

FRANKLY INC.

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

Frankly Inc. and Subsidiaries  
Condensed Consolidated Balance Sheets

	<u>December 31, 2016</u>	<u>September 30, 2017</u> (Unaudited)
<b>Assets</b>		
<b>Current Assets</b>		
Cash and cash equivalents	\$ 6,053,203	\$ 1,276,145
Restricted cash	634,115	634,115
Accounts receivable, net	3,242,866	2,743,026
Prepaid expenses and other current assets	650,898	877,938
<b>Total Current Assets</b>	<b>10,581,082</b>	<b>5,531,224</b>
Property & equipment, net	1,481,328	1,116,380
Software development costs, net	6,710,494	7,006,947
Intangible assets, net	7,635,552	6,980,550
Goodwill	6,546,581	6,546,581
Other assets	308,604	178,399
<b>Total Assets</b>	<b>\$ 33,263,641</b>	<b>\$ 27,360,081</b>
<b>Liabilities and Shareholders' Equity</b>		
<b>Current Liabilities</b>		
Accounts payable	\$ 4,687,581	\$ 5,189,417
Accrued expenses	1,367,040	949,015
Revolving credit facility	1,375,474	-
Capital leases, current portion	167,635	80,461
Deferred revenue	21,702	47,604
Due to related parties	2,561,572	3,920,847
<b>Total Current Liabilities</b>	<b>10,181,004</b>	<b>10,187,344</b>
Non-revolving credit facility, net	11,630,384	12,006,885
Capital leases, non-current portion	40,449	-
Deferred rent	42,827	37,619
Other liabilities	64,766	100,450
<b>Total Liabilities</b>	<b>21,959,430</b>	<b>22,332,298</b>
<b>Commitments and Contingencies (Note 9)</b>		
<b>Shareholders' Equity</b>		
Common shares, no par value, unlimited shares authorized, 2,030,800 and 2,183,071 shares outstanding as of December 31, 2016 and September 30, 2017, respectively	-	-
Class A restricted voting shares, no par value, unlimited shares authorized, 97,674 and 0 shares outstanding as of December 31, 2016 and September 30, 2017, respectively	-	-
Additional paid-in capital	64,986,368	65,761,144
Accumulated deficit	(53,642,691)	(60,679,755)
Accumulated other comprehensive loss	(39,466)	(53,606)
<b>Total Shareholders' Equity</b>	<b>11,304,211</b>	<b>5,027,783</b>
<b>Total Liabilities and Shareholders' Equity</b>	<b>\$ 33,263,641</b>	<b>\$ 27,360,081</b>

See accompanying notes to the condensed consolidated financial statements.

**Frankly Inc. and Subsidiaries**  
**Condensed Consolidated Statements of**  
**Operations and Comprehensive Loss – Unaudited**

	<u>Three Months Ended September 30,</u>		<u>Nine Months Ended September 30,</u>	
	<u>2016</u>	<u>2017</u>	<u>2016</u>	<u>2017</u>
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
<b>Total Revenue</b>	<b>\$ 6,196,691</b>	<b>\$ 6,537,308</b>	<b>\$ 16,664,579</b>	<b>\$ 19,390,089</b>
<b>Costs and operating expenses:</b>				
Cost of revenue (excluding depreciation and amortization)	2,677,281	3,307,870	5,761,780	9,142,558
General and administrative (excluding depreciation and amortization)	1,992,650	1,869,037	6,375,419	5,999,894
Selling and marketing	628,909	606,383	2,257,775	2,013,174
Research and development (excluding depreciation and amortization)	844,682	1,212,703	2,901,480	3,161,646
Depreciation and amortization	848,246	1,102,576	2,447,265	3,261,933
Loss on disposal of assets	-	-	1,093	-
Loss on extinguishment of debt	-	38,287	-	38,287
Nasdaq listing fees	410,225	943,822	410,225	943,822
Other expense	(135,531)	-	205,681	27,017
<b>Loss from operations</b>	<b>(1,069,771)</b>	<b>(2,543,370)</b>	<b>(3,696,139)</b>	<b>(5,198,242)</b>
Foreign exchange (gain) loss	(5,716)	(16,144)	(3,061)	(20,236)
Interest expense, net	307,932	601,909	749,706	1,859,058
<b>Loss before income tax expense</b>	<b>(1,371,987)</b>	<b>(3,129,135)</b>	<b>(4,442,784)</b>	<b>(7,037,064)</b>
Income tax expense	-	-	-	-
<b>Net Loss</b>	<b>\$ (1,371,987)</b>	<b>\$ (3,129,135)</b>	<b>\$ (4,442,784)</b>	<b>\$ (7,037,064)</b>
<b>Other Comprehensive Net Loss</b>				
Foreign currency translation	(6,612)	(18,237)	(4,325)	(14,140)
<b>Comprehensive Net Loss</b>	<b>\$ (1,378,599)</b>	<b>\$ (3,147,372)</b>	<b>\$ (4,447,109)</b>	<b>\$ (7,051,204)</b>
<b>Basic and Diluted Net Loss Per Share</b>	<b>\$ (0.71)</b>	<b>\$ (1.46)</b>	<b>\$ (2.33)</b>	<b>\$ (3.29)</b>
<b>Basic and Diluted Weighted-Average Common and Class A Restricted Voting Shares Outstanding</b>	<b>1,935,189</b>	<b>2,148,332</b>	<b>1,903,740</b>	<b>2,137,172</b>

See accompanying notes to the condensed consolidated financial statements.

