL STATEMENTS
June 30, 2016 and 2015

NOTE 4 – INVENTORY

Inventory consisted of the following at June 30, 2016:

	<u>2016</u>	<u>2015</u>
Raw materials	\$ 236,526	\$ 82,363
Work in progress	240,015	140,727
Finished goods	<u>207,776</u>	<u>221,257</u>
Inventory	<u>\$ 684,317</u>	<u>\$ 444,347</u>

The Company had written down its inventory to market value by \$412,607 and \$403,959 for the six-month periods ended June 30, 2016 and 2015 respectively.

NOTE 5 – PROPERTY AND EQUIPMENT

Property and equipment consisted of the following at June 30:

	<u>2016</u>	<u>2015</u>
Machinery and equipment	\$ 729,729	\$ 547,805
Computer equipment	150,054	94,138
Furniture and fixtures	82,543	73,392
Leasehold improvements	102,903	49,273
Software licenses	182,466	57,448
Office equipment	9,320	1,878
Construction in progress	<u>666,425</u>	<u>-</u>
Property and equipment, gross	1,923,439	823,934
Accumulated depreciation and amortization	<u>(682,553)</u>	<u>(517,956)</u>
Property and equipment, net	<u>\$ 1,240,886</u>	<u>\$ 305,978</u>

Depreciation and amortization expense amounted to \$154,349 and \$34,991 for the six-month periods ended June 30, 2016 and 2015, respectively.

AIRXPANDERS, INC.
NOTES TO FINANCIAL STATEMENTS
June 30, 2016 and 2015

NOTE 6 – ACCRUED EXPENSES

Accrued expenses consisted of the following at June 30:

	<u>2016</u>	<u>2015</u>
Accrued payroll and related expenses	\$ 282,662	\$ 133,225
Accrued rent payable	65,785	4,602
Accrued professional fees	-	360,000
Accrued other	<u>308,939</u>	<u>227,020</u>
Total accrued expenses	<u>\$ 657,386</u>	<u>\$ 724,847</u>

NOTE 7 – DEBT FINANCING

In January 2014, the Company borrowed \$3,500,000 under a loan and security agreement with a financial institution, which expires in July 2017. Interest is paid monthly on the principal amount at 7.34%. The loan is secured by substantially all of the Company's assets, excluding intellectual property. Under the terms of the agreement, interest-only payments were made monthly through March 2015, with principal payments commencing in April 2015, due in 28 equal monthly installments. A fee of \$271,250 is due at maturity, which is being accrued over the term of the loan. The Company can prepay the entire loan amount by providing a written five-day notice prior to such prepayment and pay all outstanding principal, interest and prepayment fees plus any default fees and all other sums that shall have become due and payable.

In March 2015, the Company amended the loan and security agreement to extend the interest-only period from March 2015 to April 2015, with principal payments commencing in May 2015, due in 27 equal monthly installments. The Company had the option to borrow an additional \$3,500,000 under the agreement, with the same terms, if certain conditions were met. This option expired unexercised in June 2015. The credit agreement includes a covenant whereby the Company is required to maintain all of the funds owned by it in the continental United States, provided that the Company may hold funds with an aggregate value of less than \$1,000,000 (or the foreign currency equivalent thereof) outside of the United States. At June 30, 2016, the Company had approximately \$1,220,785 of funds held outside of the United States which was in excess of the allowed limit per the covenant. In August 2016, the Company amended the loan and security agreement to raise the aggregate value of funds it is allowed to outside of the United States to \$5,000,000. In addition, the lender signed a waiver for the covenant violation at June 30, 2016. As a result, the Company has not classified all of this debt as current in the balance sheet.

