

**26 February 2016**

## **AirXpanders Full Year Financial Results**

### **Highlights**

- Total revenue for the year ended 31 December 2015 was US\$292,608, as sales of the Aeroform® tissue expander in Australia increased – approaching a monthly run rate of 20% market share in Australia as of the end of 2015
- Operating expenses of US\$9,994,866 reflecting investment in manufacturing and scaling up team in preparation for expected US launch
- Net loss after tax was US\$11,161,345
- Cash position as of December 31, 2015 was US\$19,137,802

**PALO ALTO, CA, United States:** 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 4E Preliminary Final Report for the period ended 31 December 2015 and its audited consolidated financial statements, with accompanying notes.

Following the launch of AeroForm® tissue expander in the Australian market, the company reported maiden revenues of US\$292,608 for the full year, and achieved a market share in Australia approaching 20%, based on monthly sales run rate, as of the end of December 2015. Revenue for the December quarter alone was US\$155,387, up 70% from US\$91,000 in the previous quarter.

Expenditure was US\$9,994,866 (US\$6,371,480 pcp), reflecting increased investment in transfer and scale up of manufacturing and growth in the sales, marketing and support team in preparation for launch in the United States, which, pending regulatory approval, is expected during 2016.

During the half year, AirXpanders reported final data from its XPAND clinical trial and filed its de novo application to the United States Food and Drug Administration seeking clearance to commence marketing of AeroForm in the United States.

Scott Dodson, President and CEO of AirXpanders said, “In our first financial year since listing on the ASX, we have executed a very successful launch of AeroForm® in Australia – which has been extremely well received, and also provided the company with a great blueprint for future growth. This period has also been one of investment as we build out a high calibre team and increase our manufacturing capability in preparation for US launch of AeroForm® expected this year.”

AirXpanders had cash, deposits at call and long term fixed interest term deposits of US\$19,137,802 at 31 December 2015.

- ENDS -

<b>Company</b>	<b>Investor relations</b>
Scott Dodson President & CEO Tel: +1 (650)-390-9008 Email: <a href="mailto:sdodson@airxpanders.com">sdodson@airxpanders.com</a>	Kyahn Williamson Buchan Consulting Tel: +61 (3) 9866 4722 / + 61 (0)401018828 Email: <a href="mailto:kwilliamson@buchanwe.com.au">kwilliamson@buchanwe.com.au</a>

#### **About AirXpanders:**

Founded in 2005, AirXpanders is a medical devices company focused on the design, manufacture, sale and distribution of its AeroForm® tissue expander used in patients undergoing breast reconstruction following mastectomy. It considers that its AeroForm® device is the best innovation in expander technology in 50 years. 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 for traditional saline tissue expanders and provides a faster, less painful and less stressful breast reconstruction journey. The Company has CE Mark and TGA approval for AeroForm® and is fully reimbursed under Australian private health plans with relevant coverage. To date, AeroForm® has been successfully implanted in over 400 patients worldwide. AirXpanders devices are not cleared or approved for use in the United States and are considered for investigational use only. AirXpanders is cleared for commercialization in Europe and in Australia.

For more information, refer to the Company's website at [www.airxpanders.com](http://www.airxpanders.com).

## APPENDIX 4E (RULE 4.3A)

### PRELIMINARY FINAL REPORT FOR THE YEAR ENDED 31 DECEMBER 2015

#### RESULTS FOR ANNOUNCEMENT TO THE MARKET

(All comparisons to year ended 31 December 2014)

	\$USD	up/down	% movement
<b>Revenue from ordinary activities</b>	\$292,608	up	N/A
Loss after tax from ordinary activities attributable to members	(\$11,161,345)	up	59.95%
Net loss after tax attributable to members	(\$11,161,345)	up	59.95%

<b>Dividend information</b>	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

<b>Net tangible asset backing</b>	31 Dec 2015 \$USD	31 Dec 2014 \$USD
Net tangible asset per share of Class A Common Stock (Share) of the Company	\$0.24	N/A*
Net tangible asset per CDI assuming all Shares held as CDIs	\$0.08	N/A*

*\* A per Share comparison with 2014 would not be meaningful as the Company had a major capital restructure prior to its listing on the ASX in June 2015 and no CDIs were on issue at 31 December 2014.*

- **Annual financial results:** This report is based on the accompanying consolidated 2015 Financial Statements which have been audited by SingerLewak, LLP with the Independent Auditor's Report included in the 2015 Financial Statements.
- **Changes in control over entities:** There were no entities over which control has been gained or lost during 2015.
- **Details of dividends and dividend reinvestment plans:** No dividends have been declared or proposed.
- **Details of associates or joint ventures:** N/A
- **Set of accounting standards used in compiling the report:** The audited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the U.S. (US GAAP) and are denominated in U.S. dollars.
- **Details of audit disputes or audit qualification:** None.