**Frankly Inc. and Subsidiaries**  
**Condensed Consolidated Statements of**  
**Shareholders' Equity – Unaudited**

	<b>Common Shares</b>	<b>Class A Restricted Voting Shares</b>	<b>Additional Paid-In Capital</b>	<b>Accumulated Deficit</b>	<b>Accumulated Other Comprehensive Loss</b>	<b>Total Shareholders' Equity</b>
<b>Balance, December 31, 2016</b>	<b>2,030,800</b>	<b>97,674</b>	<b>\$64,986,368</b>	<b>\$ (53,642,691)</b>	<b>\$ (39,466)</b>	<b>\$ 11,304,211</b>
Vesting of restricted share units	54,597	-	-	-	-	-
Exchange of restricted voting shares for common shares	97,674	(97,674)	-	-	-	-
Stock-based compensation	-	-	774,776	-	-	774,776
Net loss	-	-	-	(7,037,064)	-	(7,037,064)
Other comprehensive loss	-	-	-	-	(14,140)	(14,140)
<b>Balance, September 30, 2017</b>	<b><u>2,183,071</u></b>	<b><u>-</u></b>	<b><u>\$65,761,144</u></b>	<b><u>\$ (60,679,755)</u></b>	<b><u>\$ (53,606)</u></b>	<b><u>\$ 5,027,783</u></b>
<b>Balance, December 31, 2015</b>	<b>1,294,018</b>	<b>593,826</b>	<b>59,462,420</b>	<b>(42,931,749)</b>	<b>(30,623)</b>	<b>\$ 16,500,048</b>
Issuance of common shares	150,200	-	1,000,000	-	-	1,000,000
Share issuance costs	-	-	(22,722)	-	-	(22,722)
Issuance of warrants	-	-	2,921,407	-	-	2,921,407
Exchange of restricted voting shares for common shares	490,711	(490,711)	-	-	-	-
Stock-based compensation	-	-	859,799	-	-	859,799
Net loss	-	-	-	(4,442,784)	-	(4,442,784)
Other comprehensive loss	-	-	-	-	(4,325)	(4,325)
<b>Balance, September 30, 2016</b>	<b><u>1,934,929</u></b>	<b><u>103,115</u></b>	<b><u>\$64,220,904</u></b>	<b><u>\$ (47,374,533)</u></b>	<b><u>\$ (34,948)</u></b>	<b><u>\$ 16,811,423</u></b>

See accompanying notes to the condensed consolidated financial statements.

**Frankly Inc. and Subsidiaries**  
**Condensed Consolidated Statements of**  
**Cash Flows – Unaudited**

	<b>Nine Months Ended September 30,</b>	
	<b>2016</b>	<b>2017</b>
	(Unaudited)	(Unaudited)
<b>Cash flows from operating activities</b>		
Net loss	\$ (4,442,784)	\$ (7,037,064)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	2,447,265	3,261,933
Amortization of debt discount	45,146	405,788
Amortization of deferred financing costs	-	80,651
Stock-based compensation expense	859,799	774,776
Loss on disposal of assets	1,093	-
Loss on extinguishment of debt	-	38,287
Other non-cash asset writeoff	178,147	-
Changes in assets and liabilities:		
Accounts receivable	462,799	499,840
Prepaid expenses and other current assets	505,449	(265,416)
Other assets	12,980	130,205
Accounts payable	1,457,025	448,127
Accrued expenses	(1,077,226)	(421,451)
Deferred revenue	(46,188)	25,901
Due to / from related parties	(47,100)	1,359,275
Deferred rent and other liabilities	37,692	30,476
<b>Net cash provided by (used in) operating activities</b>	<b>394,097</b>	<b>(668,671)</b>
<b>Cash flows from investing activities</b>		
Capitalized software costs	(3,384,631)	(2,444,766)
Purchases of property & equipment	(42,275)	(93,667)
Proceeds from sale of intangible assets or equipment	2,111	-
<b>Net cash used in investing activities</b>	<b>(3,424,795)</b>	<b>(2,538,433)</b>
<b>Cash flows from financing activities</b>		
Restricted cash	(634,115)	-
Revolving credit facility payments	(1,950,000)	(1,375,474)
Capital lease payments	(147,620)	(127,622)
Share issuance costs	(22,722)	-
Proceeds from issuance of debt	500,000	-
Debit issuance costs	(90,573)	(64,615)
<b>Net cash used in financing activities</b>	<b>(2,345,030)</b>	<b>(1,567,711)</b>
Effect of exchange rate changes on cash	(9,502)	(2,243)
<b>Net change in cash and cash equivalents</b>	<b>(5,385,230)</b>	<b>(4,777,058)</b>
Cash and cash equivalents at beginning of period	7,554,128	6,053,203
<b>Cash and cash equivalents at end of period</b>	<b>\$ 2,168,898</b>	<b>\$ 1,276,145</b>
<b>Supplemental cash flow disclosure</b>		
Cash paid for interest	\$ 714,554	\$ 1,138,557
Cash paid for income taxes	-	-
Exchange of promissory notes for common shares	\$ 1,000,000	\$ -

See accompanying notes to the condensed consolidated financial statements.

**Frankly Inc. and Subsidiaries**  
**Notes to Condensed Consolidated Financial Statements – Unaudited**

**1. Description of Business and Going Concern**

***Organization***

Frankly Inc. (“Frankly”), has been operating since the incorporation of its predecessor, TicToc Planet Inc. (“TicToc”), on September 10, 2012. These consolidated financial statements include Frankly and its subsidiaries (Frankly Co. and Frankly Media LLC), together referred to as the “Company.”

On December 23, 2014, WB III, a Canadian public shell company traded on the Toronto Stock Exchange, completed a merger with TicToc whereby WB III Subco Inc., a wholly-owned subsidiary of the WB III, merged with TicToc. The transaction, referred to as the “Recapitalization”, was structured as a reverse triangular merger under the Delaware General Corporation Law, which resulted in TicToc becoming a wholly-owned Canadian subsidiary of WB III. Subsequent to the completion of the Recapitalization, WB III changed its name to Frankly Inc. and TicToc changed its name to Frankly Co.

As described in Note 3, on August 25, 2015, the Company completed the purchase of the outstanding units of Gannaway Web Holdings LLC, operating as Worldnow, in a transaction referred to as the acquisition of Worldnow. Subsequent to the acquisition, Worldnow changed its name to Frankly Media LLC.

On February 3, 2017, the Company effected a one-for-seventeen reverse split (the “Reverse Stock Split”) of its issued and outstanding common shares and Class A restricted voting shares. All warrant, option, restricted stock units (“RSU”), share and per share information in the consolidated financial statements gives retroactive effect to the Reverse Stock Split for all periods presented.