AIRXPANDERS, INC.
NOTES TO FINANCIAL STATEMENTS
June 30, 2016 and 2015

NOTE 7 – DEBT FINANCING (Continued)

In connection with the loan agreement, the Company granted a warrant to the financial institution for the purchase of 52,500 shares of Series E convertible preferred stock ("Series E") at \$1.00 per share. The warrant is exercisable at the option of the holder at any time through January 15, 2024. As a result of the Company's initial public offering in June 2015 and conversion of all outstanding preferred stock into common stock, the warrants were converted into warrants for 52,500 shares of common stock at an exercise price of \$1.00 per share. The fair value of the warrant of \$31,710 on the date of issuance was recorded as a debt discount. The Company recorded \$4,530 and \$4,530 to interest expense related to amortization of this debt discount for the six-month periods ended June 30, 2016 and 2015 respectively. As of June 30, 2016, the unamortized discount on the debt is \$9,437. This warrant is outstanding at June 30, 2015 (see Note 11).

The Company recorded \$76,535 and \$127,558 of interest expense on the loans for the six-month periods ended June 30, 2016 and 2015, respectively. At June 30, 2016, \$1,938,280 was outstanding under this loan agreement.

In February and June 2015, the Company raised through a private placement of convertible bridge notes payable a total of \$4,959,987 in cash proceeds. The convertible bridge notes payable carried interest at 7% per annum. All the convertible bridge notes payable and related accrued interest of \$70,233 were converted into 4,412,474 shares of common stock as part of Company's initial public offering in June 2015.

As of June 30, 2016, future scheduled principal payments are as follows:

For the Years Ending	
<u>June 30,</u>	
2017	\$ 1,500,000
2018	438,280
Unamortized discount	<u>(9,437)</u>
Total debt	<u>1,928,843</u>
Less current portion	<u>1,500,000</u>
Total noncurrent portion of debt	<u><u>\$ 428,843</u></u>

NOTE 8 – COMMITMENTS

Lease Obligations

The Company leases its office space under a non-cancelable operating lease. Monthly base rent payments range from \$26,113 to \$33,238. In July 2015 the Company signed an agreement to extend its current office space lease to September 30, 2019. Under the same lease agreement, the Company expanded the premises and leased additional office space commencing October 1, 2015.

AIRXPANDERS, INC.
NOTES TO FINANCIAL STATEMENTS
June 30, 2016 and 2015

NOTE 8 – COMMITMENTS (Continued)

The Company recognizes rent expense on a straight-line basis over the term of the lease. Rent expense (including common area maintenance) related to the Company's operating leases was \$234,459 and \$101,841 for the six-month periods ended June 30, 2016 and 2015, respectively. Deferred rent balance was \$65,785 and \$4,602 at June 30, 2016 and 2015, respectively.

At June 30, 2016 the future rental commitments due under the lease are:

Years Ending June 30,	
2017	401,842
2018	413,898
2019	317,356
Total	<u>\$ 1,133,096</u>

Indemnifications

The Company has agreed to indemnify its officers and directors for certain events or occurrences arising as a result of the officers or directors serving in such capacity. The Company has a directors and officers' liability insurance policy that limits its exposure and enables the Company to recover a portion of any future amounts paid resulting from the indemnification of its officers and directors. In addition, the Company enters into indemnification agreements with other parties in the ordinary course of business. The Company has not incurred material costs to defend lawsuits or settle claims related to these indemnification agreements. The Company's management believes the estimated fair value of these indemnification agreements is minimal and has not recorded a liability for these agreements as of June 30, 2016 and 2015.

Royalties

The Company uses AeroForm® technology in the products it is developing. AeroForm® embodies inventions that have been patented in certain key jurisdictions. Certain of those patents are held by Shalon Ventures (either alone or jointly with AirXpanders). Shalon Ventures and AirXpanders have entered into a License Agreement dated March 9, 2005 (as amended on March 9, 2009 and January 9, 2012) in relation to those inventions (Shalon Ventures License Agreement). Pursuant to the Shalon Ventures License Agreement, Shalon Ventures granted AirXpanders an exclusive license to develop, make, have made, use, offer for sale, sell, have sold, import and export products that, but for the license, would infringe one or more claims of the patents. The license covers all human uses of self-expanding tissue expanders anywhere in the world and includes the right to sublicense.

