

**ACME COMMUNICATIONS, Inc.**

**ANNUAL REPORT**

**2015**

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## **Management's Discussion and Analysis ("MD&A") of Financial Condition and Results of Operations**

### ***Forward Looking Statements***

*This Annual Report includes forward-looking statements. We have based these forward-looking statements on our current expectations and projections about future events. In some cases, you can identify forward-looking statements by terminology such as "may," "will," "could," "expect," "believe," "should" or "might" or the negative of such terms or other comparable terminology. Forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our and the television broadcast industry's actual results, levels of activity, performance, achievements and prospects to be materially different from those expressed or implied by such forward-looking statements. Actual results in the future could differ materially and adversely from those described in the forward-looking statements as a result of various important factors, including how our final liabilities are resolved, the potential discovery of new liabilities and the level of expenses required to wind our Company down.*

*These forward-looking statements speak only as of the date of this Annual Report. We undertake no duty to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, after the date of this Annual Report. In light of these risks, uncertainties and assumptions, the forward-looking events discussed in this Annual Report might not occur.*

### ***Presentation of Financial Information in this MD&A***

The financial information and discussion contained in this MD&A for the years ended December 31, 2015 and 2014 is unaudited. In the opinion of management, such financial information, however, includes all adjustments (consisting of normal recurring accruals) considered necessary for the fair presentation of the financial position and the results of operations, and cash flows for the periods presented. The information contained in the MD&A should be read in conjunction with our Consolidated Financial Statements, and notes thereto, as of and for the years ended December 31, 2015 and 2014, which can be found on pages F1-F9 of this Annual Report.

### ***Overview***

This MD&A is provided as a supplement to our Consolidated Financial Statements and notes thereto, as discussed above, in order to enhance your understanding of our results of operations and financial condition. Our MD&A is organized as follows:

- *Introduction.* This section provides a general description of our Company and discussion about our operations.
- *Critical Accounting Policies and Estimates.* This section discusses those accounting policies that are considered important to the evaluation and reporting of our financial condition and results of operations, and whose application requires us to exercise subjective or complex judgments in making estimates and assumptions. In addition, all of our significant accounting policies, including our critical accounting policies, are summarized in Note 2 to our Consolidated Financial Statements, which are, as mentioned above, posted separately on our Company's website at [www.acmecomunications.com](http://www.acmecomunications.com).
- *Results of Operations.* This section provides our analysis and outlook for the significant line items on our Consolidated Statements of Operations, as well as other information that we deem meaningful to understand our results of operations, all presented on a discontinuing operations basis.
- *Liquidity and Capital Resources.* This section provides an analysis of our liquidity and cash flows as well as our outlook on our available liquidity as of December 31, 2015.

As of December 31, 2013, our Company, ACME Communications, Inc. and its wholly-owned subsidiaries (together, unless the context otherwise requires, the "Company" or "we") had sold all of its television stations as well as its final operating asset *The Daily Buzz*, a three-hour weekday news and lifestyle morning program. The Company's only remaining assets at December 31, 2015 consisted primarily of cash.

In December 2012, the shareholders approved a plan of liquidation and the Company expects that it will be dissolved by no later than by the end of 2016 or early 2017, and all net assets will be distributed to our shareholders by or at that time. As

of December 31, 2015, the Company had no employees and its wound-down affairs were being administered by part-time consultants. Ongoing expenses have been minimized and pertain primarily to the preparation of financial statements, tax returns, minimum state taxes, entity filings, transfer agent charges, other professional fees and the maintenance and storage of historical records. We believe that we will formally conclude all activities and make a final distribution to shareholders in late 2016. All future distributions to shareholders will trigger sale bonus payments equal to approximately 11% of such distributions to certain current and former management team members in accordance with contractual obligations to them. We expect our 2016 full year corporate expenses will be less than \$50,000, excluding any sale bonus expense.

### ***Critical Accounting Policies and Estimates***

Our discussion and analysis of our financial condition and results of operations are based upon our Consolidated Financial Statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these Consolidated Financial Statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates, including those related to income taxes, contingencies and litigation reserves. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may materially differ from these estimates under different assumptions or conditions.

### ***Results of Operations***

#### ***Year Ended December 31, 2015 compared to Year Ended December 31, 2014***

Programming expenses for 2014 were negative \$4,000 and related to minor adjustments to prior year-end accruals. There was no programming expense for 2015.

Depreciation and amortization expense was \$2,000 in 2015 and 2014, as the Company had minimal property and equipment during both years.