***Going Concern***

These consolidated financial statements have been prepared on the assumption that the Company is a going concern, which contemplates the realization of its assets and the settlement of its liabilities in the normal course of operations.

As of September 30, 2017, the Company has an accumulated deficit of \$60.7 million, representative of recurring losses since inception. Additionally, the Company has not generated positive cash flow from operations since inception, except in 2016. In the first nine months of 2017, the Company used cash in operations, and in the third quarter of 2017 paid off its revolving credit facility with Silicon Valley Bank (Note 6). Also, in the third quarter of 2017, the Company decided to postpone its contemplated initial public offering in the United States (the “IPO”) and expensed deferred financing costs of \$943,822 related to the IPO effort. Lastly, as of September 30, 2017, the Company was in compliance with all debt covenants, but may not be in compliance as of December 31, 2017 with two financial covenants which have a measurement date of December 31, 2017. The Company will need additional financing in the near term to continue operations. These conditions raise substantial doubt about the Company’s ability to continue as a going concern.

The Company expects that through the next 12 months from the date of this filing, it will require external funding to sustain operations and to follow through on the execution of its business plan. The Company is considering several strategic alternatives which may include raising funds from strategic sources. The Company has retained the corporate advisory services of Waller Capital Partners, an independent investment bank and advisory firm, to explore and evaluate strategic options. There can be no assurance that the Company’s plans will materialize and/or that it will be successful in its efforts to obtain the funding to cover working capital shortfalls. These consolidated financial statements do not include any adjustments related to the carrying values and classifications of assets and liabilities that would be necessary should the Company be unable to continue as a going concern.

**2. Summary of Significant Accounting Policies**

***Basis of Presentation and Use of Estimates***

The unaudited interim condensed consolidated financial statements and accompanying notes have been prepared in accordance with United States generally accepted accounting principles (“U.S. GAAP”) and include the accounts of Frankly Inc. and its wholly-owned subsidiaries Frankly Co. and Frankly Media LLC. All intercompany balances and transactions have been eliminated in consolidation. In the opinion of the Company’s management, the unaudited interim condensed consolidated financial statements include all adjustments, which include only normal recurring adjustments, necessary for the fair presentation of the Company’s financial position for the periods presented. These unaudited interim condensed consolidated financial statements are not necessarily indicative of the results expected for the full fiscal year or for any subsequent period.

**Frankly Inc. and Subsidiaries**  
**Notes to Condensed Consolidated Financial Statements – Unaudited**

The accompanying condensed consolidated balance sheet as of December 31, 2016 was derived from the audited financial statements as of that date, but does not include all the information and footnotes required by U.S. GAAP. These unaudited interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes for the year ended December 31, 2016, included within its Form 10 as filed with the SEC on August 7, 2017.

***Accounting Estimates***

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates, judgments and assumptions that affect the amounts reported and disclosed in the financial statements and the accompanying notes. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Such estimates primarily relate to unsettled transactions and events as of the date of the financial statements. Accordingly, actual results may differ from estimated amounts.

***Concentrations of Risk***

Accounts receivable are subject to credit risk and as of December 31, 2016 and September 30, 2017, two and three customers each accounted for greater than 10% of the Company's accounts receivable balance, respectively. In total, these customers accounted for 26% and 55% of the Company's accounts receivable balance as of December 31, 2016 and September 30, 2017, respectively. Additionally, approximately 42% and 36% of the Company's revenue for the nine months ended September 30, 2016 and 2017 was generated from three and two customers, respectively, that each accounted for greater than 10% of the Company's total revenue.

***Recently Issued Accounting Pronouncements***

The Company is an "emerging growth company" ("EGC") as defined by the Jumpstart Our Business Startups ("JOBS") Act of 2012. The JOBS Act provides that an emerging growth company can take advantage of the extended transition period provided in Section 7(a)(2)(B) of the Securities Act for complying with new or revised accounting standards. In other words, an emerging growth company can selectively delay the adoption of certain accounting standards until those standards would otherwise apply to private companies. The Company has elected to avail itself of this exemption and, as a result, its financial statements may not be comparable to the financial statements of issuers that are required to comply with the effective dates for new or revised accounting standards that are applicable to public companies. Section 107 of the JOBS Act provides that the Company can elect to opt out of the extended transition period at any time, which election is irrevocable.

*ASU 2014-09: Revenue from Contracts with Customers (Topic 606)* — In May 2014, the Financial Accounting Standards Board ("FASB"), issued Accounting Standards Update ("ASU") 2014-09, "Revenue from Contracts with Customers." The new topic will replace Topic 605, "Revenue Recognition," and creates modifications to various other revenue accounting standards for specialized transactions and industries. The topic is intended to conform revenue accounting principles with a concurrently issued International Financial Reporting Standards to reconcile previously differing treatment between U.S. practices and those of the rest of the world and to enhance disclosures related to disaggregated revenue information. The updated guidance is effective for interim and annual reporting periods beginning on or after December 15, 2018, for private companies; this effective date is applicable for the Company due to the JOBS Act exemption described above. Therefore, the Company plans to adopt this ASU on January 1, 2019 and plans to use the modified retrospective method. The Company will further evaluate during the next year, the anticipated impact of the adoption of this updated guidance on its consolidated financial statements.

**Frankly Inc. and Subsidiaries**  
**Notes to Condensed Consolidated Financial Statements – Unaudited**

*ASU 2015-17: Income Taxes (Topic 740), Balance Sheet Classification of Deferred Taxes* — In November 2015, the FASB issued ASU 2015-17 to simplify the presentation of deferred taxes in the balance sheet. Current guidance requires an entity to separate deferred income tax assets and liabilities into current and noncurrent amounts. The new guidance requires all deferred tax assets and liabilities to be presented as noncurrent. ASU 2015-17 was adopted in 2017 and did not have a significant impact on the consolidated financial statements.