**A commentary on the results for the period:**

The net loss for the year increased to \$11,161,345 compared to \$6,977,751 for the previous corresponding period.

Total operating expenses increased to \$9,994,866 from \$6,371,480 for the previous corresponding period, reflecting increased investment in transfer and scale up of manufacturing and growth in the sales, marketing and support team in preparation for launch in the United States, which, pending regulatory approval, is expected during 2016.

The Company had cash, deposits at call and long term fixed interest term deposits of US\$19,137,802 at 31 December 2015.

The Company is entering the new financial year in a strong position. The Company has exceeded its 2015 revenue goal with a market share in Australia already approaching 20%, based on monthly run rate, as of the end of 2015.

The Company operated in one segment only during the period and there were no returns to shareholders or share buy backs.

Please also refer to the separate update on the full year financial results of the Company and the Company's audited consolidated financial statements, with accompanying notes, which are attached hereto.

**Annual Meeting of Stockholders**

The Annual Meeting of Stockholders of the Company will be held at *Johnson Winter & Slattery's Sydney office* at Level 25, 20 Bond Street Sydney, New South Wales, Australia on Tuesday, 17 May 2016 at 9.00am Australian Eastern Standard Time (Monday, 16 May 2016 at 4.00pm U.S. Pacific Standard Time).

**AIRXPANDERS, INC.**  
**FINANCIAL STATEMENTS**  
**AS OF AND FOR THE YEARS ENDED**  
**DECEMBER 31, 2015 AND 2014**

**AIRXPANDERS, INC.**  
**CONTENTS**  
**December 31, 2015 and 2014**

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Page

**INDEPENDENT AUDITOR'S REPORT**

1 – 2

**FINANCIAL STATEMENTS**

Balance Sheets

3

Statements of Operations

4

Statements of Stockholders' Equity (Deficit)

5

Statements of Cash Flows

6

Notes to Financial Statements

7 – 30

## **Independent Auditor's Report**

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

### **Report on the Financial Statements**

We have audited the accompanying financial statements of AirXpanders, Inc. (the Company), which comprise the balance sheets as of December 31, 2015 and 2014, and the related statements of operations, stockholder's equity (deficit) and cash flows for the years then ended and the related notes to the financial statements, (collectively, financial statements).

### **Management's Responsibility for the Financial Statements**

Management is responsible for the preparation and fair presentation of these 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 financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditor's Responsibility**

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

To the Board of Directors and Stockholders of  
AirXpanders, Inc.  
Page 2

**Opinion**

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

A handwritten signature in cursive script that reads "SingerLewak LLP".

SingerLewak LLP

San Jose, California  
February 25, 2016



**AIRXPANDERS, INC.**  
**BALANCE SHEETS**  
**December 31, 2015 and 2014**

<b>ASSETS</b>		
	2015	2014
<b>Current assets</b>		
Cash and cash equivalents	\$ 19,112,802	\$ 1,650,736
Accounts receivable	76,884	-
Inventory	527,020	171,668
Prepaid expenses and other current assets	194,593	47,043
Total current assets	19,911,299	1,869,447
<b>Property and equipment, net</b>	909,662	155,306
<b>Other assets</b>	128,628	113,044
<b>Total assets</b>	<b>\$ 20,949,589</b>	<b>\$ 2,137,797</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)</b>		
	2015	2014
<b>Current liabilities</b>		
Current portion of long-term debt, net of discount	\$ 1,500,000	\$ 993,089
Accounts payable	874,396	401,825
Accrued expenses	393,959	195,165
Total current liabilities	2,768,355	1,590,079
<b>Long-term debt, less current portion, net of discount</b>	1,136,019	2,570,957
<b>Warrant liabilities</b>	-	164,138
Total liabilities	\$ 3,904,374	\$ 4,325,174
<b>Commitments (Note 8)</b>		
<b>Stockholders' equity (deficit)</b>		
Convertible preferred stock, par value \$0.001, 0 and 132,356,630 authorized respectively; 0 and 130,509,868 shares issued and outstanding at December 31, 2015 and 2014, respectively	\$ -	\$ 130,510
Preferred stock, par value \$0.001; 10,000,000 and 0 shares authorized respectively; 0 and 0 shares issued and outstanding at December 31, 2015 and 2014, respectively	-	-
Common stock; par value \$0.001, 300,000,000 and 48,596,637 shares authorized at December 31, 2015 and 2014, respectively; 70,427,195 and 901,665 shares issued and outstanding at December 31, 2015 and 2014, respectively	70,426	902
Additional paid-in capital	63,880,186	33,425,263
Accumulated deficit	(46,905,397)	(35,744,052)
Total stockholders' equity (deficit)	17,045,215	(2,187,377)
<b>Total liabilities and stockholders' equity (deficit)</b>	<b>\$ 20,949,589</b>	<b>\$ 2,137,797</b>