AIRXPANDERS, INC.
NOTES TO FINANCIAL STATEMENTS
June 30, 2016 and 2015

NOTE 8 – COMMITMENTS (Continued)

In consideration for the license, AirXpanders is required to pay Shalon Ventures a running royalty of 3% of net sales of the licensed invention. If the amount of royalties paid in a calendar year is less than \$10,000, then AirXpanders shall also pay Shalon Ventures' out of pocket costs for prosecuting and maintaining the relevant patents. Each party indemnifies the other for any liability arising out of its material breach of the license, or its gross negligence, intentional misconduct and illegal actions. AirXpanders also indemnifies Shalon Ventures for any liability arising out of the commercialization of products using the license. Through June 30, 2016, the Company has incurred \$6,576 in royalty fees.

Mr. Teddy Shalon and Mr. Barry Cheskin are directors and shareholders of the Company. Mr. Cheskin is also the co-founder and chairman of the board of the Company. Mr. Shalon is the Chief Executive Officer and sole shareholder of Shalon Ventures. Mr. Shalon and Mr. Cheskin are each party to an agreement with Shalon Ventures, under which Shalon Ventures has agreed to pay Mr. Shalon 58%, and Mr. Cheskin 8%, of any royalties due to Shalon Ventures from AirXpanders under the Shalon Ventures License Agreement.

NOTE 9 – COMMON STOCK

In May 2015, the Company's shareholders approved a 5-for-1 reverse stock split of all outstanding common stock and all securities exercisable into common stock.

The Company's Articles of Incorporation, as amended, authorize the Company to issue 300,000,000 shares of \$0.001 par value common stock consisting of 200,000,000 shares of common stock Class A and 100,000,000 shares of common stock Class B. Class A common stockholders are entitled to dividends when and if declared by the Board of Directors, Class B common stockholders are not entitled to any dividends. The holder of each share of Class A common stock is entitled to one vote and holders of Class B common stock are not entitled to vote. At June 30, 2016 and 2015, no dividends had been declared for common stock. At June 30, 2016, 79,199,125 and 0 shares of common stock Class A and Class B, respectively, were issued and outstanding.

At June 30, 2016 and 2015, common stock that the Company had reserved for issuance was as follows:

	<u>2016</u>	<u>2015</u>
Warrants for common and convertible preferred shares	336,814	469,970
Stock option plans	<u>6,999,164</u>	<u>5,599,835</u>
Total	<u>7,335,978</u>	<u>6,069,805</u>

In June 2016, the Company issued 8,771,930 shares of common stock in connection with a Secondary Offering on the ASX. The Company raised a total of \$14,158,511, net of issuance costs of \$731,489.

NOTE 9 – COMMON STOCK (Continued)

In June 2015, the Company issued 29,629,654 shares of common stock in connection with an IPO on the ASX and conversion of convertible bridge notes payable and related accrued interest. The Company raised a total of \$30,089,162, net of issuance costs of \$2,872,649. Of this amount \$28,001,824 (AU\$36.5 million) were proceeds directly from the IPO; \$4,959,987 were proceeds from the private placement of convertible bridge notes payable.

NOTE 10 – CONVERTIBLE PREFERRED STOCK

The Company issued Series A, B, B-1, C, D and E convertible preferred stock during the period from 2005 through 2014, raising a total of \$30,393,627 in cash, net of issuance costs of \$595,493.

As part of Company's initial public offering in June 2015, all outstanding convertible preferred stock was converted into common stock. Series A, B, B-1 and E convertible preferred stock were converted to common stock at a 1:1 ratio, Series C convertible preferred stock was converted to common at a 1.25:1 ratio and Series D convertible preferred stock was converted to common at a 1.35:1 ratio. After conversion of all preferred stock to common stock, the Company cancelled all existing series of preferred stock.

The Company's Articles of Incorporation, as amended, authorize the Company to issue 10,000,000 shares of preferred stock, with rights and privileges for preferred stock to be determined by Company's Board of Directors before issuing preferred shares. As of June 30, 2016, there are no outstanding shares of preferred stock.

NOTE 11 – STOCK WARRANTS

The Company accounts for warrants in accordance with ASC 480, "*Distinguishing Liabilities from Equity*" ("ASC 480"). Under ASC 480, warrants containing certain features, such as put rights and anti-dilution protection, are required to be accounted for as liabilities and recorded at fair value, with changes in fair value being recorded in the statement of operations. The Company's preferred stock warrants contain such features, requiring liability accounting.