Corporate expenses for 2015 were \$80,000 compared to \$107,000 for 2014, a decrease of \$27,000, or 25%, as a result of the ongoing effort to minimize expenses prior to our ultimate dissolution. Apart from any sale bonus that we are obligated to pay related to future shareholder distributions, we expect our annualized 2016 corporate expenses to be less than \$50,000.

Other income of \$58,000 in 2015 relates to the recovery of stock related to prior years' executive life insurance policies. There was no other income in 2014.

The gain on the sale of assets for 2015 was \$6,000 related to the aforementioned insurance company stock recovered in the third quarter of 2015 and sold in November 2015.

Interest and investment income for 2015 was \$3,000 and represented dividend income on the insurance company stock compared to \$2,000 in interest and investment income in 2014.

Income tax expense for 2015 was \$5,000 representing minimum state income and franchise taxes. There was no income tax expense recognized in 2014.

Our net loss for 2015 was \$20,000 compared to a net loss of \$103,000 for 2014.

### ***Liquidity and Capital Resources***

Net cash used by operating activities was \$38,000 for 2015 compared to net cash used of \$30,000 for 2014. The slight increase in cash used by operations relates primarily to changes in working capital.

Net cash provided by investing activities for 2015 was \$64,000 and consisted of the sale of stock recovered from the life insurer related to prior years' executive life policies. There were no cash flows related to investing activities in 2014.

Net cash provided by financing activities for 2015 was \$290,000, consisting of the return of our deposit by the Federal Communications Commission in January 2015. There were no cash flows related to financing activities in 2014.

As of December 31, 2015, we had cash and cash equivalents of \$816,000 compared to cash and cash equivalent of \$500,000 as of December 31, 2014.

We believe existing cash and cash equivalents at December 31, 2015 will be sufficient to meet our operating cash requirements for at least the next twelve months. In late 2016, following the settlement or expiration of limitation statutes relating to our final liabilities, we expect to distribute the remaining net assets to our shareholders, net of any sale bonus to our former executive team.

### **Other Information**

On October 14, 2008, we notified the Nasdaq Stock Market of our intent to voluntarily delist our common stock from the Nasdaq Global Market, and to voluntarily deregister our common stock under the Securities Exchange Act of 1934 by filing with the Securities & Exchange Commission (“SEC”) a Form 25 relating to the delisting of our common stock on or about October 24, 2008, with the delisting of our common stock to be effective ten days thereafter.

Our last day of trading of our common stock on the Nasdaq Global Market was on Monday, November 3, 2008.

On November 4, 2008 we filed a Form 15 with the SEC to deregister our common stock under Section 12 of the Securities Exchange Act of 1934. Upon the filing of the Form 15, our obligation to file certain reports with the SEC, including Forms 10-K, 10-Q, and 8K, was immediately suspended. The deregistration of our common stock became effective February 1, 2009.

Our common stock is currently quoted on the Pink Sheets®, a centralized electronic quotation service for over-the-counter securities.

### ***Directors and Executive Officers***

The following table sets forth information about our directors and executive officers at December 31, 2014:

<u><b>Name</b></u>	<u><b>Age</b></u>	<u><b>Position</b></u>
Jamie Kellner	68	Chairman of the Board
Thomas Allen	63	President and Secretary and Director

*Jamie Kellner* is a co-founder of ACME and is our Chairman of the Board. He served as our Chief Executive Officer from our inception in 1997 until July 2010. Mr. Kellner co-founded The WB Network in 1993 and served as its Chairman and Chief Executive Officer from 1994 until June 2004. Mr. Kellner was President of Fox Broadcasting Company from its inception in 1986 to 1993. Mr. Kellner also served as Chairman and Chief Executive Officer of Turner Networks, a division of AOL-Time Warner, from March 2001 to February 2003.

*Thomas Allen* is a co-founder of ACME and from our inception in 1997 until July 2010 served as our Executive Vice President and Chief Financial Officer. He has been a member of our Board and corporate secretary since 1997 and has served as a consultant to the Company since July 2010. From August 1993 to May 1996, Mr. Allen was the Chief Operating Officer and Chief Financial Officer for Virgin Interactive Entertainment, Inc. Before that Mr. Allen served as Senior Vice President and Chief Financial Officer of the Fox Broadcasting Company from 1986 to 1993. From July 2010 through February 2012, Mr. Allen has served as Executive Vice President and Chief Financial Officer of Outdoor Channel Holdings, Inc., a national cable network publicly traded on the Nasdaq Global Market. From February 2012 through September 2013, Mr. Allen also served in the additional duty of Chief Operating Officer of Outdoor Channel Holdings, Inc. Mr. Allen left the Outdoor Channel in September 2013 following the sale of the Company and its delisting from Nasdaq. In December 2014, following the unexpected passing in November 2014 of then President and CEO, Doug Gealy, Mr. Allen assumed the additional role of President.

