

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2019

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from [] to []

Commission file number 333-177463



AudioEye, Inc.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

20-2939845

(I.R.S. Employer Identification No.)

5210 E. Williams Circle, Suite 750, Tucson, Arizona

(Address of principal executive offices)

85711

(Zip Code)

(866) 331-5324

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Trading Symbol(s)	Name of Each Exchange on Which Registered
Common Stock, par value \$0.00001 per share	AEYE	The Nasdaq Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act:

None

(Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Non-accelerated filer

Emerging growth company

Accelerated filer

Smaller reporting company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant's most recently completed second quarter ended as of June 30, 2019 was \$35,951,825.

As of March 30, 2020, 8,876,553 shares of the registrant's common stock were issued and outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive Proxy Statement to be delivered to stockholders in connection with the registrant's 2020 Annual Meeting of Stockholders scheduled to be held on May 18, 2020 are incorporated by reference into Part III of this report.

TABLE OF CONTENTS

Part I		
Item 1.	Business	2
Item 1A.	Risk Factors	14
Item 1B.	Unresolved Staff Comments	28
Item 2.	Properties	28
Item 3.	Legal Proceedings	28
Item 4.	Mine Safety Disclosures	28
Part II		
Item 5.	Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	29
Item 6.	Selected Financial Data	29
Item 7.	Management’s Discussion and Analysis of Financial Condition and Results of Operations	29
Item 7A.	Quantitative and Qualitative Disclosures About Market Risk	37
Item 8.	Financial Statements and Supplementary Data	37
Item 9.	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	37
Item 9A.	Controls and Procedures	37
Item 9B.	Other Information	39
Part III		
Item 10.	Directors, Executive Officers and Corporate Governance	40
Item 11.	Executive Compensation	40
Item 12.	Security Ownership of Certain Beneficial Owners, Management and Related Stockholder Matters	40
Item 13.	Certain Relationships and Related Transactions and Director Independence	40
Item 14.	Principal Accounting Fees and Services	40
Part IV		
Item 15.	Exhibits, Financial Statement Schedules	41
	Consolidated Financial Statements	F-1

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This annual report contains forward-looking statements within the meaning of the federal securities laws, including Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). These statements relate to either future events or our future financial performance. In some cases, you may be able to identify forward-looking statements by terms such as “may,” “should,” “expects,” “plans,” “anticipates,” “believes,” “estimates,” “predicts,” “potential,” “projects,” “outlook” or “continue,” or the negative of these terms or other synonymous terminology. These statements are only predictions and involve known and unknown risks, uncertainties and other factors, including the risks in the section entitled “Risk Factors,” that may cause our or our industry’s actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by these forward-looking statements.

Because these forward-looking statements involve known and unknown risks and uncertainties, there are important factors that could cause actual results, events or developments to differ materially from those expressed or implied by these forward-looking statements, including our plans, objectives, expectations and intentions and other factors discussed in “Part I—Item 1A. Risk Factors” contained in this Annual Report. Risk factors that could cause actual results to differ from those contained in the forward-looking statements include but are not limited to risks related to:

- the uncertain market acceptance of our existing and future products;
- our need for, and the availability of, additional capital in the future to fund our operations and the development of new products;
- the success, timing and financial consequences of new strategic relationships or licensing agreements we may enter into;
- rapid changes in Internet-based applications that may affect the utility and commercial viability of our products;
- the timing and magnitude of expenditures we may incur in connection with our ongoing product development activities;
- the level of competition from our existing competitors and from new competitors in our marketplace; and
- the regulatory environment for our products and services.

All forward-looking statements are made only as of the date hereof. Except as required by applicable law, including the securities laws of the United States, we do not intend, and we do not undertake any obligation, to revise or update any of the forward-looking statements to match actual results. Readers are urged to carefully review and consider the various disclosures made in this report, which aim to inform interested parties of the risks factors that may affect our business, financial condition, results of operations and prospects.

As used in this annual report, the terms “we,” “us,” “our,” “AudioEye,” the “Company” and similar references refer to AudioEye, Inc.

PART I

Item 1. Business

Overview

AudioEye is an industry-leading software solution provider delivering website accessibility compliance at all price points to businesses of all sizes. Our solutions advance accessibility with patented technology that reduces barriers, expands access for individuals with disabilities, and enhances the user experience for a broader audience. We believe that, when implemented, our solution offers businesses and organizations the opportunity to reach more customers, improve brand image, build additional brand loyalty, and, most importantly, provide an accessible and usable web experience to the expansive and ever-growing global population of individuals with disabilities. AudioEye provides an always-on testing, remediation, and monitoring solution that continually improves conformance with the Web Content Accessibility Guidelines (WCAG), helping businesses and organizations comply with WCAG standards as well as applicable U.S., Canadian, Australian, and United Kingdom accessibility laws.

AudioEye stands out among its competitors because it delivers machine-learning/artificial intelligence (“AI”)-driven accessibility without fundamental changes to the website architecture. Our technology publishes more than one billion remediations daily, and our solution is trusted by some of the largest and most influential companies in the world, including Uber, ADP, Tommy Hilfiger, AMI and more. Government agencies, both at the federal level and state and local levels, have also integrated our software in their digital platforms.

AudioEye generates revenue through the sale of subscriptions for our software-as-a-service (“SaaS”) accessibility solution plans. Plans range in scale from “do-it-yourself” to “do-it-for-me.” All are backed by the power of AudioEye’s machine-learning/AI-driven technology that finds and fixes the most common accessibility errors. Do-it-yourself plans, AudioEye Starter and Pro, also equip site owners with the remediation tools needed to fix remaining issues, ensuring accessibility standards are met. Do-it-for-me, AudioEye Managed and Enterprise, is for those who want AudioEye to continuously ensure legal compliance and accessibility for users of all abilities. Managed and Enterprise also come with the AudioEye Trusted Certification, our attestation of a site owner’s commitment to digital inclusion as defined by WCAG success criteria, which mitigates a customer’s risk of a costly digital accessibility-related legal action.

AudioEye customers may purchase tiered plans directly through the AudioEye marketplace, in a platform partner marketplace, through a vertical Content Management System (“CMS”) authorized reseller, or by working directly with the AudioEye sales team:

- The AudioEye marketplace offers Starter, Pro and Managed plans ideal for customers in any industry and is most effective for sites built on supported CMS platforms;
- Certain platforms, such as Duda, natively integrate AudioEye Pro and Managed plans into their marketplace, enabling web creators to immediately build legally compliant, fully accessible websites;
- Vertical CMS authorized resellers provide a website-hosting platform for their end-user customers, selling either AudioEye Pro or Managed accessibility solutions; and
- Organizations with non-platform custom websites seeking a fully managed solution, engage directly with AudioEye sales personnel for custom pricing and solutions.

Industry Background

Millions of Internet users are impacted by disabilities that prevent them from accessing and using digital content on a basis equivalent with those who are not impacted by disabilities. If not coded properly, a website may not offer full functionality for all users, in particular for users of assistive technology (“AT”), such as a screen reader. As a result, those sites may exclude potential users and customers. These sites also may not comply with U.S. and foreign laws addressing equal access and digital inclusion.

Title III of the Americans with Disabilities Act was enacted to help eliminate barriers to access. Just as building owners must implement physical accommodations to remove any physical barrier to access, transportation, or communication, website owners must adhere to Web Accessibility best practices in order to ensure barrier-free access to their websites and online materials. Over time, a website owner must maintain and prove its implementation of those techniques, such as those outlined within the globally recognized WCAG.

Traditional solutions addressing web accessibility may be costly and difficult to implement. Historically, the process for achieving compliance has been driven by costly consulting services and has not fully utilized emerging technologies to reduce the compliance cost burden. At the same time, web accessibility efforts have generally focused on a limited number of disability use cases, leaving many users’ accessibility needs for digital inclusion unaddressed. Businesses may have been reluctant to invest further in web accessibility solutions due to a perceived lack of commercial return on the significant investment required to design and implement a thorough and usable compliance solution.

Conventional solutions have been developed to help users access websites, but these systems often require the installation of a plug-in or software on the user’s computer. Many of these solutions are tailored to either single or a limited number of use cases and do not encompass a more holistic approach for addressing a wider range of use cases. In some cases, these systems can be costly, unwieldy and inconvenient. Furthermore, the assistive software’s ability to understand, process, and interpret complex and dynamic web applications that are prevalent across the web today is dependent on the quality with which the code was designed and developed, including the level to which the website adheres to best practices and standards.

AudioEye’s proprietary technology and processes remove the compliance cost burden for companies and website developers. Our machine-learning technology immediately identifies and fixes the most common accessibility errors, billions of issues daily, and addresses a wide range of disabilities including dyslexia, color blindness, epilepsy and more. And with the rapid acceleration of AudioEye on CMS templates, our technology advances in its recognition of errors, creating and pushing custom platform-level remediations. By working with strategically identified resellers and platform providers, AudioEye is able to onboard more end-user customers in a shorter period of time, leveraging economies of scale to deliver its solution in a cost-effective and highly efficient way. This strategy continues to make accessibility available to companies that would otherwise neglect the important issue of digital inclusion altogether.

Intellectual Property

Our intellectual property is primarily comprised of trade secrets, trademarks, issued, published and pending patent applications, copyrights and technological innovation. We have a patent portfolio comprised of eight issued patents in the United States. We also have two pending patent applications and two international patent applications filed via the Patent Cooperation Treaty (“PCT”) and the European Patent Office.

We have a trademark portfolio comprised of eight United States trademark registrations.

Our current patented inventions relate to:

- A server-side method and apparatus that enables users to audibly navigate websites and hear high-quality streaming audio narration and descriptions of websites. This patented invention involves creating an audio-enabled web experience by utilizing voice talent and automated text-to-speech conversion methods to read and describe web content.
- Systems for automatic remediation of non-compliant webpages and user interfaces using pre-stored remediation scripts as well as form-based quickfix remediation codes. More specifically, this patent covers various features related to crawling webpages and user interfaces to perform compliance assessments using pre-stored remediation scripts corresponding to different compliance issues and manipulating the document object model (DOM). This patent also covers various features related to using pre-stored accelerated remediation code blocks, including those derived from machine learning, corresponding to different compliance issues to modify the DOM.
- Methods for providing alternative descriptions to elements on a webpage that were previously untagged and without the appropriate tags. More specifically, this patent covers various features related to detecting an untagged element having an associated hyperlink and using pre-existing remediation scripts to assign an alt text description to the untagged element. In addition, this patent also covers various features related to detecting an untagged image and assigning an alt text description based on image recognition analysis.

Our current portfolio has established a foundation for building unique technology solutions that contribute to the way in which we differentiate ourselves from other competitors in the B2B Web Accessibility marketplace. We plan to continue to invest in research and development and expand our portfolio of proprietary intellectual property.

Business Plan and Strategy

Leveraging our own patented platform, we provide cloud-based, enterprise-grade technology solutions in conjunction with managed services as/when needed, to fully implement our solution and position our clients' sites to more fully conform with web accessibility best practices. Our technology solution and service offerings may be purchased through a subscription service for either a month (exclusive for Small & Medium sized businesses), or a one-year or multi-year term (available for both Small & Medium sized businesses as well as Enterprise customers).

Through the sale of managed and self-service contracts, our business model is to sell Business to Business and to secure revenue from multiple business channels, including (but not limited to): providers of CMS, corporate website owners, publishers, web designers, developers and operators, federal, state and local governments, educational institutions, e-learning and e-commerce websites, and not-for-profit organizations.

In what Forrester Research, Inc., a market research company that provides advice on existing and potential impact of technology, has called the "age of the customer," we believe that, by adopting our solutions, our customers gain a competitive advantage by ensuring a superior digital experience for all of their own customers, and in particular for persons with diverse abilities. Some of the many leading advantages of our solution include:

1. Maintaining a mission of inclusion and accessibility for the approximately 15% of the population with a disability or physical limitation who are denied full access to online digital content;
2. Increasing the client return on investment by opening access to the spending power of the approximately 15% of the population that is denied equal access to the internet;
3. Maximizing conformance with WCAG 2.1 Success Criteria;
4. Deploying a cost-effective—platform-wide and fully-managed, as applicable—solution that is scalable with rapid deployment and little to no project management;
5. Consistently providing an enhanced customer experience for our client customers by providing access to innovative and universally designed technology solutions;

Our primary objective is to establish and maintain a long-standing relationship with our customers, as a trusted and reliable provider of web accessibility technology and services.

From an operational perspective and to enable us to deliver on our objective, the business is organized functionally into Executive & Administration, Sales, Marketing, Product development, Engineering (which includes intellectual property development), Implementation, Quality Assurance, and Customer Experience teams. Intellectual property development is tasked with the development of new leading-edge intellectual property.

Product Service Offerings

As the leading provider of SaaS-based digital content accessibility solutions, AudioEye's mission is to eradicate all barriers to digital accessibility.

With our flagship fully managed service, AudioEye Managed, AudioEye has historically focused on providing a custom accessibility solution for enterprise-level organizations. In November 2019, AudioEye expanded its solutions suite, launching a digital marketplace with plans more amenable, and more affordable, to small and medium-sized businesses. The launch of the digital marketplace has better positioned AudioEye to significantly expand its market share, now serving businesses and organizations of all sizes at all price points.

With the launch of the AudioEye digital marketplace, every audioeye.com visitor can now also request and receive a free website accessibility scan. By providing a URL and email address, this scan audits a sample of a visitor's site, identifying a point-in-time list of WCAG errors and risks. While other providers charge for a site audit, AudioEye's scan is free.

Every AudioEye plan enables users to fully achieve WCAG compliance, whether customers do the bulk of the work themselves, utilize AudioEye's tools and technology to identify and resolve issues together with AudioEye, or fully outsource the work to our experts:

- **AudioEye Starter:** Website owners may accelerate digital accessibility easily and affordably with AudioEye Starter. Upon installing the AudioEye JavaScript, this free product provides users access to a comprehensive site accessibility report, identifying all WCAG risks and errors, as well as access to AudioEye's free, on-site developer tools. These are the same tools AudioEye experts use to identify and resolve accessibility errors. Starter is best for customers who wish to manage accessibility on their own, utilizing AudioEye's reporting and developer tools to achieve full compliance. Do it yourself digital accessibility.
- **AudioEye Pro:** Ideal for small and medium-sized businesses, AudioEye Pro customers receive access to AudioEye's on-site developer tools as well as more robust WCAG accessibility reports. Further, upon installing the AudioEye JavaScript, AudioEye's always-on, proprietary machine-learning/AI-driven technology is automatically identifying and resolving approximately 35% of the most common WCAG accessibility errors. Pro customers may then utilize AudioEye's developer tools to resolve the remaining errors. AudioEye Pro customers receive the AudioEye Accessibility Toolbar, which includes website personalization tools for end users, as well as a 24/7 Help Desk for users to report any accessibility-related issues. Pro customers receive an accessibility statement, articulating their commitment to an accessible user experience, as well as access to a library of on-demand digital accessibility training resources. Do it together digital accessibility.
- **AudioEye Managed:** AudioEye Managed is ideal for those customers interested in completely outsourcing digital accessibility compliance. Upon installing the AudioEye JavaScript, AudioEye Managed customers benefit from AudioEye's always-on, proprietary machine-learning/AI-driven technology automatically identifying and resolving the most common WCAG accessibility errors (approximately 35-percent) coupled with AudioEye's team of digital accessibility subject matter experts monitoring, manually testing and resolving the remaining errors. This team utilizes the most common assistive technologies on the most common website browsers to ensure site-specific errors are resolved. Managed customers receive the full AudioEye Accessibility Toolbar, including a 24/7 Help Desk, access to a library of on-demand digital accessibility training resources as well as invitations to live, quarterly training sessions. Unlike any solution on the market, AudioEye provides its Managed customers a public Certification Statement, which is AudioEye's attestation of a site's WCAG compliance. Managed customers also receive a Sustainable Testing & Remediation Plan in the event they are facing legal action. Do it for me digital accessibility. AudioEye Managed is priced according to a site's complexity and is designed not only for small and medium-sized businesses on CMS platforms but also for enterprises with customized websites.

AudioEye continues to offer other digital accessibility solutions for both dynamic and static documents (PDFs) as well as mobile applications.

Customers

Our potential customer base includes a very broad range of private and public sector customers, including:

- Small & Medium sized businesses,
- Corporate enterprises,
- Federal, state, and local governments and agencies,

The Company had one major customer (including such customer's affiliates) which accounted for approximately 10% of its revenues in the year ended December 31, 2019. The Company had one major customer which generated approximately 11.8% of its revenue in the fiscal year ended December 31, 2018.

Small & Medium sized customers

We have recently expanded our offerings via our Marketplace and via partnerships with Duda to capture a much larger market of Small & Medium sized customers.

Our solutions are sold by our partnership sales team through strategic partnerships, resellers and via our eCommerce platform (Marketplace). This strategy enables us to address all the broad markets covered by our technology and allows for a depth and market penetration that we could never approach on our own.

Our CMS platform partners and resellers are critical for us to reach this customer segment to both penetrate deeper and more broadly (into multiple industry verticals) by partnering with us to spread awareness and offer a unique solution to make their digital content & websites accessible.

Corporate Enterprises

Corporate Enterprises are larger customers who are served through our enterprise sales team. These companies tend to have more complicated and customized websites that need a deeper resolution to ensure they are compliant with WCAG guidelines. We serve them through multiple offerings. Our Managed services is the biggest part of that offering-set. We also offer PDF remediation and MobileApp guide solutions for them. We believe that the AudioEye products provides a business advantage for our clients by enabling them to better reach the large population of customers who are not able to gain equal access to our clients' content, products, and services delivered via their websites

Government and Not-for-Profit Organizations

Federal and state laws require that the information and services made available across government agency websites meet the diverse and unique needs of all site visitors. Conforming to Web Accessibility best practices and guidelines helps ensure public access to government information and improves the value of agency investment in their websites and online services.

The Rehabilitation Act of 1973 ("Rehabilitation Act") requires that individuals with disabilities, who are members of the public seeking information or services from a federal department or agency, have access to and use of information and data that is comparable to that provided to the public without disabilities. The federal government also requires vendors selling to the government to be compliant under Section 508 of the Rehabilitation Act, unless covered by a provable exception. Canada and the European Union have similar requirements.

Seniors and print-impaired individuals need the Internet's critical access to fundamental state, local and federal government services and information such as tax forms, social programs, emergency services and legislative representatives. In addition, the roughly 120,000 federal employees with disabilities require Internet accessibility for workplace productivity. The AudioEye Reader in the cloud provides an intuitive Internet experience across all Internet-enabled devices without imposing any additional costs on end-users. For government site administrators, our Digital Accessibility Platform is designed to be user-friendly so that sites can be made accessible and maintained as part of any web management process.

Over 100 governments have signed and ratified the UN Convention on the Rights of Persons with Disabilities. The Company's certification seal demonstrates a website owner's commitment to meeting internationally accepted accessibility standards. As a result, our management believes that providing accessibility services for website owners and developers has become a significant market opportunity in view of the potential demand across millions of internet websites.

The AudioEye solution provides a unique approach to solving a pervasive issue that has inhibited government agencies from embracing efficiencies gained through adopting new cost-effective technological capabilities. More and more federal agencies are beginning to embrace cloud-based service offerings and to leverage the capabilities afforded through the adoption of third-party cloud-based service providers. Implementing the AudioEye solution allows federal, state, and local governments to provide constituents with a reliable, scalable, and fully accessible web environment. By pairing the AudioEye Solution with other disparate SaaS offerings, organizations can more readily comply with the ADA standards. Implementing AudioEye mitigates risk of non-conformance and goes beyond basic levels of compliance through the inclusion of free cloud-based assistive tools, which lives up to the spirit of ADA - a noble and necessary aspiration for all federal, state and local government agencies.

Our solutions are sold by our enterprise sales team and through strategic partnerships and resellers. This strategy enables us to address all the broad markets covered by our technology and allows for a depth and market penetration that we could never approach on our own.

Our management believes that the government market imposes certain barriers to entry to new potential entrants. However, our management believes that the potential for recurring revenue generation, the data value appreciation that occurs over time, and low turnover upon establishment of government business all contribute to ideal long-term conditions that make this a good market for us to conduct direct sales.

The federal government boasts nearly 2,000 top-level .gov domains and 24,000 websites of varying purpose, design, navigation, usability and accessibility. Including the 50 states and all local government websites, there are over 600,000 government websites in the United States.

Potential additional market segments or verticals of focus include, but are not limited to:

- Finance & Banking Institutions;
- Travel & Hospitality;
- Public & Private Transportation Companies;
- Retail and Ecommerce Companies;
- Educational Institutions (K-12 and universities as a result of frequent and recent settlement agreements involving and structured by the Department of Justice);
- Food Services; and
- SaaS Providers.

Marketing and Sales

In addition to our enterprise sales team, we use strategic business partnerships and development referral partners, for introductions to C-level executives and key stakeholders that directly influence the buying decision of our technology and services. Success in all these efforts is not only critical in order to meet our sales objectives, but also raises market awareness of the Company's products and brand.

We also have a Partnership sales team that focuses on building and maintaining relationships with CMS providers focused on either specific verticals (e.g. Dealer.com) or who are vertical agnostic (e.g. Duda).

Our increased focus is now to further strengthen our digital marketing by enhancing the content we share with potential customers and by also ensuring that our Brand image continues to improve as we satisfy our customers and expand our reach and market share in this growing space.

The Company also attends selected accessibility and industry trade conferences, maintains memberships with key, industry-specific organizations, serves as a subject matter expert within well-attended panels covering industry-related topics, leverages paid search engine optimization for those looking online to learn about or purchase accessibility products or services, and a variety of other conventional marketing and social marketing techniques.

Competition

Website accessibility can be achieved in one of two ways.

The traditional approach is called a “Shift Left” strategy. On the continuum of an organization’s software development life cycle, shift left refers to integrating universal design and accessibility testing and analysis as early on in a project (the design and development process) as possible. The idea is to prohibit inaccessible content from reaching production environments. For many businesses and organizations with the right resources and afforded a healthy amount of time, this is absolutely the right thing to do. Without a doubt, websites should be designed, developed, and created with web accessibility in mind. This is why AudioEye offers the Digital Accessibility Platform and provides resources for organizations seeking to empower internal stakeholders to become the subject matter experts. This approach, however, does little to assist organizations being sued based on websites that are already live and public facing. No one has ever been sued for a website that was being built. By the thousands, per year, businesses are being sued because of the sites they have, today, and not the sites they are looking to build in the future.

AudioEye makes websites accessible. Our solution identifies and remediates accessibility issues with both automated *and* manual testing and engineering and provides on-going monitoring to ensure sites meet or exceed legal compliance with ADA-related laws and substantially conform with the WCAG, which is the internationally recognized benchmark used to ensure the needs of individuals of disabilities are addressed when it comes to creating and publishing websites and digital content.

We believe that other competitive solutions are insufficient when it comes to actually achieving substantial conformance with WCAG and removing access barriers that may impede or limit access for individuals with disabilities. These other solutions include:

- **Automated Testing Tools.** These tools are insufficient and not always a viable solution. There are a vast number of automated testing tools. These solutions provide businesses that tend to have very little knowledge of the issues with insights into, approximately, 35% of the overall potential access barriers. Unfortunately, they do not assist businesses in understanding true access barriers and may even provide misleading evidence (e.g. false positives) that further delay product stakeholders time (assuming the business even controls its website – i.e. many businesses rely on outsourced niche CMS providers, which leaves their hands tied when it comes to meeting compliance requirements). At the very best, these tools offer potential insight to assist internal stakeholders with information as to how to find and potentially fix, up to only 35% of the issues that are detected by the automated testing suite. The remaining issues require subject matter experts to uncover issues through manual accessibility (AT) testing.
- **Accessibility Toolbars.** These tools are insufficient and not a viable solution by themselves. For as many automated testing tools that can be found in the marketplace, there are just about as many low-cost accessibility toolbars, many of which emulate the leading edge, industry-first web personalization tools that AudioEye supplies free with the Managed Service. On their own, these solutions provide businesses with only incremental benefits that address a small percentage of potential access barriers. Automatic remediation (if any) narrowly addresses WCAG Success Criteria, which provides very little benefit for AT users, who are the ones filing lawsuits against businesses for non-compliance. This approach has worked well in countries outside of the U.S. as evidenced by the large number of international firms attempting to enter the market in the U.S. Until these tool providers achieve validation from U.S.-based security organizations and can pass stringent due diligence examinations, they face an uphill climb. Further, and more importantly, until these tool providers are able to securely and reliably deliver human-based remediation as delivered through their dynamic remediation technology, U.S. companies will gain limited benefit by incorporating and using these highly limited solutions.

In summary, our management believes that the Company's technology and solutions will primarily compete against the following:

1. **Web Accessibility Assessment Technology Providers and Automated Testing Tools.** There are a small number of Web Accessibility audit and tracking platform providers, but we do not believe their technology solutions offer the specific end-to-end services offered through the AudioEye Digital Accessibility Platform. Furthermore, their solutions are currently more standalone in that, unlike the Company, they are not combined with a cloud-based tool with a full suite of assistive tools for end-users.
2. **Web Accessibility Remediation Technology Providers.** Currently, other technology providers that utilize technology to apply compliance remediation through a server-side technology do not effectively deploy human-based remediations, nor do they pair their solution with the full breadth of services offered through the AudioEye Managed Platform product suite, including, for example, assistive tools for end-users. These providers are therefore limited in their capacity to provide a fully inclusive user experience for the customers adopting the technology.
3. **Web Accessibility Consulting Service Providers.** There are a substantial number of consulting service providers in the Web Accessibility industry. Each generally provides an analysis of the various compliance issues associated with its clients' websites. They ultimately provide resources and assistance in applying fixes and changes at the source. While we provide these services, we also provide tools that empower an end-to-end fully managed service, as well as tools that empower self-directed developers to fix issues without requiring source-code remediation.
4. **Cloud-Based Assistive Technology Providers and Accessibility Toolbars.** There are other cloud-based assistive technology providers. However, they do not offer a reliable and trusted solution with compliance detection and remediation for users of existing, native assistive technologies, such as screen readers.

Competitive Strengths

Our management believes the following competitive strengths will enable our success in the marketplace:

- **Unique patented technology.** First and foremost, AudioEye builds all its products with the primary goal of enhancing the user experience, in every way possible, regardless of the end-user's individual disability or physical limitation. AudioEye is a marketplace technology leader providing what we believe to be unparalleled Web Accessibility solutions for our clients' customers through our Managed Platform products. We own a unique patent portfolio comprised of six issued patents in the United States and we have additional U.S. patents pending. Our portfolio includes patents and pending patent applications in the United States with over 60 issued claims.
- **Freemium model.** A Freemium model that enables all website owners to leverage our free tools as well as very reasonably priced offerings all the way to our customized enterprise grade solutions. We believe that having a full-suite of offerings is a competitive differentiator for AudioEye, but the Company must continue to try and differentiate our offerings from a growing list of companies competing in various ways.
- **Unique combination of technology and specialized managed service.** Our management believes that AudioEye has addressed the problem of Web Accessibility, holistically, and provides a combination of leading-edge technology and high-quality specialized managed service. Our combined solution is designed to provide our clients with access and usability across their digital infrastructure, and to lead to cost-savings and reduced time-to-market for our customers. Our management believes that the AudioEye solution allows our customers to focus not only on achieving compliance, but also on maintaining compliance throughout the life of the subscription.

Our current portfolio has established a foundation for building unique technology solutions that contribute to the way in which we differentiate ourselves from other competitors in the B2B Web Accessibility marketplace. In this continued pursuit of expanding the capabilities of our technology and meeting the demands of our customers, AudioEye is committed to growing its IP portfolio.

- **Highly experienced inventors, technologists and product development team.** Our team is comprised of experienced software, e-commerce, mobile marketing and Internet developers and technologists that have worked together for over fifteen years. During their careers, this team has developed several technologies programs for Fortune 500 organizations; federal, state and local governments in the United States, and several leading organizations across the global marketplace.

Patent and Trademark Rights

Our intellectual property is primarily comprised of trade secrets, trademarks, issued, published and pending patent applications, copyrights and technological innovation. We have a patent portfolio comprised of eight issued patents in the United States. We also have two pending patent applications and two international patent applications filed via the Patent Cooperation Treaty ("PCT"). The patents have been extended and cover a period from 2002 through 2038.

We have eight registered trademarks with the U.S. Patent and Trademark Office. The commercial value of these patents is unknown.

Legal Landscape and Government Regulation

Government regulation in the United States that affects the market and commercial potential for our products and services includes the Rehabilitation Act, the ADA, Section 508 of the Rehabilitation Act, Section 504 of the Rehabilitation Act, the Twenty-First Century Communications and Video Accessibility Act of 2010 (“CVAA”), the Air Carrier Accessibility Act (“ACAA”), and various State Laws.

The Rehabilitation Act requires that individuals with disabilities, who are members of the public seeking information or services from a federal department or agency, have access to and use of information and data that is comparable to that provided to the public without disabilities. The federal government also requires vendors selling to the government be compliant under Section 508 of the Rehabilitation Act, unless covered by a provable exception. Canada and the European Union have similar requirements.

The ADA was passed to ensure equal opportunity for people with disabilities. It applies to employment, transportation, state and local government services, and businesses that provide public accommodations or facilities.

Title II and Title III of the ADA prevent discrimination on the basis of disability in services, programs, and activities provided by public entities (Title II) and private entities considered to be places of public accommodation (Title III). Title II and Section 504 of the Rehabilitation Act continue to be actively enforced by the Office of Civil Rights (“OCR”), who has entered into hundreds of resolution agreements with School Districts and Education Institutions requiring conformance to WCAG 2.1 Success Criteria as managed and monitored through an OCR-validated Accessibility Auditor.

Under the previous administration, the Department of Justice (“DOJ”) was in the process of formulating rules regarding the accessibility of websites and mobile applications. The DOJ had divided its rulemaking into two efforts: the first was intended to provide guidance to state and local entities to comply with Title II, and the second was intended to establish rules for private entities to comply with Title III. Under the new administration, the DOJ has placed the issuance of those rulemakings on the inactive list. However, we believe the absence of any rulemaking will only increase the prevalence of lawsuits filed by plaintiffs seeking issue resolution in continued pursuit of their civil rights as protected under ADA. According to a leading ADA law firm, Seyfarth Shaw, with over 2,258 federal lawsuits filed, federal ADA Title III lawsuits increased by 17% in 2018 due largely to Website Access Lawsuits. This trend is expected to increase in 2020.

Learn more at www.ada.gov.

Section 508 of the Rehabilitation Act Requires that federal agencies’ electronic and information technology is accessible to people with disabilities, including employees and the public.

The U.S. Government Access Board has updated the requirements to Section 508 compliance standards, commonly referred to as the “Section 508 ICT Refresh,” further formalizing the mandate to adhere to specific web accessibility best practices, namely those outlined under the WCAG, the international standards for web accessibility. Already, a growing number of legal mandates and recent settlements point to the WCAG 2.1 standards as well as making it a requirement to hire third-party Accessibility Subject Matter Experts to maintain an accessibility audit and provide certification – sources range from the DOJ, the U.S. Access Board, and the OCR.

For more information, visit www.section508.gov.

Section 504 of the Rehabilitation Act entitles individuals with disabilities to equal access to any program or activity that receives federal subsidy – this includes Web-based communications for educational institutions and government agencies.

In October 2010, the CVAA was enacted to update existing federal laws requiring communications and video programming accessibility and to fill in any current gaps in accessibility to ensure the full inclusion of people with disabilities in all aspects of daily living through accessible, affordable and usable communication and video programming technologies.

Per the Department of Transportation, the ACAA (49 U.S.C. 41705) prohibits discrimination by U.S. and foreign air carriers on the basis of physical or mental disability. The Department of Transportation, in interpreting and implementing the ACAA, has issued a rule setting forth the standards of service which air carriers are expected to provide to disabled individuals.

Beyond the federal level, many states have enacted accessibility laws and, going further, internationally, over 100 Governments have signed and ratified the UN Convention on the Rights of Persons with Disabilities.

As an example, the California Unruh Civil Rights Act, among other things, prohibits discrimination based on disability. More recently, a new law enacted in California, Assembly Bill 434 State Web Accessibility, states that prior to July 1, 2019, each State Agency Director or its Chief Information Officer must post on the homepage of its agency a declaration that the site has been made accessible by meeting the WCAG standards.

Given the many government regulations in place and/or in process, actions must be taken for businesses to comply with best practices and international standards. This presents a significant business opportunity as more pressure is being put on businesses and organizations to improve the accessibility of their web environments. In addition, from a risk mitigation standpoint, it is best if they consistently and reliably track and demonstrate their level of conformance to these internationally recognized standards over time, the WCAG 2.1.

Disabilities advocates won a major victory recently after the U.S. Supreme Court left in place an appeals court ruling arguing that Domino's website and app must abide by the same rules of accessibility as brick-and-mortar shops. The top court refused to hear a federal appeals court ruling that Domino's website and app have to follow Americans with Disabilities Act (ADA) regulations and be accessible to people with visual or other impairments. The decision could have broad implications for the restaurant industry, in particular. Chains such as Domino's are taking a lot more orders through their website and smartphone apps, making them key places of doing business. The ruling suggests restaurants could be subject to ADA lawsuits if that ordering technology isn't accessible to people with disabilities. The case is one of several that disabilities advocates have filed against companies' websites, seeking to push them to comply with federal accessibility regulations.

Employees

As of March 30, 2020, we had 84 full-time employees. None of our employees is subject to a collective bargaining agreement and we believe that relations with our employees are very good. We have a sincere focus on developing each team member to allow the team member to grow professionally and personally during his or her time with AudioEye.

Corporate Information

AudioEye, Inc. was formed as a Delaware corporation on May 20, 2005. On August 1, 2018, the Company amended its Certificate of Incorporation to implement a reverse stock split in the ratio of 1 share for every 25 shares of common stock and to reduce the number of authorized shares of common stock from 250,000,000 to 50,000,000. As a result, 186,994,384 shares of the Company's common stock were exchanged for 7,479,775 shares of the Company's common stock. Our financial statements have been retroactively restated to reflect the reverse stock split.