As part of Company's initial public offering in June 2015, all outstanding preferred stock warrants were converted into warrants for common stock. As a result of this conversion the warrants liabilities for \$122,516 were reclassified to additional paid in capital.

The Company is required to reserve authorized but unissued shares of its common and preferred stock in an amount equal to the number of warrant shares purchasable under the arrangements described below.

AIRXPANDERS, INC.
NOTES TO FINANCIAL STATEMENTS
June 30, 2016 and 2015

NOTE 11 – STOCK WARRANTS (Continued)

The Company's warrant liabilities account consisted of the following at June 30:

<u>Date Issued</u>	<u>2016</u>	<u>2015</u>
2007	\$ -	\$ 16
2008	-	5
2009	-	82
2011	-	69,082
2013	-	26,287
2014	-	35,675
	<u>\$ -</u>	<u>\$ 131,147</u>

The warrant liabilities are revalued at the end of each reporting period with the changes in fair value recorded in other income and expense in the statements of operations. The changes in fair value of these warrants recorded as other income (expense) are as follows for the six-month periods ended June 30:

<u>Date Issued</u>	<u>2016</u>	<u>2015</u>
2007	\$ -	\$ 929
2008	-	297
2009	-	59,669
2011	-	(21,082)
2013	-	(12,190)
2014	-	5,368
	<u>\$ -</u>	<u>\$ 32,991</u>

The fair value of the warrant liabilities was estimated using Black-Scholes model using the following assumptions for the six-month period ended June 30, 2015:

Stock price	\$1.22
Expected term (years)	0.50 – 8.55 years
Volatility	33.10 – 42.97%
Risk-free interest rate	0.24 – 1.99%
Dividend yield	-

AIRXPANDERS, INC.
NOTES TO FINANCIAL STATEMENTS
June 30, 2016 and 2015

NOTE 11 – STOCK WARRANTS (Continued)

The Company's outstanding warrants consisted of the following as of June 30:

	<u>2016</u>	<u>2015</u>
Warrants; exercisable in common stock, exercise price \$2.381 per share, expired in 2015	-	83,156
Warrants; exercisable in common stock, exercise price \$2.381 per share, expired in March 2016	-	50,000
Warrants; exercisable in common stock, exercise price \$0.05 per share, expiring in June 2018	119,314	119,314
Warrants; exercisable in common stock, exercise price \$0.05 per share, expiring in October 2018	5,000	5,000
Warrants; exercisable in common stock, exercise price \$1.25 per share, expiring in February 2021	120,000	120,000
Warrants; exercisable in common stock, exercise price \$1.0 per share, expiring in January 2023	40,000	40,000
Warrants; exercisable in common stock, exercise price \$1.0 per share, expiring in January 2024	<u>52,500</u>	<u>52,500</u>
Total	<u>336,814</u>	<u>469,970</u>

NOTE 12 – STOCK-BASED COMPENSATION

In March 2005, the Company adopted the 2005 Equity Incentive Plan (the "2005 Plan"). In May 2015, the Company adopted the 2015 Equity Incentive Plan (the "2015 Plan") collectively, (the "Plans"). The Plans provide for the granting of stock options to employees and consultants of the Company. Options granted under the Plan may be either incentive stock options or nonqualified stock options. Incentive stock options (ISO) may be granted only to Company employees (including officers and directors who are also employees). Nonqualified stock options (NSO) may be granted to Company employees and consultants.

During the six-month period ended June 30, 2015, the 2005 Plan expired and no future options can be granted under the 2005 Plan.

The Company has reserved 1,500,000 shares under the 2015 Plan. In addition, a total of 4,099,835 shares reserved under the 2005 Plan will be added to 2015 plan if and when the underlying options are cancelled.