### ***Transfer Agent and Stock Registrar***

Our transfer agent and stock registrar is Computershare at 250 Royall St., Canton, MA 02021.

**ACME Communications, Inc. and Subsidiaries**  
**Consolidated Balance Sheets**  
**(Unaudited)**  
(In thousands, except share data)

	<b>As of December 31,</b>	
	<b>2015</b>	<b>2014</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 816	\$ 500
Restricted cash	---	290
Prepaid expenses and other current assets	8	40
Total current assets	824	830
Property and equipment, net	1	3
Other assets	---	10
Total assets	\$ 825	\$ 843
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ ---	\$ ---
Accrued liabilities	813	811
Income taxes payable	---	---
Total current liabilities	813	811
Other liabilities, net of current portion	---	---
Total liabilities	813	811
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, \$0.01 par value; 10,000,000 shares authorized, no shares issued or outstanding	---	---
Common stock, \$0.01 par value; 50,000,000 shares authorized, 16,046,763 shares issued and outstanding at December 31, 2015 and at December 31, 2014, respectively	161	161
Additional paid-in capital	128,011	128,011
Accumulated deficit	(128,160)	(128,140)
Total stockholders' equity	12	32
Total liabilities and stockholders' equity	\$ 825	\$ 843

See the accompanying notes to the unaudited consolidated financial statements.

**ACME Communications, Inc. and Subsidiaries**  
**Consolidated Statements of Operations and Comprehensive Income**  
**(Unaudited)**  
**(In thousands, except per share data)**

	<b>For the Year Ended December 31,</b>	
	<b>2015</b>	<b>2014</b>
Net revenues	\$ ---	\$ ---
Operating expenses:		
Cost of service:		
Programming, including program amortization	---	(4)
Depreciation and amortization	2	2
Corporate expenses	80	107
Operating expenses	82	105
Operating loss	(82)	(105)
Other expenses:		
Other income	58	---
Gain on sale of assets	6	---
Interest and investment income, net	3	2
Loss from discontinuing operations, before income taxes	(15)	(103)
Income taxes	(5)	---
Net loss / Comprehensive loss	\$ (20)	\$ (103)
Net loss per share, basic and diluted (discontinued):	\$ (0.00)	\$ (0.01)
Weighted average basic and diluted common shares outstanding	16,047	16,047

See the accompanying notes to the unaudited consolidated financial statements.

**ACME Communications, Inc. and Subsidiaries**  
**Consolidated S tatements of S tockholders' Equity**  
(Unaudited)  
(In thousands)

	<u>Common Stock</u>		<u>Additional Paid-in Capital</u>	<u>Accumulated Deficit</u>	<u>Total Stockholders' Equity</u>
	<u>Shares</u>	<u>Amount</u>			
Balance at December 31, 2014	16,046	\$ 161	\$ 128,011	\$ (128,140)	\$ 32
Net loss	---	---	---	(20)	(20)
Balance at December 31, 2015	<u>16,046</u>	<u>\$ 161</u>	<u>\$ 128,011</u>	<u>\$ (128,160)</u>	<u>\$ 12</u>

See the accompanying notes to the unaudited consolidated financial statements.



**ACME Communications, Inc. and Subsidiaries**  
**Consolidated Statements of Cash Flows**  
(Unaudited)  
(In thousands)

	<b>For the Year Ended December 31,</b>	
	<b>2015</b>	<b>2014</b>
Cash flows from operating activities:		
Net loss	\$ (20)	\$ (103)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	2	2
Other income from recovered stock	(58)	---
Gain on sale of marketable securities	(6)	---
Changes in operating assets and liabilities:		
Prepaid expenses, other assets and marketable securities	42	99
Accounts payable	---	(4)
Accrued liabilities	2	(18)
Income taxes payable	---	(6)
Net cash used in operating activities	(38)	(30)
Cash flows from investing activities		
Proceeds received from sale of marketable securities	64	---
Net cash provided by investing activities	64	---
Cash flows from financing activities:		
FCC escrow refund return	290	---
Net cash provided by financing activities	290	---
Increase in cash and cash equivalents	316	(30)
Cash and cash equivalents at beginning of the period	500	530
Cash and cash equivalents at end of the period	\$ 816	\$ 500
Net cash payments for:		
Interest	\$ ---	\$ ---
Taxes	\$ 6	\$ 5

See the accompanying notes to the unaudited consolidated financial statements.