Our principal executive offices are located at 5210 East Williams Circle, Suite 750, Tucson Arizona, 85711, and our telephone number at that address is (866) 331-5324. We maintain a website at www.audioeye.com (this reference to our website is an inactive textual reference only and is not intended to incorporate our website into this report). We file reports with the Securities and Exchange Commission ("SEC") and make available, free of charge, on or through our website, our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, proxy and information statements and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act, as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. In addition, the SEC maintains a website at www.sec.gov containing reports, proxy and information statements and other information regarding issuers that file electronically with the SEC. Information on the SEC's website does not constitute part of this report. Our website also contains copies of our corporate governance guidelines, code of business conduct and ethics, related party transaction policy and whistleblower policy, and copies of the charters for our audit committee, compensation committee and nominating and corporate governance committee.

On February 25, 2020, the Board of Directors (the “Board”) of AudioEye, Inc. appointed Heath Thompson as the Company’s Chief Executive Officer, effective upon the commencement of his employment with the Company. Mr. Thompson, age 60, joined the Company on March 23, 2020. On February 25, 2020, the Company and Mr. Thompson also entered into an Executive Employment Agreement (the “Employment Agreement”), effective as of March 23, 2020, pursuant to which the Company will employ Mr. Thompson as its Chief Executive Officer on the terms and conditions set forth therein. The Employment Agreement provides for an initial one-year term (the “Initial Term”), with automatic renewals for a one-year term (the “Subsequent Term”) immediately following the Initial Term, and automatic renewals for successive one-year terms immediately following the Subsequent Term, unless the Employment Agreement is terminated as provided therein or either party provides a nonrenewal notice at least 30 days prior to the expiration of the then-current term. A copy of the Employment Agreement is filed as Exhibit 10.48 to this annual report. Mr. Thompson’s principal place of employment will be in the Atlanta, Georgia metropolitan area.

On January 13, 2020, Todd Bankofier, Chief Revenue Officer of AudioEye, Inc. (the “Company”), notified the Company of his resignation, effective as of the close of business on January 17, 2020, as Chief Revenue Officer and as an employee of the Company. In connection with the termination of Mr. Bankofier’s employment, Mr. Bankofier and the Company entered in to a Severance Agreement and General Release of Claims dated as of January 17, 2020 pursuant to which Mr. Bankofier received certain severance compensation and benefits. A copy of the Severance Agreement and General Release of Claims is filed as Exhibit 10.47 to this annual report.

Item 1A. Risk Factors

In addition to the other information included in this Annual Report, the following factors should be carefully considered in evaluating our business, financial position and future prospects. Any of the following risks, either alone or taken together, could materially and adversely affect our business, financial position or future prospects. If one or more of these or other risks or uncertainties materialize, or if our underlying assumptions prove to be incorrect, our actual results may vary materially from what we have projected. Investing in our common stock is highly speculative and involves a high degree of risk. Any potential investor should carefully consider the risks and uncertainties described below before purchasing any shares of our common stock. There may be additional risks that we do not presently know about or that we currently believe are immaterial which could also materially adversely affect our business, financial position or future prospects. As a result, the trading price of our stock could decline, and you might lose all or part of your investment. Our business, financial condition, and operating results, or the value of any investment you make in the stock of our company, or both, could be adversely affected by any of the factors listed and described below.

Risks Relating to Our Business and Industry

We have a history of generating significant losses and may not be able to achieve and sustain profitability.

To date, we have not been profitable, and we may never achieve profitability on a full-year or consistent basis. We incurred net losses of \$7,783,271 for the year ended December 31, 2019. As of December 31, 2019, we have an accumulated deficit of \$49,926,372. If we continue to experience losses, we may not be able to continue our operations, and investors may lose their entire investment.

Our future development will require additional capital, and we may be unable to obtain needed capital or financing on satisfactory terms, or at all, which would prevent us from fully developing our business and generating revenues.

As of March 30, 2020, our cash available is approximately \$1.6M. Our business plan will require additional capital expenditures, and our capital outlays could increase substantially over the next several years as we implement our business plan. As a result, we may need to raise additional capital through future private or public equity offerings, strategic alliances or debt financing. Our future capital requirements will depend on many factors, including, among others: market conditions, sales and marketing costs, mergers and acquisition activity, if any, costs of litigation in enforcing our patents, and information technology development and acquisition costs. No assurance can be given that we can successfully raise additional equity or debt capital, or that such financing will be available to us on favorable terms, if at all.

We have been subject to litigation and may in the future be subject to additional litigation, which could have a material adverse effect on our financial position or results of operations.

We may become involved in various routine disputes and allegations incidental to our business operations. Because it is not possible to determine when and whether these disputes and allegations may arise or the ultimate disposition of such matters, the resolution of any such matters, should they arise, could have a material adverse effect on our financial position or results of operations.

Weakened global economic conditions including current and ongoing microeconomic uncertainty may adversely affect our industry, business and results of operations.

Our overall performance depends in part on worldwide economic and geopolitical conditions. The United States and other key international economies have experienced cyclical downturns from time to time in which economic activity was impacted by falling demand for a variety of goods and services, restricted credit, poor liquidity, reduced corporate profitability, volatility in credit, equity and foreign exchange markets, bankruptcies and overall uncertainty with respect to the economy. These economic conditions can arise suddenly and the full impact of such conditions can remain uncertain. In addition, geopolitical developments, such as existing and potential trade wars and other events beyond our control, such as the Coronavirus epidemic, can increase levels of political and economic unpredictability globally and increase the volatility of global financial markets. For example, in response to the Coronavirus epidemic, we have shifted certain of our customer events to virtual-only experiences and we may deem it advisable to similarly alter, postpone or cancel entirely additional customer, employee or industry events in the future. Moreover, these conditions can affect the rate of IT spending and could adversely affect our customers’ ability or willingness to attend our events or to purchase our software, delay prospective customers’ purchasing decisions, reduce the value or duration of their subscription contracts, or affect attrition rates, all of which could adversely affect our future sales and operating results.

Our revenue and collections may be materially adversely affected by an economic downturn.

Recent macroeconomic conditions have shown signs of volatility and potential weakness. We believe commercial purchasing habits and corporate information technology budgets have improved in recent years but remain relatively constrained and subject to such volatile and potentially weak economic conditions. Any deterioration in prevailing economic conditions would likely result in reduced demand for our services and products, which could have a material adverse effect on our business financial position or results of operations.

An increase in market interest rates could increase our interest costs on future debt and could adversely affect our stock price.

If interest rates increase, so could our interest costs for any new debt. This increased cost could make financing, including the financing of any acquisition, costlier. We may incur variable interest rate indebtedness in the future. Rising interest rates could limit our ability to refinance debt when it matures or cause us to pay higher interest rates upon refinancing and increased interest expense on refinanced indebtedness.

Our success is dependent on certain members of our management and technical team.

Our success has depended, and continues to depend, on the efforts and talents of our senior management team and key employees, including our engineers, product managers, sales and marketing personnel, and professional services personnel. Our future success will also depend upon our continued ability to identify, hire and retain additional skilled and highly qualified personnel, including a new chief financial officer, which will require significant time, expense and attention. We cannot assure you that our management will remain in place or as to the time it will take for us to identify, hire and retain a new chief financial officer. We do not maintain "key person" life insurance policies. The loss of any of our management and technical team members could have a material adverse effect on our results of operations and financial condition, as well as on the market price of our common stock.

We intend to pursue new strategic opportunities which may result in the use of a significant amount of our management resources or significant costs, and we may not be able to fully realize the potential benefit of such opportunities.

We intend to seek other strategic partners to help us pursue our strategic, marketing, sales, or technical objectives. Although we may devote significant time and resources in pursuit of such transactions, we may struggle to successfully identify such opportunities, or to successfully conclude transactions with potential strategic partners. Should we be unable to identify or conclude important strategic transactions, our business prospects and operations could be adversely affected as a result of the devotion of significant managerial effort required, and the challenges of achieving our objectives in the absence of strategic partners. In addition, we may incur significant costs in connection with seeking acquisitions or other strategic opportunities regardless of whether the transaction is completed, and in combining its operations if such a transaction is completed. In the event that we consummate an acquisition or strategic alternative in the future, we cannot assure you that we would fully realize the potential benefit of such a transaction.

Our business plan may not be realized. If our business plan proves to be unsuccessful, our business may fail, and you may lose your entire investment.

Our operations are subject to all of the risks inherent in the establishment of a new business enterprise with a limited operating history. The likelihood of our success must be considered in light of the problems, expenses, complications, and delays frequently encountered in connection with the development of a new business. Unanticipated events may occur that could affect the actual results achieved during the forecast periods. Consequently, the actual results of operations during the forecast periods will vary from the forecasts, and such variations may be material. In addition, the degree of uncertainty increases with each successive year presented in our business plan. We cannot assure you that we will succeed in the anticipated operation of our business plan. If our business plan proves to be unsuccessful, our business may fail, and you may lose your entire investment.

We have experienced and will continue to experience competition as more companies seek to provide products and services similar to our products and services and because larger and better-financed competitors may affect our ability to compete in the marketplace and achieve profitability, our business may fail.

Competition in our market is intense, and we expect competition for our products and services to become even more intense. We compete directly against other companies offering similar products and services that compete or will compete directly with our proposed products and services. We also compete against established vendors in our markets. These companies may incorporate other competitive technologies into their product offerings, whether developed internally or by third parties. There are also established consultants who offer services to help their customers obtain compliance with accessibility standards. In many cases these consultants compete for the same funding from our prospective customers. For the foreseeable future, substantially all our competitors are likely to be larger, better-financed companies that may develop products superior to our current and proposed products, which could create significant competitive advantages for those companies. Our future success depends on our ability to compete effectively with our competitors. As a result, we may have difficulty competing with larger, established competitors. Generally, these competitors have:

- substantially greater financial, technical, and marketing resources;
- a larger customer base;
- better name recognition; and
- more expansive or different product offerings.

These competitors may command a larger market share than we do, which may enable them to establish a stronger competitive position, in part, through greater marketing opportunities. Further, our competitors may be able to respond more quickly than we are to new or emerging technologies and changes in user preferences and to devote greater resources to developing new products and offering new services. These competitors may develop products or services that are comparable or superior to ours. If we fail to address competitive developments quickly and effectively, we may not be able to remain a viable business.

If we are not able to adequately protect our patented rights, our operations would be negatively impacted.

Our ability to compete largely depends on the superiority, uniqueness and value of our technology and intellectual property. To protect our intellectual property rights, we rely on a combination of patent, trademark, copyright, and trade secret laws, confidentiality agreements with our employees and third parties, and protective contractual provisions. We cannot assure you that infringement or invalidity claims (or claims for indemnification resulting from infringement claims) will not be asserted or prosecuted against us or that any such assertions or prosecutions will not materially adversely affect our business.

Regardless of whether any future claims are valid or can be successfully asserted, defending against such claims could cause us to incur significant costs, could jeopardize or substantially delay a successful outcome in any future litigation, and could divert resources away from our other activities. In addition, assertion of infringement claims could result in injunctions that prevent us from distributing our products. In addition to challenges against our existing patents, any of the following could also reduce the value of our intellectual property now, or in the future:

- our applications for patents, trademarks, and copyrights relating to our business may not be granted and, if granted, may be challenged or invalidated;
- issued trademarks, copyrights or patents may not provide us with any competitive advantages;

- our efforts to protect our intellectual property rights may not be effective in preventing misappropriation of our technology; or
- our efforts may not prevent the development and design by others of products or technologies similar to, competitive with, or superior to those that we develop.

Also, we may not be able to effectively protect our intellectual property rights in certain foreign countries where we may do business in the future or from which competitors may operate. Obtaining patents will not necessarily protect our technology or prevent our international competitors from developing similar products or technologies. Our inability to adequately protect our patented rights would have a negative impact on our operations and revenues.

In addition, legal standards relating to the validity, enforceability, and scope of protection of intellectual property rights in Internet-related businesses are uncertain and still evolving. Because of the growth of the Internet and Internet-related businesses, patent applications are continuously and simultaneously being filed in connection with Internet-related technology. There are a significant number of U.S. and foreign patents and patent applications in our areas of interest, and we believe that there has been, and is likely to continue to be, significant litigation in the industry regarding patent and other intellectual property rights.

We may commence legal proceedings against third parties who we believe are infringing on our intellectual property rights, and if we are forced to litigate to defend our intellectual property rights, or to defend claims by third parties against us relating to intellectual property rights, legal fees and court injunctions could adversely affect our financial condition and potentially end our business.

At present, we do not have any active or pending litigation related to the violation of our patents. We expect an increase in the number of third parties who could violate our patents as the market develops new uses of similar products and consumers begin to increase their adoption of the technology and integrate it into their daily lives. We foresee the potential need to enter into active litigation to defend and enforce our patents. We anticipate that these legal proceedings could continue for several years and may require significant expenditures for legal fees and other expenses. In the event we are not successful through appeal and do not subsequently obtain monetary and injunctive relief, these litigation matters may significantly reduce our financial resources and have a material impact on our ability to continue our operations. The time and effort required of our management to effectively pursue or defend these litigation matters may adversely affect our ability to operate our business, since time spent on matters related to the lawsuits would take away from the time spent on managing and operating the business. We cannot assure you any such potential lawsuits will result in an outcome that is favorable to our stockholders or the Company.

The burdens of being a public company may adversely affect our ability to develop our business and pursue a litigation strategy.

Since we are a public company, our management must devote substantial time, attention, and financial resources to comply with U.S. securities laws. This may have a material adverse effect on our management's ability to effectively and efficiently develop our business initiatives. In addition, our disclosure obligations under U.S. securities laws may require us to disclose information publicly that could have a material adverse effect on our potential litigation strategies.

The current regulatory environment for our products and services remains unclear.

We cannot assure you that our existing or planned product and service offerings will be in compliance with local, state, and/or federal U.S. laws or the laws of any foreign jurisdiction where we operate or may operate in the future. Further, we cannot assure you that we will not unintentionally violate such laws or that such laws will not be modified, or that new laws will not be enacted in the future, which would cause us to be in violation of such laws. More aggressive domestic or international regulation of the Internet may materially and adversely affect our business, financial condition, operating results, and future prospects.

As pressure of legal ramifications from non-compliance with Web Accessibility increases, customers may be less inclined to permit or may delay AudioEye from promoting client relationships and/or the specifics associated with those relationships, and if this restricts our public communications with potential investors and stockholders, it may negatively impact our ability to gain interest in our business from potential investors and stockholders.

Due to an undefined regulatory environment and a heightened sensitivity by plaintiffs seeking retribution for inaccessible and unusable digital interfaces, any organization may be sued or faced with legal demands claiming non-compliance. As these legal actions or demands may be initiated with or without merit, they present a new level of risk for website owners and publishers. In an effort to avoid any potential unwanted attention pertaining to the subject of compliance, AudioEye clients may enforce rigid stipulations pertaining to AudioEye's promotion of their involvement or engagement with AudioEye, regardless of the level of success or positive impact any such engagement may have or have had on their businesses. Whether through the enforcement of non-disclosure agreements or through specific non-disclosure language associated with client contracts, if AudioEye is not empowered to promptly make public announcements about its client base and the adoption and success of AudioEye products and services, there may be a deleterious effect on the Company's capacity to accelerate its business growth or attract investment from existing or future investors and stockholders.

Our business greatly depends on the growth of online services, Internet of Things ("IOT"), kiosks, streaming, and other next-generation Internet-based applications, and there is a risk that such growth may not occur as expected, or at all, which would harm our business.

The Internet may ultimately prove not to be a viable commercial marketplace for such applications for several reasons, including:

- unwillingness of consumers to shift to and use other such next-generation Internet-based audio applications;
- refusal to purchase our products and services;
- perception by end-users with respect to product and service quality and performance;
- limitations on access and ease of use;
- congestion leading to delayed or extended response times;
- inadequate development of Internet infrastructure to keep pace with increased levels of use; and
- increased government regulations.

Because of these and other factors, the growth of online services, IOT, kiosks, streaming, and other next-generation Internet-based applications may be impeded or not occur as expected. As a result, our business and operations could be adversely impacted.

If the market for our online services does not grow as anticipated, our business would be adversely affected.

While other next-generation Internet-based applications have grown rapidly in personal and professional use, we cannot assure you that the adoption of our products and services will grow at a comparable rate or grow at all.

We expect that we will experience long and unpredictable sales cycles, which may impact our operating results.

We expect that our sales cycles will be long and unpredictable due to a number of uncertainties such as:

- the need to educate potential customers about the current state of accessibility for those with disabilities;
- customers' willingness to invest potentially substantial resources and infrastructures to take advantage of our products and services;

- customers' budgetary constraints;
- the timing of customers' budget cycles; and
- delays caused by customers' internal review and procurement processes.

These factors may create additional lead time before a sale is finalized and may lead to longer than expected and unpredictable sales cycles, which could delay or reduce our revenue and impact our operating results.

Our expansion into new products, services, technologies, and geographic regions subjects us to additional business, legal, financial, and competitive risks.

We may have limited or no experience in our newer market segments, and our customers may not adopt our new offerings. These offerings may present new and difficult technology challenges, and we may be subject to claims if customers of these offerings experience service disruptions or failures or other quality issues. In addition, profitability, if any, in our newer activities may be lower than in our older activities, and we may not be successful enough in these newer activities to recoup our investments in them. If any of this were to occur, it could damage our reputation, limit our growth, and negatively affect our operating results.

We face risks related to system interruption and lack of redundancy.

We experience occasional system interruptions and delays that make our websites and services unavailable or slow to respond and prevent us from efficiently providing services to third parties, which may reduce our net sales and the attractiveness of our products and services. If we are unable to continually add software and hardware, effectively upgrade our systems and network infrastructure, and take other steps to improve the efficiency of our systems, it could cause system interruptions or delays and adversely affect our operating results.

Our computer and communications systems and operations could be damaged or interrupted by fire, flood, power loss, telecommunications failure, earthquakes, acts of war or terrorism, acts of God, computer viruses, physical or electronic break-ins, and similar events or disruptions. Any of these events could cause system interruption, delays, and loss of critical data, and could prevent us from providing services, which could make our product and service offerings less attractive and subject us to liability. Our systems are not fully redundant, and our disaster recovery planning may not be sufficient. In addition, we may have inadequate insurance coverage to compensate for any related losses. Any of these events could damage our reputation and be expensive to remedy.

Government regulation is evolving, and unfavorable changes could harm our business.

We are subject to general business regulations and laws, as well as regulations and laws specifically governing the Internet, e-commerce, electronic devices, and other services. Existing and future laws and regulations may impede our growth. These regulations and laws may cover taxation, privacy, data protection, pricing, content, copyrights, distribution, mobile communications, electronic device certification, electronic waste, energy consumption, environmental regulation, electronic contracts and other communications, competition, consumer protection, web services, the provision of online payment services, information reporting requirements, unencumbered Internet access to our services, the design and operation of websites, the characteristics and quality of products and services, and the commercial operation of unmanned aircraft systems. It is not clear how existing laws governing issues such as property ownership, libel, and personal privacy apply to the Internet, e-commerce, digital content, and web services. Unfavorable regulations and laws could diminish the demand for our products and services and increase our cost of doing business.

We could be subject to additional sales tax or other indirect tax liabilities.

U.S. Supreme Court decisions restrict the imposition of obligations to collect state and local sales taxes with respect to remote sales. However, an increasing number of states have considered or adopted laws or administrative practices that attempt to impose obligations on out-of-state businesses to collect taxes on their behalf. A successful assertion by one or more states or foreign countries requiring us to collect taxes where we do not currently do so could result in substantial tax liabilities, including for past sales, as well as penalties and interest.

We may be subject to risks related to government contracts and related procurement regulations.

Our contracts with U.S., as well as state, local, and foreign, government entities are subject to various procurement regulations and other requirements relating to their formation, administration, and performance. We may be subject to audits and investigations relating to our government contracts, and any violations could result in various civil and criminal penalties and administrative sanctions, including termination of contracts, refunding or suspending of payments, forfeiture of profits, payment of fines, and suspension or debarment from future government business. In addition, such contracts may provide for termination by the government at any time, without cause.

If we do not successfully develop our planned products and services in a cost-effective manner to meet customer demand in the rapidly evolving market for next-generation Internet-based applications and services, our business may fail.

The market for next-generation Internet-based applications and services is characterized by rapidly changing technology, evolving industry standards, changes in customer needs, and frequent new service and product introductions. Our future success will depend, in part, on our ability to use new technologies effectively, to continue to develop our technical expertise and proprietary technology, to enhance our existing products and services, and to develop new products and services that meet changing customer needs on a timely and cost-effective basis. We may not be able to adapt quickly enough to changing technology, customer requirements, and industry standards. If we fail to use new technologies effectively, to develop our technical expertise and new products and services, or to enhance existing products and services on a timely basis, either internally or through arrangements with third parties, our product and service offerings may fail to meet customer needs, which would adversely affect our revenues and prospects for growth.

In addition, if we are unable to, for technological, legal, financial, or other reasons, adapt in a timely manner to changing market conditions or customer requirements, we could lose customers, strategic alliances, and market share. Sudden changes in user and customer requirements and preferences, the frequent introduction of new products and services embodying new technologies, and the emergence of new industry standards and practices could render our existing products, services and systems obsolete. The emerging nature of products and services in the technology and communications industry and their rapid evolution will require that we continually improve the performance, features, and reliability of our products and services. Our survival and success will depend, in part, on our ability to:

- design, develop, launch and/or license our planned products, services, and technologies that address the increasingly sophisticated and varied needs of our prospective customers; and
- respond to technological advances and emerging industry standards and practices on a cost-effective and timely basis.

The development of our planned products and services and other patented technology involves significant technological and business risks and requires substantial expenditures and lead time. We may be unable to use new technologies effectively. Updating our technology internally and licensing new technology from third parties may also require us to incur significant additional expenditures.

If our products and services do not gain market acceptance, we may not be able to fund future operations.

A number of factors may affect the market acceptance of our products or services or any other products or services we develop or acquire, including, among others:

- the price of our products or services relative to other competitive products and services;
- the perception by users of the effectiveness of our products and services;
- our ability to fund our sales and marketing efforts; and
- the effectiveness of our sales and marketing efforts.

If our products and services do not gain market acceptance, we may not be able to fund future operations, including the development of new products and services and/or our sales and marketing efforts for our current products and services, which inability would have a material adverse effect on our business, financial condition, and operating results.

We continually develop new products and product enhancements and actively capitalize software development costs, while making educated assumptions to anticipate the attributed revenue to be derived from each development or enhancement. If our assumptions are incorrect or if we are unable to accurately attribute revenue to each respective product or product enhancement, we may have to account for impairment, thus causing us to reverse the capitalized expenditures.

Our product developers are consistently programming new products and enhancements to existing products. Under the guidance of U.S. Accounting Standard, ASC 350-40, we make determinations to estimate the useful life of each of these products and enhancements. Based on these determinations, we amortize software expenses over a pre-determined period of time. Based on our financial forecasts and regular impairment testing, we believe that cash flows will be realized from our product development and product enhancements and will be sufficient to recover the value of the Company's expenditures. Should our estimates turn out to be inaccurate or should the business fail to attract new revenue in relation to each respective product or product enhancement, we may have to reverse or write off the related capitalized expenses.

Our products and services are highly technical and may contain undetected errors, which could cause harm to our reputation and adversely affect our business.

Our products and services are highly technical and complex and, when deployed, may contain errors or defects. Despite testing, some errors in our products and services may only be discovered after they have been installed and used by customers. Any errors or defects discovered in our products and services after commercial release could result in failure to achieve market acceptance, loss of revenue or delay in revenue recognition, loss of customers, and increased service and warranty cost, any of which could adversely affect our business, operating results and financial condition. In addition, we could face claims for product liability, tort, or breach of warranty. The performance of our products and services could have unforeseen or unknown adverse effects on the networks over which they are delivered as well as on third-party applications and services that utilize our products and services, which could result in legal claims against us, harming our business. Furthermore, we expect to provide implementation, consulting, and other technical services in connection with the implementation and ongoing maintenance of our products and services, which typically involves working with sophisticated software, computing systems, and communications systems. We expect that our contracts with customers will contain provisions relating to warranty disclaimers and liability limitations, which may not be upheld. Defending a lawsuit, regardless of its merit, is costly and may divert our management's attention and adversely affect the market's perception of us and our products and services. In addition, if our business liability insurance coverage proves inadequate or future coverage is unavailable on acceptable terms or at all, our business, operating results and financial condition could be adversely impacted.

Malfunctions of third-party communications infrastructure, hardware and software expose us to a variety of risks we cannot control, and those risks could result in harm to our business.

Our business depends upon the capacity, reliability and security of the infrastructure owned by third parties over which our product offerings are deployed. We have no control over the operation, quality or maintenance of a significant portion of that infrastructure or over whether those third parties will upgrade or improve their equipment. We do depend on these companies to maintain the operational integrity of our integrated connections. If one or more of these companies is unable or unwilling to supply or expand its levels of service in the future, our operations could be adversely impacted. System interruptions or increases in response time could result in a loss of potential or existing users and, if sustained or repeated, could reduce the appeal of the networks to users. In addition, users depend on real-time communications; outages caused by increased traffic could result in delays and system failures. These types of occurrences could cause users to perceive that our products and services do not function properly and could therefore adversely affect our ability to attract and retain strategic partners and customers.

Security breaches, computer viruses, and computer hacking attacks could harm our business, financial condition, results of operations, or reputation.

Security breaches, computer malware and computer hacking attacks have become more prevalent in our industry. Any security breach caused by hacking, which involves efforts to gain unauthorized access to information or systems, or to cause intentional malfunctions or loss or corruption of data, software, hardware or other computer equipment, or the inadvertent transmission of computer viruses could adversely affect our business, financial condition, results of operations or reputation.

Our corporate systems, third-party systems and security measures may be breached due to the actions of outside parties, employee error, malfeasance, a combination of these, or otherwise, and, as a result, an unauthorized party may obtain access to our data or any third-party data we may possess. Any such security breach could require us to comply with various breach notification laws and may expose us to litigation, remediation and investigation costs, increased costs for security measures, loss of revenue, damage to our reputation, and potential liability.

System failure or interruption or our failure to meet increasing demands on our systems could harm our business.

The success of our product and service offerings depends on the uninterrupted operation of various systems, secure data centers, and other computer and communication networks that we use or establish. To the extent the number of users of networks utilizing our future products and services suddenly increases, the technology platform and hosting services which will be required to accommodate a higher volume of traffic may result in slower response times, service interruptions or delays or system failures. The deployment of our products, services, systems and operations will also be vulnerable to damage or interruption from:

- power loss, transmission cable cuts and other telecommunications failures;
- damage or interruption caused by fire, earthquake and other natural disasters;
- computer viruses or software defects; and
- physical or electronic break-ins, sabotage, intentional acts of vandalism, terrorist attacks and other events beyond our control.

System interruptions or failures and increases or delays in response time could result in a loss of potential or existing users and, if sustained or repeated, could reduce the appeal of our products and services to users. These types of occurrences could cause users to perceive that our products and services do not function properly and could therefore adversely affect our ability to attract and retain strategic partners and customers.

Our ability to sell our solutions will be dependent on the quality of our technical support and our failure to deliver high-quality technical support services could have a material adverse effect on our sales and results of operations.

If we do not effectively assist our customers in deploying our products and services, succeed in helping our customers quickly resolve post-deployment issues and provide effective ongoing support, or if potential customers perceive that we may not be able to successfully deliver the foregoing, our ability to sell our products and services would be adversely affected, and our reputation with customers and potential customers could be harmed. As a result, our failure to deliver and maintain high-quality technical support services to our customers could result in customers choosing to use our competitors' products or services in the future.

Growth of internal operations and business may strain our financial resources.

We may need to significantly expand the scope of our operating and financial systems in order to build our business. Our growth rate may place a significant strain on our financial resources for several reasons, including, but not limited to, the following:

- the need for continued development of our financial and information management systems;
- the need to manage relationships with future resellers, distributors and strategic partners;
- the need to hire and retain skilled management, technical and other personnel necessary to support and manage our business; and
- the need to train and manage our employee base.

The addition of products and services and the attention they demand may also strain our management resources.

We do not expect to pay any dividends for the foreseeable future, which will affect the extent to which our investors realize any future gains on their investment.

We do not anticipate that we will pay any dividends to holders of our convertible preferred and common stock in the foreseeable future. Accordingly, investors must rely on the ability to convert preferred stock to common stock and on sales of their common stock after price appreciation, which may never occur, as the only way to realize any future gains on their investment.

We will need to recruit and retain additional qualified personnel to successfully grow our business.

Our future success will depend in part on our ability to attract and retain qualified operations, marketing and sales personnel as well as technical personnel. Inability to attract and retain such personnel could adversely affect our business. Competition for technical, sales, marketing and executive personnel is intense, particularly in the technology and Internet sectors. We cannot assure you that we will be able to attract or retain such personnel.

If we fail to establish and maintain effective internal control over financial reporting and effective disclosure controls and procedures, we may not be able to report financial results accurately or on a timely basis, or to detect fraud, which could have a material adverse effect on our business and stock price.

In connection with this annual report, our management carried out an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures. Based on that evaluation, our Principal Executive Officer and Principal Financial Officer have concluded that, primarily due to material weaknesses in our internal control over financial reporting as described in this annual report, our disclosure controls and procedures were not effective as of December 31, 2019 in accordance with generally accepted accounting principles.

Our management had identified, and disclosed in last year's annual report, control deficiencies in our financial reporting process that, as of December 31, 2018, constituted material weaknesses in our internal control over financial reporting. These material weaknesses related to the segregation of duties and the lack of formal policies that provide for multiple levels of supervision and reviews.

Our failure to establish and maintain the required internal control over financial reporting, and to establish and maintain effective disclosure controls and procedures, or any failure of those controls or procedures once established, could adversely impact our public disclosures regarding our business, financial condition or results of operations. Upon review of the required internal control over financial reporting, our management and/or our auditors have in the past and may in the future identify material weaknesses and/or significant deficiencies that need to be addressed. Any actual or perceived weaknesses or conditions that need to be addressed in our internal control over financial reporting and disclosure of management's assessment of the Company's internal control over financial reporting or disclosure of our independent registered public accounting firm's attestation to or report on management's assessment of our internal control over financial reporting, or our failure to obtain such an attestation or report, could adversely impact the price of and our ability to list our common stock and may lead to stockholder claims and regulatory action against us. Failure to remediate our current material weaknesses or to maintain effective internal controls in the future could also result in a material misstatement of our annual or quarterly financial statements that would not be prevented or detected on a timely basis and that could cause us to restate our financial statements for a prior period, cause investors to lose confidence in our financial statements and/or limit our ability to raise capital.

Additionally, any such failure may also negatively impact our operating results and financial condition, impair our ability to timely file our periodic and other reports with the SEC, consume a significant amount of management's time, and cause us to incur substantial additional costs relating to the implementation of remedial measures.

Risks Related to the Market for Our Common Stock

Although our shares of common stock are now listed on the NASDAQ Capital Market, we currently have a limited trading volume, which results in higher price volatility for, and reduced liquidity of, our common stock.

Although our shares of common stock are now listed on the NASDAQ Capital Market under the symbol "AEYE," trading volume in our common stock has been limited and an active trading market for our shares of common stock may never develop or be maintained. The absence of an active trading market increases price volatility and reduces the liquidity of our common stock. As long as this condition continues, the sale of a significant number of shares of common stock at any particular time could be difficult to achieve at the market prices prevailing immediately before such shares are offered.

If we cannot continue to satisfy the continuing listing criteria of the NASDAQ Capital Market, the exchange may subsequently delist our common stock.

The NASDAQ Capital Market requires us to meet certain financial, public float, bid price and liquidity standards on an ongoing basis in order to continue the listing of our common stock. Generally, we must maintain a minimum amount of stockholders' equity and a minimum number of holders of our securities, as well as meet certain disclosure and corporate governance requirements. If we fail to meet any of the continuing listing requirements, our common stock may be subject to delisting. If our common stock is delisted and we are not able to list our common stock on another national securities exchange, we expect our securities would be quoted on an over-the-counter market. If this were to occur, our stockholders could face significant material adverse consequences, including limited availability of market quotations for our common stock and reduced liquidity for the trading of our securities. In addition, we could experience a decreased ability to issue additional securities and obtain additional financing in the future.

The market price for our common stock may fluctuate significantly, which could result in substantial losses by our investors.

The market price of our common stock may fluctuate significantly in response to numerous factors, some of which are beyond our control, such as:

- the outcomes of potential future patent litigation;
- our ability to monetize our future patents;
- changes in our industry;
- announcements of technological innovations, new products or product enhancements by us or others;
- announcements by us of significant strategic partnerships, out-licensing, in-licensing, joint ventures, acquisitions or capital commitments;
- changes in earnings estimates or recommendations by security analysts, if our common stock is covered by analysts;
- investors' general perception of us;
- future issuances of common stock;

- investors' future resales of our securities under our currently effective Registration Statement on Form S-1;
- the addition or departure of key personnel;
- general market conditions, including the volatility of market prices for shares of technology companies, generally, and other factors, including factors unrelated to our operating performance; and
- the other factors described in this "Risk Factors" section.

These factors and any corresponding price fluctuations may materially and adversely affect the market price of our common stock and result in substantial losses by our investors.

Further, the stock market in general, and the market for technology companies in particular, has experienced extreme price and volume fluctuations in the past. Continued market fluctuations could result in extreme volatility in the price of our common stock, which could cause a decline in the value of our common stock.

Price volatility of our common stock might be worse if the trading volume of our common stock is low. In the past, following periods of market volatility, stockholders have often instituted securities class action litigation. We have previously been the target of securities litigation and may in the future be subject to additional securities litigation, which could result in substantial costs to us and divert resources and attention of management from our business, even if we are successful in any such litigation. Future sales of our common stock could also reduce the market price of such stock.