Options under the Plans may be granted for periods of up to 10 years and at prices no less than 100% of the estimated fair value of the shares on the date of grant. In the case of an Incentive Stock Option granted to a holder who, at the time the Option is granted, owns stock representing more than 10% of the voting power of all classes of stock of the Company, the term of the Option shall be up to 5 years from the date of grant and at no less than 110% of the estimated fair value of the shares on the date of grant. Options granted generally vest 1/4 on the 12-month anniversary of the vesting commencement date and 1/48 on each monthly anniversary thereafter.

AIRXPANDERS, INC.
NOTES TO FINANCIAL STATEMENTS
June 30, 2016 and 2015

NOTE 12 – STOCK-BASED COMPENSATION (Continued)

As of June 30, 2016 and 2015, 5,186,634 and 4,036,335 options were vested and expected to vest with a weighted-average exercise prices of \$0.7476 and \$0.2982, and weighted average remaining contractual life of 6.82 and 7.0 years, respectively. The weighted average grant date fair value per share of options granted the six-month periods ended June 30, 2016 and 2015 was \$0.80 and \$0.21 respectively. The fair value of shares vested during the six-month periods ended June 30, 2016 and 2015 was \$88,769 and \$47,668 respectively. There were no options exercised six-month period ended June 30, 2016 and June 30, 2015.

In connection with the grant of stock options to employees and non-employees, the Company recorded stock compensation expense in the amounts of \$119,927 and \$51,635 for the six-month periods ended June 30, 2016 and 2015, respectively. As of June 30, 2016, unrecognized compensation expense related to employees totaled \$671,098 and will be recognized over approximately 3.2 years.

Activity under the Plan is set forth below:

	Options Available for Grant	Number of Options Outstanding	Exercise Price per Share	Weighted Average Remaining Contractual Life in Years
Balance – December 31, 2015	<u>1,419,327</u>	<u>4,171,292</u>	\$ 0.33	6.57
Additional shares reserved	1,408,544	-	\$ -	
Options granted	(1,130,669)	1,130,669	\$ 2.30	
Options exercised	-	-	\$ -	
Options forfeited/cancelled	<u>63,119</u>	<u>(63,119)</u>	\$ 0.89	
Balance June 30, 2016	<u>1,760,322</u>	<u>5,238,842</u>	\$ 0.75	6.83

AIRXPANDERS, INC.
NOTES TO FINANCIAL STATEMENTS
June 30, 2016 and 2015

NOTE 12 – STOCK-BASED COMPENSATION (Continued)

	Options Available for Grant	Number of Options Outstanding	Exercise Price per Share	Weighted Average Remaining Contractual Life in Years
Balance – December 31, 2014	<u>1,516,822</u>	<u>3,845,709</u>	\$ 0.29	7.33
Additional shares reserved (net of released)	237,304	-	\$ -	
Options granted	(254,126)	254,126	\$ 0.50	
Options exercised	-	-	\$ -	
Options forfeited/cancelled	<u>8,250</u>	<u>(8,250)</u>	\$ 0.38	
Balance June 30, 2015	<u>1,508,250</u>	<u>4,091,585</u>	\$ 0.30	7.01

The fair value of options granted to employees was estimated at the date of grant using the following assumptions for the six-month periods ended June 30:

	2016	2015
Expected term (years)	5.54 – 6.08 years	5.91 – 6.58 years
Volatility	34.11 – 34.88%	36.70 – 43.52%
Risk-free interest rate	1.18 – 1.43%	1.74 – 1.85%
Dividend yield	- %	- %

NOTE 13 – INCOME TAXES

The significant components of the net deferred tax asset are as follows at June 30, 2016 and 2015:

	2016	2015
Gross deferred income tax assets		
Net operating loss carryforwards	\$ 20,442,548	\$ 15,324,023
R&D credits	955,101	637,114
Property and equipment (depreciation)	(34,556)	(29,376)
Others	<u>701,353</u>	<u>317,838</u>
	22,064,447	16,249,599
Valuation allowance	<u>(22,064,447)</u>	<u>(16,249,599)</u>
Total	<u>\$ -</u>	<u>\$ -</u>

NOTE 13 – INCOME TAXES (Continued)

A valuation allowance has been recorded for the entire amount of the Company's deferred tax assets as a result of uncertainties regarding the realization of the deferred tax assets. The change in the valuation allowance totaled \$3,356,285 and \$1,574,780 for the six-month periods ended June 30, 2016 and 2015, respectively, principally due to increases in the valuation allowance associated with increased net operating losses.