**ACME Communications, Inc. and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
**(Unaudited)**

**1. NATURE OF BUSINESS**

The Company commenced operations in 1997 and ACME Communications, Inc. was formed as the Company's holding company on July 23, 1999, in preparation for and in conjunction with an initial public offering of its stock.

ACME Communications, Inc. (together with its subsidiaries, hereinafter, individually and collectively, "ACME" or the "Company") is a holding company with no independent operations other than through its indirect wholly-owned subsidiary, ACME Television, LLC ("ACME Television").

Effective November 4, 2008, the Company's common stock was delisted from the Nasdaq Global Market and on that same day the Company filed a Form 15 with the U.S. Securities & Exchange Commission ("SEC") to deregister its common stock under Section 12 of the Securities Exchange Act of 1934. Upon the filing of the Form 15, the Company's obligation to file certain reports with the SEC, including Forms 10-K, 10-Q, and 8-K, was immediately suspended. The deregistration of the Company's common stock became effective February 1, 2009. The Company's common stock is currently quoted on the Pink Sheets®, a centralized electronic quotation service for over-the counter securities.

As of December 31, 2012, the Company had completed the sale of all of its previously owned television stations, and on March 29, 2013 the Company's last remaining operating asset, *The Daily Buzz* morning news show, was sold to Mojo Brands Media, LLC for \$1.5 million in cash. Also see "*Sale of Asset and Other Events*".

***Sale of Asset and Other Events***

On December 10, 2012, the Company's Board of Directors and shareholders ratified and approved a formal plan of liquidation.

On March 29, 2013, the Company completed the sale of its last operating asset, *The Daily Buzz*, to Mojo Brands Media, LLC for approximately \$1.5 million in cash.

On April 1, 2013, the Company's Board of Directors approved a special distribution to its shareholders of record as of April 16, 2013 in the form of a cash distribution of \$.08 per common share. The cash distribution which amounted to approximately \$1.3 million was paid on April 24, 2013.

On April 1, 2013, the Company's Board of Directors approved a special distribution to its shareholders of record as of April 16, 2013 in the form of a cash distribution of \$.08 per common share. The cash distribution which amounted to approximately \$1.3 million was paid on April 24, 2013.

On November 5, 2013, the \$150,000 restricted cash established in an escrow account as part of the Daily Buzz sale on March 29, 2013, was released.

On December 10, 2013, the \$1.0 million restricted cash established in an escrow account as part of the sale of the Company's New Mexico stations KWBQ, its satellite station KRWB and KASY to Tamer Media and LIN Media on December 10, 2012, was released.

On December 13, 2013, the Company's Board of Directors approved a special distribution to its shareholders of record as of December 26, 2013 in the form of a cash distribution of \$.05 per common share. The cash distribution which amounted to approximately \$800,000 was paid on December 30, 2013.

On February 4, 2015, the \$290,000 restricted cash established in an escrow account for the Federal Communications Commission in connection with the sale of our final television licenses in December 2012 was released.

***Discontinued Operations***

The Company had sold all of its television stations prior to 2012.

In accordance with accounting principles generally accepted in the United States of America, the accompanying Consolidated Statements of Operations and Cash Flows reflect the Company's entire results pursuant to the approved plan of liquidation as discontinued for all periods presented.

## **2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

### ***Principles of Consolidation***

The accompanying Consolidated Financial Statements include the accounts of the Company and its wholly-owned subsidiaries, including The Daily Buzz, LLC. All significant intercompany accounts and transactions have been eliminated for all periods presented. Segment information is not presented since all of the Company's revenues are attributed to a single reportable segment.

### ***Basis of Presentation***

The accompanying Consolidated Financial Statements as of and for the years ended December 31, 2015 and 2014 are unaudited and have been prepared in accordance with accounting principles generally accepted in the United States of America. As of and for the years ended December 31, 2015 and 2014 all operations are considered "*Discontinued Operations*". In the opinion of management, such consolidated financial statements include all adjustments (consisting of normal recurring accruals) considered necessary for the fair presentation of the financial position and the results of operations, and cash flows for these periods.