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

**AIRXPANDERS, INC.**  
**STATEMENTS OF OPERATIONS**  
For the Years Ended December 31, 2015 and 2014

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	<u>2015</u>	<u>2014</u>
<b>Revenue</b>	\$ 292,608	\$ -
<b>Cost of goods sold</b>	<u>1,378,145</u>	<u>-</u>
<b>Gross loss</b>	(1,085,537)	-
<b>Operating expenses</b>		
Research and development	3,131,118	1,193,930
Clinical trials and regulatory	1,696,231	2,948,742
Selling, general and administrative	<u>5,167,517</u>	<u>2,228,808</u>
Total operating expenses	<u>9,994,866</u>	<u>6,371,480</u>
<b>Operating loss</b>	(11,080,403)	(6,371,480)
<b>Interest expense</b>	421,996	561,075
<b>Other (income) expense, net</b>	<u>(341,054)</u>	<u>45,196</u>
<b>Net loss</b>	<u><u>\$ (11,161,345)</u></u>	<u><u>\$ (6,977,751)</u></u>

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

**AIRXPANDERS, INC.**  
**STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT)**  
**For the Years Ended December 31, 2015 and 2014**

	Convertible Preferred Stock		Common Stock		Additional Paid-In Capital	Accumulated Deficit	Total Stockholders' Equity (Deficit)
	Issued and Outstanding Shares	Amount	Issued and Outstanding Shares	Amount			
<b>Balance, January 1, 2014</b>	<b>125,509,868</b>	<b>\$ 125,510</b>	<b>901,665</b>	<b>\$ 902</b>	<b>\$ 32,342,921</b>	<b>\$ (28,766,301)</b>	<b>\$ 3,703,032</b>
Additional Series E preferred stock for cash (net of issuance costs of \$20,981)	5,000,000	5,000	-	-	974,019	-	979,019
Stock-based compensation	-	-	-	-	108,323	-	108,323
Net loss	-	-	-	-	-	(6,977,751)	(6,977,751)
<b>Balance, December 31, 2014</b>	<b>130,509,868</b>	<b>\$ 130,510</b>	<b>901,665</b>	<b>\$ 902</b>	<b>\$ 33,425,263</b>	<b>\$ (35,744,052)</b>	<b>\$ (2,187,377)</b>
Issuance of common stock for cash (net of issuance costs of \$2,872,649)	-	-	25,217,180	25,217	25,055,056	-	25,080,273
Exercise of warrants to purchase common stock	-	-	9,780,489	9,780	39,122	-	48,902
Exercise of Stock Options	-	-	2,965	3	520	-	523
Conversion of convertible bridge notes payable and accrued interest of \$70,233 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	-	-
Conversion of warrants to purchase preferred stock into warrants to purchase common stock	-	-	-	-	122,516	-	122,516
Stock-based compensation	-	-	-	-	111,503	-	111,503
Net loss	-	-	-	-	-	(11,161,345)	(11,161,345)
<b>Balance, December 31, 2015</b>	<b>-</b>	<b>\$ -</b>	<b>70,427,195</b>	<b>\$ 70,426</b>	<b>\$ 63,880,186</b>	<b>\$ (46,905,397)</b>	<b>\$ 17,045,215</b>