*ASU 2016-02: Leases (Topic 842)* — In February 2016, the FASB issued ASU 2016-02, which requires a lessee to recognize assets and liabilities on its consolidated balance sheet for leases with accounting lease terms of more than 12 months. ASU 2016-02 will replace most existing lease accounting guidance in GAAP when it becomes effective. The new standard states that a lessee will recognize a lease liability for the obligation to make lease payments and a right-of-use asset for the right to use the underlying asset for the lease term. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the consolidated statements of operations. ASU 2016-02 will be effective for the Company as an EGC in 2020 and requires the modified retrospective method of adoption. Early adoption is permitted. Although the Company is currently evaluating the effect that ASU 2016-02 will have on its consolidated financial statements and related disclosures, the Company expects that most of its operating lease commitments will be subject to the new standard and recognized as operating lease liabilities and right-of-use assets upon adoption.

*ASU 2016-09: Compensation – Stock Compensation (Topic 718), Improvements to Employee Share-Based Payment Accounting* — In March 2016, the FASB issued ASU 2016-09, which is intended to simplify several aspects of the accounting for share-based payment award transactions, including the income tax consequences and classification on the statement of cash flows. ASU 2016-09 was adopted in 2017 and did not have a significant impact on the consolidated financial statements.

### **3. Acquisition of Worldnow**

On July 28, 2015, the Company signed an agreement (the “Purchase Agreement”) to purchase all of the outstanding units of Gannaway Web Holdings LLC, operating as Worldnow, for total consideration of \$45,000,000. On August 25, 2015 (the “Closing Date”), the Company completed the acquisition of Worldnow. Subsequent to the acquisition, Worldnow changed its name to Frankly Media LLC. The acquisition of Worldnow was made primarily to extend the reach of Frankly to Worldnow’s existing customer base within the local broadcast marketplace.

Under the terms of the Purchase Agreement, the Company paid \$10,000,000 in cash, issued \$20,000,000 in Class A restricted voting shares of the Company (the “Share Consideration”) and executed promissory notes to two shareholders of Worldnow bearing simple interest at a rate of 5 percent per year and agreed to pay \$15,000,000 on August 31, 2016 (Note 6). The number of restricted voting shares comprising the Share Consideration was 574,836, determined with reference to the volume-weighted average price of the common shares of the Company on the TSX-V for the five days prior to the date of the Purchase Agreement (CDN\$45.46 or \$34.79). For purposes of the purchase price allocation, the Share Consideration, prior to discount for lack of marketability, was reflected at fair value as of the Closing Date which amounted to \$15,523,058.

All of the securities comprising the Share Consideration are subject to a lock-up agreement. The lock-up period with respect to securities representing 50 percent of the value of the Share Consideration expired August 25, 2016; and the lock-up period with respect to the remainder of the Share Consideration expired upon August 25, 2017. The lock-up periods are subject to earlier expiry upon the occurrence of certain events that constitute a change of control of the Company.

### **4. Related Party Transactions and Balances**

The Company has several significant shareholders as follows: SKP America LLC (“SKP America”), Raycom Media Inc. (“Raycom”), and Gannaway Entertainment Inc. (“GEI”) which each owned approximately 25.6%, 25.7% and 8.3%, respectively, as of December 31, 2016 and 25.0%, 25.1% and 8.1%, respectively, as of September 30, 2017 of the aggregate common shares and Class A restricted voting shares.

**Frankly Inc. and Subsidiaries**  
**Notes to Condensed Consolidated Financial Statements – Unaudited**

The following table summarizes related party balances in the condensed consolidated balance sheets for the periods presented:

<b>Amounts Due (to) from Related Parties</b>	<b>December 31, 2016</b>	<b>September 30, 2017 (Unaudited)</b>
Non-revolving credit facility, net		
Raycom	\$ 11,630,384	\$ 12,006,885
Due (to) from Raycom:		
Accounts receivable, net	295,231	1,425,501
Prepaid expenses and other current assets	70,000	-
Accounts payable	(159,385)	(257,368)
Accrued expenses	-	(234,062)
Deferred revenue	(2,896,585)	(4,896,585)
Total due to Raycom, net	<u>(2,690,739)</u>	<u>(3,962,514)</u>
Due from Mobdub:		
Prepaid expenses and other current assets	129,167	41,667
Total due from Mobdub	<u>129,167</u>	<u>41,667</u>
Total due (to) from related parties	<u>\$ (2,561,572)</u>	<u>\$ (3,920,847)</u>

The following table summarizes related party transactions in the condensed consolidated statements of operations and comprehensive loss for the periods presented:

<b>Revenue (Expense) from Related Parties</b>	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2016</b>	<b>2017</b>	<b>2016</b>	<b>2017</b>
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
Raycom:				
Revenue	\$ 1,236,060	\$ 1,272,827	\$ 3,790,811	\$ 3,920,180
Interest on promissory notes	(33,333)	-	(133,333)	-
Interest on non-revolving credit facility	(160,037)	(508,646)	(160,037)	(1,525,637)
Interest on the Advance Agreement	-	(78,021)	-	(234,062)
	<u>1,042,690</u>	<u>686,160</u>	<u>3,497,441</u>	<u>2,160,481</u>
GEI:				
Interest on promissory notes	(93,806)	-	(368,806)	-
Mobdub:				
License fees	(36,190)	(29,167)	(109,288)	(87,500)
	<u>(36,190)</u>	<u>(29,167)</u>	<u>(109,288)</u>	<u>(87,500)</u>
	<u>\$ 912,694</u>	<u>\$ 656,993</u>	<u>\$ 3,019,347</u>	<u>\$ 2,072,981</u>

**Raycom**

As partial consideration for the acquisition of Worldnow on August 25, 2015, the Company issued a \$4,000,000 promissory note to Raycom and 397,126 Class A restricted voting shares (Note 3). The note bore interest at 5% per annum and was due on August 31, 2016 (Note 6). Raycom was a customer and significant shareholder of Worldnow and, subsequent to the acquisition of Worldnow, remains a customer and significant shareholder of Frankly. Accordingly, during the three and nine months ended September 30, 2016 and 2017, revenue-related transactions and balances with Raycom arose in the ordinary course of business.