Moreover, the liquidity of our common stock is limited, not only in terms of the number of shares that can be bought and sold at a given price, but by delays in the timing of transactions and reduction in security analysts' and the media's coverage of us, if any. These factors may result in lower prices for our common stock than might otherwise be obtained and could also result in a larger spread between the bid and ask prices for our common stock. In addition, without a large float, our common stock is less liquid than the stock of companies with broader public ownership and, as a result, the trading price of our common stock may be more volatile. In the absence of an active public trading market, an investor may be unable to liquidate its investment in our common stock. Trading of a relatively small volume of our common stock may have a greater impact on the trading price of our stock than would be the case if our public float were larger. We cannot predict the prices at which our common stock will trade in the future.

Sales or the availability for sale of a substantial number of shares of our common stock may cause the price of our common stock to decline and adversely affect our ability to raise capital.

If our stockholders sell substantial amounts of our common stock in the public market, including pursuant to our currently effective Registration Statement on Form S-1, such sales or the anticipation of such sales could cause the market price of our common stock to fall. Such circumstances, whether or not sales have occurred or are occurring, also could make more difficult our ability to raise additional financing through the sale of equity or equity-related securities in the future at a time and price that we deem reasonable or appropriate.

When we issue additional shares of common stock in the future, including shares of common stock upon conversion of our Series A Convertible Preferred Stock or in future financings, it will result in the dilution of our existing stockholders and may also result in a reduction in the market price of our common stock.

Our Certificate of Incorporation authorizes the issuance of up to 50,000,000 shares of common stock with a \$0.00001 par value per share and 10,000,000 shares of preferred stock with a \$0.00001 par value per share, of which, as of December 31, 2019, 8,876,553 shares of common stock and 105,000 shares of Series A Convertible Preferred Stock were issued and outstanding. Such shares of Series A Convertible Preferred Stock, based upon the applicable conversion rate as of December 31, 2019, were at such time convertible into an aggregate of approximately 295,380 shares of common stock. As of December 31, 2019, we also had outstanding warrants and options to purchase an aggregate of 1,389,751 shares of our common stock and unvested, or vested but not yet settled, restricted stock units covering an aggregate of 428,919 shares of common stock. The exercise of such options and warrants and the vesting or vesting and settlement of such restricted stock units would further increase the number of our outstanding shares of common stock.

From time to time, we may adopt new equity compensation plans or increase the number of shares available for issuance in connection with our existing equity compensation plans. Our board of directors may also choose to issue some or all of our available shares to provide additional financing or acquire businesses in the future.

The issuance of any shares upon conversion of any preferred stock, including our Series A Convertible Preferred Stock, under our equity compensation plans, for acquisition, licensing or financing efforts, upon exercise of warrants and options, or upon settlement of restricted stock units will dilute the interests of our holders of common stock and cause a reduction in the proportionate ownership and voting power of all then current stockholders. Any such issuances may also result in a reduction in the market price of our common stock.

The interests of our controlling stockholders may not coincide with yours and such controlling stockholders may make decisions with which you may disagree.

As of March 13, 2020, four of our stockholders, one of whom is our Executive Chairman and two others of whom are directors, beneficially owned in the aggregate over 50% of the voting power of our outstanding shares of common stock and Series A Preferred Stock on an as-converted basis. As a result, these stockholders may be able to influence the outcome of matters requiring stockholder approval, including the election of directors and approval of significant corporate transactions. In addition, this concentration of ownership may delay or prevent a change in control of our company and make some future transactions more difficult or impossible without the support of our controlling stockholders. The interests of our controlling stockholders may not coincide with our interests or the interests of other stockholders.

If securities or industry analysts do not publish research or publish inaccurate or unfavorable research about our business, our stock price and trading volume could decline.

The trading market for our common stock will depend in part on the research and reports that securities or industry analysts publish about us or our business. We currently have new research coverage by securities and industry analysts. If one or more of the analysts who covers us downgrades our stock or publishes inaccurate or unfavorable research about our business, our stock price would likely decline. If one or more of these analysts ceases coverage of us or fails to publish reports on us regularly, demand for our stock could decrease, which could cause our stock price and trading volume to decline.

We are subject to financial reporting and other requirements that place significant demands on our resources.

We are subject to reporting and other obligations under the Securities Exchange Act of 1934, as amended, including the requirements of Section 404 of the Sarbanes-Oxley Act of 2002. Section 404 requires us to conduct an annual management assessment of the effectiveness of our internal control over financial reporting. These reporting and other obligations place significant demands on our management, administrative, operational, internal audit and accounting resources. Any failure to maintain effective internal controls could have a material adverse effect on our business, operating results and stock price. Moreover, effective internal control is necessary for us to provide reliable financial reports and prevent fraud. If we cannot provide reliable financial reports or prevent fraud, we may not be able to manage our business as effectively as we would if an effective control environment existed, and our business and reputation with investors may be harmed. We may also face claims by our investors, which could harm our business and financial condition.

Risks Relating to Our Charter Documents and Capital Structure

We are close to being controlled by a small number of “insider” stockholders, which could determine corporate and stockholder action on significant matters.

As of March 13, 2020, our directors and executive officers beneficially owned an aggregate of 4,494,964 of our outstanding shares of common stock and 71,407 shares of our outstanding shares of Series A Convertible Preferred Stock, which represents approximately 49% of the aggregate voting power of our outstanding shares of common stock and Series A Preferred Stock on an as-converted basis. Through their collective ownership of our outstanding stock, such holders, if they were to act together, would be close to controlling the voting of our shares at all meetings of stockholders and, because the common stock does not have cumulative voting rights, to determining the outcome of the election of all of our directors and determining corporate and stockholder action on other matters. The beneficial holdings of our directors and executive officers as a group represent approximately 50% of our shares of common stock on a fully diluted basis.

Provisions of our Certificate of Incorporation and bylaws could discourage potential acquisition proposals and could deter or prevent a change in control.

Some provisions in our Certificate of Incorporation and bylaws, as well as statutes, may have the effect of delaying, deterring or preventing a change in control. These provisions, including those providing for the possible issuance of shares of our preferred stock, which may be divided into series and with the preferences, limitations and relative rights to be determined by our board of directors, and the right of the board of directors to amend the bylaws, may make it more difficult for other persons, without the approval of our board of directors, to make a tender offer or otherwise acquire a substantial number of shares of our common stock or to launch other takeover attempts that a stockholder might consider to be in his or her best interest. These provisions could limit the price that some investors might be willing to pay in the future for shares of our common stock.

Delaware law may delay or prevent takeover attempts by third parties and therefore inhibit our stockholders from realizing a premium on their stock.

We are subject to the anti-takeover provisions of Section 203 of the Delaware General Corporation Law. These provisions prevent any stockholder who owns 15% or more of our outstanding shares of common stock from engaging in certain business combinations with us for a period of three years following the time that the stockholder acquired such stock ownership unless certain approvals were or are obtained from our board of directors or from the holders of 66 2/3% of our outstanding shares of common stock (excluding the shares of our common stock owned by the 15% or more stockholder). Our board of directors can use these and other provisions to discourage, delay or prevent a change in the control of our company or a change in our management. Any delay or prevention of a change of control transaction or a change in our board of directors or management could deter potential acquirers or prevent the completion of a transaction in which our stockholders could receive a substantial premium over the then current market price of our shares. These provisions could also limit the price that investors might be willing to pay for shares of our common stock.

Failure to manage growth effectively could adversely affect our business, results of operations and financial condition.

The success of our future operating activities will depend upon our ability to expand our support system to meet the demands of our growing business. Any failure by our management to effectively anticipate, implement, and manage changes required to sustain our growth would have a material adverse effect on our business, financial condition, and results of operations. We cannot assure you that we will be able to successfully operate acquired businesses (if any), become profitable in the future, or effectively manage any other change.

The elimination of the monetary liability of our directors under Delaware law and the existence of indemnification rights held by our directors, officers and employees may result in substantial expenditures by us and may discourage lawsuits against our directors, officers and employees.

Our Certificate of Incorporation contains specific provisions that eliminate the liability of our directors for monetary damages to our company and stockholders and requires indemnification of our directors and officers to the extent provided by Delaware law. Our Bylaws also contain provisions that require the indemnification of our directors, officers and employees. We may also have contractual indemnification obligations under our employment agreements with our officers. The foregoing limitation of liability and indemnification obligations could result in our company incurring substantial expenditures to cover the cost of settlement or damage awards against directors and officers, which we may be unable to recoup. These provisions and resultant costs may also discourage our company from bringing a lawsuit against directors and officers for breaches of their fiduciary duties and may similarly discourage the filing of derivative litigation by our stockholders against our directors and officers even though such actions, if successful, might otherwise benefit our company and our stockholders.

Item 1B. Unresolved Staff Comments

Not applicable.

Item 2. Properties

The Company's principal executive offices are located at 5210 E. Williams Circle, Suite 750, Tucson, Arizona 85711, consisting of approximately 5,151 square feet as of March 13, 2020 in a facility that is leased under an agreement that expires on October 31, 2022.

The Company also leases offices in Scottsdale, Arizona; Atlanta, Georgia; and New York, New York.

We believe our current premises are suitable and adequate for our operations. We believe that suitable additional or substitute space will be available as needed to accommodate changes in our operations and location needs.

Item 3. Legal Proceedings

For a description of any material legal proceedings, see the section titled "Litigation" included in Note 10 – "Commitments and Contingencies" in the notes to the consolidated financial statements, which is incorporated by reference herein.

Item 4. Mine Safety Disclosures

Not applicable.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Common Stock Information

Our common stock has been listed on The NASDAQ Capital Market under the symbol "AEYE" since September 4, 2018. From April 15, 2013 to September 4, 2018, our common stock was quoted on the OTCQB (the Venture Market) and the Over the Counter "OTC" Bulletin Board (each being part of the OTC Markets Group) under the same symbol.

On March 13, 2020, there were 234 holders of record of our common stock, and a greater number of beneficial holders of our common stock for whom shares were held in a "nominee" or "street" name. As of that same date, there were nine holders of record of our preferred stock.

The transfer agent of our common stock is Corporate Stock Transfer, 3200 Cherry Creek Drive, Suite 430, Denver, Colorado 80209, telephone number: (303) 282-4800.

Dividend Policy

In April 2015, the Company issued 175,000 shares of Series A Convertible Preferred Stock with cumulative 5% dividend rights payable when declared by the board of directors of the Company.

Dividends to preferred stockholders take precedence over any dividends to common stockholders. Holders of our common stock are entitled to receive ratably such dividends, if any, as may be declared by our board of directors out of funds legally available therefor. We have not declared or paid any dividends on our preferred or common stock since our inception, and we presently anticipate that earnings, if any, will be retained for development of our business. There are no restrictions in our Certificate of Incorporation or By-laws that prevent us from declaring dividends. Any future declaration of dividends will be at the discretion of our board of directors and will depend upon, among other things, our future earnings, operating and financial condition, and capital requirements.

Item 6. Selected Financial Data

Not applicable.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in conjunction with our consolidated audited financial statements and the related notes for the years ended December 31, 2019 and 2018 that appear elsewhere in this annual report on Form 10-K. The following discussion contains forward-looking statements that reflect our plans, estimates and beliefs. Our actual results could differ materially from those discussed in the forward-looking statements. Factors that could cause or contribute to such differences include but are not limited to those discussed below and elsewhere in this annual report on Form 10-K, particularly in "Special Note Regarding Forward-Looking Statements" and "Risk Factors." The forward-looking statements included in this annual report on Form 10-K are made only as of the date hereof.

Background

AudioEye, Inc. was formed as a Delaware corporation on May 20, 2005. On August 1, 2018, the Company amended its Certificate of Incorporation to implement a reverse stock split in the ratio of 1 share for every 25 shares of common stock and to reduce the number of authorized shares of common stock from 250,000,000 to 50,000,000. As a result, 186,994,384 shares of the Company's common stock were exchanged for 7,479,775 shares of the Company's common stock. The financial statements have been retroactively restated to reflect the reverse stock split.

Overview

AudioEye is an industry-leading software solution provider delivering website accessibility compliance at a range of price points to businesses of all sizes. Our solutions advance accessibility with patented technology that reduces barriers, expands access for individuals with disabilities, and enhances the user experience for a broader audience. We believe that, when implemented, our solutions offer businesses and organizations the opportunity to reach more customers, improve brand image, build additional brand loyalty, and, most importantly, provide an accessible and usable web experience to the expansive and ever-growing global population of individuals with disabilities who wish to access and use digital content. AudioEye provides an always-on testing, remediation, and monitoring solution that continually improves conformance with the Web Content Accessibility Guidelines (WCAG), helping businesses and organizations comply with WCAG standards as well as applicable U.S., Canadian, Australian, and United Kingdom accessibility laws.

AudioEye stands out among its competitors because it delivers machine-learning/AI-driven accessibility without fundamental changes to our customers' site architecture. Our technology publishes more than one billion remediations daily, and our solution is trusted by some of the largest and most influential companies in the world, including Uber, ADP, Tommy Hilfiger, AMI and more. Government agencies, both at the federal level and state and local levels, have also integrated our software in their digital platforms.

AudioEye generates revenue through the sale of subscriptions for our software-as-a-service ("SaaS") accessibility solution plans. Plans range in scale from "do-it-yourself" to "do-it-for-me." All are backed by the power of AudioEye's patented machine-learning/AI-driven technology finding and fixing the most common accessibility errors. Do-it-yourself plans, AudioEye Starter and Pro, also equip site owners with the remediation tools needed to fix remaining issues, ensuring accessibility standards are met. Do-it-for-me, AudioEye Managed and Enterprise, is for those who want AudioEye to continuously ensure legal compliance and accessibility for users of all abilities. Managed and Enterprise also come with the AudioEye Trusted Certification, our attestation of a site owner's commitment to digital inclusion as defined by WCAG success criteria, mitigating a customers' risk of a costly digital accessibility-related lawsuit.

AudioEye customers may purchase tiered plans directly through the AudioEye marketplace, in a platform partner marketplace, through a vertical CMS authorized reseller, or by working directly with the AudioEye sales team:

- The AudioEye marketplace offers Starter, Pro and Managed plans ideal for customers in any industry and is most effective for sites built on supported CMS platforms;
- Certain platforms, such as Duda, natively integrate AudioEye Pro and Managed plans into their marketplace, enabling web creators to immediately build legally compliant, fully accessible websites;
- Vertical CMS authorized resellers provide a website-hosting platform for their end-user customers, selling either AudioEye Pro or Managed accessibility solutions; and
- Organizations with non-platform, custom websites seeking a fully managed solution, engage directly with AudioEye sales personnel for custom pricing.

We have seen momentous growth in both our Enterprise and Partner business channels. With the significant number of additional implementations that each Partner offers, our revenues from our Vertical Partner channel clients represent as much as 40% of Monthly Recurring Revenue "MRR" towards the end 2019. Monthly Recurring Revenue is the annualized spend of the customer divided by 12. Since most of these Partners' underlying clients are billed monthly, we believe our bookings, revenue, and cash flow will converge in this segment as it scales. Renewal rates for the Enterprise channel and renewal contract terms continue to remain strong, which further illustrates the confidence our customers have in the AudioEye accessibility solution.

Our accelerating topline growth is a testament to the ongoing demand for solutions aimed at addressing the broad issues of digital accessibility, and more specifically, to our internal efforts at continually refining our go-to-market strategy as well as expanding our sales and implementation teams to meet the building demand we are experiencing. AudioEye presents the only 'all-in-one solution' created to address the public call for compliance with WCAG 2.1 standards.

During the fourth quarter as well as throughout 2019, we continued to see significant growth within our Enterprise and Vertical Partner sales channels, which was fueled by a number of factors. The number of legal cases related to issues of accessibility has driven adoption of our solutions from a compliance perspective. Further, more companies are recognizing the business value of making their sites accessible to millions more consumers. Recognition of the business ROI is being sparked by demand from end-users who are letting companies and organizations know of the significant importance of accessibility to their websites.

Beyond this secular momentum, we have remained focused on several internal initiatives that are designed to make us more effective at an operational level. More specifically, we have made refinements to our lead generation processes, which have led to expansion of our overall sales pipeline, and we have continued to make enhancements to the technology that underlies our solution.

According to Forrester Research, there is a significant business opportunity considering that individuals with disabilities worldwide have more than \$1.2 trillion in disposable income. More than a million new websites are active daily, representing commerce, jobs, and key parts of everyday life, and yet, despite the ever-growing digital world, digital accessibility on the web is not improving. Many current and new websites are not ADA / WCAG compliant and exclude individuals using assistive technology. AudioEye's mission is to eradicate these access barriers, bringing thousands of new sites into compliance and, through a perpetual combination of technological and human-based oversight from AudioEye, supporting them into the future as the standards and regulations continue to evolve.

Results of Operations

Our consolidated audited financial statements are stated in United States Dollars and are prepared to conform to accounting principles, generally accepted in the United States of America, and consistently applied in the preparation of the financial statements.

	Year Ended December 31,	
	2019	2018
Results of Operations		
Revenues	\$ 10,765,153	\$ 5,660,427
Cost of revenue	4,383,112	2,626,815
Gross profit	6,382,041	3,033,612
Selling and marketing expenses	4,583,796	2,462,865
Research and development expenses	701,054	194,429
General and administrative expenses	8,914,988	4,950,138
Operating loss	(7,817,797)	(4,573,820)
Unrealized gain (loss) on marketable securities	(510)	(240)
Change in fair value of warrant liability	98,919	-
Other income (loss)	12,000	-
Loss on settlement of debt	-	(267,812)
Interest expense, net	(75,883)	(178,002)
Net loss	(7,783,271)	\$ (5,019,874)
Dividend on Series A convertible preferred stock	(52,500)	(53,740)
Net loss attributable to common stockholders	(7,835,771)	\$ (5,073,614)
Net loss per weighted average common share-basic and diluted	(0.97)	\$ (0.74)

In 2019, our net loss increased to \$7,835,771 from \$5,073,614 in 2018, primarily as a result of the following:

Revenue

For the years ended December 31, 2019 and 2018, revenue was in the amount of \$10,765,153 and \$5,660,427, respectively, consisted primarily of various levels of revenue from our core product sales to new customers and renewing a vast majority of existing customers. Revenues increased due to the execution of the Company's business plan which includes the hiring of additional sales team members, securing new negotiated channel partnerships thus increasing the volume of reselling of the AudioEye products and services, and a continued focus on highly transactional industry verticals.

The following table presents our revenues disaggregated by sales channel:

	<u>Year ended December 31,</u>	
	<u>2019</u>	<u>2018</u>
Subscription revenue and support – Enterprise	\$ 7,251,819	\$ 4,315,168
Subscription revenue and support –Vertical partners	3,513,334	1,345,259
Total revenues	\$ 10,765,153	\$ 5,660,427

Cost of Revenue

For the years ended December 31, 2019 and 2018, cost of revenue in the amount of \$4,383,112 and \$2,626,815, respectively, consisted primarily of employee-related costs, including payroll, benefits and stock-based compensation expense for our technology operations and customer experience teams, fees paid to our managed hosting providers and other third-party service providers, amortization of capitalized software development costs and acquired technology, and allocated overhead costs. The increase in cost of revenue was due to significant increase in direct labor headcount and related payroll and use of sub-contracting to support the increase in revenues.

Gross Profit

The increase in revenue and increase in sub-contracting and direct labor costs resulted in a gross profit of \$6,382,041 and \$3,033,612 for the years ended December 31, 2019 and 2018, respectively. Gross profit increased as a result of increasing sales, partially offset by an increase in sub-contracting and direct labor costs. The increase in gross profit was primarily due to overall improvement in revenue from new and renewal sales along with recognition of deferred revenue from prior periods. Advancements in the Company's technology also led to certain efficiencies in the delivery of service.

Selling and Marketing Expenses

Selling and marketing expenses were \$4,583,796 and \$2,462,865 for the years ended December 31, 2019 and 2018, respectively. The increase in expenses resulted primarily from staff and salary increases as we expand and grow our business lines and expand our marketing outreach to further enhance our Brand recognition and generate leads

Research and Development Expenses

Research and development expenses were \$701,054 and \$194,429 for the years ended December 31, 2019 and 2018, respectively. Research and development expenses increased predominantly as a result of an increase in technology staff

General and Administrative Expenses

General and administrative expenses were \$8,914,988 and \$4,950,138 for the years ended December 31, 2019 and 2018, respectively. General and administrative expenses increased primarily as a result of added headcount, higher contract labor costs, and higher benefits costs to support business growth and expansion strategy

Loss on Settlement of Debt

In October 2018, we issued common stock upon the conversion of convertible notes payable in the amount of \$224,975 plus accrued interest. In connection with this issuance, we incurred a \$267,812 loss on settlement.

Interest Expense, net

Interest expense, net during the years ended December 31, 2019 and 2018 was \$75,883 and \$178,002, respectively. For 2019, interest expense, net is principally related to our finance lease liabilities, partially offset by interest income earned on our cash balances. For 2018, interest expense, net consists primarily of amortization of debt discounts and interest incurred relating to our issued convertible notes payable.

Contracts in Process/Revenue Recognition

Under current accounting procedures, revenue is recognized when delivery of the promised goods or services is transferred to customers, in an amount that reflects the consideration that the Company expects to be entitled to in exchange for those goods or services. Certain Software as a Service (“SaaS”) invoices are prepared on an annual basis. Any funds received for services not provided yet are held in deferred revenue and are recorded as revenue when earned. Subscription revenue is recognized on a ratable basis over the contractual subscription term of the arrangement beginning on the date that our service is made available to the customer. The Company records accounts receivable for the amount of revenue recognized as service is rendered and for invoiced amount for non-cancellable contracts. The table below summarizes the amount of contract value in excess of the revenue recognized of \$17,326,092, our deferred revenue of \$5,526,001 and amount recognized as revenue in the amount of \$10,765,153 in 2019. Contract and deferred revenues are expected to be recognized in future periods.

A summary of our contracts in process is as follows:

	Contracts in Process				
	December 31, 2019				
	Contract	Revenue	Revenue	Deferred	Contract Amount in
	Amount	Recognized	Recognized	Revenue	Excess of Deferred
		prior to 2019	12 Months Ended	December 31, 2019	Revenue and
			December 31, 2019		Recognized Revenue
Fixed Contracts	\$ 38,560,001	\$ 4,942,754	\$ 10,765,153	\$ 5,526,002	\$ 17,326,092

Revenues for the fourth quarter of 2019 were a record \$3.57 million, representing an increase of 100% from \$1.78 million in the same year-ago period. The revenues for the fourth quarter of 2019 represent the 16th consecutive quarter of topline growth for the Company. In addition, both deferred revenues and contracts in excess of revenues and deferred revenues continue to grow.

Contract bookings for the fourth quarter of 2019 were the highest quarter of such contract bookings in Company history, totaling approximately \$6.65 million. This represents an increase of 90% from \$3.50 million in the same year-ago period.

About Key Operating Metrics

To supplement our financial information presented in accordance with generally accepted accounting principles in the United States (“GAAP”), we consider certain operating measures that are not prepared in accordance with GAAP, including monthly recurring revenue and contract bookings. AudioEye reviews a number of operating metrics such as these to evaluate its business, measure performance, identify trends, formulate business plans, and make strategic decisions. We believe these metrics and measures are useful to facilitate period-to-period comparisons of our business and to facilitate comparisons of our performance to that of other similar companies.

AudioEye's Contract Bookings is the contracted amount of money the customer commits to spend with the Company over an agreed amount of time, generally ranging from 12 to 60 months. These contracts may be cancellable, however, this poses limited risk as our historical performance on retaining our customers is quite good.

AudioEye's Monthly Recurring Revenue is the annualized run-rate spend of a customer divided by 12.

Vertical Partner is a CMS provider or a company which provides a web-hosting platform for private and public entities and resells the AudioEye Managed service as a new accessibility service offering to its customers. CMS providers who are focused on a specific industry vertical are referred to as Vertical Partners by AudioEye. CMS providers who are vertical agnostic are referred to as Platform partners by AudioEye.

Liquidity and Capital Resources

Working Capital

As of December 31, 2019, the Company had cash and cash equivalents of \$1,972,160 and a working capital deficit of \$(1,118,567). The Company used actual net cash in operations of \$(5,615,841) during the year ended December 31, 2019. While the Company has been successful in raising capital in the past, there is no assurance that it will be successful at raising additional capital in the future. Additionally, if the Company's plans are not achieved and/or if significant unanticipated events occur, the Company may have to further modify its business plan.

	At December 31,	
	2019	2018
Current assets	\$ 5,608,765	\$ 6,140,350
Current liabilities	6,727,332	2,769,367
Working capital (deficit)	\$ (1,118,567)	\$ 3,370,983

The working capital (deficit) as of December 31, 2019 and 2018 was \$(1,118,567) and \$3,370,983, respectively. The change in working capital was primarily due to the decrease in cash balances and increase in accounts payable and accrued expenses.

Cash Flows

	December 31,	
	2019	2018
Net cash used in operating activities	\$ (5,615,841)	\$ (1,643,854)
Net cash used in investing activities	(363,146)	(425,783)
Net cash provided by financing activities	2,209,598	5,850,756
Net increase (decrease) in cash and cash equivalents	\$ (3,769,389)	\$ 3,781,119

We had cash and cash equivalents in the amount of \$1,972,160 and \$5,741,549 as of December 31, 2019 and December 31, 2018, respectively.

In August 2018, the Company sold 1,000,000 shares of its common stock in a private placement for a purchase price of \$6.25 per share resulting in net proceeds of \$5,609,215, after costs and expenses of \$640,785. In addition, the Company received proceeds of \$100,000 from the issuance of convertible notes in September 2018 and an additional \$124,975 from the issuance of convertible notes in the subsequent month of October.

In August 2019, the Company negotiated with holders of certain warrants to purchase the Company's common stock with respect to a transaction in which the Company and the holders agreed to amend certain warrant agreements to provide that from the date of amendment through August 16, 2019, the exercise prices of the warrants were temporarily reduced for a three-day period. During such period, an aggregate of 1,212,136 warrants to purchase the Company's common stock were exercised at the discounted prices for net proceeds of \$2,114,918.

On August 14, 2019, the Company entered into a Loan Agreement (the "Loan Agreement") with Sero Capital LLC, a stockholder who owns more than 10% of the outstanding shares of common stock of the Company. The beneficial owner of Sero Capital LLC is David Moradi, who became a director of the Company on November 8, 2019. In consideration of the Loan Agreement, the Company issued to Sero Capital LLC a common stock warrant to acquire up to a total of 146,667 shares of the Company's common stock at an exercise price of \$6.00 per share, which exercise price may be paid in cash or, at the election of the holder, in a cashless, or "net," exercise transaction. The warrant expires one year from the date of issuance. The Loan Agreement provides the Company with an unsecured credit facility under which the Company may, during the one-year term of the credit facility, borrow up to the aggregate principal amount of \$2,000,000. As of the date of the filing of this annual report, there are no amounts outstanding under the credit facility.

We may raise additional capital through the sale of equity or debt securities or borrowings from financial institutions or third parties or a combination of the foregoing. Capital raised will be used to implement our business plan, grow current operations, make acquisitions and/or start new vertical businesses among some of the possible uses.

Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that are material to stockholders.

Critical Accounting Policies

The 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 the accounting principles generally accepted in the United States. Preparing financial statements requires our management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses. These estimates and assumptions are affected by our management's application of accounting policies. We believe that understanding the basis and nature of the estimates and assumptions involved with the following aspects of our financial statements is critical to an understanding of our financial statements.

Revenue Recognition

The Company recognizes revenue when delivery of the promised goods or services is transferred to its customers, in an amount that reflects the consideration that the Company expects to be entitled to in exchange for those goods or services. We determine revenue recognition through the following five steps:

- Identify the contract with the customer;
- Identify the performance obligations in the contract;
- Determine the transaction price;
- Allocate the transaction price to the performance obligations in the contract; and
- Recognize revenue when, or as, the performance obligations are satisfied.

Certain SaaS invoices are prepared on an annual basis. Subscription revenue is recognized on a ratable basis over the contractual subscription term of the arrangement beginning on the date that our service is made available to the customer. Payments received in advance of services being rendered are recorded as deferred revenue. Any funds received for services not provided yet are held in deferred revenue and are recorded as revenue when earned. We generate majority of our revenue from subscription services—both annual and monthly, which are comprised of subscription fees from customer accounts via our Managed offering.

Effective January 1, 2018, the Company adopted ASU 2014-09, Revenue from Contracts with Customers (Topic 606), which supersedes the revenue recognition requirements in Topic 605, Revenue Recognition, and most industry-specific revenue recognition guidance throughout the Industry Topics of the Accounting Standards Codification. The updated guidance states 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. The guidance also provides for additional disclosures with respect to revenues and cash flows arising from contracts with customers. The Company adopted the standard using the modified retrospective approach effective January 1, 2018.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates include the fair value of the Company's stock, stock-based compensation, fair values relating to derivative liabilities, debt discounts and the valuation allowance related to deferred tax assets. Actual results may differ from these estimates.

Stock based compensation

The Company measures the cost of services received in exchange for an award of equity instruments based on the fair value of the award. For employees and directors, the fair value of the award is measured on the grant date. The fair value amount is then recognized over the period during which services are required to be provided in exchange for the award, usually the vesting period. Stock-based compensation expense is recorded by the Company in the same expense classifications in the consolidated statements of operations, as if such amounts were paid in cash.

Capitalization of Software Development Costs

In accordance with ASC 350-40, the Company capitalizes certain computer software and software development costs incurred in connection with developing or obtaining computer software for internal use when both the preliminary project stage is completed, and it is probable that the software will be used as intended. Capitalized software costs include only (i) external direct costs of materials and services utilized in developing or obtaining computer software, (ii) compensation and related benefits for employees who are directly associated with the software project and (iii) any interest costs incurred while developing internal-use computer software. Capitalized software costs are included in intangible assets on our balance sheet and amortized on a straight-line basis when placed into service over the estimated useful lives of the software.

Recent Accounting Pronouncements

In February 2016, the Financial Accounting Standards Board (“FASB”) established ASC Topic 842, Leases (Topic 842), by issuing ASU No. 2016-02, which requires lessees to recognize leases on the balance sheet and disclose key information about leasing arrangements. Topic 842 was subsequently amended by ASU No. 2018-01, Land Easement Practical Expedient for Transition to Topic 842; ASU No. 2018-10, Codification Improvements to Topic 842, Leases; and ASU No. 2018-11, Targeted Improvements. The new standard establishes a right-of-use (ROU) model that requires a lessee to recognize a ROU asset and lease liability on the balance sheet. Leases will be classified as finance or operating, with classification affecting the pattern and classification of expense recognition in the statement of operations. The Company adopted the new standard using the modified-retrospective method on January 1, 2019 and thus did not adjust comparative periods.

The new standard provides a number of optional practical expedients in transition. The Company has elected the ‘package of practical expedients’, which permits it not to reassess under the new standard its prior conclusions about lease identification, lease classification and initial direct costs. The Company did not elect the use-of-hindsight or the practical expedient pertaining to land easements; the latter is not applicable to the Company.

The new standard had a material effect on the Company’s financial statements. The most significant effects of adoption relate to (1) the recognition of new ROU assets and lease liabilities on its balance sheet for real estate operating leases; and (2) providing significant new disclosures about its leasing activities.

As of January 1, 2019, the Company recognized additional operating lease liabilities of \$568,268 based on the present value of the remaining minimum rental payments under current leasing standards for existing operating leases. The Company recognized corresponding ROU assets of \$557,212. In February 2019, the Company entered into a new lease in Marietta, Georgia, which resulted in ROU assets of an incremental \$483,565 being recognized on the balance sheet upon lease commencement in June 2019.

The new standard also provides practical expedients for an entity’s ongoing accounting. The Company elected the short-term lease recognition exemption for all leases that qualify. This means, for those leases that qualify, that the Company does not recognize ROU assets or lease liabilities, and this includes not recognizing ROU assets or lease liabilities for existing short-term leases of those assets in transition. The Company changed its disclosed lease recognition policies and practices, as well as to other related financial statement disclosures due to the adoption of this standard. See Note 7.

In June 2018, the FASB issued ASU 2018-07, regarding ASC Topic 718 *Compensation - Stock Compensation*, which largely aligns the accounting for share-based compensation for non-employees with employees. The Company implemented this effective January 1, 2019 and no material impact was recognized.

There are various other updates recently issued, most of which represented technical corrections to the accounting literature or application to specific industries and are not expected to have a material impact on the Company's financial position, results of operations or cash flows.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Not applicable.

Item 8. Financial Statements and Supplementary Data

Our Financial Statements begin on page F-1 of this Annual Report on Form 10-K and are incorporated herein by reference.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

Not applicable.

Item 9A. Controls and Procedures

Conclusions of Management Regarding Effectiveness of Disclosure Controls and Procedures

Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed in our reports filed or submitted under the Securities Exchange Act of 1934 (the "Exchange Act") is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's ("SEC") rules and forms. Disclosure controls and procedures include controls and procedures designed to ensure that information required to be disclosed in our reports filed or submitted under the Exchange Act is accumulated and communicated to management to allow timely decisions regarding required disclosure.

As required by paragraph (b) of Rules 13a-15 or 15d-15 under the Exchange Act, our management, with the participation of our Principal Executive Officer and our Principal Financial Officer reviewed the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) or 15d-15(e) under the Exchange Act) as of December 31, 2019, which is the end of the period covered by this annual report (the "Evaluation Date"). Based on such evaluation, such officers have concluded that, as of the Evaluation Date, the Company's disclosure controls and procedures were not effective in ensuring that information required to be disclosed by the Company in the reports that the Company files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms is (i) recorded, processed, summarized and reported within the time periods specified in SEC rules and forms and (ii) accumulated and communicated to our management, including our Principal Executive Officer and our Principal Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Our management, including our CEO and CFO, believes that any disclosure controls and procedures or internal controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must consider the benefits of controls relative to their costs. Inherent limitations within a control system include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of a simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by unauthorized override of the control. While the design of any system of controls is to provide reasonable assurance of the effectiveness of disclosure controls, such design is also based in part upon certain assumptions about the likelihood of future events, and such assumptions, while reasonable, may not take into account all potential future conditions. Accordingly, because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and may not be prevented or detected. Because of the inherent limitations in all control systems, our management, including our Principal Executive Officer and our Chief Financial Officer, believes that no disclosure controls and procedures or internal controls and procedures can provide absolute assurance that all control issues within our Company have been detected. These inherent limitations include the realities that the design of a control system must consider the benefits of controls relative to their costs, judgments in decision-making can be faulty and breakdowns can occur because of simple error or mistake.