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

**AIRXPANDERS, INC.**  
**STATEMENTS OF CASH FLOWS**  
For the Years Ended December 31, 2015 and 2014

	2015	2014
<b>Cash flows from operating activities</b>		
Net loss	\$ (11,161,345)	\$ (6,977,751)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	85,619	36,851
Amortization of debt discount	9,060	23,729
Interest on convertible bridge notes payable converted to common stock	70,233	110,356
Change in fair value of warrant liabilities	(41,622)	50,684
Inventory provision	527,444	160,406
Stock-based compensation	111,503	108,323
Changes in operating assets and liabilities		
Accounts receivable	(76,884)	-
Inventory	(882,796)	(332,074)
Prepaid expenses and other assets	(147,550)	6,448
Accounts payable	472,571	(26,689)
Accrued expenses	198,794	48,661
Net cash used in operating activities	<u>(10,834,973)</u>	<u>(6,791,056)</u>
<b>Cash flows from investing activities</b>		
Purchase of property and equipment	<u>(839,975)</u>	<u>(95,874)</u>
Cash used in investing activities	<u>(839,975)</u>	<u>(95,874)</u>
<b>Cash flows from financing activities</b>		
Proceeds from convertible bridge notes payable	4,959,987	-
Proceeds from notes payable	-	3,500,000
Principal payments on notes payable	(937,087)	(1,083,148)
Proceeds from issuance of common stock, net of issuance costs	25,080,273	979,019
Proceeds from exercise of stock options	523	-
Proceeds from exercise of warrants for common stock	48,902	-
Debt issue costs	<u>(15,584)</u>	<u>(83,053)</u>
Net cash provided by financing activities	<u>29,137,014</u>	<u>3,312,818</u>
<b>Increase (decrease) in cash and cash equivalents</b>	17,462,066	(3,574,112)
<b>Cash and cash equivalents - beginning of period</b>	<u>1,650,736</u>	<u>5,224,848</u>
<b>Cash and cash equivalents - end of period</b>	<u><u>\$ 19,112,802</u></u>	<u><u>\$ 1,650,736</u></u>
<b>Supplemental disclosure</b>		
Cash paid for interest	<u>\$ 240,144</u>	<u>\$ 429,311</u>
Cash paid for taxes	<u>\$ 800</u>	<u>\$ 800</u>
<b>Supplemental schedule of noncash investing and financing activities:</b>		
Conversion of preferred stock to common stock in connection with initial public offering	<u>\$ 34,632,758</u>	<u>\$ -</u>
Conversion of convertible bridge notes payable and accrued interest to common stock in connection with initial public offering	<u>\$ 5,030,220</u>	<u>\$ -</u>
Conversion of warrant liabilities to equity	<u>\$ 122,516</u>	<u>\$ -</u>

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

**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 (CO<sub>2</sub>) reservoir in the expander gradually releases a predetermined amount of CO<sub>2</sub> 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 \$46,905,397 at December 31, 2015. The Company recorded net losses of \$11,161,345 and \$6,977,751 for the years ended December 31, 2015 and 2014, respectively. The Company also recorded negative cash flows from operating activities for the years ended December 31, 2015 and 2014 of \$10,834,973 and \$6,791,056, 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) 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 2015, the Company issued 29,629,654 shares of common stock in connection with an initial public offering ("IPO") on the Australian Securities Exchange (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 directly from the IPO; \$4,959,987 were proceeds from the private placement of convertible bridge notes payable. In January 2014, the Company borrowed \$3,500,000 under a loan and security agreement with a financial institution which expires in July 2017. 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 in June 2015 and the Company did not borrow the additional \$3,500,000.

**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 December 31, 2015 and 2014, the Company had cash balances of approximately \$16,508,489 and \$1,425,736 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 \$182,188 (AU\$ 250,000). At December 31, 2015, the Company had a cash balance of approximately \$2,197,125 that was in excess of the guaranteed limit.

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 December 31, 2015, the Company maintained a balance of \$16,758,489 with one U.S. financial institution and the equivalent of approximately U.S. \$2,379,313 with one Australian financial institution. Restricted cash of \$25,000 at December 31, 2015 and 2014, which serves as collateral for corporate credit cards, is included in other assets in the balance sheet.

**NOTE 3 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Inventory

Inventory is valued at the lower of cost or market value, with cost determined by the first-in, first-out method.

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 December 31, 2015, 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 hierarchal 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.

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.

**NOTE 3 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

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 December 31, 2015:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Cash and cash equivalents	<u>\$ 19,112,802</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 19,112,802</u>
<b>Total assets at fair value</b>	<b><u>\$ 19,112,802</u></b>	<b><u>\$ -</u></b>	<b><u>\$ -</u></b>	<b><u>\$ 19,112,802</u></b>

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 December 31, 2014:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Cash and cash equivalents	<u>\$ 1,650,736</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,650,736</u>
<b>Total assets at fair value</b>	<b><u>\$ 1,650,736</u></b>	<b><u>\$ -</u></b>	<b><u>\$ -</u></b>	<b><u>\$ 1,650,736</u></b>
Warrant liabilities	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 164,138</u>	<u>\$ 164,138</u>
<b>Total liabilities at fair value</b>	<b><u>\$ -</u></b>	<b><u>\$ -</u></b>	<b><u>\$ 164,138</u></b>	<b><u>\$ 164,138</u></b>

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



**NOTE 3 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Fair Value of Financial Instruments (Continued)

At December 31, 2015 and 2014, 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. 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 December 31, 2015.

Concentration

24% of the Company's revenue for the year ended December 31, 2015 was from one customer and two customers accounted for 47% of the accounts receivable balance at December 31, 2015.

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.

**NOTE 3 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

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.

*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.

Development-Stage Company, Early adoption of ASU 2014-10

The Company was previously classified as a development-stage company as defined in Accounting Standards Codification ("ASC") No. 915, Development Stage Entities. The Company has elected to early adopt Accounting Standards Update ("ASU") 2014-10 ("ASU 2014-10"), which eliminates the additional disclosures previously required for development stage companies, in particular, the inception-to-date reporting for the statement of operations, statement of cash flows, and statement of stockholders' equity (deficit).