The accompanying Consolidated Financial Statements as of and for the year ended December 31, 2014 are derived from the consolidated financial statements included in the Company's 2014 Annual Report.

In accordance with the Financial Accounting Standards Board (the "FASB") *Accounting Standards Codification*<sup>TM</sup> ("ASC") Topic 855, *Subsequent Events*, or ASC 855, the Company evaluated all events or transactions that occurred after December 31, 2015 through January 25, 2016, which represents the date the Consolidated Financial Statements were available to be issued.

### ***Revenue Recognition***

The Company sold its last operating asset, The Daily Buzz, in 2013 and has not generated any revenue since then.

### ***Cash and Cash Equivalents***

The Company considers all highly liquid debt instruments purchased with an original maturity of three months or less to be cash equivalents. Cash that is restricted and pledged as collateral for capital lease obligations or is escrowed in connection with pending acquisitions, including acquisitions of construction permits, is considered restricted cash.

### ***Concentration of Credit Risk and Fair Value of Financial Instruments***

Financial instruments that potentially subject the Company to concentration of credit risk consist primarily of cash. Due to the short-term nature of these instruments, the carrying value approximates the fair value. The Company may be exposed to credit loss for amounts in excess of the Federal Deposit Insurance Corporation insurance limit of \$250,000 per owner, in the event of non-performance by the institutions; however, the Company does not anticipate non-performance by these financial institutions.

The carrying amounts reported in the Consolidated Balance Sheets for all of the items presented approximate fair values because of the immediate or short-term maturity of these financial instruments.

### ***Long-Lived Assets, Including Intangibles Subject to Amortization***

As of December 31, 2015 and 2014, the Company's only long-lived asset is its property, plant and equipment.

Property and equipment are stated at cost. The cost of maintenance is expensed when incurred. Depreciation and

amortization are computed using the straight-line method over the estimated useful lives of the respective assets, or for leasehold improvements, the shorter of useful lives or the lease term. When property is retired or otherwise disposed of, the cost and accumulated depreciation are removed from the appropriate accounts and any gain or loss is included in the results of current operations. As of December 31, 2013, the Company's sold equipment consisted of computers which are depreciated over three years.

### ***Income Taxes***

The Company accounts for income taxes in accordance with FASB ASC Topic 740, *Income Taxes*, or ASC 740. Income taxes are provided based on current taxable income and the future tax consequences of temporary differences between the basis of assets and liabilities for financial and tax reporting. The deferred income tax assets and liabilities represent the future state and federal tax return consequences of those differences, which will either be taxable or deductible when the assets and liabilities are recovered or settled. Deferred income taxes are also recognized for operating losses that are available to offset future taxable income and tax credits that are available to offset future income taxes. At each reporting period, management assesses the realizable value of deferred tax assets based on, among other things, estimates of future taxable income, and adjusts the related valuation allowance as necessary. Management makes a number of assumptions and estimates in determining the appropriate amount of expense to record for income taxes. These assumptions and estimates consider the taxing jurisdiction in which the Company operates as well as current tax regulations. Accruals are established for estimates of tax effects for certain transactions and future projected profitability of the Company's businesses based on management's interpretation of existing facts and circumstances.

ASC 740 defines the threshold for recognizing the benefits of tax return positions in the financial statements as "more-likely-than-not" to be sustained by the taxing authority. A tax position that meets the "more-likely-than-not" criterion shall be measured at the largest amount of benefit that is more than 50% likely of being realized upon ultimate settlement. The Company has reviewed its tax positions and determined that an adjustment to the tax provision is not considered necessary nor is a reserve for income taxes required. When necessary, the Company would accrue interest related to uncertain tax positions as a component of interest expense and penalties as a component of income tax expense.

### ***Income (Loss) per Share***

Basic income (loss) per common share is computed by dividing net income (loss) to common stockholders by the weighted average number of common shares outstanding for the period. Diluted income (loss) per share includes the effect of the Company's outstanding stock options, if including such instruments is dilutive.

During the year ended December 31, 2015, 648,000 stock options expired reducing our stock options outstanding at December 31, 2015 to 20,000 shares compared to stock options outstanding at December 31, 2014 of 668,000.

### ***Stock-Based Compensation***

FASB ASC Topic 718 *Compensation — Stock Compensation*, or ASC 718, requires companies to estimate the fair value of share-based payment awards on the date of grant using an option-pricing model. There were no stock options granted or any other type of share-based issuances during the years ended December 31, 2015 and 2014. There was no stock-based compensation expense during the years ended December 31, 2015 or 2014.