Management's Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting for the Company (including its consolidated subsidiaries) and all related information appearing in our Annual Report on Form 10-K. Our internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America. Internal control over financial reporting includes those policies and procedures that:

1. pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of our assets;
2. provide reasonable assurance that the transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with the authorization of management and/or of our Board of Directors; and
3. provide reasonable assurance regarding the prevention or timely detection of any unauthorized acquisition, use or disposition of our assets that could have a material effect on our financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness in future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. Our management (with the participation of our Principal Executive Officer and our Chief Financial Officer) conducted an evaluation of the effectiveness of our internal control over financial reporting as of December 31, 2019 using the criteria established in Internal Control—2013 Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). This evaluation included review of the documentation of controls, evaluation of the design effectiveness of controls, testing of the operating effectiveness of controls and a conclusion on this evaluation. Based on this evaluation under the criteria established in Internal Control – Integrated Framework, our management concluded that our internal control over financial reporting was not effective as of December 31, 2019.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the Company's annual or interim financial statements will not be prevented or detected on a timely basis.

In connection with management's assessment of our internal control over financial reporting, management has identified the following deficiencies that constituted material weaknesses in our internal control over financial reporting as of December 31, 2019:

1. A lack of segregation of duties.
2. A lack of formal policies that provide for multiple levels of supervision and reviews.

Because of these material weaknesses, management has concluded that we did not maintain effective internal control over financial reporting as of December 31, 2019. This annual report does not include an attestation report of our registered public accounting firm regarding internal control over financial reporting. Management's report is not subject to attestation by our registered, public accounting firm pursuant to the rules of the Securities and Exchange Commission that permit us to provide only management's report in this annual report.

Management's Internal Control Remediation Initiatives

During the fiscal year ended December 31, 2019 and now during the current fiscal year ending December 31, 2020, the Company has invested in staff and systems as part of management's effort to address the material weaknesses in the Company's internal control over financial reporting and create an effective internal control environment, including remediation efforts involving: segregation of duties; review, supervision and approval of financial reporting activities; and automation and standardization of manual financial reporting activities. Management expects to continue to use reasonable care in following and seeking improvements to its internal control processes that have been and continue to be in use at the Company. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple errors or mistakes. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Projections of any evaluation of controls effectiveness to future periods are subject to risks.

Changes in Internal Control over Financial Reporting

During the quarter ended December 31, 2019, there were no changes to our internal control over financial reporting that have materially affected, or that are reasonably likely to materially affect, our internal control over financial reporting.

Item 9B. Other Information

On March 27, 2020, the Board of Directors of the Company adopted resolutions (the "Resolutions") approving the ratification of the issuance of 175,000 shares of the Company's Series A Convertible Preferred Stock on May 1, 2015 (the "Preferred Stock Issuance"), pursuant to Section 204 of the General Corporation Law of the State of Delaware (the "Ratification"). Our Board approved the Ratification after it determined that (i) the Preferred Stock Issuance may not have been duly authorized in the manner required by with Section 151 of the General Corporation Law of the State of Delaware and (ii) the Certificate of Designations filed in connection with the Preferred Stock Issuance failed to (a) authorize a sufficient number of shares of Series A Convertible Preferred Stock and (b) be filed and become effective prior to the issuance of certain of the shares of the Series A Convertible Preferred Stock in May 2015.

A copy of the Resolutions adopted by the Board setting forth the information with respect to the Ratification required under Section 204 of the General Corporation Law of the State of Delaware is attached hereto as Exhibit 99.1. Any claim that any defective corporate act or putative stock ratified pursuant to the Ratification is void or voidable due to the failure of authorization specified in the Resolutions, or that the Delaware Court of Chancery should declare in its discretion that the Ratification in accordance with Section 204 of the General Corporation Law of the State of Delaware not be effective or be effective only on certain conditions, must be brought within 120 days from the later of (i) the validation effective time (which is March 27, 2020) and (ii) the giving of this notice (which is deemed given on the date that this Annual Report on Form 10-K is filed with the Securities and Exchange Commission).

PART III

Item 10. Directors, Executive Officers and Corporate Governance

The information required by this item is hereby incorporated by reference to the definitive proxy statement for our 2020 Annual Meeting of Stockholders, which proxy statement is anticipated to be filed with the Securities and Exchange Commission within 120 days after December 31, 2019.

Item 11. Executive Compensation

The information required by this item is hereby incorporated by reference to the definitive proxy statement for our 2020 Annual Meeting of Stockholders, which proxy statement is anticipated to be filed with the Securities and Exchange Commission within 120 days after December 31, 2019.

Item 12. Security Ownership of Certain Beneficial Owners, Management and Related Stockholder Matters

The information required by this item is hereby incorporated by reference to the definitive proxy statement for our 2020 Annual Meeting of Stockholders scheduled to be held on May 18, 2020, which proxy statement is anticipated to be filed with the Securities and Exchange Commission within 120 days after December 31, 2019.

Item 13. Certain Relationships and Related Transactions and Director Independence

The information required by this item is hereby incorporated by reference to the definitive proxy statement for our 2020 Annual Meeting of Stockholders, which proxy statement is anticipated to be filed with the Securities and Exchange Commission within 120 days after December 31, 2019.

Item 14: Principal Accounting Fees and Services

The information required by this item is hereby incorporated by reference to the definitive proxy statement for our 2020 Annual Meeting of Stockholders, which proxy statement is anticipated to be filed with the Securities and Exchange Commission within 120 days after December 31, 2019.

PART IV

Item 15. Exhibits, Financial Statement Schedules

a) The following documents are filed as part of this report:

- (1) Financial Statements — See Index to Consolidated Financial Statements on page F-1 below and the financial pages that follow.
- (2) Financial Statements Schedules — Schedule II - Valuation and Qualifying Accounts. All schedules other than those listed above are omitted because of the absence of conditions under which they are required or because the required information is presented in the financial statements or related notes thereto.
- (3) Exhibits — The following exhibits are either filed herewith or have previously been filed with the Securities and Exchange Commission and are referred to and incorporated herein by reference to such filings:

Exhibit No.	Description
3.1	Certificate of Incorporation of AudioEye, Inc., dated as of May 20, 2005 (1)
3.2	Certificate of Amendment of the Certificate of Incorporation of AudioEye, Inc., dated as of February 12, 2010 (1)
3.3	Certificate of Amendment of the Certificate of Incorporation of AudioEye, Inc., dated as of August 16, 2012 (2)
3.4	Certificate of Amendment of the Certificate of Incorporation of AudioEye, Inc., dated as of March 26, 2014 (7)
3.5	Certificate of Amendment of the Certificate of Incorporation of AudioEye, Inc., dated as of August 1, 2018 (18)
3.6*	Certificate of Designations - Series A Convertible Preferred Stock
3.7*	By-laws of AudioEye, Inc., as amended
4.1	Form of Warrant dated as of June 30, 2014 (8)
4.2	Form of Warrant dated as of December 31, 2014 (9)
4.3	Certificate of Designations — Series A Convertible Preferred Stock dated as of April 29, 2015 (10)
4.4	Form of Secured Convertible Promissory Note dated as of October 9, 2015 (12)
4.5	Form of Warrant dated as of October 9, 2014 (12)
4.6	Form of Warrant dated as of April 18, 2016 (13)
4.7	Form of Omnibus Amendment to Secured Convertible Promissory Notes dated as of April 18, 2016 (13)
4.8	Form of First Amendment to Common Stock Warrant dated as of April 18, 2016 (13)

- [4.9 Form of Registration Rights Agreement between AudioEye, Inc. and each Purchaser dated as of August 6, 2018 \(18\)](#)
- [4.10 Form of Warrant dated as of December 19, 2016 \(14\)](#)
- [4.11 Form of Common Stock and Warrant Purchase Agreement dated as of December 19, 2016 \(14\)](#)
- [4.12* Description of Registered Securities](#)
- [10.1** AudioEye, Inc. 2012 Incentive Compensation Plan effective December 19, 2012 \(3\)](#)
- [10.2** AudioEye, Inc. 2013 Incentive Compensation Plan effective August 20, 2013 \(5\)](#)
- [10.3** Executive Employment Agreement dated August 7, 2013 between Sean Bradley and AudioEye, Inc. \(4\)](#)
- [10.4** Performance Share Unit Agreement dated August 7, 2013 between Sean Bradley and AudioEye, Inc. \(4\)](#)
- [10.5** AudioEye, Inc. 2014 Incentive Compensation Plan effective January 27, 2014 \(6\)](#)
- [10.6** AudioEye, Inc. 2015 Incentive Compensation Plan effective September 5, 2014 \(8\)](#)
- [10.7** Executive Employment Agreement dated July 1, 2015 between Dr. Carr Bettis and AudioEye, Inc. \(11\)](#)
- [10.8** Executive Employment Agreement dated February 13, 2018 between Todd Bankofier and AudioEye, Inc. \(16\)](#)
- [10.9** Executive Employment Agreement dated February 13, 2018 between Sean Bradley and AudioEye, Inc. \(16\)](#)
- [10.10** Amended and Restated Executive Employment Agreement dated February 25, 2019 between Todd Bankofier and AudioEye, Inc. \(19\)](#)
- [10.11** Executive Employment Agreement dated February 27, 2019 between Sean Bradley and AudioEye, Inc. \(19\)](#)
- [10.12** Executive Employment Agreement dated February 28, 2019 between Lonny Sternberg and AudioEye, Inc. \(19\)](#)
- [10.13** Executive Employment Agreement dated May 10, 2019 between Sachin Barot and AudioEye, Inc. \(20\)](#)
- [10.14** AudioEye, Inc. 2016 Incentive Compensation Plan effective December 17, 2015 \(19\)](#)
- [10.15 Note and Warrant Purchase Agreement dated October 9, 2015 between investors and AudioEye, Inc. \(12\)](#)
- [10.16 Security Agreement dated October 9, 2015 between investors and AudioEye, Inc. \(12\)](#)

- [10.17 Common Stock and Warrant Purchase Agreement dated April 18, 2016 between investors and AudioEye, Inc. \(13\)](#)
- [10.18 First Amendment to Note and Warrant Purchase Agreement dated April 18, 2016 between investors and AudioEye, Inc. \(13\)](#)
- [10.19 Second Amendment to Note and Warrant Purchase Agreement dated October 9, 2015 between investors and AudioEye, Inc. \(15\)](#)
- [10.20 Omnibus Amendment to Common Stock Warrants dated October 9, 2015 between investors and AudioEye, Inc. \(15\)](#)
- [10.21 First Amendment to Warrant 2016-A-17 dated April 18, 2016 between Anthion Partners II, LLC and AudioEye, Inc. \(15\)](#)
- [10.22 First Amendment to Warrant 2016-A-18 dated April 18, 2016 between Anthion Partners II, LLC and AudioEye, Inc. \(15\)](#)
- [10.23 First Amendment to Warrant 2016-A-03 dated April 19, 2016 between David Moradi and AudioEye, Inc. \(15\)](#)
- [10.24 First Amendment to Warrant WC-06 dated November 6, 2015 between Anthion Partners II, LLC and AudioEye, Inc. \(15\)](#)
- [10.25 First Amendment to Warrant WC-14 dated November 6, 2015 between Anthion Partners II, LLC and AudioEye, Inc. \(15\)](#)
- [10.26 Second Amendment to Warrant 2014-B-05 dated January 15, 2015 between David Moradi and AudioEye, Inc. \(15\)](#)
- [10.27 Second Amendment to Warrant 2014-B-06 dated January 15, 2015 between David Moradi and AudioEye, Inc. \(15\)](#)
- [10.28 Second Amendment to Warrant 2013-B-26 dated June 30, 2014 between David Moradi and AudioEye, Inc. \(15\)](#)
- [10.29 Placement Agent Agreement dated July 30, 2018 between AudioEye, Inc. and B. Riley FBR, Inc. \(17\)](#)
- [10.30 Form of Securities Purchase Agreement by and between AudioEye, Inc. and each Purchaser dated August 6, 2018 \(18\)](#)
- [10.31** Form of Restricted Stock Unit Award Agreements for grants under the AudioEye, Inc. 2012, 2013, 2014, 2015 and 2016 Incentive Compensation Plans \(19\)](#)
- [10.32** Form of Performance Option Agreement for grants under the AudioEye, Inc. 2012, 2013, 2014, 2015 and 2016 Incentive Compensation Plans \(19\)](#)
- [10.33** Form of Stock Option Agreement for grants under the AudioEye, Inc. 2012, 2013, 2014, 2015 and 2016 Incentive Compensation Plans \(19\)](#)
- [10.34 Convertible Promissory Note dated September 26, 2018 issued by AudioEye, Inc. to Equity Trust Custodian, FBO Alexandre Zyngier IRA \(19\)](#)
- [10.35 Warrants dated September 26, 2018 issued by AudioEye, Inc. to Equity Trust Custodian, FBO Alexandre Zyngier IRA \(19\)](#)

- [10.36](#) [Schedule of Certain Parties to Securities Purchase Agreements and Registration Rights Agreements dated as of August 6, 2018.](#) (19)
- [10.37**](#) [AudioEye, Inc. 2019 Equity Incentive Plan](#) (20)
- [10.38**](#) [AudioEye, Inc. 2019 Equity Incentive Plan – Form of Incentive Stock Option Agreement](#) (20)
- [10.39**](#) [AudioEye, Inc. 2019 Equity Incentive Plan – Form of Nonqualified Stock Option Agreement](#) (20)
- [10.40**](#) [AudioEye, Inc. 2019 Equity Incentive Plan – Form of Restricted Stock Unit Agreement](#) (20)
- [10.41**](#) [Form of Omnibus Amendment to Common Stock Warrants dated as of August 14, 2019](#) (21)
- [10.42](#) [Letter Agreement dated as of August 14, 2019 between the Company and Sero Capital LLC](#) (21)
- [10.43](#) [Loan Agreement dated as of August 14, 2019 between the Company and Sero Capital LLC](#) (21)
- [10.44](#) [Common Stock Warrant dated as of August 14, 2019 Issued by the Company to Sero Capital LLC](#) (21)
- [10.45**](#) [Second Amended and Restated Executive Employment Agreement, effective as of September 16, 2019, between the Company and Todd Bankofier](#) (22)
- [10.46**](#) [Form of AudioEye, Inc. Indemnification Agreement \(Directors and Executive Officers\)](#) (23)
- [10.47*, **](#) [Severance Agreement and General Release of Claims dated as of January 17, 2020 between the Company and Todd Bankofier](#)
- [10.48**](#) [Executive Employment Agreement, entered into as of February 25, 2020, between the Company and Heath Thompson](#) (24)
- [14.1](#) [Code of Business Conduct and Ethics](#) (19)
- [23.1*](#) [Consent of MaloneBailey LLP, Independent Registered Public Accounting Firm](#)
- [24.1*](#) [Power of Attorney](#)
- [31.1*](#) [Certification of the Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002](#)
- [31.2*](#) [Certification of the Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002](#)

- [32.1# Certification of the Principal Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002](#)
- [32.2# Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002](#)
- [99.1* Resolutions adopted by the Board setting forth the information with respect to the Ratification required under Section 204 of the Delaware General Corporation Law.](#)

- 101.INS* XBRL Instance Document
- 101.SCH* XBRL Taxonomy Extension Schema Document
- 101.CAL* XBRL Taxonomy Extension Calculation Linkbase Document
- 101.DEF* XBRL Taxonomy Extension Definition Linkbase Document
- 101.LAB* XBRL Taxonomy Extension Label Linkbase Document
- 101.PRE* XBRL Taxonomy Extension Presentation Linkbase Document

- * Filed herewith.
- ** Constitutes a management contract or compensatory plan or arrangement.
- # Furnished herewith.

- (1) Incorporated by reference to Form S-1, filed with the U.S. Securities and Exchange Commission (the "SEC") on October 21, 2011 (File No. 333-177463).
- (2) Incorporated by reference to Form S-1/A, filed with the SEC on October 1, 2012 (File No. 333-177463).
- (3) Incorporated by reference to Form S-1/A, filed with the SEC on January 11, 2013 (File No. 333-177463).
- (4) Incorporated by reference to Form 10-Q, filed with the SEC on August 9, 2013 (File No. 333-177463).
- (5) Incorporated by reference to Form S-8, filed with the SEC on August 28, 2013 (File No. 333-177463).
- (6) Incorporated by reference to Form S-1/A, filed with the SEC on February 4, 2014 (File No. 333-177463).
- (7) Incorporated by reference to Form 10-K, filed with the SEC on March 31, 2014.
- (8) Incorporated by reference to Form 10-Q, filed with the SEC on November 7, 2014.
- (9) Incorporated by reference to Form 8-K, filed with the SEC on January 7, 2015.
- (10) Incorporated by reference to Form 8-K, filed with the SEC on May 7, 2015.
- (11) Incorporated by reference to Form 8-K, filed with the SEC on July 8, 2015.
- (12) Incorporated by reference to Form 8-K, filed with the SEC on October 16, 2015.
- (13) Incorporated by reference to Form 8-K, filed with the SEC on April 19, 2016.
- (14) Incorporated by reference to Form 8-K, filed with the SEC on December 22, 2016.
- (15) Incorporated by reference to Form 8-K, filed with the SEC on October 16, 2017.

- (16) Incorporated by reference to Form 8-K, filed with the SEC on February 16, 2018.
- (17) Incorporated by reference to Form 8-K, filed with the SEC on July 31, 2018.
- (18) Incorporated by reference to Form 8-K, filed with the SEC on August 7, 2018.
- (19) Incorporated by reference to Form 10-K, filed with the SEC on March 27, 2019.
- (20) Incorporated by reference to Form 8-K, filed with the SEC on May 14, 2019.
- (21) Incorporated by reference to Form 8-K, filed with the SEC on August 16, 2019.
- (22) Incorporated by reference to Form 8-K, filed with the SEC on September 20, 2019.
- (23) Incorporated by reference to Form 8-K, filed with the SEC on December 16, 2019.
- (24) Incorporated by reference to Form 8-K, filed with the SEC on March 2, 2020.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on the 30th day of March 2020.

AUDIOEYE, INC.

By: /s/ Dr. Carr Bettis
Dr. Carr Bettis
Principal Executive Officer

By: /s/ Sachin Barot
Sachin Barot
Chief Financial Officer

POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Dr. Carr Bettis, his attorney-in-fact, with the power of substitution, for him in any and all capacities, to sign any amendments to this Annual Report on Form 10-K and to file the same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that each of said attorneys-in-fact or his substitute or substitutes, may do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>/s/ Dr. Carr Bettis</u> Dr. Carr Bettis	Executive Chairman/Chairman of the Board and Director	March 30, 2020
<u>/s/ Heath Thompson</u> Heath Thompson	Chief Executive Officer	March 30, 2020
<u>/s/ Sachin Barot</u> Sachin Barot	Chief Financial Officer	March 30, 2020
<u>/s/ Anthony Coelho</u> Anthony Coelho	Director	March 30, 2020
<u>/s/ David Moradi</u> David Moradi	Director	March 30, 2020
<u>/s/ Ernest Purcell</u> Ernest Purcell	Director	March 30, 2020
<u>/s/ Jamil Tahir</u> Jamil Tahir	Director	March 30, 2020
<u>/s/ Alexandre Zyngier</u> Alexandre Zyngier	Director	March 30, 2020

ITEM 8 – FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

AUDIOEYE, INC.

FINANCIAL STATEMENTS

TABLE OF CONTENTS

Report of Independent Registered Public Accounting Firm	F-2
Consolidated Balance Sheets as of December 31, 2019 and 2018	F-3
Consolidated Statements of Operations for the Years Ended December 31, 2019 and 2018	F-4
Consolidated Statements of Stockholders' Equity for the two Years Ended December 31, 2019	F-5
Consolidated Statements of Cash Flows for the Years Ended December 31, 2019 and 2018	F-7
Notes to Consolidated Financial Statements	F-8

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and Board of Directors of
AudioEye, Inc.

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of AudioEye, Inc. and its subsidiary (collectively the "Company") as of December 31, 2019 and 2018, and the related consolidated statements of operations, stockholders' equity, and cash flows for the years then ended, and the related notes (collectively referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 2019 and 2018, and the results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Going Concern Matter

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 2 to the financial statements, the Company has suffered recurring losses from operations and has a net capital deficiency that raises substantial doubt about its ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 2. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.

Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ MaloneBailey, LLP
www.malonebailey.com

We have served as the Company's auditor since 2011.

Houston, Texas

March 27, 2020

AUDIOEYE, INC.
CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2019 AND 2018

	December 31, 2019	December 31, 2018
ASSETS		
Current assets:		
Cash & cash equivalents	\$ 1,972,160	\$ 5,741,549
Accounts receivable, net	3,118,319	172,384
Marketable securities, held in related party	-	510
Deferred costs, short term	182,664	176,006
Debt issuance costs, net	137,084	-
Prepaid expenses and other current assets	198,538	49,901
Total current assets	5,608,765	6,140,350
Property and equipment, net	156,171	108,007
Right of use assets	826,630	-
Deferred costs, long term	144,932	93,790
Intangible assets, net	1,715,217	2,061,404
Goodwill	700,528	700,528
Total assets	\$ 9,152,243	\$ 9,104,079
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	\$ 972,691	\$ 93,544
Related party payables	-	14,467
Finance lease liabilities	52,449	30,172
Operating lease liabilities	209,009	-
Deferred rent	-	4,472
Warrant liability	120,416	-
Deferred revenue	5,372,767	2,626,712
Total current liabilities	6,727,332	2,769,367
Long term liabilities:		
Finance lease liabilities	51,564	51,150
Operating lease liabilities	655,431	-
Deferred rent	-	6,585
Deferred revenue	153,235	402,075
Total liabilities	7,587,562	3,229,177
Stockholders' equity:		
Preferred stock, \$0.00001 par value, 10,000,000 shares authorized		
Series A Convertible Preferred stock, \$0.00001 par value, 200,000 shares authorized, 105,000 shares issued and outstanding as of December 31, 2019 and December 31, 2018	1	1
Common stock, \$0.00001 par value, 50,000,000 shares authorized, 8,876,553 and 7,579,995 shares issued and outstanding as of December 31, 2019 and December 31, 2018, respectively	89	76
Additional paid-in capital	51,490,963	48,017,926
Accumulated deficit	(49,926,372)	(42,143,101)
Total stockholders' equity	1,564,681	5,874,902
Total liabilities and stockholders' equity	\$ 9,152,243	\$ 9,104,079

See Notes to Consolidated Financial Statements

AUDIOEYE, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS

	Year ended December 31,	
	2019	2018
Revenue	\$ 10,765,153	\$ 5,660,427
Cost of revenue	4,383,112	2,626,815
Gross profit	6,382,041	3,033,612
Operating expenses:		
Selling and marketing	4,583,796	2,462,865
Research and development	701,054	194,429
General and administrative	8,914,988	4,950,138
Total operating expenses	14,199,838	7,607,432
Operating loss	(7,817,797)	(4,573,820)
Other income (expense):		
Other income	12,000	-
Change in fair value of warrant liability	98,919	-
Unrealized gain (loss) on marketable securities	(510)	(240)
Loss on settlement of debt	-	(267,812)
Interest (expense) income, net	(75,883)	(178,002)
Total other (loss) income	34,526	(446,054)
Net loss	(7,783,271)	(5,019,874)
Dividends on Series A Convertible preferred stock	(52,500)	(53,740)
Net loss available to common stockholders	\$ (7,835,771)	\$ (5,073,614)
Net loss per common share-basic and diluted	\$ (0.97)	\$ (0.74)
Weighted average common shares outstanding-basic and diluted	8,107,181	6,892,238

See Notes to Consolidated Financial Statements

AUDIOEYE, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
TWO YEARS ENDED DECEMBER 31, 2019

	Common stock		Preferred stock		Additional Paid-in Capital	Accumulated Deficit	Total
	Shares	Amount	Shares	Amount			
Balance, December 31, 2018	7,579,995	\$ 76	105,000	\$ 1	\$ 48,017,926	\$ (42,143,101)	\$ 5,874,902
Common stock issued in exchange for exercise of options and warrants	1,296,558	13	-	-	2,256,629	-	2,256,642
Restricted stock units, warrants and options issued for services	-	-	-	-	1,216,408	-	1,216,408
Net loss	-	-	-	-	-	(7,783,271)	(7,783,271)
Balance, December 31, 2019	<u>8,876,553</u>	<u>\$ 89</u>	<u>105,000</u>	<u>\$ 1</u>	<u>\$ 51,490,963</u>	<u>\$ (49,926,372)</u>	<u>\$ 1,564,681</u>

AUDIOEYE, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
TWO YEARS ENDED DECEMBER 31, 2019

	Common stock		Preferred stock		Additional Paid-in Capital	Accumulated Deficit	Total
	Shares	Amount	Shares	Amount			
Balance, December 31, 2017	6,467,066	\$ 65	110,000	\$ 1	\$40,121,845	\$ (39,425,900)	\$ 696,011
Common stock sold for cash	1,000,000	10	-	-	5,609,205	-	5,609,215
Common stock issued upon conversion of preferred stock	13,204	-	(5,000)	-	-	-	-
Common stock issued in exchange for exercise of warrants on a cashless basis	5,842	-	-	-	-	-	-
Common stock issued in exchange for exercise of options on a cashless basis	3,701	-	-	-	-	-	-
Common stock issued in settlement of convertible notes and accrued interest	60,182	1	-	-	225,686	-	225,687
Common stock issued in exchange for exercise of options at \$1.025 per share	20,000	-	-	-	20,500	-	20,500
Common stock issued in exchange for exercise of warrants at \$1.025 per share	10,000	-	-	-	10,250	-	10,250
Effect of adoption of Accounting Codification Standard 2014-09, Revenue from Contracts with Customers	-	-	-	-	-	80,153	80,153
Reclassify derivative liability to equity upon adoption of Accounting Codification Standard 2017-11, Earnings Per Share	-	-	-	-	761,490	2,222,520	2,984,010
Warrants issued with convertible notes	-	-	-	-	175,617	-	175,617
Loss on settlement of debt	-	-	-	-	267,812	-	267,812
Restricted stock units, warrants and options issued for services	-	-	-	-	825,521	-	825,521
Net loss	-	-	-	-	-	(5,019,874)	(5,019,874)
Balance, December 31, 2018	<u>7,579,995</u>	<u>\$ 76</u>	<u>105,000</u>	<u>\$ 1</u>	<u>\$48,017,926</u>	<u>\$ (42,143,101)</u>	<u>\$ 5,874,902</u>

See Notes to Consolidated Financial Statements

AUDIOEYE, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year ended December 31,	
	2019	2018
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	\$ (7,783,271)	\$ (5,019,874)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	722,521	551,335
Amortization of debt issuance costs and discounts	82,251	175,617
Option, warrant, RSU and PSU expense	1,216,408	825,521
Gain from change in fair value of warrant liability	(98,919)	-
Unrealized loss on marketable securities	510	240
Noncash operating lease expense	214,146	-
Amortization of deferred commission	240,486	103,383
Loss on settlement of debt	-	267,812
Changes in operating assets and liabilities:		
Accounts receivable	(2,945,935)	(66,567)
Deferred costs	(298,286)	(293,026)
Other current assets	(148,637)	17,505
Accounts payable and accruals	879,147	11,628
Operating lease liabilities	(179,010)	(3,393)
Deferred revenue	2,497,215	1,795,033
Related party payables	(14,467)	(9,068)
Net cash used in operating activities	<u>(5,615,841)</u>	<u>(1,643,854)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of equipment	(55,939)	(10,893)
Purchase of domain name	-	(10,000)
Software development costs	(307,207)	(404,890)
Net cash used in investing activities	<u>(363,146)</u>	<u>(425,783)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Issuance of common stock and warrants for cash	-	5,609,215
Issuance of convertible note payable-related party	-	50,000
Issuance of convertible notes payable	-	174,975
Proceeds from exercise of warrants	2,231,744	10,250
Proceeds from exercise of options	24,898	20,500
Repayments of notes payable and finance leases	(47,044)	(14,184)
Net cash provided by financing activities	<u>2,209,598</u>	<u>5,850,756</u>
Net increase (decrease) in cash and cash equivalents	(3,769,389)	3,781,119
Cash and cash equivalents-beginning of period	5,741,549	1,960,430
Cash and cash equivalents-end of period	<u>\$ 1,972,160</u>	<u>\$ 5,741,549</u>
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Interest paid	\$ 5,845	\$ 3,491
Non-cash investing and financing activities:		
Right-of-use assets and operating lease obligations recognized upon adoption of ASU 2016-02	\$ 568,268	\$ -
Right-of-use assets and operating lease obligations recognized during the year	483,565	-
Debt issuance costs	219,335	-
Common stock issued in settlement of convertible notes payable and accrued interest	-	225,687
Debt discount originated from issuance of warrant attached to notes payable	-	175,617
Equipment acquired from capital leases	61,352	95,506
Reclassify fair value of warrant liabilities to equity upon adoption of ASU 2017-11	-	2,984,010
Effect of adoption of Accounting Codification Standard 2014-09, Revenue from Contracts with Customers	-	80,153

See Notes to Consolidated Financial Statements

AUDIOEYE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2019 AND 2018

NOTE 1 — ORGANIZATION

AudioEye, Inc. (“we”, “our”, the “Company”) was incorporated on May 20, 2005 in the state of Delaware. The Company has developed patented, Internet content publication and distribution software that enables conversion of any media into accessible formats and allows for real time distribution to end users on any Internet connected device. The Company’s focus is to create more comprehensive access to Internet, print, broadcast and other media to all people regardless of their network connection, device, location, or disabilities.

The Company is focused on developing innovations in the field of networked and device embedded audio technology. Our intellectual property is primarily comprised of trade secrets, trademarks, issued, published and pending patent applications, copyrights and technological innovation. We have a patent portfolio comprised of eight issued patents in the United States. We also have two pending patent applications and two international patent applications filed via the Patent Cooperation Treaty (“PCT”) and the European Patent Office. The patents have been extended and cover a period from 2002 through 2026.

Our common stock is listed on The NASDAQ Capital Market under the symbol “AEYE” since September 4, 2018. Prior to September 4, 2018, our common stock was listed on the OTCQB and the OTC Bulletin Board since April 15, 2013 under the same symbol.

In August 2018, the Company sold 1,000,000 shares of its common stock at \$6.25 per share for net proceeds of \$5,609,215, after costs and expenses of \$640,785 (the “Private Placement”). At the closing of the Private Placement, the Company entered into a registration rights agreement (the “Registration Rights Agreement”) with the investors pursuant to which the Company agreed to register the Shares for resale. On September 4, 2018, the Company filed a registration statement on Form S-1 covering the resale or other disposition of the securities subject to the Registration Rights Agreement.

On August 1, 2018, the Company amended its Articles of Incorporation to implement a reverse stock split in the ratio of 1 share for every 25 shares of common stock and to reduce the number of authorized common stock from 250,000,000 to 50,000,000. As a result, 186,994,384 shares of the Company’s common stock were exchanged for 7,479,775 shares of the Company’s common stock. These financial statements have been retroactively restated to reflect the reverse stock split. (See Note 11)

NOTE 2 — GOING CONCERN AND MANAGEMENT’S LIQUIDITY PLANS

As of December 31, 2019, the Company had cash and cash equivalents of \$1,972,160 and a working capital deficit of \$(1,118,567). In addition, the Company used actual net cash in operations of \$5,615,841 during the year ended December 31, 2019. The Company has incurred net losses since inception. These conditions raise substantial doubt about the Company’s ability to continue as a going concern.

On August 14, 2019, the Company entered into a Loan Agreement (the “Loan Agreement”) with Sero Capital LLC, a shareholder who owns more than 10% of the outstanding shares of common stock of the Company. The Loan Agreement provides the Company with an unsecured credit facility under which the Company may borrow up to the aggregate principal amount of \$2,000,000. Any advances under the Loan Agreement will bear interest at a per annum rate of 10% (subject to increase in the event of a default), which is payable monthly and may, at the Company’s option, be paid either in cash or by the issuance of shares of the Company’s common stock. The term of the Loan Agreement extends through August 14, 2020, subject to earlier termination as provided in the Loan Agreement. The Company’s obligations under the Loan Agreement are subject to acceleration upon the occurrence of an event of default (as defined in the Loan Agreement). The Company may prepay its obligations under the Loan Agreement without penalty, but subject to certain limitations regarding the number, timing and dollar amounts of prepayments. The Loan Agreement provides for certain customary covenants, representations and events of default. No amounts have been drawn under the Loan Agreement as of December 31, 2019.

In consideration of the Loan Agreement, the Company issued to Sero Capital LLC a common stock warrant to acquire up to a total of 146,667 shares of the Company’s common stock at an exercise price of \$6.00 per share, which exercise price may be paid in cash or, at the election of the holder, in a cashless, or “net,” exercise transaction. The warrant expires one year from the date of issuance.

The estimated fair value of the Sero Capital LLC warrant was \$219,335 at date of issuance. The Company valued the warrants using the Black-Scholes pricing model and the following assumptions: contractual term of 1 year, a risk-free interest rate of 1.86%, a dividend yield of 0%, and volatility of 75.9%. The deferred costs attributed to the value of the warrants of \$219,335 is amortized ratably over the term of the credit facility as interest expense. As of December 31, 2019, the unamortized balance was \$137,084 and included as debt issuance costs in current assets on the consolidated balance sheet.

The Company expects that cash used in operations will decrease significantly over the next several quarters as the Company executes its business plan. In the event that the Company is not able to fully achieve its plan, the Company may need to raise additional funds through equity or debt financing. If the Company is unsuccessful in raising additional financing, it will need to reduce costs and operations in the future.