**NOTE 3 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Recent Accounting Pronouncements

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.

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.

**NOTE 3 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Recent Accounting Pronouncements (Continued)

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 15 December 2016 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.

**NOTE 4 – INVENTORY**

Inventory consisted of the following at December 31, 2015:

	<u>2015</u>	<u>2014</u>
Raw materials	\$ 211,169	\$ 37,258
Work in progress	241,949	16,052
Finished goods	64,404	118,358
Inventory in transit	<u>9,498</u>	<u>-</u>
<b>Inventory</b>	<b><u>\$ 527,020</u></b>	<b><u>\$ 171,668</u></b>

The Company had written down its inventory to market value by \$687,850 and \$160,406 for the years ended December 31, 2015 and 2014 respectively.

**AIRXPANDERS, INC.**  
**NOTES TO FINANCIAL STATEMENTS**  
**December 31, 2015 and 2014**

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**NOTE 5 – PROPERTY AND EQUIPMENT**

Property and equipment consists of the following at December 31:

	<u>2015</u>	<u>2014</u>
Machinery and equipment	\$ 714,382	\$ 433,682
Computer equipment	121,926	74,716
Furniture and fixtures	77,457	72,060
Leasehold improvements	100,354	36,875
Software licenses	19,061	19,061
Office equipment	8,679	1,878
Construction in progress	<u>395,903</u>	<u>-</u>
Property and equipment, gross	1,437,762	638,272
Accumulated depreciation and amortization	<u>(528,100)</u>	<u>(482,966)</u>
<b>Property and equipment, net</b>	<b><u>\$ 909,662</u></b>	<b><u>\$ 155,306</u></b>

Depreciation and amortization expense amounted to \$85,619 and \$36,851 for the years ended December 31, 2015 and 2014, respectively.

**NOTE 6 – ACCRUED EXPENSES**

Accrued expenses consisted of the following at December 31:

	<u>2015</u>	<u>2014</u>
Accrued payroll and related expenses	\$ 199,290	\$ 92,760
Accrued rent payable	28,976	4,579
Accrued other	<u>165,693</u>	<u>97,826</u>
<b>Total accrued expenses</b>	<b><u>\$ 393,959</u></b>	<b><u>\$ 195,165</u></b>

**NOTE 7 – DEBT FINANCING**

In March 2011, the Company borrowed \$3,000,000 under a loan and security agreement with a financial institution which expired in September 2014. In January 2014, the Company repaid the entire loan balance. Interest was paid monthly on the principal amount at 9.01%. Under the terms of the agreement, interest-only payments were made monthly through September 2011, with principal payments commencing in October 2011, due in 36 equal monthly installments. A fee of \$165,000 was due at maturity. The Company could prepay the entire loan amount by providing a written ten day notice prior to such prepayment and pay all outstanding principal, interest and prepayment fee plus any default fees and all other sums that shall have become due and payable. The loan was secured by substantially all of the Company's assets, excluding intellectual property.

**NOTE 7 – DEBT FINANCING (Continued)**

In connection with this loan agreement, the Company granted a warrant to the financial institution to purchase 96,000 shares of Series C convertible preferred stock ("Series C") at \$1.25 per share. The warrant is exercisable at the option of the holder at any time through February 28, 2021 and is outstanding at December 31, 2015 (see Note 11). 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 120,000 shares of common stock at an exercise price of \$1.25 per share. The fair value of the warrant of \$76,647 on the date of issuance was recorded as a debt discount. The debt discount was being amortized over the expected term of the loan as a component of interest expense. The Company recorded \$0 and \$31,921 to interest expense related to amortization of this debt discount for the years ended December 31, 2015 and 2014, respectively.

In January 2013, the Company entered into a loan modification agreement related to the loan and security agreement, to make monthly repayments of interest only from February 1, 2013 to June 1, 2013. The Company paid a modification fee of \$15,000. In conjunction with the modification, the Company issued a warrant for the purchase of 29,629 shares of Series D Preferred Stock at an exercise price of \$1.35. As a result of the Series E round of financing during 2013, the holder of the warrant had the election under their existing warrant agreement to convert their warrants into warrants for 40,000 shares of Series E at an exercise price of \$1.00 per share. 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 40,000 shares of common stock at an exercise price of \$1.00 per share. This warrant is outstanding at December 31, 2015 (see Note 11).

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.

Part of the loan proceeds were used to pay off the balance of the loan borrowed in March 2011.