As of June 30, 2016, the Company had net operating loss carryforwards for federal and state income tax reporting purposes of approximately \$53,408,503 and \$39,141,255 respectively. As of June 30, 2016 the Company also had Federal and California research and development tax credit carryforwards of approximately \$465,484, and \$489,618 respectively. The Federal net operating loss and tax credit carryforwards will expire at various dates beginning in 2025 through 2036. The California net operating loss carryforwards will expire at various dates beginning in 2017 through 2036. The California research and development tax credit carryforwards have no expiration date.

Utilization of the NOL and tax credit carryforwards may be subject to a substantial annual limitation due to ownership change limitations that may have occurred or that could occur in the future, as required by the Internal Revenue Code (the "Code"), as well as similar state provisions. In general, an "ownership change" as defined by the Code results from a transaction or series of transactions over a three-year period resulting in an ownership change of more than 50 percentage points of the outstanding stock of a company by certain stockholders or public groups.

Since the Company's formation, the Company has raised capital through the issuance of capital stock on several occasions which, combined with the purchasing stockholders' subsequent disposition of those shares, may have resulted in such an ownership change, or could result in an ownership change in the future upon subsequent disposition. The annual limitation may result in the expiration of NOL and tax credit carryforwards before utilization.

The Company has not completed a study to assess whether an ownership change has occurred or whether there have been multiple ownership changes since the Company's formation due to the complexity and cost associated with such a study, and the fact that there may be additional such ownership changes in the future. If the Company has experienced an ownership change at any time since its formation, utilization of the NOL or tax credit carryforwards to offset future taxable income and taxes, respectively, would be subject to an annual limitation under the Code, which is determined by first multiplying the value of the Company's stock at the time of the ownership change by the applicable long-term, tax-exempt rate, and then could be subject to additional adjustments, as required. Any limitation may result in expiration of all or a portion of the NOL or tax credit carryforwards before utilization.

NOTE 13 – INCOME TAXES (Continued)

The Company maintains a full valuation allowance for its deferred tax assets due to its historical losses and uncertainties surrounding its ability to generate future taxable income to realize these assets. Due to the existence of the valuation allowance, future changes in any unrecognized tax benefits and recognizable deferred tax benefits after the completion of an ownership change analysis is not expected to impact its effective tax rate.

The effective tax rate of the Company's provision for income tax benefit differs from federal statutory rate for the six-month periods ended June 30, 2016 and 2015, principally due to state taxes and changes in the valuation allowance.

As of June 30, 2016, and 2015, the Company had not identified any significant uncertain tax positions.

A number of the Company's tax returns remain subject to examination by taxing authorities: these include U.S. federal and state tax returns from 2005 forward.

NOTE 14 – RETIREMENT PLAN

The Company has a salary deferral plan under Section 401(k) of the Internal Revenue Code. The plan allows eligible employees to defer a portion of their compensation ranging from 1% to the maximum allowable dollar limit which is set by law. Such deferrals accumulate on a tax deferred basis until the employee withdraws the funds. The Company, at its option, may match a portion of the employees' contribution. During the six-month periods ended June 30, 2016 and 2015 the Company had not made any matching contributions.

NOTE 15 – MANAGEMENT INCENTIVE PLAN

On May 30, 2013, the Company adopted a management incentive plan that establishes a bonus pool with the objective of retaining its key employees and service providers through a potential Corporate Transaction, as defined in the plan. The plan provides for up to 7% of the total proceeds in a Corporate Transaction to be paid to key employees covered under the Plan. The plan was terminated in June 2015 as of the Company's IPO.

NOTE 16 – SUBSEQUENT EVENTS

In August 2016, the Company amended the loan and security agreement to raise the aggregate value of assets allowed to maintain outside of the United States from \$1,000,000 to \$5,000,000.

The Company has performed an evaluation of subsequent events through August 24, 2016 which is the date these financial statements were issued.