Accordingly, the accompanying financial statements have been prepared in conformity with U.S. GAAP, which contemplates continuation of the Company as a going concern and the realization of assets and satisfaction of liabilities in the normal course of business. The carrying amounts of assets and liabilities presented in the financial statements do not necessarily purport to represent realizable or settlement values. The financial statements do not include any adjustment that might result from the outcome of this uncertainty

AUDIOEYE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2019 AND 2018

NOTE 3 — SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

This summary of significant accounting policies is presented to assist in understanding the Company’s financial statements. These accounting policies conform to accounting principles, generally accepted in the United States of America, and have been consistently applied in the preparation of the financial statements. The Company has a fiscal year ending on December 31. Certain prior period amounts have been reclassified to conform to current period classification.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiary, Empire Technologies, LLC (“Empire”). All significant inter-company accounts and transactions have been eliminated. During the years ended December 31, 2019 and 2018, Empire had no activity. Empire had no assets or liabilities as of December 31, 2019 and 2018.

Revenue Recognition

Revenue is recognized when delivery of the promised goods or services is transferred to its customers, in an amount that reflects the consideration that the Company expects to be entitled to in exchange for those goods or services.

We determine revenue recognition through the following five steps:

- Identify the contract with the customer;
- Identify the performance obligations in the contract;
- Determine the transaction price;
- Allocate the transaction price to the performance obligations in the contract; and
- Recognize revenue when, or as, the performance obligations are satisfied.

Certain Software as a Service (“SaaS”) invoices are prepared on an annual basis. Any funds received for services not provided yet are held in deferred revenue and are recorded as revenue when earned. Subscription revenue is recognized on a ratable basis over the contractual subscription term of the arrangement beginning on the date that our service is made available to the customer. Payments received in advance of services being rendered are recorded as deferred revenue. Any funds received for services not provided yet are held in deferred revenue and are recorded as revenue when earned. We generate substantially all our revenue from subscription services, which are comprised of subscription fees from customer accounts on the Managed Platform.

The following table presents our revenues disaggregated by type of good or service and sales channel:

	Year ended December 31,	
	2019	2018
Subscription revenue and support – Enterprise	\$ 7,251,819	\$ 4,315,168
Subscription revenue and support – Vertical Partners	3,513,334	1,345,259
Total revenues	\$ 10,765,153	\$ 5,660,427

In accordance with Accounting Standard ASU 2014-09 *Revenue from Contracts with Customers* and all subsequent amendments to the ASU (collectively, “ASC 606”), the Company records accounts receivable for amounts invoiced to customers for which service has been rendered and for amounts invoiced and are in deferred revenue but for which the Company has an unconditional right to consideration as provided under the contractual arrangement.

The table below compares the deferred revenue balance as of December 31, 2019 versus December 31, 2018:

	December 31,	December 31,
	2019	2018
Deferred revenue	\$ 5,526,002	\$ 3,028,787

As of December 31, 2019, \$5,372,767 was classified as short term and is expected to be recognized over the next twelve months. The remaining \$153,235 is long-term deferred revenue to be recognized thereafter.

At December 31, 2019, the Company had one customer representing approximately 40% of the outstanding accounts receivable. At December 31, 2018, the Company had one customer representing 22% of the outstanding accounts receivable.

The Company had one major customer (including such customer’s affiliates) which accounted for approximately 10% of its revenues in the year ended December 31, 2019.

The Company had one major customer including their affiliates which generated approximately 11.8% of its revenue in the year ended December 31, 2018.

AUDIOEYE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2019 AND 2018

Effective January 1, 2018, the Company adopted ASU 2014-09, Revenue from Contracts with Customers (Topic 606), which supersedes the revenue recognition requirements in Topic 605, Revenue Recognition, and most industry-specific revenue recognition guidance throughout the Industry Topics of the Accounting Standards Codification. The updated guidance states 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. The guidance also provides for additional disclosures with respect to revenues and cash flows arising from contracts with customers. The Company adopted the standard using the modified retrospective approach effective January 1, 2018.

The Company applied Topic 606 using the following practical expedients:

- The measurement of the transaction price excludes all taxes assessed by a governmental authority that are both imposed on and concurrent with a specific revenue-producing transaction and collected by the Company from a customer;
- The new revenue guidance has been applied to portfolios of contracts with similar characteristics;
- The modified retrospective approach has been applied only to contracts that are not completed contracts at the date of initial adoption;
- The value of unsatisfied performance obligations for contracts with an original expected length of one year or less has not been disclosed; and
- the costs of obtaining contracts with customers are expensed when the amortization period would have been one year or less.

The most significant impact of the standard relates to capitalizing costs to acquire contracts, which have historically been expensed as incurred. As of December 31, 2017, the Company's sales commission plans have included multiple payments, including initial payments in the period a customer contract is obtained and deferred payments over the life of the contract as future payments are collected from the customers. Under the standard, only the initial payment is subject to capitalization as the deferred payments require a substantive performance condition of the employee. These initial commission payments are now capitalized in the period a customer contract is obtained and payment is received; and will be amortized consistent with the transfer of the goods or services to the customer over the expected period of benefit. The expected period of benefit is the contract term, except when the commission payment is expected to provide economic benefit to the Company for a period longer than the contract term, such as for new customer or incremental sales where renewals are expected, and renewal commissions are not commensurate with initial commissions. Such commissions are amortized over the greater of contract term or technological obsolescence period when the underlying contracted products are technology-based, such as for the SaaS-based platforms, or the expected customer relationship period when the underlying contracted products are not technology-based, such as for patient experience survey products. Upon adoption of Topic 606, the Company reclassified \$80,153 from equity previously expensed commissions to deferred costs effective January 1, 2018. See Note 6 below for a summary of activity in the deferred costs account during the year ended December 31, 2019.

Effects of adoption of ASU 2014-09 are as follows:

	At January 1, 2018:		
	Prior to adoption of ASU 2014-09	Subsequent to adoption of ASU 2014-09	Change
Accumulated deficit	\$ (39,425,900)	\$ (39,345,747)	\$ (80,153)
Deferred commission costs	\$ -	\$ 80,153	\$ 80,153

Cost of Revenue

Cost of revenue consists primarily of employee-related costs, including payroll, benefits and stock-based compensation expense for our technology operations and customer experience teams, fees paid to our managed hosting providers and other third-party service providers, amortization of capitalized software development costs and acquired technology, and allocated overhead costs.

AUDIOEYE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2019 AND 2018

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates include the fair value of the Company's stock, stock-based compensation, fair values relating to derivative liabilities, debt discounts, allowance for doubtful accounts, impairment of long-lived assets and goodwill and the valuation allowance related to deferred tax assets. Actual results may differ from these estimates.

Capitalization of Software Development Costs

In accordance with ASC 350-40, the Company capitalizes certain computer software and software development costs incurred in connection with developing or obtaining computer software for internal use when both the preliminary project stage is completed, and it is probable that the software will be used as intended. Capitalized software costs include only (i) external direct costs of materials and services utilized in developing or obtaining computer software, (ii) compensation and related benefits for employees who are directly associated with the software project and (iii) any interest costs incurred while developing internal-use computer software. Capitalized software costs are included in intangible assets on our balance sheet and amortized on a straight-line basis when placed into service over the estimated useful lives of the software (see Note 5).

Research and Technology Expenses

Research and technology expenses are expensed in the period costs are incurred. For the years ended December 31, 2019 and 2018, research and technology expenses totaled \$701,054 and \$194,429 respectively.

Cash and Cash Equivalents

The Company considers cash in savings accounts to be cash equivalents. The Company considers any short-term, highly liquid investments with maturities of three months or less as cash and cash equivalents.

Investments in Equity Securities

The Company has elected the fair value option under ASC 825 for its investments in marketable equity securities. Investments in marketable securities are measured at fair value through earnings and consist of common stock holdings of publicly traded companies. These equity securities are marked to market at the end of each reporting period based on the closing price of the security at each balance sheet date. Changes in fair value are recorded as unrealized gains or losses in the consolidated statements of operations in accordance with ASC 321.

From time to time, the Company invests in the securities of other entities where there exists no active market for the securities held. These strategic investments may consist of non-controlling equity investments in privately held companies. These investments without readily determinable fair values for which the Company does not have the ability to exercise significant influence are accounted for using the measurement alternative. Under the measurement alternative, the non-marketable securities are carried at cost less any impairments, plus or minus adjustments resulting from observable price changes in orderly transactions for identical or similar investments of the same issuer. Fair value is not estimated for non-marketable equity securities if there are no identified events or changes in circumstances that may have an effect on the fair value of the investment.

Allowance for Doubtful Accounts

The Company establishes an allowance for bad debts through a review of several factors including historical collection experience, current aging status of the customer accounts, and financial condition of the Company's customers. The Company does not generally require collateral for its accounts receivable. During the years ended December 31, 2019 and 2018, the Company incurred \$-0- as bad debt expense. There was an allowance for doubtful accounts of \$63,210 and \$-0- as of December 31, 2019 and 2018, respectively.

AUDIOEYE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2019 AND 2018

Property and Equipment

Property and equipment are carried at the cost of acquisition or construction and depreciated over the estimated useful lives of the assets. Costs associated with repairs and maintenance are expensed as incurred. Costs associated with improvements which extend the life, increase the capacity or improve the efficiency of the Company's property and equipment are capitalized and depreciated over the remaining life of the related asset. Gains and losses on dispositions of equipment are reflected in operations. Depreciation is provided using the straight-line method over the estimated useful lives of the assets, which are 5 to 7 years.

Goodwill, Intangible Assets, and Long-Lived Assets

Goodwill is carried at cost and is not amortized. The Company tests goodwill for impairment on an annual basis at the end of each fiscal year, relying on a number of factors including operating results, business plans, economic projections, anticipated future cash flows and marketplace data. Company management uses its judgment in assessing whether goodwill has become impaired between annual impairment tests according to specifications set forth in ASC 350. The Company completed an evaluation of goodwill at December 31, 2019 and 2018 and determined that there was no impairment.

The fair value of the Company's reporting unit is dependent upon the Company's estimate of future cash flows and other factors. The Company's estimates of future cash flows include assumptions concerning future operating performance and economic conditions and may differ from actual future cash flows. Estimated future cash flows are adjusted by an appropriate discount rate derived from the Company's market capitalization plus a suitable control premium at date of the evaluation.

The financial and credit market volatility directly impacts the Company's fair value measurement through the Company's weighted average cost of capital that the Company uses to determine its discount rate and through the Company's stock price that the Company uses to determine its market capitalization. Therefore, changes in the stock price may also affect the amount of impairment recorded.

The Company recognizes an acquired intangible asset apart from goodwill whenever the intangible asset arises from contractual or other legal rights, or when it can be separated or divided from the acquired entity and sold, transferred, licensed, rented or exchanged, either individually or in combination with a related contract, asset or liability. Such intangibles are amortized over their useful lives. Impairment losses are recognized if the carrying amount of an intangible asset subject to amortization is not recoverable from expected future cash flows and its carrying amount exceeds its fair value.

The Company reviews its long-lived assets, including property and equipment, identifiable intangibles, and goodwill annually or whenever events or changes in circumstances indicate that the carrying amount of the assets may not be fully recoverable. To determine recoverability of its long-lived assets, the Company evaluates the probability that future undiscounted net cash flows will be less than the carrying amount of the assets.

Impairment of Long-Lived Assets

The Company's long-lived assets, including intangibles, are reviewed for impairment whenever events or changes in circumstances indicate that the historical-cost carrying value of an asset may no longer be appropriate. The Company assesses recoverability of the asset by comparing the undiscounted future net cash flows expected to result from the asset to its carrying value. If the carrying value exceeds the undiscounted future net cash flows of the asset, an impairment loss is measured and recognized. An impairment loss is measured as the difference between the net book value and the fair value of the long-lived asset. Long-lived assets were evaluated for impairment and no impairment losses were incurred during the years ended December 31, 2019 and 2018, respectively.

Stock Based Compensation

The Company measures the cost of services received in exchange for an award of equity instruments based on the fair value of the award. For employees and directors and non-employees (effective January 1, 2019), the fair value of the award is measured on the grant date. The fair value amount is then recognized over the period during which services are required to be provided in exchange for the award, usually the vesting period. Stock-based compensation expense is recorded by the Company in the same expense classifications in the consolidated statements of operations, as if such amounts were paid in cash.

AUDIOEYE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2019 AND 2018

Income Taxes

Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. These assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which the temporary differences are expected to reverse.

The Company has net operating loss carryforwards available to reduce future taxable income. Future tax benefits for these net operating loss carryforwards are recognized to the extent that realization of these benefits is considered more likely than not. To the extent that the Company will not realize a future tax benefit, a valuation allowance is established.

Earnings (loss) per Share

Basic earnings (loss) per share is calculated by dividing net income (loss) available to common stockholders by the weighted average number of shares of the Company's common stock outstanding during the period. "Diluted earnings per share" reflects the potential dilution that could occur if our share-based awards and convertible securities were exercised or converted into common stock. The dilutive effect of our share-based awards is computed using the treasury stock method, which assumes all share-based awards are exercised and the hypothetical proceeds from exercise are used to purchase common stock at the average market price during the period. The incremental shares (difference between shares assumed to be issued versus purchased), to the extent they would have been dilutive, are included in the denominator of the diluted EPS calculation. The dilutive effect of our convertible preferred stock is computed using the if-converted method, which assumes conversion at the beginning of the year.

Potentially dilutive securities excluded from the computation of basic and diluted net earnings (loss) per share for the years ended December 31, 2019 and 2018 are as follows:

	2019	2018
Preferred stock on a converted basis	295,380	283,407
Options to purchase common stock	965,043	997,989
Warrants to purchase common stock	424,708	1,781,715
Restricted stock units	428,919	222,514
Totals	2,114,050	3,285,625

Derivative Instrument Liability

The Company accounts for derivative instruments in accordance with ASC 815, which establishes accounting and reporting standards for derivative instruments and hedging activities, including certain derivative instruments embedded in other financial instruments or contracts and requires recognition of all derivatives on the balance sheet at fair value, regardless of hedging relationship designation. Accounting for changes in fair value of the derivative instruments depends on whether the derivatives qualify as hedging relationships and the types of relationships designated are based on the exposures hedged. At December 31, 2019 and 2018, the Company did not have any derivative instruments that were designated as hedges.

In 2017 and prior and in accordance with ASC 815, certain warrants with anti-dilutive provisions were deemed to be derivatives. The value of the derivative instrument will fluctuate with the price of the Company's common stock and is recorded as a current liability on the Company's Consolidated Balance Sheet. The change in the value of the liability is recorded as "unrealized gain (loss) on derivative liability" on the Consolidated Statements of Operations.

Effective January 1, 2018, the Company adopted ASU No. 2017-11, Earnings Per Share (Topic 260), Distinguishing Liabilities from Equity (Topic 480), Derivatives and Hedging (Topic 815). The amendments in Part I of this Update change the classification analysis of certain equity-linked financial instruments (or embedded features) with down round features.

AUDIOEYE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2019 AND 2018

When determining whether certain financial instruments should be classified as liabilities or equity instruments, a down round feature no longer precludes equity classification when assessing whether the instrument is indexed to an entity's own stock. The amendments also clarify existing disclosure requirements for equity-classified instruments. As a result, a freestanding equity-linked financial instrument (or embedded conversion option) no longer would be accounted for as a derivative liability at fair value as a result of the existence of a down round feature. For freestanding equity classified financial instruments, the amendments require entities that present earnings per share (EPS) in accordance with Topic 260 to recognize the effect of the down round feature when it is triggered. That effect is treated as a dividend and as a reduction of income available to common stockholders in basic EPS. Convertible instruments with embedded conversion options that have down round features are now subject to the specialized guidance for contingent beneficial conversion features (in Subtopic 470-20, Debt—Debt with Conversion and Other Options), including related EPS guidance (in Topic 260). The amendments in Part II of this Update recharacterize the indefinite deferral of certain provisions of Topic 480 that now are presented as pending content in the Codification, to a scope exception.

On January 1, 2018, the Company adopted ASU 2017-11 by electing the modified retrospective method to the outstanding financial instruments with a down round feature by means of a cumulative-effect adjustment to the statement of financial position as of the beginning of the fiscal year. Accordingly, the Company reclassified the fair value of the reset provisions embedded in previously issued warrants from liability to equity (accumulated deficit) in aggregate of \$2,984,010.

Effects of adoption of ASU 2017-11 modified retrospective are as follows:

	At January 1, 2018:		
	Prior to adoption	Subsequent to adoption	Change
Derivative liabilities	\$ 2,984,010	\$ -	\$ (2,984,010)
Additional paid in capital	40,120,293	40,881,783	761,490
Accumulated deficit	\$ (39,425,900)	\$ (37,203,380)	\$ 2,222,520

Financial Instruments

The carrying amount of the Company's financial instruments, consisting of cash equivalents, short-term investments, accounts receivable and notes payable, short-term borrowings and certain other liabilities, approximate their fair value due to their relatively short maturities.

Fair Value Measurements

Fair value is an estimate of the exit price, representing the amount that would be received upon the sale of an asset or paid to transfer a liability in an orderly transaction between market participants (i.e., the exit price at the measurement date). Fair value measurements are not adjusted for transaction cost. Fair value measurement under generally accepted accounting principles provides for use of a fair value hierarchy that prioritizes inputs to valuation techniques used to measure fair value into three levels:

Level 1: Unadjusted quoted prices in active markets for identical assets or liabilities.

Level 2: Inputs other than quoted market prices that are observable, either directly or indirectly, and reasonably available. Observable inputs reflect the assumptions market participants would use in pricing the asset or liability and are developed based on market data obtained from sources independent of the Company.

AUDIOEYE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2019 AND 2018

Level 3: Unobservable inputs reflect the assumptions that the Company develops based on available information about what market participants would use in valuing the asset or liability.

An asset or liability's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Availability of observable inputs can vary and is affected by a variety of factors. The Company uses judgment in determining fair value of assets and liabilities and Level 3 assets and liabilities involve greater judgment than Level 1 and Level 2 assets or liabilities.

On August 14, 2019, the Company entered into a Loan Agreement (the "Loan Agreement") with Sero Capital LLC, a shareholder who owns more than 10% of the outstanding shares of common stock of the Company. The Loan Agreement provides the Company with an unsecured credit facility under which the Company may borrow up to the aggregate principal amount of \$2,000,000.

In consideration of the Loan Agreement, the Company issued to Sero Capital LLC a common stock warrant to acquire up to a total of 146,667 shares of the Company's common stock at an exercise price of \$6.00 per share, which exercise price may be paid in cash or, at the election of the holder, in a cashless, or "net," exercise transaction. The warrant expires one year from the date of issuance.

The estimated fair value of the Sero Capital LLC warrant was \$219,335 at date of issuance and \$150,562 at December 31, 2019. The Company valued the warrants using the Black-Scholes pricing model and the following assumptions: contractual term of 1 year, a risk-free interest rate of 1.86%, a dividend yield of 0%, and volatility of 75.9%. The deferred costs attributed to the value of the warrants of \$219,335 are amortized ratably over the term of the credit facility as interest expense. The warrants are classified as a liability instrument since the holder has the option to require the Company to repurchase the warrants when certain events occur that are considered outside of the control of the Company.

AUDIOEYE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2019 AND 2018

The following are the Company's assets and liabilities, measured at fair value on a recurring basis, as of December 31, 2019 and 2018:

	Fair Value	Fair Value Hierarchy
Assets		
Marketable securities, December 31, 2019	\$ -	Level 1
Marketable securities, December 31, 2018	\$ 510	Level 1
Liabilities		
Warrant liability, December 31, 2019	\$ 120,416	Level 3
Warrant liability, December 31, 2018	\$ -	Level 3

Recent Accounting Pronouncements

In February 2016, the Financial Accounting Standards Board ("FASB") established ASC Topic 842, Leases (Topic 842), by issuing ASU No. 2016-02, which requires lessees to recognize leases on the balance sheet and disclose key information about leasing arrangements. Topic 842 was subsequently amended by ASU No. 2018-01, Land Easement Practical Expedient for Transition to Topic 842; ASU No. 2018-10, Codification Improvements to Topic 842, Leases; and ASU No. 2018-11, Targeted Improvements. The new standard establishes a right-of-use (ROU) model that requires a lessee to recognize a ROU asset and lease liability on the balance sheet. Leases will be classified as finance or operating, with classification affecting the pattern and classification of expense recognition in the statement of operations. The Company adopted the new standard using the modified-retrospective method on January 1, 2019 and thus did not adjust comparative periods.

The new standard provides a number of optional practical expedients in transition. The Company has elected the 'package of practical expedients', which permits it not to reassess under the new standard its prior conclusions about lease identification, lease classification and initial direct costs. The Company did not elect the use-of-hindsight or the practical expedient pertaining to land easements; the latter is not applicable to the Company.

The new standard had a material effect on the Company's financial statements. The most significant effects of adoption relate to (1) the recognition of new ROU assets and lease liabilities on its balance sheet for real estate operating leases; and (2) providing significant new disclosures about its leasing activities.

As of January 1, 2019, the Company recognized additional operating lease liabilities of \$568,268 based on the present value of the remaining minimum rental payments under current leasing standards for existing operating leases. The Company recognized corresponding ROU assets of \$557,212. In February 2019, the Company entered into a new lease in Marietta, Georgia, which resulted in ROU assets of an incremental \$483,565 being recognized on the balance sheet upon lease commencement in June 2019.

The new standard also provides practical expedients for an entity's ongoing accounting. The Company elected the short-term lease recognition exemption for all leases that qualify. This means, for those leases that qualify, that the Company does not recognize ROU assets or lease liabilities, and this includes not recognizing ROU assets or lease liabilities for existing short-term leases of those assets in transition. The Company changed its disclosed lease recognition policies and practices, as well as to other related financial statement disclosures due to the adoption of this standard. See Note 7.

In June 2018, the FASB issued ASU 2018-07, regarding ASC Topic 718 *Compensation - Stock Compensation*, which largely aligns the accounting for share-based compensation for non-employees with employees. The Company implemented this effective January 1, 2019 and no material impact was recognized.

There are various other updates recently issued, most of which represented technical corrections to the accounting literature or application to specific industries and are not expected to have a material impact on the Company's financial position, results of operations or cash flows.

AUDIOEYE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2019 AND 2018

NOTE 4 — PROPERTY AND EQUIPMENT

Property and equipment as of December 31, 2019 and 2018 is summarized as follows:

	2019	2018
Computer equipment	\$ 64,194	\$ 62,170
Equipment under capital lease	156,858	95,506
Furniture and fixtures	58,883	4,968
Total	279,935	162,644
Less accumulated depreciation	(123,764)	(54,637)
Property and equipment, net	\$ 156,171	\$ 108,007

Property and equipment are stated at cost and depreciated using the straight-line method over their estimated useful life of 3 years. When retired or otherwise disposed, the related carrying value and accumulated depreciation are removed from the respective accounts and the net difference less any amount realized from disposition, is reflected in earnings.

Included in net property are assets under capital leases of \$156,858, less accumulated depreciation of \$59,777 as of December 31, 2019 and \$95,506, less accumulated depreciation of \$16,117 as of December 31, 2018, respectively.

The Company spent \$55,939 in purchases and leased \$61,352 of equipment during the year ended December 31, 2019 and spent \$10,893 in purchases and leased \$95,506 during the year ended December 31, 2018. Depreciation expense was \$69,127 and \$33,386 for the years ended December 31, 2019 and 2018, respectively.

NOTE 5 — INTANGIBLE ASSETS

For the years ended December 31, 2019 and 2018, the Company invested in software development costs in the amounts of \$307,207 and \$404,890 respectively and acquired a domain name in 2018 in the amount of \$10,000.

Patents, technology and other intangibles with contractual terms are generally amortized over their estimated useful lives of ten years. When certain events or changes in operating conditions occur, an impairment assessment is performed and lives of intangible assets with determinable lives may be adjusted. Due to the Company's history of operating losses, intangible assets were evaluated for impairment and no impairment losses were incurred during the years ended December 31, 2019 and 2018, respectively.

Software development costs are amortized over their estimated useful life of three years.

Intangible assets as of December 31 consisted of the following:

	2019	2018
Patents	\$ 3,697,709	\$ 3,697,709
Capitalized software development	1,717,466	1,410,259
Domain name	10,000	10,000
Accumulated amortization	(3,709,958)	(3,056,564)
Intangible assets, net	<u>\$ 1,715,217</u>	<u>\$ 2,061,404</u>

Amortization expense for patents totaled \$374,631 and \$374,632 for the years ended December 31, 2019 and 2018, respectively. Amortization expense for software development totaled \$278,763 and \$143,317 for the years ended December 31, 2019 and 2018, respectively.

Total amortization expense totaled \$653,394 and \$517,949 for the years ended December 31, 2019 and 2018, respectively.

AUDIOEYE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2019 AND 2018

NOTE 6 — DEFERRED COSTS

Effective January 1, 2018, the Company capitalizes initial and renewal sales commission payments in the period a customer contract is obtained, and payment is received; and is amortized consistent with the transfer of the goods or services to the customer over the expected period of benefit, which we have deemed to be the contract term.

Such commissions are amortized over the greater of contract term or technological obsolescence period when the underlying contracted products are technology-based, such as for the SaaS-based platforms, or the expected customer relationship period when the underlying contracted products are not technology-based, such as for patient experience survey products. The table below summarizes the activity within the deferred commission costs account, during the year ended December 31, 2019:

	January 1, 2019	Commission Costs Deferred	Commission Amortized	December 31, 2019
Deferred costs, short term	\$ 176,006	\$ 247,144	\$ (240,486)	\$ 182,664
Deferred costs, long term	93,790	51,142	-	144,932
Deferred commission costs	\$ 269,796	\$ 298,286	\$ (240,486)	\$ 327,596

During the year ended December 31, 2019, the Company deferred an aggregate \$298,286 commissions paid. Amortization of deferred costs for the year ended December 31, 2019 was \$240,486.

NOTE 7 — LEASE LIABILITIES AND RIGHT OF USE ASSETS

Finance Leases

Finance leases as of December 31 consist of:

	2019	2018
Finance equipment lease dated April 5, 2018	\$ 7,683	\$ 13,056
Finance equipment lease dated May 8, 2018	9,060	14,525
Finance equipment lease dated June 27, 2018	13,408	21,701
Finance equipment lease dated September 18, 2018	9,890	15,368
Finance equipment lease dated September 28, 2018	11,108	16,672
Finance equipment lease dated February 20, 2019	14,090	-
Finance equipment lease dated June 4, 2019	17,674	-
Finance equipment lease dated September 30, 2019	21,100	-
Total finance lease liabilities	104,013	81,322
Less current portion	(52,449)	(30,172)
Long term portion	\$ 51,564	\$ 51,150

During the year ended December 31, 2019, the Company entered into three finance leases for computer equipment for a three-year term. The Company recognized these arrangements as finance leases based on the determination that the leases exceeded 75% of the economic life of the underlying assets. The Company initially recorded the equipment and finance leases liability at the estimated present value of the minimum lease payments of \$61,352, collectively. During the year ended December 31, 2018, the Company entered into five finance leases for computer equipment for a three-year term and initially recorded the equipment and the finance leases liability at the estimated present value of the minimum lease payments of \$95,506.

The leases include base monthly payments in aggregate of \$4,761, due on the contract monthly anniversary of each calendar month. At the expiration of the lease, the Company is required to return all leased equipment to the lessor with right of repurchase at fair value. The Company has made payments in the amount of \$47,044 during the year ended December 31, 2019. The effective interest rate of the finance leases is estimated at 6.00% based on the implicit rate in the lease agreements.

The following summarizes the right to use assets under finance leases included in property and equipment as of December 31:

	2019	2018
Classes of property		
Computer equipment	\$ 156,858	\$ 95,506
Less: accumulated depreciation	(59,777)	(16,117)
	\$ 97,081	\$ 79,389

AUDIOEYE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2019 AND 2018

The following summarizes total future minimum lease payments at December 31, 2019:

Period ending December 31,	
2020	\$ 57,126
2021	43,375
2022	10,083
Total minimum lease payments	110,584
Amount representing interest	(6,571)
Present value of minimum lease payments	104,013
Current portion of finance lease obligations	52,449
Finance lease obligations, less current portion	\$ 51,564

Operating Leases

The Company's principal offices are located at 5210 E. Williams Circle, Suite 750, Tucson, Arizona 85711, consisting of approximately 5,151 square feet as of December 31, 2019. The Company's principal office originally consisted of approximately 2,362 square feet. On December 21, 2017, effective February 1, 2018, the Company amended its existing lease to expand its principal office to approximately 4,248 square feet and to extend the expiration date to September 30, 2021. Beginning February 1, 2018, the basic rent increased to \$9,598 per month. On October 2, 2018, effective December 1, 2018, the Company further amended its existing lease to expand its principal office to approximately 5,151 square feet. In accordance with the amended lease, rent increased to \$11,810 on January 1, 2019, escalating over time to \$12,977 at the end of the lease, which was further extended to October 31, 2022.

The Company also had offices in Atlanta, Georgia located at 3901 Roswell Road, Suite 134, leased for an aggregate of \$3,937 per month as of December 31, 2017 under a lease that expired on September 30, 2019 and was not renewed. On December 29, 2017, effective February 1, 2018, the Company amended its existing lease to expand its Atlanta office from approximately 2,739 square feet to approximately 3,831 square feet. Beginning February 1, 2018, the basic rent increased by \$1,500 through the remainder of the lease term. In February 2019, the Company entered into a lease for new offices in Marietta, Georgia located at 450 Franklin Gateway, Marietta, Georgia consisting of approximately 9,662 square feet. The new lease commenced on June 1, 2019, with move-in on June 15, 2019.

Beginning in 2017, the Company leased office space in New York for \$300 per month, which was increased to \$850 per month in October 2018 through May 31, 2019. Beginning in June 2019, the Company moved to larger office space in New York, leased for \$4,482 per month, for a term of 12 months ending May 31, 2020. Beginning November 1, 2015, we subleased an office in Scottsdale, Arizona from a company controlled by our Executive Chairman for \$3,578 per month, which continues on a month to month basis as of December 31, 2019. These New York and Scottsdale properties were considered short-term leases and therefore were not measured under Topic 842.

The Company has made operating lease payments in the amount of \$230,882 during the fiscal year ended December 31, 2019. Rent expense charged to operations, which differs from rent paid due to rent credits and to increasing amounts of base rent, is calculated by allocating total rental payments on a straight-line basis over the term of the lease. Operating lease liabilities at December 31, 2019 and January 1, 2019 consist of:

	December 31, 2019	January 1, 2019
Tucson Arizona office lease	\$ 402,015	\$ 518,309
Marietta Georgia office lease	462,425	-
Atlanta Georgia office lease	-	49,959
Total operating lease liabilities	864,440	568,268
Less current portion	(209,009)	(166,252)
Long term portion	\$ 655,431	\$ 402,016

As of January 1, 2019, the Company adopted the provisions of ASC Topic 842 using the modified retrospective method. In adopting ASC Topic 842, *Leases* (Topic 842), the Company elected the 'package of practical expedients', which permitted it not to reassess under the new standard its prior conclusions about lease identification, lease classification and initial direct costs. The Company did not elect the use-of-hindsight or the practical expedient pertaining to land easements; the latter is not applicable to the Company. In addition, the Company elected not to apply ASC Topic 842 to arrangements with lease terms of 12 month or less. Effective January 1, 2019, the Company initially recognized operating lease liabilities of \$568,268 based on the present value of the remaining minimum rental payments under current leasing standards for existing operating leases. The discount rate utilized in such present value calculation was 6% based on an estimate of the Company's incremental borrowing rate. At such time, the Company also recognized corresponding right-of-use (ROU) assets of \$557,212 and eliminated the prior period deferred rent of \$11,056.

During the fiscal year ended December 31, 2019, the Company entered into an operating lease for new office space in Marietta, Georgia, for a five-year term. The Company measured and recorded a right of use asset and corresponding operating lease liability of \$483,565 at the lease commencement date in June 2019.

The following summarizes total future minimum operating lease payments at December 31, 2019:

Period ending December 31,	
2020	\$ 255,222
2021	261,773
2022	256,970
2023	118,166

2024	80,637
Total minimum lease payments	972,768
Less: present value discount	(108,328)
Present value of minimum lease payments	864,440
Current portion of operating lease obligations	209,009
Operating lease obligations, less current portion	\$ 655,431

As of December 31, 2019, the weighted average discount rate for these leases is 6% and the weighted average remaining term is 46 months.

The following summarizes lease expenses for the fiscal year ended December 31, 2019:

Finance lease expenses:	
Depreciation/amortization expense	\$ 43,660
Interest on lease liabilities	6,571
Finance lease expense	50,231
Operating lease expense	257,635
Short-term lease expense	78,560
Total lease expenses	\$ 386,426

AUDIOEYE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2019 AND 2018

NOTE 8 — CONVERTIBLE NOTES PAYABLE

In connection with the October 9, 2015 Note and Warrant Purchase Agreement, in September 2018 and October 2018, the Company issued convertible promissory notes in aggregate principal amount of \$224,975 (the “Notes”) and warrants (the “Warrants”) to purchase 89,990 shares of common stock of the Company. \$50,000 of the principal was in connection with an entity that a member of the Company’s board of directors is deemed a beneficial owner (see Note 9). Subject to the agreement, any investor in the October 9, 2015 Purchase Agreement within the three-year period immediately following the initial closing date, may purchase an additional note in the principal amount equal to 50% of the principal amount of the initial note purchased by such investor at previous closings and an additional warrant equal to the principal amount of such additional note divided by the exercise price of the additional warrant.

The Notes bore interest at 10% and matured on the earlier of October 9, 2018 or after the occurrence of an event of default (as defined in the Note). In the event of any conversion, all interest was converted into equity and shall not be payable in cash.

Under the terms of the October 9, 2015 Note and Warrant Purchase Agreement, if the Company sells equity securities in a single transaction or series of related transactions for cash of at least \$1,000,000 (excluding the conversion of the Notes and excluding the shares of common stock to be issued upon exercise of the warrants) on or before the maturity date, all of the unpaid principal on the Note plus accrued interest shall be automatically converted at the closing of the equity financing into a number of shares of the same class or series of equity securities as are issued and sold by the Company in such equity financing (or a class or series of equity securities identical in all respects to and ranking pari passu with the class or series of equity securities issued and sold in such equity financing) as is determined by dividing (i) the principal and accrued and unpaid interest amount of the Notes by (ii) 60% of the price per share at which such equity securities are issued and sold in such equity financing.