**NOTE 7 – DEBT FINANCING (Continued)**

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 December 31, 2015, the Company had approximately \$2,379,313 of funds held outside of the United States which was in excess of the allowed limit per the covenant. In November 2015, the lender signed a waiver stating that despite the covenant violation, it would allow a grace period ending May 15, 2016 to comply with this covenant. Until that date, the loan may not be called. The Company plans to cure the covenant violation during the grace period and as a result has not classified all of this debt as current in the balance sheet.

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 \$9,060 and \$8,683 to interest expense related to amortization of this debt discount for the years ended December 31, 2015 and 2014 respectively. As of December 31, 2015, the unamortized discount on the debt is \$13,967. This warrant is outstanding at December 31, 2015 (see Note 11).

The Company recorded \$346,251 and \$561,075 of interest expense on the loans for the years ended December 31, 2015 and 2014, respectively. At December 31, 2015, \$2,636,019 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 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.



**NOTE 7 – DEBT FINANCING (Continued)**

At December 31, 2015, future scheduled principal payments are as follows:

For the Years Ending <u>December 31,</u>	
2016	\$ 1,500,000
2017	1,149,986
Unamortized discount	<u>(13,967)</u>
Total debt	<u>2,636,019</u>
Less current portion	<u>1,500,000</u>
<b>Total noncurrent portion of debt</b>	<b><u>\$ 1,136,019</u></b>

**NOTE 8 – COMMITMENTS**

Lease Obligations

The Company leases its office space under a non-cancelable operating lease. Monthly base rent payments range from \$12,807 to \$21,627. The Company amended the lease to extend the term of the lease from August 2013 through July 2016. 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 totaling approximately 5,692 square foot space commencing October 1, 2015.

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 \$272,967 and \$203,130 for the years ended December 31, 2015 and 2014, respectively. Deferred rent balance was \$28,976 and \$4,579 at December 31, 2015 and 2014, respectively.

At December 31, 2015 the future rental commitments due under the lease are:

<u>Years Ending December 31,</u>	
2016	347,045
2017	401,842
2018	413,898
2019	<u>317,356</u>
<b>Total</b>	<b><u>\$ 1,480,141</u></b>

**NOTE 8 – COMMITMENTS (Continued)**

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 December 31, 2015 and 2014.

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.

In consideration for the license, AirXpanders pays 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 December 31, 2015, the Company has incurred \$6,483 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 December 31, 2015 and 2014, no dividends had been declared for common stock. At December 31, 2015 70,427,195 and 0 shares of common stock Class A and Class B respectively were issued and outstanding.

At December 31, 2015 and 2014, common stock that the Company had reserved for issuance was as follows:

	<u>2015</u>	<u>2014</u>
Convertible preferred shares	-	26,101,974
Warrants for common and convertible preferred shares	386,814	10,250,452
Stock option plans	<u>5,590,619</u>	<u>5,362,531</u>
<b>Total</b>	<b><u>5,977,433</u></b>	<b><u>41,714,957</u></b>

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's convertible preferred stock consisted of the following at December 31, 2014:

Series E, 8% convertible noncumulative preferred stock, par value \$0.001; 0 and 50,200,000 shares authorized respectively; 0 and 49,499,028 shares issued and outstanding at December 31, 2015 and 2014, respectively (liquidation preference of \$0 and \$9,899,806)	\$ 49,499
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**NOTE 10 – CONVERTIBLE PREFERRED STOCK (Continued)**

Series D, 8% convertible noncumulative preferred stock, par value \$0.001; 0 and 42,176,625 shares authorized and outstanding at December 31, 2015 and 2014, respectively (liquidation preference of \$0 and \$11,387,689)	42,177
Series C, 8% convertible noncumulative preferred stock, par value \$0.001; 0 and 22,725,718 shares authorized respectively; 0 and 22,245,718 shares issued and outstanding at December 31, 2015 and 2014, respectively (liquidation preference of \$0 and \$5,561,430 respectively)	22,246
Series B-1, 8% convertible noncumulative preferred stock, par value \$0.001; 0 and 9,554,375 shares authorized and outstanding at December 31, 2015 and 2014, respectively (liquidation preference of \$0 and \$4,549,793 respectively)	9,554
Series B, 8% convertible noncumulative preferred stock, par value \$0.001; 0 and 3,375,954 shares authorized respectively; 0 and 3,125,954 shares issued and outstanding at December 31, 2015 and 2014, respectively (liquidation preference of \$0 and \$1,488,579 respectively)	3,126
Series A, 8% convertible noncumulative preferred stock, par value \$0.001; 0 and 4,323,958 shares authorized respectively; 0 and 3,908,168 shares issued and outstanding at December 31, 2015 and 2014, respectively (liquidation preference of \$0 and \$1,861,070 respectively)	<div style="border-top: 1px solid black;">3,908</div>
	<div style="border-top: 1px solid black; border-bottom: 3px double black;">\$ 130,510</div>

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.