**Frankly Inc. and Subsidiaries**  
**Notes to Condensed Consolidated Financial Statements – Unaudited**

On September 1, 2016, the Company completed the closing of its financing with Raycom (Note 6). The Company received a non-revolving term line of credit from Raycom in the principal amount of \$14.5 million and, subject to approval of Raycom, an additional available \$1.5 million non-revolving line of credit (collectively, the “Loan”). The proceeds were used to pay down \$14 million of the \$15 million outstanding promissory notes. In addition, Raycom converted the remaining \$1.0 million of its existing \$4.0 million promissory note from the Company into 150,200 common shares of the Company and the Company issued 871,160 common share purchase warrants to Raycom. The Loan was recorded at fair value of \$11,578,593 with the remaining \$2,921,407 being allocated to the warrants. The carrying value of the Loan at December 31, 2016 and September 30, 2017, net of debt discount and deferred financing costs, was \$11,630,384 and \$12,006,885, respectively. Interest expense on the Loan for the three and nine months ended September 30, 2016 and 2017, respectively, amounted to \$160,037, \$160,037, \$508,646 and \$1,525,637 and is presented within interest expense, net on the consolidated statements of operations and comprehensive loss.

On December 22, 2016, Raycom pre-paid \$3 million of future fees for services to be provided by the Company (the “Advance Agreement”). On March 30, 2017, the Company entered into an amendment to the Advance Agreement pursuant to which Raycom pre-paid an additional \$2 million of future fees for services to be provided by the Company. In connection with this agreement, the Company recognized interest expense of \$78,021 and \$234,062 for the three and nine months ended September 30, 2017, respectively.

**GEI**

As partial consideration for the acquisition of Worldnow on August 25, 2015, the Company issued an \$11,000,000 promissory note to GEI and 177,710 Class A restricted voting shares (Note 3). The note had interest at 5% per annum and was due on August 31, 2016 (Note 6). On September 1, 2016, the promissory note to GEI was paid in full using the proceeds from the Raycom financing transaction discussed above.

**Mobdub**

The Company has a license agreement with a company that is owned by an officer of the Company. The agreement is for licensing of mobile applications and has a total contract value of \$350,000. The period of the agreement is three years and commenced on October 14, 2015.

**5. Long-Lived Assets**

All of the Company’s long-lived assets are domiciled in the U.S. Depreciation and amortization expense for long-lived assets was as follows for the periods presented:

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2016</b>	<b>2017</b>	<b>2016</b>	<b>2017</b>
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
Depreciation of property and equipment	\$ 169,235	\$ 151,281	\$ 536,998	\$ 458,616
Amortization of capitalized software	460,677	732,961	1,255,265	2,148,315
Amortization of other intangibles	218,334	218,334	655,002	655,002
Total depreciation and amortization	<u>\$ 848,246</u>	<u>\$ 1,102,576</u>	<u>\$ 2,447,265</u>	<u>\$ 3,261,933</u>

**Frankly Inc. and Subsidiaries**  
**Notes to Condensed Consolidated Financial Statements – Unaudited**

***Property and Equipment, Net***

The following table summarizes property and equipment, net, including assets held under capital lease:

	<u>December 31, 2016</u>	<u>September 30, 2017</u> (Unaudited)
Cost:		
Office and computer equipment and software	\$ 1,981,889	\$ 2,050,360
Leasehold improvements	578,781	603,978
	<u>2,560,670</u>	<u>2,654,338</u>
Accumulated depreciation and amortization:		
Office and computer equipment and software	(926,901)	(1,299,978)
Leasehold improvements	(152,441)	(237,980)
	<u>(1,079,342)</u>	<u>(1,537,958)</u>
	<u>\$ 1,481,328</u>	<u>\$ 1,116,380</u>

Depreciation expense for assets held under capital lease for the three and nine months ended September 30, 2016 and 2017, respectively, was \$41,062, \$123,186, \$35,400 and \$107,299. The net carrying value of assets held under capital lease was \$404,346 and \$297,046 as of December 31, 2016 and September 30, 2017, respectively (Note 9).

***Software Development Costs, Net***

The following table summarizes software development costs, net for the periods presented:

	<u>December 31, 2016</u>	<u>September 30, 2017</u> (Unaudited)
Cost	\$ 9,001,660	\$ 11,446,427
Accumulated amortization	(2,291,166)	(4,439,480)
	<u>\$ 6,710,494</u>	<u>\$ 7,006,947</u>

During the nine months ended September 30, 2016 and 2017, the Company capitalized software development costs of \$3,384,631 and \$2,444,766, respectively.

***Goodwill***

The following table summarizes the changes in goodwill for the periods presented:

	<u>Carrying Value</u>
Balance, December 31, 2015	\$ 10,755,581
Impairment	(4,209,000)
Balance, December 31, 2016	<u>\$ 6,546,581</u>
Activity	-
Balance, September 30, 2017 (Unaudited)	<u>\$ 6,546,581</u>

**Frankly Inc. and Subsidiaries**  
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***Intangible Assets, Net***

The following table summarizes intangible assets, net for the periods presented:

	<u>December 31, 2016</u>	<u>September 30, 2017</u> (Unaudited)
Cost:		
Broadcast relationships, 12-year useful life	\$ 7,600,000	\$ 7,600,000
Advertiser relationships, 5-year useful life	1,200,000	1,200,000
	<u>8,800,000</u>	<u>8,800,000</u>
Accumulated amortization:		
Broadcast relationships	(844,448)	(1,319,450)
Advertiser relationships	(320,000)	(500,000)
	<u>(1,164,448)</u>	<u>(1,819,450)</u>
	<u>\$ 7,635,552</u>	<u>\$ 6,980,550</u>

**6. Debt**

***Non-revolving Credit Facility, Extinguishment of Promissory Notes and Old Revolving Credit Facility***

On September 1, 2016, the Company completed the closing of its financing with Raycom, a related party (Note 4). The Company received a non-revolving term line of credit from Raycom in the principal amount of \$14.5 million and, subject to approval of Raycom, an additional available \$1.5 million non-revolving line of credit. In addition, Raycom converted \$1.0 million of its existing \$4.0 million promissory note from the Company into 150,200 common shares of the Company and the Company issued 871,160 warrants to Raycom entitling the holder of each warrant to acquire one common share of the Company upon exercise of each warrant at a price per common share equal to CDN\$8.50 (\$6.63 based on the exchange rate at August 18, 2016). The warrants will expire on the earlier of: (i) the repayment of the Loan in accordance with its terms; and (ii) 5 years. To the extent that there is a mandatory repayment of any portion of the principal balance of the Loan, a proportionate number of the warrants will have their term reduced to the later of one year from issuance and 30 days from the date of such repayment.