On October 2, 2018, the Company’s board of directors approved to convert the debt, upon maturity, at \$3.75 per share, which is 60% of the price per share at which equity was sold in August 2018 and will be treated as debt extinguishment at conversion. On October 29, 2018, the Company issued an aggregate of 60,182 shares of its common stock in settlement of the outstanding notes and accrued interest of \$225,687 (principal plus accrued interest). In connection with the settlement, the Company incurred a loss on settlement of debt of \$267,812, calculated as the difference between the fair value of the shares of common stock issued less the value of convertible debt settled.

The Warrants are exercisable at \$2.50 per share and expire 5 years following the date of issuance. The Warrants are subject to anti-dilution protection, subject to certain customary exceptions.

In accordance with Accounting Standards Codification subtopic 470-20, the Company estimated relative fair value of the issued warrants, determined to be \$175,617 as a credit to additional paid in capital. The Company amortized \$175,617 of the debt discount to current period operations as interest expense for the year ended December 31, 2018.

NOTE 9 — RELATED PARTY TRANSACTIONS

On August 14, 2019, the Company entered into a Loan Agreement (the “Loan Agreement”) with Sero Capital LLC, a stockholder who owns more than 10% of the outstanding shares of common stock of the Company. The beneficial owner of Sero Capital LLC is David Moradi, who became a director of the Company on November 8, 2019. The Loan Agreement provides the Company with an unsecured credit facility under which the Company may borrow up to the aggregate principal amount of \$2,000,000. Any advances under the Loan Agreement will bear interest at a per annum rate of 10% (subject to increase in the event of a default), which is payable monthly and may, at the Company’s option, be paid either in cash or by the issuance of shares of the Company’s common stock. The term of the Loan Agreement extends through August 14, 2020, subject to earlier termination as provided in the Loan Agreement. The Company’s obligations under the Loan Agreement are subject to acceleration upon the occurrence of an event of default (as defined in the Loan Agreement). The Company may prepay its obligations under the Loan Agreement without penalty, but subject to certain limitations regarding the number, timing and dollar amounts of prepayments. The Loan Agreement provides for certain customary covenants, representations and events of default. No amounts have been drawn under the Loan Agreement as of December 31, 2019.

In consideration of the Loan Agreement, the Company issued to Sero Capital LLC a common stock warrant to acquire up to a total of 146,667 shares of the Company’s common stock at an exercise price of \$6.00 per share, which exercise price may be paid in cash or, at the election of the holder, in a cashless, or “net,” exercise transaction. The warrant expires one year from the date of issuance.

Sero Capital LLC, beneficially owned by David Moradi who became a director of the Company on November 8, 2019, was paid \$70,000 in consulting fees through December 31, 2019.

On September 26, 2018, the Company issued a \$50,000 convertible note payable and warrants to acquire 20,000 shares of the Company’s common stock with a term of five years, an exercise price of \$2.50 per share to an entity that Alexandre Zyngier, a member of the Company’s board of directors is deemed a beneficial owner. On October 29, 2018, the Company issued 13,384 shares of the Company’s common stock in settlement of this outstanding convertible note for \$50,000 and accrued interest.

As of December 31, 2019 and 2018, the total balances of related party payable were \$0 and \$14,467, respectively.

AUDIOEYE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2019 AND 2018

NOTE 10 — COMMITMENTS AND CONTINGENCIES

Litigation

On January 23, 2017, the court granted preliminary approval of the settlement pursuant to the terms set forth in the Stipulation of Settlement, provisionally certified a settlement class of shareholders, and directed plaintiffs' counsel to provide notice to that class. The Court held a Settlement Hearing May 8, 2017 to consider any objections to the Settlement that might be raised by settlement class members, to consider plaintiffs' counsel's application for an award of fees and costs, and to determine whether the Order and Final Judgment as provided under the Stipulation of Settlement should be entered, dismissing the case with prejudice. On May 8, 2017, this Court granted final approval to the settlement of the securities class action brought by Lead Plaintiffs, individually and on behalf of all others similarly situated. On February 9, 2018, the Court authorized distribution of the Net Settlement Fund and approved the proposed modified plan of allocation.

On May 16, 2016, a stockholder derivative complaint entitled LiPoChing, Derivatively and on Behalf of AudioEye, Inc., v. Bradley, et al., was filed in the United States District Court for the District of Arizona. As a derivative complaint, the plaintiff-stockholder purported to act on behalf of the Company against the Named Individuals. The Company was named as a nominal defendant. The complaint asserted causes of action including breach of fiduciary duty and others, arising from the Company's restatement of its financial results for the first three quarters of 2014. The complaint sought, among other relief, compensatory damages, restitution and attorneys' fees. In October 2016, the Company and Named Defendants filed a motion to dismiss. In response, the Plaintiff voluntarily dismissed the complaint without prejudice. Plaintiff's counsel subsequently submitted a demand to the Company's Board of Directors, to investigate the circumstances surrounding restatement of its financial results for the first three quarters of 2014. On June 22, 2018, the matter was resolved to the parties' satisfaction. The resolution of the matter did not have a material adverse effect on our financial position or results of operations.

On July 26, 2016, a stockholder derivative complaint entitled Denese M. Hebert, derivatively on Behalf of Nominal Defendant AudioEye, Inc., v. Bradley, et al., was filed in the State of Arizona Superior Court for Pima County. The complaint generally asserted causes of action related to the Company's restatement of its financial statements for the first three fiscal quarters of 2014. As a derivative complaint, the plaintiff-stockholder purported to act on behalf of the Company against the Named Individuals. The Company was named as a nominal defendant. The defendants filed a motion to dismiss, which the Court granted on May 8, 2017, while also denying Plaintiff's request for leave to amend the complaint. As in the above matter, after this matter was dismissed Plaintiff's counsel subsequently submitted a demand to the Company's Board of Directors, to investigate the circumstances surrounding restatement of its financial results for the first three quarters of 2014. On June 22, 2018, the matter was resolved to the parties' satisfaction. The resolution of the matter did not have a material adverse effect on our financial position or results of operations.

We may become involved in various other routine disputes and allegations incidental to our business operations. While it is not possible to determine the ultimate disposition of these matters, our management believes that the resolution of any such matters, should they arise, is not likely to have a material adverse effect on our financial position or results of operations.

NOTE 11 — STOCKHOLDERS' EQUITY AND STOCK-BASED COMPENSATION

On August 1, 2018, the Company amended its Certificate of Incorporation to implement a reverse stock split in the ratio of 1 share for every 25 shares of common stock and to reduce the number of authorized common stock from 250,000,000 to 50,000,000. No fractional shares were issued from such aggregation of common stock, upon the reverse split; any fractional share was rounded up and converted to the nearest whole share of common stock. As a result, 186,994,384 shares of the Company's common stock were exchanged for 7,479,775 shares of the Company's common stock resulting in the transfer of \$1,795 from common stock to additional paid in capital. These amendments were approved and filed of record by the Delaware Secretary of State and effective on August 1, 2018. FINRA declared the Company's 1-for-25 reverse stock split market effective as of August 8, 2018. These financial statements have been retroactively restated to reflect the reverse stock split.

AUDIOEYE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2019 AND 2018

Preferred Stock

As of December 31, 2019, and 2018, the Company had 105,000 shares of Series A Convertible Preferred Stock (the "Preferred Stock"), issued at \$10 per share, paying a 5% cumulative annual dividend and convertible for common stock at a price of \$4.385 per share. For the fiscal year ended December 31, 2019, preferred stockholders earned, but were not paid, \$52,500 in annual dividends, or equivalent to 11,973 shares of common stock based on a conversion price of \$4.385 per share. As of December 31, 2019, and December 31, 2018, cumulative and unpaid dividends were \$245,240 and \$192,740, respectively, or equivalent to 55,927 and 43,954 shares of common stock, respectively, based on a conversion price of \$4.385 per share.

On any matter presented to the stockholders of the Company, holders of Preferred Stock are entitled to cast the number of votes equal to the number of shares of common stock into which the shares of Preferred Stock are convertible as of the record date to vote on such matter. As long as any shares of Preferred Stock are outstanding, the Company has certain restrictions on share repurchases or amendments to the Certificate of Incorporation in a manner that adversely affects any rights of the preferred stockholders.

In addition, the preferred stockholders have a liquidation preference for purposes of which the Preferred Stock would be valued at \$10 per share plus accrued cumulative annual dividend. At December 31, 2019 and December 31, 2018, the total liquidation preference was valued at \$1,295,240 and \$1,242,740, respectively. In the event of any liquidity event, holders of each share of Preferred Stock shall be entitled to be paid the liquidation preference out of the assets of the Company legally available before any sums shall be paid to holders of common stock.

Common Stock

As of December 31, 2019, and December 31, 2018, the Company had 8,876,553 and 7,579,995 shares, respectively, of common stock issued and outstanding.

In the fiscal year ended December 31, 2019, the Company issued 21,932 shares of its common stock upon the exercise of options, for aggregate proceeds of \$24,898. During the same period, the Company issued 1,252,319 shares of its common stock, upon the exercise of outstanding warrants to purchase an aggregate of 1,252,319 shares of common stock, for aggregate proceeds of \$2,231,744. Additionally, the Company issued an aggregate of 11,083 shares of its common stock upon the net exercise of 15,596 outstanding options, and issued an aggregate of 11,224 shares of its common stock upon the net exercise of outstanding warrants.

AUDIOEYE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2019 AND 2018

Options

As of December 31, 2019 and 2018, the Company had outstanding options to purchase 965,043 and 997,989 shares of common stock, respectively.

	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Term	Exercisable	Intrinsic Value of Options
Outstanding at December 31, 2017	1,003,836	\$ 4.69	2.64	891,087	\$ 1,356,188
Granted	73,440	6.32	5.00		-
Exercised	(32,173)	2.15			-
Forfeited/Expired	(47,114)	9.31			-
Outstanding at December 31, 2018	997,989	\$ 4.67	2.14	925,545	\$ 4,705,220
Granted	189,599	6.54	9.25		-
Exercised	(37,528)	1.75			-
Forfeited/Expired	(185,017)	11.83			-
Outstanding at December 31, 2019	965,043	\$ 3.70	3.01	759,631	\$ 1,666,266

On February 7, 2019, the Company granted an aggregate of 28,700 incentive stock options to certain employees hired June 4, 2018. The options to purchase shares of common stock are exercisable at \$10.55 per share, have a term of five years, and vest as to 50% of the options at the vesting commencement date, which is generally one year from the date of hire (vesting commencement dates range from June 4, 2019 through January 25, 2020), and vest as to the remaining 50% of the options in eight equal quarterly installments commencing on the first day of each calendar quarter following the vesting commencement date and installments continuing on the first day of each of the seven calendar quarters thereafter. All vesting is subject to the employee's continued service through the vesting date. The exercise price was determined using the closing price of the Company's common stock on February 7, 2019. The Black-Scholes value on the grant date of the options was \$258,392.

On June 3, 2019, the Company granted an aggregate of 93,734 nonqualified stock options to certain employees hired after February 7, 2019, and longer-tenured employees for performance in 2018. The options to purchase shares of common stock are exercisable at \$6.53 per share, have a term of ten years, and vest in approximately equal annual installments on the first three anniversaries of the grant date. All vesting is subject to the employee's continued service through the vesting date. The exercise price was determined using the closing price of the Company's common stock on June 3, 2019. The Black-Scholes value on the grant date of the options was \$571,471.

On December 6, 2019, the Company granted an aggregate of 67,960 nonqualified stock options to certain employees hired after June 3, 2019, and longer-tenured employees for performance in 2019. The options to purchase shares of common stock are exercisable at \$4.85 per share, have a term of ten years, and vest in approximately equal annual installments on the first three anniversaries of the grant date. All vesting is subject to the employee's continued service through the vesting date. The exercise price was determined using the closing price of the Company's common stock on December 6, 2019. The Black-Scholes value on the grant date of the options was \$268,068.

Option grants during the fiscal year ended December 31, 2019 were valued using the Black-Scholes pricing model. Significant assumptions used in the valuation include expected term of 3.25 to 6.00 years, expected volatility of 139.40% to 156.23%, risk free interest rate of 1.67% to 2.48%, and expected dividend yield of 0%.

On March 9, 2018, the Company granted an aggregate of 60,390 options to employees as compensation for services rendered. The options are exercisable at \$6.45 per share for five years with (i) 37,890 options vesting 50% over the first year on the first day of each month beginning January 1, 2018 through December 1, 2018, 25% vesting over the year on the first day of each month from January 1, 2019 through December 1, 2019 and 25% vesting over the year on the first day of each month beginning January 1, 2020 through December 1, 2020; (ii) 12,500 options vesting 50% on January 1, 2018, 50% vesting over the year on each month beginning on January 1, 2019 for 24 months; and (iii) 10,000 options fully vesting on January 1, 2018.

The exercise price was determined using the 10-day average closing price beginning with the closing price on January 9, 2018. The value on the grant date of the options was \$298,914.

On April 12, 2018, the Company granted 6,000 options to purchase the Company's common stock for services rendered at an exercise price of \$6.20 per share for five years with 2,000 options vesting immediately and 1,000 options vesting every 90 days thereafter. The exercise price was determined using the 10-day average closing price beginning with the closing price on March 12, 2018. The value on the grant date of the options was \$29,694.

On May 31, 2018, the Company granted an aggregate of 7,050 options to employees as compensation for services rendered. The options are exercisable at \$5.30 per share for five years with 50% of options vesting upon one-year employee anniversary and 50% vesting at a rate of 1/24 per month thereafter. The exercise price was determined using the 10-day average closing price beginning with the closing price on May 16, 2018. The value on the grant date of the options was \$33,130.

Option grants during the year ended December 31, 2018 were valued using the Black-Scholes pricing model. Significant assumptions used in the valuation include expected term of 2.50 to 3.50 years, expected volatility of 160.87% to 163.85%, risk free interest rate of 2.45% to 2.65%, and expected dividend yield of 0%.

For the fiscal years ended December 31, 2019 and December 31, 2018, total stock compensation expense related to options totaled \$320,868 and \$342,384, respectively. As of December 31, 2019, the outstanding unamortized stock compensation expense related to options was \$741,909 (which will be recognized through December 2022).

AUDIOEYE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2019 AND 2018

Warrants

Below is a table summarizing the Company's outstanding warrants activity for the two years ended December 31, 2019. The Company had outstanding warrants to purchase 424,708 and 1,781,715 shares of the Company's common stock as of December 31, 2019 and 2018, respectively:

	Number of Warrants	Weighted Average Exercise Price	Weighted Average Remaining Term	Intrinsic Value of Warrants
Outstanding at December 31, 2017	1,919,906	\$ 4.84	2.61	\$ 1,656,083
Granted	303,234	5.14	2.64	—
Exercised	(137,525)	5.87		
Forfeited	(303,900)	8.43		—
Outstanding at December 31, 2018	1,781,715	\$ 4.20	2.23	\$ 8,930,058
Granted	146,667	6.00	0.62	—
Exercised	(1,279,550)	1.85		
Forfeited/Expired	(224,124)	5.33		—
Outstanding at December 31, 2019	424,708	\$ 5.31	0.82	\$ 189,450

In August 2019, the Company negotiated with holders of certain warrants to purchase the Company's common stock with respect to a transaction in which the Company and the holders agreed to amend certain warrant agreements to provide that from the date of amendment through August 16, 2019, the exercise price was reduced from \$2.50 to \$1.63 per share for warrants to purchase an aggregate of 1,194,990 shares and from \$6.25 to \$4.07 per share for warrants to purchase an aggregate of 85,719 shares, provided that any exercise during such period was in full and the exercise price was paid in cash. During the August period, an aggregate of 1,212,136 warrants to purchase the Company's common stock were exercised for net proceeds of \$2,114,918.

On August 14, 2019, the Company issued to Sero Capital LLC 146,667 warrants to acquire the Company's common stock at an exercise price of \$6.00 per share for a term of one year (see Note 9). The estimated fair value of the Sero Capital LLC warrant was \$219,335 at date of issuance. The Company valued the warrants using the Black-Scholes pricing model and the following assumptions: contractual term of 1 year, a risk-free interest rate of 1.86%, a dividend yield of 0%, and volatility of 75.9%. As of December 31, 2019, the warrants are classified as a deferred financing costs asset and amortized over a twelve-month term. For the year ended December 31, 2019, the Company recorded \$82,251 of amortization expense. As of December 31, 2019, the Company has \$137,084 of debt issuance costs remaining to be amortized during 2020. A related liability is also on the balance sheet at a fair value of \$120,416 using the Black-Scholes pricing model. Changes in value of the warrant liability flow through our income statement accordingly.

AUDIOEYE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2018 AND 2017

On April 17, 2018, the Company granted 127,525 warrants to a consultant for services rendered. The warrants were exercisable at \$6.25 per share through May 16, 2018. The fair value of the warrants of \$109,207 was charged to current operations.

On August 23, 2018, the Company granted 85,719 warrants in connection with the 2017 sale of the Company's common stock. The warrants are exercisable at \$6.25 through September 29, 2022.

In September 2018 and October 2018, the Company issued an aggregate of 89,990 warrants in connection with the issuance of convertible notes payable. The warrants are exercisable at \$2.50 through five years from the date of issuance. The aggregate fair value of the warrants (up to the net note proceeds) was charged as a debt discount against the convertible notes.

Warrants issued during the year ended December 31, 2018 were valued using the Black-Scholes pricing model. Significant assumptions used in the valuation include expected term of 0.08 to 5.0 years, expected volatility of 159.77% to 162.35%, risk free interest rate of 1.68% to 2.96%, and expected dividend yield of 0%.

For the year ended December 31, 2019 and 2018, the Company has incurred warrant-based expense of \$0 and \$110,600, respectively. There was no outstanding unamortized stock compensation expense related to warrants as of December 31, 2019.

Restricted Stock Units ("RSU")

The following table summarizes the restricted stock activity for the two years ended December 31, 2019:

Total Restricted Shares Issued at December 31, 2017	156,340
Granted	92,174
Forfeited/Canceled	(26,000)
Total Restricted Shares Issued at December 31, 2018	222,514
Granted	206,405
Forfeited/Canceled	-
Total Restricted Shares Issued at December 31, 2019	428,919
Vested at December 31, 2019	269,114
Unvested restricted shares as of December 31, 2019	186,405

On June 3, 2019, the Company granted 11,280 RSUs to each of Alexandre Zyngier, Ernest Purcell and Anthony Coelho for their continued service on the Board of Directors. Such RSUs will vest on June 3, 2020, subject to the director's continuous service through the vesting date. The settlement date for such RSUs is the earlier of (i) June 3, 2026 or (ii) the date on which the Company undergoes a change of control. The fair value of the RSUs at grant date was \$220,975.

On June 3, 2019, the Company granted 20,000 RSUs for services provided. Such RSUs vest each calendar month at a rate of one-third of 20,000 per month, whereby the RSUs would vest by September 3, 2019 provided that services are not terminated by the Company or the grantee. The settlement date for such RSUs is (i) March 15, 2020 or (ii) the date on which the Company undergoes a change of control during the seven-year term of the award. The fair value of the RSU's at grant date was \$130,600.

On June 3, 2019, the Company granted 80,900 RSUs to Sachin Barot, its Chief Financial Officer, in accordance with his employment agreement. Such RSUs will vest annually over a three-year period, in installments of (i) 26,967 RSUs on June 3, 2020, (ii) 26,967 RSUs on June 3, 2021 and (iii) 26,966 RSUs on June 3, 2022, subject to Mr. Barot's continuous service through the vesting date. The settlement date for such RSUs is the earlier of (a) promptly after each vesting date or (b) in any event no later than March 15 of the calendar year following the calendar year in which such vesting occurs. The fair value of the RSUs at grant date was \$528,277.

On August 19, 2019, the Company granted 24,105 RSUs to a consultant to the Company in accordance with a consulting agreement. Such RSUs will vest in installments according to performance conditions establishing certain milestones to be achieved within a timeframe stipulated by the consulting agreement, and as determined quarterly and certified by the Compensation Committee of the Board of Directors. The settlement date for such RSUs is the earlier of (a) promptly after each vesting date or (b) in any event no later than March 15 of the calendar year following the calendar year in which such vesting occurs. The fair value of the RSUs at grant date was \$95,697.

On December 6, 2019, the Company granted 11,280 RSUs to each of David Moradi and Jamil Tahir for their service on the Board of Directors. Such RSUs will vest on December 6, 2020, subject to the director's continuous service through the vesting date. The settlement date for such RSUs is the earlier of (i) December 6, 2026 or (ii) the date on which the Company undergoes a change of control. The fair value of the RSUs at grant date was \$109,416.

On December 6, 2019, the Company granted 25,000 RSUs to Christopher Meinerz, its Corporate Controller, in accordance with his employment agreement. Such RSUs will vest annually over a three-year period, in installments of (i) 8,333 RSUs on December 6, 2020, (ii) 8,334 RSUs on December 6, 2021 and (iii) 8,333 RSUs on December 6, 2022, subject to Mr. Meinerz's continuous service through the vesting date. The settlement date for such RSUs is the earlier of (a) promptly after each vesting date or (b) in any event no later than March 15 of the calendar year following the calendar year in which such vesting occurs. The fair value of the RSUs at grant date was \$121,250.

On March 27, 2018, the Company granted 38,334 RSUs for services provided. 20,000 of such RSUs began vesting May 1, 2018 and will vest each calendar month at a rate of 1,667 RSUs per month, whereby the RSUs would vest provided that services are not terminated by the Company or the grantee. 18,333 RSU's vested immediately. The settlement date for such RSUs is (i) April 1, 2025 or (ii) the date on which the Company undergoes a change of control during the seven-year term of the award. As of December 31, 2018, no RSUs have been settled. The fair value of the RSU's at grant date was \$247,250.

On December 31, 2018, the Company following consideration of the report prepared by Fariant Advisors LLC granted 11,280 RSUs to each of Alexandre Zyngier, Ernest Purcell and Anthony Coelho for their continued service on the Board of Directors and 20,000 RSUs to Dr. Carr Bettis for his continued service as the chair of the Board of Directors (for an aggregate grant of 53,840 RSUs). Such RSUs vest upon the first to occur of the following: (i) April 30, 2019 provided that the director's service with the Company has not terminated prior to such date and (ii) the date of a meeting of the stockholders of the Company at which the director, being willing and available to serve as a director, is nominated for election but is not reelected by the stockholders. The settlement date for such RSUs is the earlier of (i) April 30, 2025 or (ii) the date on which the Company undergoes a change of control. The fair value of the RSU's at grant date was \$460,332.

AUDIOEYE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2018 AND 2017

For the year ended December 31, 2019 and 2018, the Company has incurred RSU-based expense of \$895,540 and \$372,537, respectively. The outstanding unamortized stock compensation expense related to RSUs was \$798,898 (which will be recognized through December 2022) as of December 31, 2019.

NOTE 12 — INCOME TAXES

The Company accounts for income taxes under ASC 740, "Income Taxes". Temporary differences are differences between the tax basis of assets and liabilities and their reported amounts in the financial statements that will result in taxable or deductible amounts in future years. Under this method, deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. A valuation allowance is recorded when the ultimate realization of a deferred tax is uncertain. The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities are presented below:

Deferred tax assets:	2019	2018
Net operating loss carry forwards	\$ 7,757,797	\$ 5,329,518
Less valuation allowance	(7,757,797)	(5,329,518)
Net deferred tax asset	\$ -	\$ -

At this time, the Company is unable to determine if it will be able to benefit from its deferred tax asset. There are limitations on the utilization of net operating loss carry forwards, including a requirement that losses be offset against future taxable income, if any. In addition, there are limitations imposed by certain transactions, which are deemed to be ownership changes. Accordingly, a valuation allowance has been established for the entire deferred tax asset. The approximate net operating loss carry forward was \$36,941,892 and \$25,378,656 as of December 31, 2019 and 2018, respectively and will start to expire in 2031. The Company's tax return for the years 2016, 2017 and 2018 are open to IRS inspection.

On December 22, 2017, the Tax Act was signed into law making significant changes to the Internal Revenue Code. Changes include, but are not limited to, a corporate tax rate decrease from 35% to 21%, effective for tax years beginning after December 31, 2017, and the transition of U.S international taxation from a worldwide tax system to a territorial system. We use the asset and liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to reverse.

NOTE 13 — SUBSEQUENT EVENTS

On January 13, 2020, the Company granted 15,000 performance based RSUs to a consultant to the Company. Such RSUs will vest in installments according to performance conditions establishing certain milestones to be achieved within a specified timeframe.

**CERTIFICATE OF VALIDATION
OF
AUDIOEYE, INC.**

Pursuant to Section 204 of the
General Corporation Law of the State of Delaware

AudioEye, Inc., a corporation organized and existing under the laws of the State of Delaware (the "Corporation"), certifies as follows:

1. The defective corporate act that is the subject of this Certificate of Validation is the issuance of 175,000 shares of the Corporation's Series A Convertible Preferred Stock, par value \$0.00001 per share (the "Series A Preferred Stock"), on May 1, 2015 (the "Preferred Stock Issuance").

2. The nature of the failures of authorization in respect of the Preferred Stock Issuance was: (i) the failure of the Board to have duly approved the Certificate of Designations in the manner required by Section 151 of the General Corporation Law of the State of Delaware (the "General Corporation Law") and (ii) the failure of the Certificate of Designations to have authorized a sufficient number of shares of Series A Preferred Stock and to have been filed and become effective prior to the issuance of the stock.

3. The defective corporate act that is the subject of this Certificate of Validation was duly ratified in accordance with Section 204 of General Corporation Law pursuant to resolutions of the Board of Directors of the Corporation adopted on March 27, 2020.

4. The Certificate of Designations of Series A Convertible Preferred Stock was previously filed under Section 103 of the General Corporation Law on May 4, 2015 and such certificate requires change, both as to the effective date and the number of shares authorized, to give effect to the defective corporate acts that are the subject of this Certificate of Validation. A certificate containing all of the information required to be included under Section 151 of the General Corporation Law to give effect to the Preferred Stock Issuance is attached hereto as Exhibit A. Such certificate shall be deemed to have become effective as of May 1, 2015.

[Signature Page Follows]

IN WITNESS WHEREOF, the Corporation has caused this Certificate of Validation to be executed by its duly authorized officer as of this 27th day of March, 2020.

AUDIOEYE, INC.

By: /s/ Carr Bettis
Name: Carr Bettis
Title: Executive Chairman

EXHIBIT A

**CERTIFICATE OF DESIGNATIONS
SERIES A CONVERTIBLE PREFERRED STOCK
OF AUDIOEYE, INC.**

(pursuant to Section 151 of the Delaware General Corporation Law)

AudioEye, Inc., a corporation organized and existing under the laws of the State of Delaware (the "Corporation"), hereby certifies that the Board of Directors of the Corporation (the "Board of Directors" or the "Board") pursuant to authority of the Board of Directors under Section 151 of the Delaware General Corporation Law ("DGCL"), and in accordance with the provisions of its Certificate of Incorporation and Bylaws, adopted a resolution on April 24, 2015, which authorizes a series of the Corporation's Preferred Stock, par value \$0.00001 per share designated Series A Convertible Preferred Stock (the "Preferred Stock");

RESOLVED, that a series of Preferred Stock in the Corporation, having the rights, preferences, privileges and restrictions, and the number of shares constituting such series and the designation of such series, set forth below be, and it hereby is, authorized by the Board of Directors of the Corporation pursuant to authority given by the Corporation's Certificate of Incorporation.

NOW, THEREFORE, BE IT RESOLVED, that the Board of Directors hereby fixes and determines the number of shares constituting, and the rights, preferences, privileges and restrictions relating to, a new series of Preferred Stock designated Series A Convertible Preferred Stock as follows:

Section 1. Definitions. For the purposes hereof, the following terms shall have the following meanings:

"**Affiliate**" means any Person that, directly or indirectly through one or more intermediaries, controls or is controlled by or is under common control with a Person, as such terms are used in and construed under Rule 405 of the Securities Act.

"**Alternate Consideration**" shall have the meaning set forth in Section 7(d).

"**Board of Directors**" means the board of directors of the Corporation.

"**Business Day**" means any day except any Saturday, any Sunday, any day which is a federal legal holiday in the United States or any day on which banking institutions in the State of New York are authorized or required by law or other governmental action to close.

"**Certificate of Designations**" means this Certificate of Designations of the Series A Convertible Preferred Stock

"**Closing**" means the closing of the purchase and sale of the Securities pursuant to of the Purchase Agreement.

“**Commission**” means the United States Securities and Exchange Commission.

“**Common Stock**” means the Corporation’s common stock, par value \$0.00001 per share, and stock of any other class of securities into which such securities may hereafter be reclassified or changed.

“**Conversion Date**” shall have the meaning set forth in Section 6(a).

“**Conversion Price**” shall have the meaning set forth in Section 6(b).

“**Conversion Shares**” means, collectively, the shares of Common Stock issuable upon conversion of the shares of Preferred Stock in accordance with the terms hereof.

“**Corporation**” means AudioEye, Inc., a Delaware corporation.

“**Dividend Payment Date**” shall have the meaning set forth in Section 2.

“**Exchange Act**” means the Securities Exchange Act of 1934, as amended, and the rules and regulations promulgated thereunder.

“**Fundamental Transaction**” shall have the meaning set forth in Section 7(d).

“**GAAP**” means United States generally accepted accounting principles.

“**Holder**” shall mean a holder of the Preferred Stock, and “**Holders**” shall mean multiple or all, as the context requires, holders of the Preferred Stock.

“**Junior Securities**” means the Common Stock and all other Common Stock Equivalents of the Corporation other than those securities which are explicitly senior or *pari passu* to the Preferred Stock in dividend rights or liquidation preference.

“**Liquidity Event**” means (i) any liquidation, dissolution or winding up of the Company, whether voluntary or involuntary, (ii) any sale of all or substantially all of the Company’s assets, or (iii) any other transaction that results in the Company’s stockholders immediately prior to such transaction holding less than 50% of the voting power of the surviving entity.

“**Liquidity Preference**” shall have the meaning set forth in Section 5.

“**Notice of Conversion**” shall have the meaning set forth in Section 6(a).

“**Original Issue Date**” means the date of the first issuance of any shares of the Preferred Stock regardless of the number of transfers of any particular shares of Preferred Stock and regardless of the number of certificates which may be issued to evidence such Preferred Stock.

“**Person**” means an individual or corporation, partnership, trust, incorporated or unincorporated association, joint venture, limited liability company, joint stock company, government (or an agency or subdivision thereof) or other entity of any kind.

“**Preferred Stock**” shall have the meaning set forth in Section 2.

“**Purchase Agreement**” means the Securities Purchase Agreement among the Corporation and the original Holders, as amended, modified or supplemented from time to time in accordance with its terms for the purchase and sale of the Preferred Stock.

“**Redemption Price**” shall have the meaning set forth in Section 8(a).

“**Rule 144**” means Rule 144 promulgated by the Commission pursuant to the Securities Act, as such Rule may be amended from time to time, or any similar rule or regulation hereafter adopted by the Commission having substantially the same effect as such Rule.

“**Securities**” means the Preferred Stock and the Underlying Shares subject to the Purchase Agreement.

“**Securities Act**” means the Securities Act of 1933, as amended, and the rules and regulations promulgated thereunder.

“**Share Delivery Date**” shall have the meaning set forth in Section 6(c).

“**Stated Value**” shall have the meaning set forth in Section 2.

“**Subsidiary**” means any subsidiary of the Corporation.

“**Successor Entity**” shall have the meaning set forth in Section 7(d).

“**Trading Day**” means a day on which the principal Trading Market is open for business.

“**Trading Market**” means any of the following markets or exchanges on which the Common Stock is listed or quoted for trading on the date in question: the NYSE MKT LLC, the Nasdaq Capital Market, the Nasdaq Global Market, the Nasdaq Global Select Market, the New York Stock Exchange, OTC Markets, or the OTC Bulletin Board (or any successors to any of the foregoing).

“**Transaction Documents**” means this Certificate of Designations, the Purchase Agreement, all exhibits and schedules thereto and hereto and any other documents or agreements executed in connection with the transactions contemplated pursuant to the Purchase Agreement.

“**Transfer Agent**” means Corporate Stock Transfer, Inc., the current transfer agent of the Corporation, and any successor transfer agent of the Corporation.

“**Underlying Shares**” means the shares of Common Stock issued and issuable upon conversion of the Preferred Stock.

“**VWAP**” means, for any date, the price determined by the first of the following clauses that applies: (a) if the Common Stock is then listed or quoted on a Trading Market, the daily volume weighted average price of the Common Stock for such date (or the nearest preceding date) on the Trading Market on which the Common Stock is then listed or quoted as reported by Bloomberg L.P. (based on a Trading Day from 9:30 a.m. (New York City time) to 4:02 p.m. (New York City time)), (b) if the OTC Bulletin Board is not a Trading Market, the volume weighted average price of the Common Stock for such date (or the nearest preceding date) on the OTC Bulletin Board, (c) if the Common Stock is not then listed or quoted for trading on the OTC Bulletin Board and if prices for the Common Stock are then reported in the “Pink Sheets” published by Pink OTC Markets, Inc. (or a similar organization or agency succeeding to its functions of reporting prices), the most recent bid price per share of the Common Stock so reported, or (d) in all other cases, the fair market value of a share of Common Stock as determined by an independent appraiser selected in good faith by the Holders of a majority in interest of the Preferred Stock then outstanding and reasonably acceptable to the Corporation, the fees and expenses of which shall be paid by the Corporation.

Section 2. Designation, Amount and Par Value. The series of Preferred Stock shall be designated as its Series A Convertible Preferred Stock (the “Preferred Stock”) and the number of shares so designated shall be 200,000 (which shall not be subject to increase without the written consent of Holders representing at least 67% of the Preferred Stock based on Liquidity Preference). Each share of Preferred Stock shall have a par value of \$0.00001 per share and a stated value equal to \$10.00 (the “Stated Value”). Preferred Stock represents equity interests in the Corporation and shall not give rise to a claim for payment of a principal amount at a particular date.

Section 3. Dividends.