As of December 31, 2015, there was no unrecognized compensation cost related to unvested stock options.

### ***Use of Estimates in the Preparation of Financial Statements***

The preparation of Consolidated Financial Statements in conformity with accounting principles generally accepted in the United States 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 Consolidated Financial Statements and the reported amounts of revenues and expenses during the reporting period. On an on-going basis, management evaluates its estimates, including those related to income taxes, and contingencies and litigation reserves. The Company bases its estimates on historical experience and on various other assumptions that they believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may materially differ from these estimates under different assumptions or conditions.

### ***Recent Accounting Pronouncements***

In April 2013, the FASB issued ASU No. 2013-07, Presentation of Financial Statements (Topic 205): Liquidation Basis of Accounting, which became effective for interim and annual reporting periods beginning after December 15, 2013, with early adoption permitted. While the Company is in a liquidation stage, it has not adopted this standard and does not believe that the financial statements presented herein are materially affected by such lack of adoption.

Apart from the foregoing, the Company has implemented all new accounting pronouncements that are in effect and that may impact its consolidated financial statements and does not believe that there are any other new accounting pronouncements that have been issued that might have a material impact on its financial position or results of operations.

### **3. PROPERTY AND EQUIPMENT**

At December 31, 2015 property and equipment consists solely of computer equipment at the Company's corporate headquarters with a net book value of \$1,000. Also see Note 1 "*Sale of stations and Other Events*".

There are no assets subject to a capital lease at December 31, 2015 or 2014.

There were no assets and liabilities at December 31, 2015 that are required to be measured at fair value on a recurring basis.

### **4. COMMITMENTS AND CONTINGENCIES**

Total rental expense under operating rental agreements, all of which are month-to-month, for the years ended December 31, 2014 and 2013 was approximately \$4,000 and \$10,000, respectively.

#### ***Obligations Under Capital Leases***

As of December 31, 2015, the Company had no equipment that was leased under capital equipment facilities.

### **5. INCOME TAXES**

Income tax expense for 2015 was \$5,000, representing minimum state income and franchise taxes. There was no income tax expense in 2014.

At December 31, 2015 and 2014, the Company's deferred tax assets consisted mainly of net operating loss carryforwards for which the Company has established a full valuation allowance.

### **6. DEFINED CONTRIBUTION PLAN**

In 1998, the Company established a 401(k) defined contribution plan (the "Plan") which covered all eligible employees (as defined in the Plan). Participants were allowed to make non-forfeitable contributions up to 50% of their annual salary, but could not exceed the annual maximum contribution limitations established by the Internal Revenue Service. The Plan provided for the Company to match 50% of the amounts contributed by each participant, but not match participants' contributions in excess of 6% of their compensation per pay period. The Company suspended its matching contributions effective January 1, 2009 and, terminated the Plan in 2013.

### **7. STOCK OPTION COMPENSATION**

The Company's 1999 Stock Incentive Plan provides additional means to attract, motivate, reward and retain key personnel. The Compensation Committee of the Board of Directors (the plan administrator) has the authority to grant different types of stock and cash incentive awards and to select participants. While only stock options and restricted stock awards are contemplated at this time, other forms of awards may be granted to give the Company's flexibility to structure future incentives. The Company's employees, officers, directors, and consultants may be selected to receive awards under the plan.

A maximum of 4,200,000 shares of the Company's common stock may be issued under the plan, (approximately 26% of the Company's current outstanding shares). As of December 31, 2015, 4,180,000 shares are reserved and available for future exercises of stock options. The number of shares subject to all awards granted under the plan to any one person in a calendar

year cannot exceed 1,000,000 shares. Performance-based awards payable solely in cash that are granted under the plan to any one person in a calendar year cannot provide for payment of more than \$1,000,000.

Each share limit and award under the plan is subject to adjustment for certain changes in the Company's capital structure, reorganizations and other extraordinary events. Shares subject to awards that are not paid or exercised before they expire or are terminated are available for future grants under the plan.

At December 31, 2015 there were 20,000 stock options outstanding and exercisable, with an exercise price of \$4.89. These will expire in December 2016.

#### **8. ACCUMULATED OTHER COMPREHENSIVE INCOME**

As of December 31, 2015 the Company had no component of accumulated other comprehensive income.