The warrants were recorded within shareholders' equity in accordance with ASC 470-20 - *Debt With Conversion and Other Options*. Proceeds from the sale of the debt instrument with stock purchase warrants (detachable call options) were allocated to the two elements based on the relative fair values of the debt instrument without the warrants and of the warrants themselves at time of issuance. The value allocated to the Loan with Raycom was \$11,578,593 with the remaining \$2,921,407 being allocated to the warrants. The fair value of the 871,160 warrants issued were estimated based on the Black-Scholes pricing model, using the following assumptions: 1) Dividend yield of 0%, 2) Risk free rate of 0.66% for 751,000 warrants and 0.56% for 120,160 warrants, 3) Volatility of 71.14%, 4) Expected term of 5 years for 751,000 warrants and 7 months for 120,160 warrants, and 5) Forfeiture rate of 0%.

The debt discount of \$2,921,407 is being amortized to interest expense, net on the consolidated statement of operations and comprehensive loss using the effective-interest method. Amortization of debt discount included in interest expense, net for the three and nine months ended September 30, 2016 and 2017, respectively, amounted to \$45,146, \$45,146, \$132,826 and \$405,788. In accordance with ASC 470-50 *Debt Modifications and Extinguishments*, the Company accounted for the refinancing transaction as an extinguishment of debt. The Company incurred legal fees directly related to the refinancing of \$206,805, which were recorded as deferred financing costs and recorded against the carrying value of the Loan. Amortization of deferred financing costs included in interest expense, net for the three and nine months ended September 30, 2016 and 2017, respectively, amounted to \$0, \$0, \$10,340 and \$35,328.

**Frankly Inc. and Subsidiaries**  
**Notes to Condensed Consolidated Financial Statements – Unaudited**

Prior to the completion of the financing arrangements, Raycom held 397,125 voting shares of the Company, which represented approximately 21% of the issued and outstanding voting shares of the Company. Immediately following the completion of the financing transactions, Raycom held 547,325 voting shares of the Company and 871,160 warrants, which collectively represented approximately 27% of the issued and outstanding voting shares of the Company on a non-diluted basis.

The proceeds of the Loan were used to pay off the outstanding \$15.0 million of promissory notes issued by the Company in connection with the 2015 acquisition of Worldnow, including \$3.0 million of the \$4.0 million of such notes issued to Raycom, with the remaining \$1.0 million promissory note balance owed to Raycom being converted to common shares of the Company as described above.

The Loan has a five-year term and is secured by the grant of a security interest in the Company's assets, a pledge of shares of the Company's subsidiaries and a guarantee by the Company's subsidiaries secured by their assets. Simultaneously, the Company and Raycom also entered into a software code escrow agreement.

Interest on outstanding balances of the Loan will accrue at a rate of 10% per annum, with a default interest rate of 12% per annum. The Loan is subject to certain scheduled mandatory principal repayments, with additional mandatory repayments occurring upon the Company's raising of additional financing, sales of assets and excess cash flow.

In addition, the Company must maintain certain leverage ratios and interest coverage ratios beginning with the fiscal quarter ending December 31, 2017. The Company is also subject to certain covenants relating to, among others, indebtedness, fundamental corporate changes, dispositions, acquisitions and distributions.

Upon an event of default, Raycom may by written notice terminate the facility immediately and declare all obligations under the Loan, whether matured or not, to be immediately due and payable. Raycom may also as and by way of collateral security, deposit and retain in an interest bearing account, amounts received by Raycom from the Company under the Loan and realize upon the security interest agreements, guaranty agreements and pledge agreement.

***Promissory Notes Payable to Related Parties***

In connection with the acquisition of Worldnow on August 25, 2015 (Note 3), the Company executed unsecured promissory notes, bearing a simple interest at a rate of 5% per year, to pay an aggregate of \$15,000,000 in cash on August 31, 2016. The holders of the promissory notes were Raycom (\$4,000,000) and GEI (\$11,000,000), former shareholders of Worldnow (Note 4). Interest expense on the promissory notes amounted to \$125,000 and \$500,000 for the three and nine months ended September 30, 2016, respectively, and is presented within interest expense, net on the consolidated statements of operations and comprehensive loss. On September 1, 2016, the promissory notes were extinguished in connection with the refinancing transaction discussed above.

***Revolving Credit Facility – Silicon Valley Bank***

On December 28, 2016, the Company entered into the Loan and Security Agreement pursuant to which Silicon Valley Bank ("SVB") issued to the Company a \$3 million revolving line of credit (the "Revolving Credit Facility").

Subject to any adjustments upon an event of default, the principal amount outstanding under the line of credit had accrued interest at a floating per annum rate equal to 2.25% above the Prime Rate published on the Wall Street Journal, which interest was payable monthly and computed on the basis of a 360-day year for the actual number of days elapsed.

As of December 31, 2016 and September 30, 2017, the principal amount outstanding under the Revolving Credit Facility was \$1,375,474 and \$0, respectively. On August 1, 2017, the Company repaid all amounts owed to SVB under these agreements and such agreements were terminated.