The Holders shall be entitled to receive, when, as and if declared by the Board of Directors of the Corporation out of funds legally available therefore, cumulative dividends at the annual rate of 5% of the Stated Value per share of the Preferred Stock. To the extent declared, such dividends shall be payable in cash quarterly, on the last day of each quarter, beginning June 30, 2015 (each of such dates being a “Dividend Payment Date”). Such dividends shall accrue on each such share commencing on the date of issue, and shall accrue from day to day, whether or not earned or declared.

(a) So long as any shares of Preferred Stock remain outstanding, neither the Corporation nor any subsidiary thereof shall redeem, purchase or otherwise acquire directly or indirectly any material amount of Junior Securities.

Section 4. Voting Rights. On any matter presented to the stockholders of the Corporation for their action or consideration at any meeting of stockholders of the Corporation (or by written consent of stockholders in lieu of meeting), each holder of outstanding shares of Preferred Stock shall be entitled to cast the number of votes equal to the number of whole shares of Common Stock into which the shares of Preferred Stock held by such holder are convertible as of the record date for determining stockholders entitled to vote on such matter. Except as provided by law or by the other provisions of the Certificate of Designations, holders of the Preferred Stock shall vote together with the holders of Common Stock, as a single class. Notwithstanding the foregoing, as long as any shares of Preferred Stock are outstanding, the Corporation shall not, without the affirmative vote of the Holders of at least 75% in Stated Value of Preferred Stock then outstanding, except as may be necessary to increase the authorized shares of Common Stock in order to account for any increase in the number of shares issuable upon conversion of the Preferred Stock, (a) purchase or redeem any capital stock other than stock repurchased from former employees or consultants in connection with the cessation of their employment services, at the lower of fair market value or cost, or (b) amend, alter or repeal any provision of its certificate of incorporation or other charter documents in a manner that adversely affects any rights of the Holders.

Section 5. Liquidation Rights. In the event of any Liquidity Event, holders of each share of Preferred Stock shall be entitled to be paid out of the assets or surplus funds of the Corporation legally available for distribution to holders of the Corporation's capital stock of all classes (whether such assets are capital, surplus, or earnings) and subject to the liquidating preference of the holders of any other series of Preferred Shares which may be on parity or senior in right of preference to the Preferred Stock and before any sums shall be paid or any assets or surplus funds distributed among the holders of Common Stock, an amount equal to the Stated Value plus accrued dividends as to such share (the "Liquidity Preference"). If the assets of the Corporation shall be insufficient to permit the payment in full to holders of the Preferred of the preferential amount set forth in this Section 5, then the entire assets of the Corporation available for such distribution shall be distributed ratably among the holders of the Preferred in accordance with the aggregate liquidation preference of the shares of Preferred Stock held by each of them.

Section 6. Conversion.

(a) Conversion at Option of Holder. Each share of Preferred Stock shall be convertible, at any time and from time to time from and after the Original Issue Date at the option of the Holder thereof, into that number of shares of Common Stock determined by dividing the Stated Value plus any accrued dividends with respect to such share by the Conversion Price. Holders shall effect conversions by providing the Corporation with the form of conversion notice attached hereto as Annex A (a "Notice of Conversion"). Each Notice of Conversion shall specify the number of shares of Preferred Stock to be converted, the number of shares of Preferred Stock owned prior to the conversion at issue, the number of shares of Preferred Stock owned subsequent to the conversion at issue and the date on which such conversion is to be effected, which date may not be prior to the date the applicable Holder delivers by facsimile such Notice of Conversion to the Corporation (such date, the "Conversion Date"). If no Conversion Date is specified in a Notice of Conversion, the Conversion Date shall be the date that such Notice of Conversion to the Corporation is deemed delivered hereunder. The calculations and entries set forth in the Notice of Conversion shall control in the absence of manifest or mathematical error. To effect conversions of shares of Preferred Stock, a Holder shall not be required to surrender the certificate(s) representing the shares of Preferred Stock to the Corporation unless (i) the full or remaining number of shares of Preferred Stock represented by such certificate are being converted or (ii) such Holder has provided the Corporation with prior written notice (which notice may be included in a Notice of Conversion) requesting reissuance of a certificate representing the remaining shares of Preferred Stock upon physical surrender of any certificate representing the shares of Preferred Stock being converted. Each Holder and the Corporation shall maintain records showing the number of shares of Preferred Stock so converted by such Holder and the dates of such conversions or shall use such other method, reasonably satisfactory to such Holder and the Corporation, so as not to require physical surrender of the certificate representing the shares of Preferred Stock upon each such conversion. In the event of any dispute or discrepancy, such records of the Corporation establishing the number of shares of Preferred Stock to which the record holder is entitled shall be controlling and determinative in the absence of manifest error. Shares of Preferred Stock converted into Common Stock in accordance with the terms hereof shall be canceled and shall not be reissued.

(b) Conversion Price. The per share conversion price for the Preferred Stock shall equal the greater of (a) \$0.15 or (b) the average of 90% of the closing prices of the Company's Common Stock for the five Trading Days immediately preceding the initial Closing plus any accrued dividends with respect to such share, subject to adjustment herein (the "Conversion Price").

(c) Mechanics of Conversion.

(i) Delivery of Certificate Upon Conversion. Not later than three (3) Trading Days after each Conversion Date (the "Share Delivery Date"), the Corporation shall deliver, or cause to be delivered, to the converting Holder a certificate or certificates representing the number of Conversion Shares being acquired upon the conversion of the Preferred Stock. If requested by the Holder, the Corporation shall use its best efforts to deliver any certificate or certificates required to be delivered by the Corporation under this Section 6 electronically through the Depository Trust Company or another established clearing corporation performing similar functions.

(ii) Reservation of Shares Issuable Upon Conversion. The Corporation covenants that it will at all times reserve and keep available out of its authorized and unissued shares of Common Stock for the sole purpose of issuance upon conversion of the Preferred Stock as herein provided, not less than such aggregate number of shares of the Common Stock as shall (subject to the terms and conditions set forth in the respective Purchase Agreement) be issuable (taking into account the adjustments and restrictions of Section 7) upon the conversion of the then outstanding shares of Preferred Stock. The Corporation covenants that all shares of Common Stock that shall be so issuable shall, upon issue, be duly authorized, validly issued, fully paid and nonassessable.

(iii) Fractional Shares. No fractional shares or scrip representing fractional shares shall be issued upon the conversion of the Preferred Stock. As to any fraction of a share which the Holder would otherwise be entitled to purchase upon such conversion, the Corporation shall at its election, either pay a cash adjustment in respect of such final fraction in an amount equal to such fraction multiplied by the Conversion Price or round up to the next whole share.

(iv) Transfer Taxes. The issuance of certificates for shares of the Common Stock on conversion of this Preferred Stock shall be made without charge to any Holder for any documentary stamp or similar taxes that may be payable in respect of the issue or delivery of such certificates, provided that the Corporation shall not be required to pay any tax that may be payable in respect of any transfer involved in the issuance and delivery of any such certificate upon conversion in a name other than that of the Holders of such shares of Preferred Stock and the Corporation shall not be required to issue or deliver such certificates unless or until the Person or Persons requesting the issuance thereof shall have paid to the Corporation the amount of such tax or shall have established to the satisfaction of the Corporation that such tax has been paid.

Section 7. Certain Adjustments.

(a) **Stock Dividends and Stock Splits.** If the Corporation, at any time while this Preferred Stock is outstanding: (i) pays a stock dividend or otherwise makes a distribution or distributions payable in shares of Common Stock on shares of Common Stock or any other Common Stock Equivalents (which, for avoidance of doubt, shall not include any shares of Common Stock issued by the Corporation upon conversion of this Preferred Stock), (ii) subdivides outstanding shares of Common Stock into a larger number of shares, (iii) combines (including by way of a reverse stock split) outstanding shares of Common Stock into a smaller number of shares, or (iv) issues, in the event of a reclassification of shares of the Common Stock, any shares of capital stock of the Corporation, then the Conversion Price shall be multiplied by a fraction of which the numerator shall be the number of shares of Common Stock (excluding any treasury shares of the Corporation) outstanding immediately before such event, and of which the denominator shall be the number of shares of Common Stock outstanding immediately after such event. Any adjustment made pursuant to this Section 7(a) shall become effective immediately after the record date for the determination of stockholders entitled to receive such dividend or distribution and shall become effective immediately after the effective date in the case of a subdivision, combination or reclassification.

(b) **Subsequent Rights Offerings.** If the Corporation, at any time while the Preferred Stock is outstanding, shall issue rights, options or warrants to all holders of Common Stock (and not proportionately to the Holders) entitling them to subscribe for or purchase shares of Common Stock at a price per share that is lower than the VWAP on the record date for such issuance, and do not offer the same rights to the Holders, then the Holder will be entitled to acquire, upon conversion of the Preferred Stock, such rights, options or warrants which the Holder could have acquired if the Holder had held the number of shares of Common Stock acquirable upon complete conversion of such Holder's Preferred Stock (without regard to any limitations on the conversion of such Preferred Stock) immediately before the date on which a record is taken for the issuance of such rights, options or warrants, or, if no such record is taken, the date as of which the record holders of shares of Common Stock are to be determined for the issuance of such rights, options or warrants.

(c) **Pro Rata Distributions.** If the Corporation, at any time while the Preferred Stock is outstanding, distributes to all holders of Common Stock (and not to the Holders) evidences of its indebtedness or assets (including cash and cash dividends) or rights or warrants to subscribe for or purchase any security, then in each such case the Conversion Price shall be adjusted by multiplying such Conversion Price in effect immediately prior to the record date fixed for determination of stockholders entitled to receive such distribution by a fraction of which the denominator shall be the VWAP determined as of the record date mentioned above, and of which the numerator shall be such VWAP on such record date less the then fair market value at such record date of the portion of such assets or evidence of indebtedness or rights or warrants so distributed applicable to one outstanding share of the Common Stock as determined by the Board of Directors of the Corporation in good faith. In either case the adjustments shall be described in a statement delivered to the Holders describing the portion of assets or evidences of indebtedness so distributed or such subscription rights applicable to one share of Common Stock. Such adjustment shall be made whenever any such distribution is made and shall become effective immediately after the record date mentioned above.

(d) Fundamental Transaction. If, at any time while this Preferred Stock is outstanding, (i) the Corporation, directly or indirectly, in one or more related transactions effects any merger or consolidation of the Corporation with or into another Person, (ii) the Corporation, directly or indirectly, effects any sale, lease, license, assignment, transfer, conveyance or other disposition of all or substantially all of its assets in one or a series of related transactions, (iii) any, direct or indirect, purchase offer, tender offer or exchange offer (whether by the Corporation or another Person) is completed pursuant to which holders of Common Stock are permitted to sell, tender or exchange their shares for other securities, cash or property and has been accepted by the holders of 50% or more of the outstanding Common Stock, (iv) the Corporation, directly or indirectly, in one or more related transactions effects any reclassification, reorganization or recapitalization of the Common Stock or any compulsory share exchange pursuant to which the Common Stock is effectively converted into or exchanged for other securities, cash or property, (v) the Corporation, directly or indirectly, in one or more related transactions consummates a stock or share purchase agreement or other business combination (including, without limitation, a reorganization, recapitalization, spin-off or scheme of arrangement) with another Person whereby such other Person acquires more than 50% of the outstanding shares of Common Stock (not including any shares of Common Stock held by the other Person or other Persons making or party to, or associated or affiliated with the other Persons making or party to, such stock or share purchase agreement or other business combination and excluding shares acquired upon conversion of any currently outstanding convertible securities in accordance with the terms thereof as in effect on the date hereof) (each a "Fundamental Transaction"), then, upon any subsequent conversion of this Preferred Stock, the Holder shall have the right to receive, for each Conversion Share that would have been issuable upon such conversion immediately prior to the occurrence of such Fundamental Transaction, the number of shares of Common Stock of the successor or acquiring corporation or of the Corporation, if it is the surviving corporation, and any additional consideration (the "Alternate Consideration") receivable as a result of such Fundamental Transaction by a holder of the number of shares of Common Stock for which this Preferred Stock is convertible immediately prior to such Fundamental Transaction. For purposes of any such conversion, the determination of the Conversion Price shall be appropriately adjusted to apply to such Alternate Consideration based on the amount of Alternate Consideration issuable in respect of one share of Common Stock in such Fundamental Transaction, and the Corporation shall apportion the Conversion Price among the Alternate Consideration in a reasonable manner reflecting the relative value of any different components of the Alternate Consideration. If holders of Common Stock are given any choice as to the securities, cash or property to be received in a Fundamental Transaction, then the Holder shall be given the same choice as to the Alternate Consideration it receives upon any conversion of this Preferred Stock following such Fundamental Transaction. To the extent necessary to effectuate the foregoing provisions, any successor to the Corporation or surviving entity in such Fundamental Transaction shall file a new Certificate of Designations with the same terms and conditions and issue to the Holders new preferred stock consistent with the foregoing provisions and evidencing the Holders' right to convert such preferred stock into Alternate Consideration. The Corporation shall cause any successor entity in a Fundamental Transaction in which the Corporation is not the survivor (the "Successor Entity") to assume in writing all of the obligations of the Corporation under this Certificate of Designations and the other Transaction Documents (as defined in the Purchase Agreement) in accordance with the provisions of this Section 7(d) pursuant to written agreements in form and substance reasonably satisfactory to the Holder and approved by the Holder (without unreasonable delay) prior to such Fundamental Transaction and shall, at the option of the holder of this Preferred Stock, deliver to the Holder in exchange for this Preferred Stock a security of the Successor Entity evidenced by a written instrument substantially similar in form and substance to this Preferred Stock which is convertible for a corresponding number of shares of capital stock of such Successor Entity (or its parent entity) equivalent to the shares of Common Stock acquirable and receivable upon conversion of this Preferred Stock (without regard to any limitations on the conversion of this Preferred Stock) prior to such Fundamental Transaction, and with a conversion price which applies the conversion price hereunder to such shares of capital stock (but taking into account the relative value of the shares of Common Stock pursuant to such Fundamental Transaction and the value of such shares of capital stock, such number of shares of capital stock and such conversion price being for the purpose of protecting the economic value of this Preferred Stock immediately prior to the consummation of such Fundamental Transaction), and which is reasonably satisfactory in form and substance to the Holder. Upon the occurrence of any such Fundamental Transaction, the Successor Entity shall succeed to, and be substituted for (so that from and after the date of such Fundamental Transaction, the provisions of this Certificate of Designation and the other Transaction Documents referring to the "Corporation" shall refer instead to the Successor Entity), and may exercise every right and power of the Corporation and shall assume all of the obligations of the Corporation under this Certificate of Designation and the other Transaction Documents with the same effect as if such Successor Entity had been named as the Corporation herein.

(e) Calculations. All calculations under this Section 7 shall be made to the nearest cent or the nearest 1/100th of a share, as the case may be. For purposes of this Section 7, the number of shares of Common Stock deemed to be issued and outstanding as of a given date shall be the sum of the number of shares of Common Stock (excluding any treasury shares of the Corporation) issued and outstanding.

(f) Notice to the Holders.

(i) Adjustment to Conversion Price. Whenever the Conversion Price is adjusted pursuant to any provision of this Section 7, the Corporation shall promptly deliver to each Holder a notice setting forth the Conversion Price after such adjustment and setting forth a brief statement of the facts requiring such adjustment.

(ii) Notice to Allow Conversion by Holder. If (A) the Corporation shall declare a dividend (or any other distribution in whatever form) on the Common Stock, (B) the Corporation shall declare a special nonrecurring cash dividend on or a redemption of the Common Stock, (C) the Corporation shall authorize the granting to all holders of the Common Stock of rights or warrants to subscribe for or purchase any shares of capital stock of any class or of any rights, (D) the approval of any stockholders of the Corporation shall be required in connection with any reclassification of the Common Stock, any consolidation or merger to which the Corporation is a party, any sale or transfer of all or substantially all of the assets of the Corporation, or any compulsory share exchange whereby the Common Stock is converted into other securities, cash or property or (E) the Corporation shall authorize the voluntary or involuntary dissolution, liquidation or winding up of the affairs of the Corporation, then, in each case, the Corporation shall cause to be filed at each office or agency maintained for the purpose of conversion of this Preferred Stock, and shall cause to be delivered to each Holder at its last address as it shall appear upon the stock books of the Corporation, at least ten (10) calendar days prior to the applicable record or effective date hereinafter specified, a notice stating (x) the date on which a record is to be taken for the purpose of such dividend, distribution, redemption, rights or warrants, or if a record is not to be taken, the date as of which the holders of the Common Stock of record to be entitled to such dividend, distributions, redemption, rights or warrants are to be determined or (y) the date on which such reclassification, consolidation, merger, sale, transfer or share exchange is expected to become effective or close, and the date as of which it is expected that holders of the Common Stock of record shall be entitled to exchange their shares of the Common Stock for securities, cash or other property deliverable upon such reclassification, consolidation, merger, sale, transfer or share exchange, provided that the failure to deliver such notice or any defect therein or in the delivery thereof shall not affect the validity of the corporate action required to be specified in such notice. To the extent that any notice provided hereunder constitutes, or contains, material, non-public information regarding the Corporation or any of the Subsidiaries, the Corporation shall simultaneously file such notice with the Commission pursuant to a Current Report on Form 8-K. The Holder shall remain entitled to convert the Preferred Stock (or any part hereof) during the 10-day period commencing on the date of such notice through the effective date of the event triggering such notice except as may otherwise be expressly set forth herein.

Section 8. Redemption.

(a) Optional Company Redemption. Subject to the terms hereof, at any time the Corporation shall be entitled to redeem any or all of the outstanding shares of Preferred Stock (the "Optional Company Redemption") at a per share price equal to 125% of the Stated Value plus accumulated dividends (such amount, the "Redemption Price"), payable in cash; provided that the Corporation shall have funds legally available for such payment.

(b) Notice of Optional Company Redemption. Notice of any Optional Company Redemption of shares of Preferred Stock, specifying the time and place of redemption and the Redemption Price (a "Redemption Notice"), shall be sent by courier or first class overnight mail, pre-paid, to each holder of Preferred Stock to be redeemed, at the address for such holder shown on the Company's records, not more than sixty (60) nor less than ten (10) days prior to the Redemption Date. If, in any case, less than all of the shares of Preferred Stock then owned by such holder are to be redeemed, the Redemption Notice shall also specify the number of shares which are to be redeemed; provided, however, that no failure to give such Redemption Notice nor any defect therein shall affect the validity of the procedure for the redemption of any shares of Preferred Stock to be redeemed except as to the holder to whom the Corporation has failed to give said Redemption Notice or except as to the holder whose Redemption Notice was defective. Each such Redemption Notice shall state:

(i) the Redemption Date;

(ii) the Redemption Price;

(iii) the number of shares of Preferred Stock to be redeemed and, if fewer than all the shares of Preferred Stock held by a holder are to be redeemed, the number of shares thereof to be redeemed from such holder;

(iv) the manner and place or places at which payment for the shares of Preferred Stock to be redeemed will be made, upon presentation and surrender to the Corporation of the certificates evidencing the shares being redeemed; and

(v) that the rights of holders to convert shares of Preferred Stock being redeemed shall terminate at the close of business on the Redemption Date unless the Corporation defaults in the payment of the Redemption Price.

Upon mailing any such Redemption Notice, the Corporation shall become obligated to redeem at the Redemption Price on the Redemption Date all shares of Preferred Stock therein specified; provided, however, any redemption contemplated by any Redemption Notice may be conditioned upon the occurrence of one or more transactions or other events and the Redemption Date in such Redemption Notice may be the date on which such transaction is consummated or such other event occurs.

Section 9. Miscellaneous.

(a) Notices. Any and all notices or other communications or deliveries to be provided by the Holders hereunder including, without limitation, any Notice of Conversion, shall be in writing and delivered personally, by facsimile, or sent by a nationally recognized overnight courier service, addressed to the Corporation at 5210 E. Williams Circle, Suite 500, Tucson, Arizona 85711, facsimile number (520) 844-2989, or such other facsimile number or address as the Corporation may specify for such purposes by notice to the Holders delivered in accordance with this Section 10. Any and all notices or other communications or deliveries to be provided by the Corporation hereunder shall be in writing and delivered personally, by facsimile, or sent by a nationally recognized overnight courier service addressed to each Holder at the facsimile number or address of such Holder appearing on the books of the Corporation, or if no such facsimile number or address appears on the books of the Corporation, at the principal place of business of such Holder, as set forth in the Purchase Agreement. Any notice or other communication or deliveries hereunder shall be deemed given and effective on the earliest of (i) the date of transmission, if such notice or communication is delivered via facsimile at the facsimile number set forth in this Section prior to 5:30 p.m. (Arizona time) on any date, (ii) the next Trading Day after the date of transmission, if such notice or communication is delivered via facsimile at the facsimile number set forth in this Section on a day that is not a Trading Day or later than 5:30 p.m. (Arizona time) on any Trading Day, (iii) the second Trading Day following the date of mailing, if sent by U.S. nationally recognized overnight courier service, or (iv) upon actual receipt by the party to whom such notice is required to be given.

(b) Absolute Obligation. Except as expressly provided herein, no provision of this Certificate of Designations shall alter or impair the obligation of the Corporation, which is absolute and unconditional, to pay dividends, as applicable, on the shares of Preferred Stock at the time, place, and rate, and in the coin or currency, herein prescribed.

(c) Lost or Mutilated Preferred Stock Certificate. If a Holder's Preferred Stock certificate shall be mutilated, lost, stolen or destroyed, the Corporation shall execute and deliver, in exchange and substitution for and upon cancellation of a mutilated certificate, or in lieu of or in substitution for a lost, stolen or destroyed certificate, a new certificate for the shares of Preferred Stock so mutilated, lost, stolen or destroyed, but only upon receipt of evidence of such loss, theft or destruction of such certificate, and of the ownership hereof reasonably satisfactory to the Corporation.

(d) Governing Law. All questions concerning the construction, validity, enforcement and interpretation of this Certificate of Designations shall be governed by and construed and enforced in accordance with the internal laws of the State of Delaware, without regard to the principles of conflict of laws thereof. If any party shall commence an action or proceeding to enforce any provisions of this Certificate of Designation, then the prevailing party in such action or proceeding shall be reimbursed by the other party for its attorneys' fees and other costs and expenses incurred in the investigation, preparation and prosecution of such action or proceeding.

(e) Waiver. Any waiver by the Corporation or a Holder of a breach of any provision of this Certificate of Designation shall not operate as or be construed to be a waiver of any other breach of such provision or of any breach of any other provision of this Certificate of Designations or a waiver by any other Holders. The failure of the Corporation or a Holder to insist upon strict adherence to any term of this Certificate of Designations on one or more occasions shall not be considered a waiver or deprive that party (or any other Holder) of the right thereafter to insist upon strict adherence to that term or any other term of this Certificate of Designation on any other occasion. Any waiver by the Corporation or a Holder must be in writing.

(f) Severability. If any provision of this Certificate of Designations is invalid, illegal or unenforceable, the balance of this Certificate of Designations shall remain in effect, and if any provision is inapplicable to any Person or circumstance, it shall nevertheless remain applicable to all other Persons and circumstances. If it shall be found that any interest or other amount deemed interest due hereunder violates the applicable law governing usury, the applicable rate of interest due hereunder shall automatically be lowered to equal the maximum rate of interest permitted under applicable law.

(g) Next Business Day. Whenever any payment or other obligation hereunder shall be due on a day other than a Business Day, such payment shall be made on the next succeeding Business Day.

(h) Headings. The headings contained herein are for convenience only, do not constitute a part of this Certificate of Designations and shall not be deemed to limit or affect any of the provisions hereof.

(i) Status of Converted Preferred Stock. If any shares of Preferred Stock shall be converted or reacquired by the Corporation, such shares shall resume the status of authorized but unissued shares of preferred stock and shall no longer be designated as Series A Convertible Preferred Stock.

BY-LAWS
OF
AUDIOEYE, INC.
(a Delaware corporation)

ARTICLE I

Offices

SECTION 1. Registered Office. The registered office of the Corporation within the State of Delaware shall be in the City of Dover, County of Kent.

SECTION 2. Other Offices. The Corporation may also have an office or offices other than said registered office at such place or places, either within or without the State of Delaware, as the Board of Directors shall from time to time determine or the business of the Corporation may require.

ARTICLE II

Stockholders

SECTION 1. Place of Meetings. All meetings of the stockholders for the election of directors or for any other purpose shall be held at any such place, either within or without the State of Delaware, as shall be designated from time to time by the Board of Directors and stated in the notice of meeting or in a duly executed waiver thereof.

SECTION 2. Annual Meeting. The annual meeting of stockholders shall be held at such date and time as shall be designated from time to time by the Board of Directors and stated in the notice of meeting. At such annual meeting, the stockholders shall elect, by a plurality vote, a Board of Directors and transact such other business as may properly be brought before the meeting.

SECTION 3. Special Meetings. Special meetings of stockholders, unless otherwise prescribed by statute, may be called at any time by the Board of Directors or the Chairman of the Board, if one shall have been elected, or the Chief Executive Officer, if one shall have been elected, or the President.

SECTION 4. Notice of Meetings. Except as otherwise expressly required by statute, written notice of each annual and special meeting of stockholders stating the date, place and hour of the meeting, and, in the case of a special meeting, the purpose or purposes for which the meeting is called, shall be given to each stockholder of record entitled to vote thereat not less than ten nor more than sixty days before the date of the meeting. Business transacted at any special meeting of stockholders shall be limited to the purposes stated in the notice. Notice shall be given personally or by mail and, if by mail, shall be sent in a postage prepaid envelope, addressed to the stockholder at his address as it appears on the records of the Corporation. Notice by mail shall be deemed given at the time when the same shall be deposited in the United States mail, postage prepaid. Notice of any meeting shall not be required to be given to any person who attends such meeting, except when such person attends the meeting in person or by proxy for the express purpose of objecting, at the beginning of the meeting, to the transaction of any business because the meeting is not lawfully called or convened, or who, either before or after the meeting, shall submit a signed written waiver of notice, in person or by proxy. Neither the business to be transacted at, nor the purpose of, an annual or special meeting of stockholders need be specified in any written waiver of notice.

SECTION 5. List of Stockholders. The officer who has charge of the stock ledger of the Corporation shall prepare and make, at least ten days before each meeting of stockholders, a complete list of the stockholders entitled to vote at the meeting, arranged in alphabetical order, showing the address of and the number of shares registered in the name of each stockholder. Such list shall be open to the examination of any stockholder, for any purpose germane to the meeting, during ordinary business hours, for a period of at least ten days prior to the meeting, either at a place within the city, town or village where the meeting is to be held, which place shall be specified in the notice of meeting, or, if not specified, at the place where the meeting is to be held. The list shall be produced and kept at the time and place of the meeting during the whole time thereof, and may be inspected by any stockholder who is present.

SECTION 6. Quorum; Adjournments. The holders of a majority of the voting power of the issued and outstanding stock of the Corporation entitled to vote thereat, present in person or represented by proxy, shall constitute a quorum for the transaction of business at all meetings of stockholders, except as otherwise provided by statute or by the Certificate of Incorporation. If, however, such quorum shall not be present or represented by proxy at any meeting of stockholders, the stockholders entitled to vote thereat, present in person or represented by proxy, shall have the power to adjourn the meeting from time to time, without notice other than announcement at the meeting, until a quorum shall be present or represented by proxy. At such adjourned meeting at which a quorum shall be present or represented by proxy, any business may be transacted which might have been transacted at the meeting as originally called. If the adjournment is for more than thirty days, or, if after adjournment a new record date is set, a notice of the adjourned meeting shall be given to each stockholder of record entitled to vote at the meeting.

SECTION 7. Organization. At each meeting of stockholders, the Chairman of the Board, if one shall have been elected, or, in his absence or if one shall not have been elected, the Chief Executive Officer, if one shall have been elected, or, in his absence or if one shall not have been elected, the President shall act as chairman of the meeting. The Secretary or, in his absence or inability to act, the person whom the chairman of the meeting shall appoint secretary of the meeting shall act as secretary of the meeting and keep the minutes thereof.

SECTION 8. Order of Business. The order of business at all meetings of the stockholders shall be as determined by the chairman of the meeting.

SECTION 9. Voting. Except as otherwise provided by statute or the Certificate of Incorporation, each stockholder of the Corporation shall be entitled at each meeting of stockholders to one vote for each share of capital stock of the Corporation standing in his name on the record of stockholders of the Corporation:

(a) on the date fixed pursuant to the provisions of Section 7 of Article V of these By-Laws as the record date for the determination of the stockholders who shall be entitled to notice of and to vote at such meeting; or

(b) if no such record date shall have been so fixed, then at the close of business on the day next preceding the day on which notice thereof shall be given, or, if notice is waived, at the close of business on the date next preceding the day on which the meeting is held.

Each stockholder entitled to vote at any meeting of stockholders may authorize another person or persons to act for him by a proxy signed by such stockholder or his attorney-in-fact, but no proxy shall be voted after three years from its date, unless the proxy provides for a longer period. Any such proxy shall be delivered to the secretary of the meeting at or prior to the time designated in the order of business for so delivering such proxies. When a quorum is present at any meeting, the vote of the holders of a majority of the voting power of the issued and outstanding stock of the Corporation entitled to vote thereon, present in person or represented by proxy, shall decide any question brought before such meeting, unless the question is one upon which by express provision of statute or of the Certificate of Incorporation or of these By-Laws, a different vote is required, in which case such express provision shall govern and control the decision of such question. Unless required by statute, or determined by the chairman of the meeting to be advisable, the vote on any question need not be by ballot. On a vote by ballot, each ballot shall be signed by the stockholder voting, or by his proxy, if there by such proxy, and shall state the number of shares voted.

SECTION 10. Inspectors. The Board of Directors may, in advance of any meeting of stockholders, appoint one or more inspectors to act at such meeting or any adjournment thereof. If any of the inspectors so appointed shall fail to appear or act, the chairman of the meeting shall, or if inspectors shall not have been appointed, the chairman of the meeting may, appoint one or more inspectors. Each inspector, before entering upon the discharge of his duties, shall take and sign an oath faithfully to execute the duties of inspector at such meeting with strict impartiality and according to the best of his ability. The inspectors shall determine the number of shares of capital stock of the Corporation outstanding and the voting power of each, the number of shares represented at the meeting, the existence of a quorum, the validity and effect of proxies, and shall receive votes, ballots or consents, hear and determine all challenges and questions arising in connection with the right to vote, count and tabulate all votes, ballots or consents, determine the results, and do such acts as are proper to conduct the election or vote with fairness to all stockholders. On request of the chairman of the meeting, the inspectors shall make a report in writing of any challenge, request or matter determined by them and shall execute a certificate of any fact found by them. No director or candidate for the office of director shall act as an inspector of an election of directors. Inspectors need not be stockholders.

SECTION 11. Action by Consent. Whenever the vote of stockholders at a meeting thereof is required or permitted to be taken for or in connection with any corporate action, by any provision of statute or of the Certificate of Incorporation or of these By-Laws, the meeting and vote of stockholders may be dispensed with, and the action taken without such meeting and vote, if a consent in writing, setting forth the action so taken, shall be signed by the holders of outstanding stock having not less than the minimum number of votes that would be necessary to authorize or take such action at a meeting at which all shares of stock of the Corporation entitled to vote thereon were present and voted.

ARTICLE III

Board of Directors

SECTION 1. General Powers. The business and affairs of the Corporation shall be managed by or under the direction of the Board of Directors. The Board of Directors may exercise all such authority and powers of the Corporation and do all such lawful acts and things as are not by statute or the Certificate of Incorporation directed or required to be exercised or done by the stockholders.

SECTION 2. Number, Qualifications, Election and Term of Office. The number of directors constituting the initial Board of Directors shall be three (3). Thereafter, the number of directors may be fixed, from time to time, by the affirmative vote of a majority of the entire Board of Directors or by action of the stockholders of the Corporation. Any decrease in the number of directors shall be effective at the time of the next succeeding annual meeting of stockholders unless there shall be vacancies in the Board of Directors, in which case such decrease may become effective at any time prior to the next succeeding annual meeting to the extent of the number of such vacancies. Directors need not be stockholders. Except as otherwise provided by statute or these By-Laws, the directors (other than members of the initial Board of Directors) shall be elected at the annual meeting of stockholders. Each director shall hold office until his successor shall have been elected and qualified, or until his death, or until he shall have resigned, or have been removed, as hereinafter provided in these By-Laws.

SECTION 3. Place of Meetings. Meetings of the Board of Directors shall be held at such place or places, within or without the State of Delaware, as the Board of Directors may from time to time determine or as shall be specified in the notice of any such meeting.

SECTION 4. Annual Meeting. The Board of Directors shall meet for the purpose of organization, the election of officers and the transaction of other business, as soon as practicable after each annual meeting of stockholders, on the same day and at the same place where such annual meeting shall be held. Notice of such meeting need not be given. In the event such annual meeting is not so held, the annual meeting of the Board of Directors may be held at such other time or place (within or without the State of Delaware) as shall be specified in a notice thereof given as hereinafter provided in Section 7 of this Article III.

SECTION 5. Regular Meetings. Regular meetings of the Board of Directors shall be held at such time and place as the Board of Directors may fix. If any day fixed for a regular meeting shall be a legal holiday at the place where the meeting is to be held, then the meeting which would otherwise be held on that day shall be held at the same hour on the next succeeding business day. Notice of regular meetings of the Board of Directors need not be given except as otherwise required by statute or these By-Laws.

SECTION 6. Special Meetings. Special meetings of the Board of Directors may be called by the Chairman of the Board, if one shall have been elected, or by two or more directors of the Corporation, or by the Chief Executive Officer, if one shall have been elected, or by the President.

SECTION 7. Notice of Meetings. Notice of each special meeting of the Board of Directors (and of each regular meeting for which notice shall be required) shall be given by the Secretary as hereinafter provided in this Section 7, in which notice shall be stated the time and place of the meeting. Except as otherwise required by these By-Laws, such notice need not state the purposes of such meeting. Notice of each such meeting shall be mailed, postage prepaid, to each director, addressed to him at his residence or usual place of business, by first class mail, at least four days before the day on which such meeting is to be held, or shall be sent addressed to him at such place by telegraph, cable, telex, telecopier or other similar means, or be delivered to him personally or be given to him by telephone or other similar means, at least twenty-four hours before the time at which such meeting is to be held. Notice of any such meeting need not be given to any director who shall, either before or after the meeting, submit a signed waiver of notice or who shall attend such meeting, except when he shall attend for the express purpose of objecting, at the beginning of the meeting, to the transaction of any business because the meeting is not lawfully called or convened.