**NOTE 10 – CONVERTIBLE PREFERRED STOCK (Continued)**

The Company's Articles of Incorporation, as amended, authorize the Company to issue 10,000,000 authorized shares of preferred stock, with rights and privileges for preferred stock to be determined by Company's Board of Directors before issuing preferred shares. At December 31, 2015, the Company has 10,000,000 authorized shares of preferred stock and there are no outstanding shares.

**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.

The Company's warrant liabilities account consisted of the following at December 31:

<u>Date Issued</u>	<u>2015</u>	<u>2014</u>
2007	\$ -	\$ 1,003
2008	-	321
2009	-	59,751
2011	-	47,998
2013	-	23,355
2014	-	31,710
	<u>\$ -</u>	<u>\$ 164,138</u>

**AIRXPANDERS, INC.**  
**NOTES TO FINANCIAL STATEMENTS**  
**December 31, 2015 and 2014**

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**NOTE 11 – STOCK WARRANTS (Continued)**

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 years ended December 31:

<u>Date Issued</u>	<u>2015</u>	<u>2014</u>
2007	\$ (979)	\$ (959)
2008	(313)	(307)
2009	(59,665)	(23,737)
2011	16,372	(23,591)
2013	1,281	(2,090)
2014	<u>1,681</u>	<u>-</u>
	<b><u>\$ (41,623)</u></b>	<b><u>\$ (50,684)</u></b>

The fair value of the warrant liabilities was estimated using Black-Scholes model using the following assumptions for 2015 at the date of conversion and December 31, 2014:

	<u>2015</u>	<u>2014</u>
Stock price	\$1.16	\$0.10 - \$0.29
Expected term (years)	0.62 – 8.67 years	1.00 – 9.04 years
Volatility	33.06 – 43.08%	32.20 – 44.70%
Risk-free interest rate	0.24 – 1.99%	0.11 – 2.57%
Dividend yield	- %	- %

In August 2007, in connection with a loan and security agreement, the Company issued a warrant to a financial institution to purchase 62,998 Series A convertible preferred shares at \$2.40 per share. 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 62,998 shares of common stock at an exercise price of \$2.381 per share. The warrant is exercisable at any time at the option of the holder and expired in 2015.

In March 2008, in connection with a loan and security agreement, the Company issued a warrant to a financial institution to purchase 20,158 Series A convertible preferred shares at \$2.40 per share. 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 20,158 shares of common stock at an exercise price of \$2.381 per share. The warrant is exercisable at any time at the option of the holder and expired in 2015.

**NOTE 11 – STOCK WARRANTS (Continued)**

In March 2009, in connection with a loan and security agreement, the Company issued a warrant to a financial institution to purchase 50,000 Series B convertible preferred shares at \$2.40 per share. 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 50,000 shares of common stock at an exercise price of \$2.381 per share. The warrant is exercisable at any time at the option of the holder and expires in 2016. This warrant remains outstanding at December 31, 2015 and is classified as equity.

In February 2011, in connection with the loan and security agreement, the Company issued a warrant to a financial institution to purchase 96,000 Series C convertible preferred shares at \$1.25 per share (See Note 7). 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 120,000 shares of common stock at an exercise price of \$1.25 per share. This warrant remains outstanding at December 31, 2015 and is classified as equity.

In January 2013, in connection with a loan modification agreement entered into with a lender the Company issued a warrant for the purchase of 29,629 shares of Series D Preferred Stock at an exercise price of \$1.35. As a result of the Series E round of financing during 2014, the holder of the warrant had the election under their existing warrant agreement to convert their warrant into a warrant for 40,000 shares of Series E at an exercise price of \$1.00 per share. 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 40,000 shares of common stock at an exercise price of \$1.00 per share. This warrant remains outstanding at December 31, 2015 and is classified as equity.

In 2013, in connection with the issuance of Series E Preferred Stock the Company issued warrants to Series E investors to purchase 8,904,805 common stock shares at \$0.005 per share. These warrants were exercised during the year ended December 31, 2015.

In January 2014, in connection with the loan and security agreement, the Company issued a warrant to a financial institution to purchase 52,500 Series E convertible preferred shares at \$1.00 per share (See Note 7). 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. This warrant remains outstanding at December 31, 2015 and is classified as equity.

In 2014, in connection with the issuance of Series E Preferred Stock the Company issued warrants to Series E investors to purchase 1,000,000 common stock shares at \$0.005 per share. These warrants were exercised during the year ended December 31, 2015.

**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.

In May 2013, the 2005 Plan was amended to increase the number of shares reserved for issuance under the Plan to 6,170,159 shares of common stock. During the year ended December 31, 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.