***Letter of Credit – Western Alliance Bank***

On August 31, 2016, in lieu of a security deposit under the lease dated October 26, 2010, with Metropolitan Life Insurance Company, for real property located at 27-01 Queens Plaza North, Long Island City, NY, Frankly Media LLC entered into a standby letter of credit with Western Alliance Bank for an amount of \$500,000 (the "Letter of Credit"). For each advance, interest will accrue at a rate equal to the sum of (i) the Base Rate (as defined below), plus (ii) 3.50%, provided that such interest rate will change from time to time as the Base Rate changes. The "Base Rate" means the rate of interest used as the reference or base rate to establish the actual rates charged on commercial loans and which is publicly announced or reported from time to time by the Wall Street Journal as the "prime rate". Interest will accrue from the date of the advance until such advance is paid in full. The Company has granted Western Alliance Bank a security interest in a \$524,115 controlled cash deposit account together with (i) all interest, whether now accrued or hereafter accruing; (ii) all additional deposits hereafter made to the account; (iii) any and all proceeds from the account; and (iv) all renewals, replacements and substitutions for any of the foregoing. As of December 31, 2016 and September 30, 2017, no advances were made under the Letter of Credit. The cash security interest of \$524,115 is presented within restricted cash on the consolidated balance sheet.

**Frankly Inc. and Subsidiaries**  
**Notes to Condensed Consolidated Financial Statements – Unaudited**

**7. Shareholders' Equity**

***Common Shares and Class A Restricted Voting Shares***

Subsequent to the Recapitalization on December 23, 2014, all common and Class A restricted voting shares and related stock-based grants have been denominated in Canadian dollars and have been translated to U.S. dollars using the exchange rate in effect at the date of transaction or grant, as applicable.

The Class A restricted voting shares have the same voting rights as common shares except for voting for the election and removal of directors of the Company. The Class A restricted voting shares participate in dividends and liquidation events in the same manner as common shares. In terms of restrictions on transfer, no Class A restricted voting shares shall be transferred to another party unless an offer to acquire common shares is concurrently made that is identical to the offer for the Class A restricted voting shares in terms of price per share, percentage of outstanding shares to be transferred and in all other material respects.

On February 3, 2017, the Company effected the one-for-seventeen reverse split of its issued and outstanding common shares and Class A restricted voting shares. All warrant, option, RSU, share and per share information in the consolidated financial statements gives retroactive effect to the Reverse Stock Split for all periods presented.

*Shares Issued During the Nine Months Ended September 30, 2017*

During the nine months ended September 30, 2017, the Company issued a total of 54,597 common shares for employee and director RSUs that vested.

In addition, the Company exchanged 97,674 Class A restricted shares for an equal number of common shares.

***Stock-Based Compensation***

*Description of the Plan*

On April 1, 2015, the Company adopted an amended and restated equity incentive plan, which amends and restates the equity incentive plan, or the "Plan", which was previously established as of December 23, 2014. On January 22, 2016, the Company and its Board of Directors (the "Board") amended the Plan to fix the number of shares reserved for issuance of both stock options and RSUs at 336,183.

Based on the number of outstanding options and RSUs as of September 30, 2017 and RSUs vested through September 30, 2017, the Company had 7,531 options or RSUs remaining for issuance under the Plan.

The Company did not recognize any tax benefits for stock-based compensation during any of the periods presented.

On March 3, 2017, the Company cancelled all outstanding options granted under the Plan with an exercise price of CDN\$17.00 or greater and issued one new option for each 1.7 canceled options.

**Frankly Inc. and Subsidiaries**  
**Notes to Condensed Consolidated Financial Statements – Unaudited**

*Stock Options*

The following table sets forth the activity for the Company's stock options during the periods presented:

	Shares	Weighted Average		Remaining Contractual Term (Years)
		Exercise Price	Grant Date Fair Value	
Balance, December 31, 2015	140,809	\$ 35.53	\$ 17.17	7.12
Granted	170,147	12.19	3.61	
Exercised	-	-	-	
Forfeited or canceled	(65,194)	34.82	12.32	
Balance, December 31, 2016	245,762	\$ 19.52	\$ 9.10	8.71
Vested and expected to vest, December 31, 2016	235,854	\$ 19.62	\$ 9.18	8.70
Exercisable, December 31, 2016	47,595	\$ 29.18	\$ 17.07	7.74
<u>Unaudited interim activity:</u>				
Balance, January 1, 2017	245,762	\$ 19.52	\$ 9.10	8.71
Adjustment - Balance, January 1, 2017	(53)(a)	-	-	
Granted	69,827	5.47	2.92	
Exercised	-	-	-	
Forfeited or canceled	(46,857)	19.19	9.49	
Canceled (Option Replacement)	(193,339)(b)	19.90	9.11	
Granted (Option Replacement)	113,677(b)	5.30	9.11	
Balance, September 30, 2017	189,017	\$ 5.47	\$ 6.72	8.44
Vested and expected to vest, September 30, 2017	182,756	\$ 5.48	\$ 6.78	8.42
Exercisable, September 30, 2017	63,797	\$ 5.77	\$ 10.29	7.53

(a) On February 3, 2017, the Company effected a one-for-seventeen reverse split. Upon finalizing the impact at the holder level, a small rounding adjustment was required to true-up options outstanding as of December 31, 2016.

(b) On March 3, 2017, the Company cancelled all outstanding options granted under the Plan with an exercise price of CDN\$17.00 or greater and issued one new option for each 1.7 canceled options (the "Option Replacement"). The Company accounted for the Option Replacement as a modification in accordance with ASC 718, *Compensation—Stock Compensation*. The Company canceled 193,339 existing options (the "original options") and concurrently granted 113,677 replacement options (the "replacement options"). The total stock-based compensation expense recognized by the Company for the nine months ended September 30, 2017, relating to the Option replacement, was computed using the original grant date fair value of the original options, plus the incremental fair value calculated as the excess of the fair value of the replacement options over the fair value of the original options on the modification date.

The aggregate intrinsic value of outstanding and exercisable stock options as of September 30, 2017 is \$0.