At December 31, 2015 and 2014, 4,127,900 and 3,786,339 options were vested and expected to vest with a weighted-average exercise price of \$0.3329 and \$0.2850 and weighted average remaining contractual life of 6.56 and 7.33 years, respectively. The weighted average grant date fair value per share of options granted the years ended December 31, 2015 and 2014 was \$0.3439 and \$0.05 respectively. The fair value of shares vested during the years ended December 31, 2015 and 2014 was \$96,344 and \$149,804 respectively. The weighted average exercise price of options exercised during the year ended December 31, 2015 was \$0.18. There were no options exercised for the year ended December 31, 2014. The intrinsic value of the options exercised during the year ended December 31, 2015 was \$5,343.

In connection with the grant of stock options to employees and non-employees, the Company recorded stock compensation expense to general and administrative expenses in the amounts of \$111,503 and \$108,323 for the years ended December 31, 2015 and 2014, respectively. As of December 31, 2015, unrecognized compensation expense related to employees totaled \$193,737 and will be recognized over approximately 2.40 years.



**AIRXPANDERS, INC.**  
**NOTES TO FINANCIAL STATEMENTS**  
**December 31, 2015 and 2014**

**NOTE 12 – STOCK-BASED COMPENSATION (Continued)**

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
<b>Balance – December 31, 2013</b>	<u><b>1,551,925</b></u>	<u><b>3,810,607</b></u>	<b>\$ 0.30</b>	<b>8.29</b>
Additional shares reserved	-	-	\$ -	-
Options granted	(52,026)	52,026	\$ 0.10	-
Options exercised	-	-	\$ -	-
Options forfeited/cancelled	<u>16,924</u>	<u>(16,924)</u>	\$ 0.20	-
<b>Balance – December 31, 2014</b>	<u><b>1,516,823</b></u>	<u><b>3,845,709</b></u>	<b>\$ 0.30</b>	<b>7.33</b>
Additional shares reserved (net of released)	231,052	-	\$ -	-
Options granted	(357,127)	357,127	\$ 0.90	-
Options exercised	-	(2,965)	\$ 0.18	-
Options forfeited/cancelled	<u>28,579</u>	<u>(28,579)</u>	\$ 0.96	-
<b>Balance December 31, 2015</b>	<u><b>1,419,327</b></u>	<u><b>4,171,292</b></u>	<b>\$ 0.33</b>	<b>6.57</b>

The fair value of options granted to employees was estimated at the date of grant using the following assumptions for the years ended December 31:

	2015	2014
Expected term (years)	5.83 – 6.58 years	5.69 – 6.07 years
Volatility	34.91 – 43.52%	44.66 – 46.58%
Risk-free interest rate	1.44 – 1.85%	1.67 – 1.97%
Dividend yield	- %	- %

**AIRXPANDERS, INC.**  
**NOTES TO FINANCIAL STATEMENTS**  
**December 31, 2015 and 2014**

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**NOTE 13 – INCOME TAXES**

The significant components of the net deferred tax asset are as follows at December 31, 2015 and 2014:

	<u>2015</u>	<u>2014</u>
Gross deferred income tax assets		
Net operating loss carryforwards	\$ 17,561,629	\$ 13,968,747
R&D credits	801,566	589,936
Property and equipment (depreciation)	(75,493)	(31,147)
Others	<u>420,459</u>	<u>147,283</u>
	18,708,161	14,674,819
 Valuation allowance	 <u>(18,708,161)</u>	 <u>(14,674,819)</u>
 <b>Total</b>	 <u><u>\$ -</u></u>	 <u><u>\$ -</u></u>

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 \$4,033,342 and \$2,602,184 for the years ended December 31, 2015 and 2014, respectively, principally due to increases in the valuation allowance associated with increased net operating losses.

As of December 31, 2015, the Company had net operating loss carryforwards for federal and state income tax reporting purposes of approximately \$45,482,439 and \$35,952,291 respectively. As of December 31, 2015 the Company also had Federal and California research and development tax credit carryforwards of approximately \$390,656 and \$410,910 respectively. The Federal net operating loss and tax credit carryforwards will expire at various dates beginning in 2025 through 2035. The California net operating loss carryforwards will expire at various dates beginning in 2016 through 2035. 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.

**NOTE 13 – INCOME TAXES (Continued)**

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.

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 years ended December 31, 2015 and 2014, principally due to state taxes and changes in the valuation allowance.

As of December 31, 2015, and 2014, 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 years ended December 31, 2015 and 2014 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.

**NOTE 16 – SUBSEQUENT EVENTS**

The Company has performed an evaluation of subsequent events through February 25, 2016 which is the date these financial statements were issued.