**Frankly Inc. and Subsidiaries**  
**Notes to Condensed Consolidated Financial Statements – Unaudited**

*Restricted Share Units*

The following table sets forth the activity for the Company's RSUs for the periods presented:

	<u>Shares</u>	<u>Weighted-Average Grant Date Fair Value</u>
Balance, December 31, 2015	35,767	21.26
Granted	60,832	6.38
Vested	(5,299)	10.89
Forfeited or canceled	(14,569)	36.35
Balance, December 31, 2016	<u>76,731</u>	<u>\$ 7.31</u>
<u>Unaudited interim activity:</u>		
Balance, January 1, 2017	76,731	\$ 7.31
Adjustment - Balance, January 1, 2017	(7)(a)	-
Granted	58,365	5.01
Vested	(54,597)	6.05
Forfeited or canceled	(754)	6.44
Balance, September 30, 2017	<u>79,738</u>	<u>\$ 6.50</u>

(a) On February 3, 2017, the Company effected a one-for-seventeen reverse split. Upon finalizing the impact at the holder level, a small rounding adjustment was required to true-up RSUs outstanding as of December 31, 2016.

The RSUs granted during the nine months ended September 30, 2016 and 2017 had an aggregate fair value of \$364,822 and \$292,336, respectively, based on the closing price for common shares on the date of grant. Unrecognized compensation cost related to the Company's non-vested RSUs was \$369,976 as of December 31, 2016, which is expected to be recognized from 2017 through 2019.

**8. Income Taxes**

The Company had \$0 income tax expense for all periods presented. Deferred tax assets have been fully reserved given the Company's history of losses.

**9. Commitments and Contingencies**

*Legal Proceedings*

On July 21, 2017, a complaint was filed by GEI, Albert C. Gannaway III, and Samantha Gannaway, and was served on August 4, 2017, captioned Gannaway Entertainment, Inc., Albert C. Gannaway III, Samantha Gannaway V.S. Frankly Inc., Steve Chung, SKP America, LLC, JJR Private Capital Limited Partnership, Ron Schmeichel, Louis Schwartz in the United States District Court for the Northern District of California against the Company, the Company's Chief Executive Officer, Chief Financial Officer and Chief Operating Officer and others alleging violations of U.S. securities laws, fraud and breach of fiduciary duties, and seeking in excess of \$15 million in damages, arising out of the Company's acquisition of Gannaway Web Holdings, LLC from GEI and other parties in 2015.

On September 30, 2017, the defendants filed a motion to dismiss the complaint. On October 11, 2017 the plaintiffs filed an amended complaint. On October 31, 2017 the defendants filed a motion to dismiss the amended complaint. The Company and its counsel continue to believe that the claims are without merit. The Company intends to defend the claims vigorously.

*Operating Lease Commitments*

The Company is obligated under several non-cancellable operating leases for office space, expiring in 2017 through 2023. The Company has one sublease for its excess office space as of December 31, 2016.

The future aggregate minimum lease payments under these non-cancellable operating leases, without regard to subleases, are payable as follows as of September 30, 2017:

<u>Payments Due During the Years Ending December 31,</u>	<u>Total</u>
2017	\$ 1,403,958
2018	1,381,158
2019	1,076,658
2020	852,908
2021	852,908
Thereafter	995,061
Total	<u>\$ 6,562,651</u>

**Frankly Inc. and Subsidiaries**  
**Notes to Condensed Consolidated Financial Statements – Unaudited**

***Capital Lease Commitments***

The Company is party to various computer-related equipment leases that qualify as capital lease obligations, expiring in 2017 and 2018. The present value of the future minimum lease payments at inception of the lease is recorded as a capitalized asset within property and equipment (Note 5) with the related capital lease obligation as a liability in the accompanying consolidated balance sheets.

Future minimum capital lease payments were payable as follows as of December 31, 2016:

<u>Payments Due During the Years Ending December 31,</u>	<u>Total</u>
2017	\$ 173,224
2018	40,742
<b>Total</b>	<b>213,966</b>
Amount representing interest	(5,882)
<b>Present value of minimum lease payments</b>	<b>208,084</b>
Less current portion	(167,635)
<b>Non-current portion</b>	<b>\$ 40,449</b>

***Employee Benefit Plan***

The Company's subsidiaries, Frankly Co. and Frankly Media, have a 401(k) plan (the "Plan"), which covers all eligible employees. Under the Plan, employees may contribute from their gross salaries on a before tax basis up to annual statutory limits determined each year.

**10. Subsequent Events**

The Company has evaluated subsequent events through November 14, 2017 which is the date these unaudited interim condensed consolidated financial statements were available to be issued, and determined that there have been no events that have occurred that would require adjustments to or disclosure in the unaudited interim condensed consolidated financial statements except for the transactions described below.

***Retention Plan***

On October 19, 2017, the Company began a Retention Plan (the "Retention Plan") to induce selected key contributors to remain employed with the Company, or an acquirer of the Company in a strategic transaction, and to remain actively engaged in the Company's business, and to enhance the Company's value by providing participants incentive benefits to help assure the success of any strategic transaction concerning the Company.

The Retention Plan has two primary incentive components, a severance component and a bonus component. The severance component is contingently payable upon a double trigger as follows: 1) the Company completes a strategic transaction by February 15, 2018; and 2) within six months thereafter, Company (including any subsidiary or successor thereof) terminates participant employment without cause. The bonus component is payable at various percentages of base salary, and is contingent upon the occurrence of the following events, with each event being allocated a portion of the total eligible bonus amount, depending on the participant: 1) Retention bonus in the event that the participant remains employed by the Company through February 15, 2018; 2) Company performance goal bonus in the event that the Company achieves internal performance goals in specific areas in the last four months of 2017, subject to final approval by the Board of Directors of the Company; and 3) Strategic transaction bonus in the event that the Company enters a definitive binding agreement for a strategic transaction, as defined in the plan document, by February 15, 2018. The bonus component will be payable in a combination of cash and/or RSUs to be determined by the Company in its sole discretion.

***Equity Incentive Plan***

On October 20, 2017, the Company adopted an amended and restated equity incentive plan (the "Restated Plan"). The Restated Plan amends the current equity incentive plan, effective as of October 1, 2017, by replacing the compensation plan limit with a fixed total limit of 435,000 common shares that may be granted under Option and RSU awards.