SECTION 8. Quorum and Manner of Acting. A majority of the entire Board of Directors shall constitute a quorum for the transaction of business at any meeting of the Board of Directors, and, except as otherwise expressly required by statute or the Certificate of Incorporation or these By-Laws, the act of a majority of the directors present at any meeting at which a quorum is present shall be the act of the Board of Directors. In the absence of a quorum at any meeting of the Board of Directors, a majority of the directors present thereat may adjourn such meeting to another time and place. Notice of the time and place of any such adjourned meeting shall be given to all of the directors unless such time and place were announced at the meeting at which the adjournment was taken, in which case such notice shall only be given to the directors who were not present thereat. At any adjourned meeting at which a quorum is present, any business may be transacted which might have been transacted at the meeting as originally called. The directors shall act only as a Board and the individual directors shall have no power as such.

SECTION 9. Organization. At each meeting of the Board of Directors, the Chairman of the Board, if one shall have been elected, or, in the absence of the Chairman of the Board or if one shall not have been elected, the Chief Executive Officer, or, in the absence of the Chief Executive Officer or if one shall not have been elected, the President (or, in his absence, another director chosen by a majority of the directors present) shall act as chairman of the meeting and preside thereat. The Secretary or, in his absence, any person appointed by the chairman shall act as secretary of the meeting and keep the minutes thereof.

SECTION 10. Resignations. Any director of the Corporation may resign at any time by giving written notice of his resignation to the Corporation. Any such resignation shall take effect at the time specified therein or, if the time when it shall become effective shall not be specified therein, immediately upon its receipt. Unless otherwise specified therein, the acceptance of such resignation shall not be necessary to make it effective.

SECTION 11. Vacancies. Any vacancy in the Board of Directors, whether arising from death, resignation, removal (with or without cause), an increase in the number of directors or any other cause, may be filled by the vote of a majority of the directors then in office, though less than a quorum, or by the sole remaining director or by the stockholders at the next annual meeting thereof or at a special meeting thereof. Each director so elected shall hold office until his successor shall have been elected and qualified.

SECTION 12. Removal of Directors. Any director may be removed, either with or without cause, at any time, by the holders of a majority of the voting power of the issued and outstanding capital stock of the Corporation entitled to vote at an election of directors.

SECTION 13. Compensation. The Board of Directors shall have authority to fix the compensation, including fees and reimbursement of expenses, of directors for services to the Corporation in any capacity.

SECTION 14. Committees. The Board of Directors may, by resolution passed by a majority of the entire Board of Directors, designate one or more committees, including an executive committee, each committee to consist of one or more of the directors of the Corporation. The Board of Directors may designate one or more directors as alternate members of any committee, who may replace any absent or disqualified member at any meeting of the committee. Except to the extent restricted by statute or the Certificate of Incorporation, each such committee, to the extent provided in the resolution creating it, shall have and may exercise all the powers and authority of the Board of Directors and may authorize the seal of the Corporation to be affixed to all papers which require it. Each such committee shall serve at the pleasure of the Board of Directors and have such name as may be determined from time to time by resolution adopted by the Board of Directors. Each committee shall keep regular minutes of its meetings and report the same to the Board of Directors.

SECTION 15. Action by Consent. Unless restricted by the Certificate of Incorporation, any action required or permitted to be taken by the Board of Directors or any committee thereof may be taken without a meeting if all members of the Board of Directors or such committee, as the case may be, consent thereto in writing, and the writing or writings are filed with the minutes of the proceedings of the Board of Directors or such committee, as the case may be.

SECTION 16. Telephonic Meeting. Unless restricted by the Certificate of Incorporation, any one or more members of the Board of Directors or any committee thereof may participate in a meeting of the Board of Directors or such committee by means of a conference telephone or similar communications equipment by means of which all persons participating in the meeting can hear each other. Participation by such means shall constitute presence in person at a meeting.

ARTICLE IV

Officers

SECTION 1. Number and Qualifications. The officers of the Corporation shall be elected by the Board of Directors and shall include the President, the Secretary and the Treasurer. If the Board of Directors wishes, it may also elect as an officer of the Corporation a Chairman of the Board, a Chief Executive Officer and one or more Vice-Presidents, and may elect other officers (including one or more Assistant Treasurers and one or more Assistant Secretaries) as may be necessary or desirable for the business of the Corporation. Any two or more offices may be held by the same person, and no officer except the Chairman of the Board need be a director. Each officer shall hold office until his successor shall have been duly elected and shall have qualified, or until his death, or until he shall have resigned or have been removed, as hereinafter provided in these By-Laws.

SECTION 2. Resignations. Any officer of the Corporation may resign at any time by giving written notice of his resignation to the Corporation. Any such resignation shall take effect at the time specified therein or, if the time when it shall become effective shall not be specified therein, immediately upon receipt. Unless otherwise specified therein, the acceptance of any such resignation shall not be necessary to make it effective.

SECTION 3. Removal. Any officer of the Corporation may be removed, either with or without cause, at any time, by the Board of Directors at any meeting thereof.

SECTION 4. Chairman of the Board. The Chairman of the Board, if one shall have been elected, shall be a member of the Board, an officer of the Corporation and, if present, shall preside at each meeting of the Board of Directors or the stockholders. He shall advise and counsel with the Chief Executive Officer and the President, and in their absence with other executives of the Corporation, and shall perform such other duties as may from time to time be assigned to him by the Board of Directors.

SECTION 5. The Chief Executive Officer. The Board of Directors may elect a Chief Executive Officer to serve as the chief executive officer of the Corporation. He shall, in the absence of the Chairman of the Board or if a Chairman of the Board shall not have been elected, preside at each meeting of the Board of Directors or the stockholders. The Chief Executive Officer, subject to the direction of the Board of Directors, shall have general charge of the business, affairs, and property of the Corporation and general supervision over its other officers and agents. In general, he shall perform all duties incident to the office of Chief Executive Officer and shall see that all orders and resolutions of the Board of Directors are carried into effect. If there is no President, or in the case of his absence or inability to act, the Chief Executive Officer shall perform the duties of the President in addition to performing his duties as Chief Executive Officer. The Chief Executive Officer shall make a report of the state of the business of the Corporation at each annual meeting of the stockholders and from time to time shall report to the stockholders and to the Board of Directors all matters within his knowledge which in his judgment the interests of the Corporation may require to be brought to their notice. The Chief Executive Officer may sign, execute and deliver in the name of the Corporation all deeds, mortgages, bonds, contracts or other instruments, except in cases where the signing, execution or delivery thereof shall be expressly delegated by the Board of Directors or by these By-laws to some other officer or agent of the Corporation or where any of them shall be required by law otherwise to be signed, executed or delivered. The Chief Executive Officer may cause the seal of the Corporation to be affixed to any instrument which shall require it and shall perform such other duties as from time to time may be assigned to him by the Board of Directors.

SECTION 6. The President. The President shall be a general executive officer of the Corporation. He shall, in the absence of the Chairman of the Board or Chief Executive Officer or if a Chairman of the Board or Chief Executive Officer shall not have been elected, preside at each meeting of the Board of Directors or the stockholders. The President, subject to the direction of the Board of Directors and the Chief Executive Officer, shall have general charge of the business, affairs, and property of the Corporation and general supervision over its other officers and agents. If there is no Chief Executive Officer, or in case of his absence or inability to act, the President shall perform the duties of the chief executive officer of the Corporation, and, when so acting, shall have all the powers of, and be subject to all the restrictions upon, the Chief Executive Officer. The President shall see that all orders and resolutions of the Board of Directors are carried into effect and may sign, execute and deliver in the name of the Corporation all deeds, mortgages, bonds, contracts and other instruments authorized by the Board of Directors or the Chief Executive Officer, except in cases where the signing, execution or delivery thereof shall be expressly delegated by the Board of Directors or by these By-laws to some other officer, officers, agent, or agents of the Corporation or where any of them shall be required by the law otherwise to be signed, executed or delivered. The President may cause the seal of the Corporation to be affixed to any instrument which shall require it and shall perform such other duties as from time to time may be assigned to him by the Board of Directors or the Chief Executive Officer.

SECTION 7. Vice President. Each Vice President shall perform all such duties as from time to time may be assigned to him by the Board of Directors, the Chief Executive Officer or the President. At the request of the President or in his absence or in the event of his inability or refusal to act, the Vice President, or if there shall be more than one, the Vice Presidents in the order determined by the Board of Directors (or if there be no such determination, then the Vice Presidents in the order of their election), shall perform the duties of the President, and, when so acting, shall have the powers of and be subject to the restrictions placed upon the President in respect of the performance of such duties.

SECTION 8. Treasurer. The Treasurer shall:

- (a) have charge and custody of, and be responsible for, all the funds and securities of the Corporation;
- (b) keep full and accurate accounts of receipts and disbursements in books belonging to the Corporation;
- (c) deposit all moneys and other valuables to the credit of the Corporation in such depositories as may be designated by the Board of Directors or pursuant to its direction;
- (d) receive, and give receipts for, moneys due and payable to the Corporation from any source whatsoever;
- (e) disburse the funds of the Corporation and supervise the investments of its funds, taking proper vouchers therefor;
- (f) render to the Board of Directors, whenever the Board of Directors may require, an account of the financial condition of the Corporation; and
- (g) in general, perform all duties incident to the office of Treasurer and such other duties as from time to time may be assigned to him by the Board of Directors.

SECTION 9. Secretary. The Secretary shall:

- (a) keep or cause to be kept in one or more books provided for the purpose, the minutes of all meetings of the Board of Directors, the committees of the Board of Directors and the stockholders;
- (b) see that all notices are duly given in accordance with the provisions of these By-Laws and as required by law;
- (c) be custodian of the records and the seal of the Corporation and affix and attest the seal to all certificates for shares of the Corporation (unless the seal of the Corporation on such certificates shall be a facsimile, as hereinafter provided) and affix and attest the seal to all other documents to be executed on behalf of the Corporation under its seal;
- (d) see that the books, reports, statements, certificates and other documents and records required by law to be kept and filed are properly kept and filed; and
- (e) in general, perform all duties incident to the office of Secretary and such other duties as from time to time may be assigned to him by the Board of Directors.

SECTION 10. The Assistant Treasurer. The Assistant Treasurer, or if there shall be more than one, the Assistant Treasurers in the order determined by the Board of Directors (or if there be no such determination, then in the order of their election), shall, in the absence of the Treasurer or in the event of his inability or refusal to act, perform the duties and exercise the powers of the Treasurer and shall perform such other duties as from time to time may be assigned by the Board of Directors.

SECTION 11. The Assistant Secretary. The Assistant Secretary, or if there be more than one, the Assistant Secretaries in the order determined by the Board of Directors (or if there be no such determination, then in the order of their election), shall, in the absence of the Secretary or in the event of his inability or refusal to act, perform the duties and exercise the powers of the Secretary and shall perform such other duties as from time to time may be assigned by the Board of Directors.

SECTION 12. Officers' Bonds or Other Security. If required by the Board of Directors, any officer of the Corporation shall give a bond or other security for the faithful performance of his duties, in such amount and with such surety as the Board of Directors may require.

SECTION 13. Compensation. The compensation of the officers of the Corporation for their services as such officers shall be fixed from time to time by the Board of Directors. An officer of the Corporation shall not be prevented from receiving compensation by reason of the fact that he is also a director of the Corporation.

ARTICLE V

Stock Certificates and Their Transfer

SECTION 1. Stock Certificates. Every holder of stock in the Corporation shall be entitled to have a certificate, signed by, or in the name of the Corporation by, the Chairman of the Board or the Chief Executive Officer or the President or a Vice-President and by the Treasurer or an Assistant Treasurer or the Secretary or an Assistant Secretary of the Corporation, certifying the number of shares owned by him in the Corporation. If the Corporation shall be authorized to issue more than one class of stock or more than one series of any class, the designations, preferences and relative, participating, optional or other special rights of each class of stock or series thereof and the qualifications, limitations or restriction of such preferences and/or rights shall be set forth in full or summarized on the face or back of the certificate which the Corporation shall issue to represent such class or series of stock, provided that, except as otherwise provided in Section 202 of the General Corporation Law of the State of Delaware, in lieu of the foregoing requirements, there may be set forth on the face or back of the certificate which the Corporation shall issue to represent such class or series of stock, a statement that the Corporation will furnish without charge to each stockholder who so requests the designations, preferences and relative, participating, optional or other special rights of each class of stock or series thereof and the qualifications, limitations or restrictions of such preferences and/or rights.

SECTION 2. Facsimile Signatures. Any or all of the signatures on a certificate may be a facsimile. In case any officer, transfer agent or registrar who has signed or whose facsimile signature has been placed upon a certificate shall have ceased to be such officer, transfer agent or registrar before such certificate is issued, it may be issued by the Corporation with the same effect as if he were such officer, transfer agent or registrar at the date of issue.

SECTION 3. Lost Certificates. The Board of Directors may direct a new certificate or certificates to be issued in place of any certificate or certificates theretofore issued by the Corporation alleged to have been lost, stolen, or destroyed. When authorizing such issue of a new certificate or certificates, the Board of Directors may, in its discretion and as a condition precedent to the issuance thereof, require the owner of such lost, stolen, or destroyed certificate or certificates, or his legal representative, to give the Corporation a bond in such sum as it may direct sufficient to indemnify it against any claim that may be made against the Corporation on account of the alleged loss, theft or destruction of any such certificate or the issuance of such new certificate.

SECTION 4. Transfers of Stock. Upon surrender to the Corporation or the transfer agent of the Corporation of a certificate for shares duly endorsed or accompanied by proper evidence of succession, assignment or authority to transfer, it shall be the duty of the Corporation to issue a new certificate to the person entitled thereto, cancel the old certificate and record the transaction upon its records; provided, however, that the Corporation shall be entitled to recognize and enforce any lawful restriction on transfer. Whenever any transfer of stock shall be made for collateral security, and not absolutely, it shall be so expressed in the entry of transfer if, when the certificates are presented to the Corporation for transfer, both the transferor and the transferee request the Corporation to do so.

SECTION 5. Transfer Agents and Registrars. The Board of Directors may appoint, or authorize any officer or officers to appoint, one or more transfer agents and one or more registrars.

SECTION 6. Regulations. The Board of Directors may make such additional rules and regulations, not inconsistent with these By-Laws, as it may deem expedient concerning the issue, transfer and registration of certificates for shares of stock of the Corporation.

SECTION 7. Fixing the Record Date. In order that the Corporation may determine the stockholders entitled to notice of or to vote at any meeting of stockholders or any adjournment thereof, or to express consent to corporate action in writing without a meeting, or entitled to receive payment of any dividend or other distribution or allotment of any rights, or entitled to exercise any rights in respect of any chance, conversion or exchange of stock or for the purpose of any other lawful action, the Board of Directors may fix, in advance, a record date, which shall not be more than sixty nor less than ten days before the date of such meeting, nor more than sixty days prior to any other action. A determination of stockholders of record entitled to notice of or to vote at a meeting of stockholders shall apply to any adjournment of the meeting; provided, however, that the Board of Directors may fix a new record date for the adjourned meeting.

SECTION 8. Registered Stockholders. The Corporation shall be entitled to recognize the exclusive right of a person registered on its records as the owner of shares of stock to receive dividends and to vote as such owner, shall be entitled to hold liable for calls and assessments a person registered on its records as the owner of shares of stock, and shall not be bound to recognize any equitable or other claim to or interest in such share or shares of stock on the part of any other person, whether or not it shall have express or other notice thereof, except as otherwise provided by the laws of Delaware.

ARTICLE VI

Indemnification of Directors and Officers

SECTION 1. General. The Corporation shall indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative (other than an action by or in the right of the Corporation) by reason of the fact that he is or was a director, officer, employee or agent of the Corporation, or is or was serving at the request of the Corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise, against expenses (including attorneys' fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by him in connection with such action, suit or proceeding if he acted in good faith and in a manner he reasonably believed to be in or not opposed to the best interests of the Corporation, and, with respect to any criminal action or proceeding, had no reasonable cause to believe his conduct was unlawful. The termination of any action, suit or proceeding by judgment, order, settlement, conviction, or upon a plea of *nolo contendere* or its equivalent, shall not, of itself, create a presumption that the person did not act in good faith and in a manner which he reasonably believed to be in or not opposed to the best interests of the Corporation, and, with respect to any criminal action or proceeding, had reasonable cause to believe that his conduct was unlawful.

SECTION 2. Derivative Actions. The Corporation shall indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action or suit by or in the right of the Corporation to procure a judgment in its favor by reason of the fact that he is or was a director, officer, employee or agent of the Corporation, or is or was serving at the request of the Corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise against expenses (including attorneys' fees) actually and reasonably incurred by him in connection with the defense or settlement of such action or suit if he acted in good faith and in a manner he reasonably believed to be in or not opposed to the best interests of the Corporation, provided that no indemnification shall be made in respect of any claim, issue or matter as to which such person shall have been adjudged to be liable to the Corporation unless and only to the extent that the Court of Chancery of the State of Delaware or the court in which such action or suit was brought shall determine upon application that, despite the adjudication of liability but in view of all the circumstances of the case, such person is fairly and reasonably entitled to indemnity for such expenses which the Court of Chancery or such other court shall deem proper.

SECTION 3. Indemnification in Certain Cases. To the extent that a director, officer, employee or agent of the Corporation has been successful on the merits or otherwise in defense of any action, suit or proceeding referred to in Sections 1 and 2 of this Article VI, or in defense of any claim, issue or matter therein, he shall be indemnified against expenses (including attorneys' fees) actually and reasonably incurred by him in connection therewith.

SECTION 4. Procedure. Any indemnification under Sections 1 and 2 of this Article VI (unless ordered by a court) shall be made by the Corporation only as authorized in the specific case upon a determination that indemnification of the director, officer, employee or agent is proper in the circumstances because he has met the applicable standard of conduct set forth in such Sections 1 and 2. Such determination shall be made (a) by the Board of Directors by a majority vote of a quorum consisting of directors who were not parties to such action, suit or proceeding, or (b) if such a quorum is not obtainable, or, even if obtainable a quorum of disinterested directors so directs, by independent legal counsel in a written opinion, or (c) by the stockholders.

SECTION 5. Advances for Expenses. Expenses incurred in defending a civil or criminal action, suit or proceeding may be paid by the Corporation in advance of the final disposition of such action, suit or proceeding upon receipt of an undertaking by or on behalf of the director, officer, employee or agent to repay such amount if it shall be ultimately determined that he is not entitled to be indemnified by the Corporation as authorized in this Article VI.

SECTION 6. Rights Not Exclusive. The indemnification and advancement of expenses provided by, or granted pursuant to, the other subsections of this Article VI shall not be deemed exclusive of any other rights to which those seeking indemnification or advancement of expenses may be entitled under any law, by-law, agreement, vote of stockholders or disinterested directors or otherwise, both as to action in his official capacity and as to action in another capacity while holding such office.

SECTION 7. Insurance. The Corporation shall have power to purchase and maintain insurance on behalf of any person who is or was a director, officer, employee or agent of the Corporation, or is or was serving at the request of the Corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise against any liability asserted against him and incurred by him in any such capacity, or arising out of his status as such, whether or not the Corporation would have the power to indemnify him against such liability under the provisions of this Article VI.

SECTION 8. Definition of Corporation. For the purposes of this Article VI, references to “the Corporation” include all constituent corporations absorbed in a consolidation or merger as well as the resulting or surviving corporation so that any person who is or was a director, officer, employee or agent of such a constituent corporation or is or was serving at the request of such constituent corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise shall stand in the same position under the provisions of this Article VI with respect to the resulting or surviving corporation as he would if he had served the resulting or surviving corporation in the same capacity.

SECTION 9. Survival of Rights. The indemnification and advancement of expenses provided by, or granted pursuant to this Article VI shall continue as to a person who has ceased to be a director, officer, employee or agent and shall inure to the benefit of the heirs, executors and administrators of such a person.

ARTICLE VII

General Provisions

SECTION 1. Dividends. Subject to the provisions of statute and the Certificate of Incorporation, dividends upon the shares of capital stock of the Corporation may be declared by the Board of Directors at any regular or special meeting. Dividends may be paid in cash, in property or in shares of stock of the Corporation, unless otherwise provided by statute or the Certificate of Incorporation.

SECTION 2. Reserves. Before payment of any dividend, there may be set aside out of any funds of the Corporation available for dividends such sum or sums as the Board of Directors may, from time to time, in its absolute discretion, think proper as a reserve or reserves to meet contingencies, or for equalizing dividends, or for repairing or maintaining any property of the Corporation or for such other purpose as the Board of Directors may think conducive to the interests of the Corporation. The Board of Directors may modify or abolish any such reserves in the manner in which it was created.

SECTION 3. Seal. The seal of the Corporation shall be in such form as shall be approved by the Board of Directors.

SECTION 4. Fiscal Year. The fiscal year of the Corporation shall be fixed, and once fixed, may thereafter be changed, by resolution of the Board of Directors.

SECTION 5. Checks. Notes, Drafts. Etc. All checks, notes, drafts or other orders for the payment of money of the Corporation shall be signed, endorsed or accepted in the name of the Corporation by such officer, officers, person or persons as from time to time may be designated by the Board of Directors or by an officer or officers authorized by the Board of Directors to make such designation.

SECTION 6. Execution of Contracts, Deeds, Etc. The Board of Directors may authorize any officer or officers, agent or agents, in the name and on behalf of the Corporation to enter into or execute and deliver any and all deeds, bonds, mortgages, contracts and other obligations or instruments, and such authority may be general or confined to specific instances.

SECTION 7. Voting of Stock in Other Corporations. Unless otherwise provided by resolution of the Board of Directors, the Chairman of the Board or the Chief Executive Officer or the President, from time to time, may (or may appoint one or more attorneys or agents to) cast the votes which the Corporation may be entitled to cast as a shareholder or otherwise in any other corporation, any of whose shares or securities may be held by the Corporation, at meetings of the holders of the shares or other securities of such other corporation. In the event one or more attorneys or agents are appointed, the Chairman of the Board or the Chief Executive Officer or the President may instruct the person or persons so appointed as to the manner of casting such votes or giving such consent. The Chairman of the Board or the Chief Executive Officer or the President may, or may instruct the attorneys or agents appointed to, execute or cause to be executed in the name and on behalf of the Corporation and under its seal or otherwise, such written proxies, consents, waivers or other instruments as may be necessary or proper in the circumstances.

ARTICLE VIII

Amendments

These By-Laws may be amended or repealed or new by-laws adopted (a) by action of the stockholders entitled to vote thereon at any annual or special meeting of stockholders or (b) if the Certificate of Incorporation so provides, by action of the Board of Directors at a regular or special meeting thereof. Any by-law made by the Board of Directors may be amended or repealed by action of the stockholders at any annual or special meeting of stockholders.

**AMENDMENT NO. 1 TO
AUDIOEYE, INC.
BY-LAWS**

Effective as of March 19, 2020 and pursuant to a resolution adopted by the Board of Directors of AudioEye, Inc., a Delaware corporation (the "Company"), Section 1 of Article II of the By-Laws of the Company is hereby amended and restated to read in its entirety as follows:

"ARTICLE II

SECTION 1. Place of Meetings. All meetings of the stockholders for the election of directors or for any other purpose shall be held at any such place, either within or without the State of Delaware, as shall be designated from time to time by the Board of Directors and stated in the notice of meeting or in a duly executed waiver thereof. The Board of Directors may, in its sole discretion, alternatively determine that a meeting of stockholders (i) shall not be held at any place, but may instead be held solely by means of remote communication as authorized by Section 211(a)(2) of the General Corporation Law of the State of Delaware or (ii) shall be held at such place so designated by the Board of Directors and also held by means of such remote communication."

IN WITNESS WHEREOF, I have hereunto set my hand as of the 19th day of March, 2020.

/s/ Carr Bettis

Dr. Carr Bettis

Executive Chairman

**DESCRIPTION OF THE REGISTRANT'S SECURITIES
REGISTERED PURSUANT TO SECTION 12 OF THE
SECURITIES EXCHANGE ACT OF 1934**

The following summary describes the common stock, par value \$0.00001 per share, of AudioEye, Inc. (the "Company," "AudioEye," "we," "our," "us," and "our"), which are the only securities of the Company registered pursuant to Section 12 of the Securities Exchange Act of 1934, as amended.

The following description is a summary and does not purport to be complete. It is subject to and qualified in its entirety by reference to (i) our Amended and Restated Certificate of Incorporation, as amended (as so amended, the "Certificate of Incorporation"), and (ii) our By-laws, as amended (By-laws"), each of which are incorporated by reference as an exhibit to the Annual Report on Form 10-K of which this Exhibit 4.12 is a part. We encourage you to read our Certificate of Incorporation, our By-laws and the applicable provisions of the Delaware General Corporation Law, which we sometimes refer to as Delaware law or the DGCL, for additional information.

Authorized and Outstanding Capital Stock

Authorized Shares. As of December 31, 2019, we were authorized to issue up to 60,000,000 shares of capital stock, par value \$0.00001 per share, divided into two classes designated, respectively, "common stock" and "preferred stock." Of such shares authorized, 50,000,000 shares are designated as common stock, and 10,000,000 shares are designated as preferred stock. In May 2015, we filed a Certificate of Designations of Series A Preferred Stock (the "Series A Certificate of Designations") to authorize the issuance of shares of Series A Convertible Preferred Stock (the "Series A Preferred").

Outstanding Shares of Common Stock. As of December 31, 2019, there were 8,876,553 shares of common stock outstanding.

Outstanding Shares of Series A Preferred; Conversion Rights. As of December 31, 2019, there were 105,000 shares of Series A Preferred outstanding. Each share of Series A Preferred is convertible at the option of the holder from and after the original date of issuance, at a conversion price of \$4.385 per share plus accrued and unpaid dividends on such shares, subject to adjustment in the event of stock splits, dividends, certain pro rata distributions and fundamental transactions such mergers, sales of all or substantially all of our assets or similar transactions. As of December 31, 2019, cumulative and unpaid dividends on the outstanding shares of Series A Preferred were \$245,240 and as a result such shares were convertible as of such date into an aggregate of approximately 295,380 shares of common stock. We may redeem the Series A Preferred at any time for an amount equal to \$12.50 (125% of the stated value) plus accumulated dividends.

Common Stock

Voting Rights. The holders of our common stock are entitled to one vote for each share of record on all matters to be voted on by stockholders. On any matter presented to the stockholders of the Company, holders of the Series A Preferred are entitled to cast the number of votes equal to the number of shares of common stock into which the shares of Series A Preferred are convertible as of the record date to vote on such matter. There is no cumulative voting with respect to the election of our directors or any other matter. Therefore, the holders of more than 50% of the shares voted for the election of those directors can elect all of the directors.

Dividend Rights. The holders of our common stock are entitled to receive dividends when, as and if declared by our board of directors from funds legally available therefore, subject to restrictions on such ability to pay dividends, if any, set forth in the relevant terms of any preferred stock as may then be outstanding. Cash dividends are at the sole discretion of our board of directors. Each holder of our common stock is entitled to a pro rata share of cash distributions made to stockholders, including dividend payments. The Series A Preferred bears dividends at a rate of 5% percent (5.0%) per annum, which are cumulative and accrue daily from the date of issuance on the \$10.00 stated value, whether or not earned or declared. As of December 31, 2019, cumulative and unpaid dividends were \$245,240. The Series A Certificate of Designations does not contain a provision that restricts our ability to pay dividends on the common stock even if there are accrued and unpaid dividends on the Series A Preferred.

Liquidation Rights. In the event of our liquidation, dissolution or winding up, the holders of common stock are entitled to share ratably in all assets remaining available for distribution to them after payment of our liabilities and after provision has been made for each class of stock, if any, having any preference in relation to our common stock. The Series A Preferred ranks senior to our common stock as to distributions and payments upon the liquidation, dissolution and winding up of the Company. As a result, no such distributions or payments may be made to the holders of our common stock upon the liquidation, dissolution and winding up of the Company unless and until the holders of Series A Preferred have received the stated value of \$10.00 per share plus any accrued and unpaid dividends as to such shares of Series A Preferred. At December 31, 2019, the total liquidation preference was valued at \$1,295,240.

Other Rights and Preferences. Holders of shares of our common stock have no conversion, preemptive or other subscription rights, and there are no redemption provisions applicable to our common stock. So long as any shares of Series A Preferred remain outstanding, neither we or any of our subsidiaries may redeem, purchase or otherwise acquire any material amount of junior securities, which includes shares of our common stock.

Anti-Takeover Provisions

We are governed by the Delaware General Corporation Law. Certain provisions of the DGCL and our Certificate of Incorporation and By-laws could make more difficult our acquisition by means of a tender offer, a proxy contest or otherwise.

Vacancies on Board of Directors

Our Certificate of Incorporation provides that any newly created directorships resulting from any increase in the authorized number of directors or any vacancies resulting from death, resignation, retirement, disqualification, removal from office or other cause will be filled solely by the affirmative vote of a majority of the remaining directors then in office, even though less than a quorum of the board.

Stockholder Meetings

Under our Certificate of Incorporation and subject to the rights of holders of preferred stock, if any, only a majority of the members of the board of directors, the chairman of the board of directors or the chief executive officer or the president may call special meetings of stockholders. This provision will make it more difficult for stockholders to take action opposed by the board of directors.

Authorized but Unissued Shares

Our authorized but unissued shares of common stock will be available for future issuance without stockholder approval. We may issue additional shares for a variety of corporate purposes, including future public offerings to raise additional capital, corporate acquisitions and employee benefit plans. The existence of authorized but unissued shares of common stock could render more difficult or discourage an attempt to obtain control of our company by means of a proxy contest, tender offer, merger or otherwise.

The overall effect of the foregoing provisions may be to deter a future tender offer. Our stockholders might view such an offer to be in their best interest should the offer include a substantial premium over the market price of our common stock at that time. In addition, these provisions may have the effect of assisting our management to retain its position and place it in a better position to resist changes that the stockholders may want to make if dissatisfied with the conduct of our business.

Business Combinations

We are subject to Section 203 of the DGCL, which regulates corporate acquisitions. In general, Section 203 prohibits a publicly held Delaware corporation from engaging in a business combination with an interested stockholder for a period of three years following the date the person became an interested stockholder, unless:

- the board of directors approved the transaction in which the stockholder became an interested stockholder prior to the date the interested stockholder attained such status;
- upon consummation of the transaction that resulted in the stockholder becoming an interested stockholder, the interested stockholders owned at least 85% of the voting stock of the corporation outstanding at the time the transaction commenced, excluding shares owned by persons who are directors and also officers and employee stock plans in which employee participants do not have the right to determine confidentially whether shares held subject to the plan will be tendered in a tender or exchange offer; or
- the business combination is approved by a majority of the board of directors and by the affirmative vote of at least two-thirds of the outstanding voting stock that is not owned by the interested stockholder.

Listing

Our common stock is listed on the NASDAQ Capital Market under the symbol "AEYE."

Transfer Agent And Registrar

The transfer agent and registrar for our common stock is Corporate Stock Transfer. Its address is 3200 Cherry Creek Drive, Suite 430, Denver, Colorado, 80209, and its telephone number is (303) 282-4800.

**SEVERANCE AGREEMENT
AND GENERAL RELEASE OF ALL CLAIMS**

TO: Todd Bankofier
FROM: Sachin Barot, on behalf of AudioEye, Inc.
SUBJECT: Severance Agreement and General Release of All Claims
DATE: January 17, 2020

Your last day of employment with AudioEye, Inc. (“**AudioEye**”) is January 17, 2020 (the “**Termination Date**”). AudioEye generally does not provide employees with unearned compensation upon their separation from employment. Ordinarily, therefore, you would not be entitled to any pay in addition to what you have earned and what is specified in and being paid to you under your September 16, 2019 your Second Amended and Restated Executive Employment Agreement (“**Employment Agreement**”). But under the circumstances, where AudioEye has made the business decision to lay off multiple employees, AudioEye has decided to offer you certain additional compensation (“**Severance Payment**”) beyond the severance compensation that is provided for in Paragraph 6 of your Employment Agreement, subject to the terms of this Severance Agreement and General Release of All Claims (“**Agreement**”).

1. **Severance Payment.** If you sign and return this Agreement to me within 45 days after you receive it, then, in addition to paying you the severance compensation that is provided for in Paragraph 6 of your Employment Agreement, and commissions that would have become earned and payable under your Employment Agreement had you been employed with AudioEye through January 31, 2020, AudioEye also will pay you a Severance Payment of \$25,000, less taxes and applicable deductions. This \$25,000 will be paid on AudioEye’s next regular pay date that occurs at least 10 business days after you have returned the signed Agreement and the revocation period, as addressed in Section 10 below, expires.

2. **General Release of All Claims.** In exchange for the Severance Payment, you agree to waive and release any and all claims to relief from AudioEye and its affiliated entities, and their respective current and former officers, directors, stockholders, employees, owners, partners, members, parents, affiliates, subsidiaries, divisions, related entities, agents, attorneys, and insurers, (collectively, the “**Released Parties**”), including without limitation, any and all claims, demands, liabilities, obligations, causes, and causes of action of whatever kind or nature, whether known or unknown, past or present, suspected or unsuspected including, without limitation, those that arise out of or that relate to: your employment with AudioEye; the termination of your employment with AudioEye; all statements or actions of the Released Parties; all claims that arise under the Civil Rights Act of 1964, the Americans with Disabilities Act, the Age Discrimination in Employment Act (the “**ADEA**”), the Family and Medical Leave Act, the Arizona Employment Protection Act, and the Arizona Civil Rights Act; all claims for wrongful discharge; all claims for retaliation; all claims for breach of any implied or express contract; all claims for intentional or negligent infliction of emotional distress; all claims for defamation; all claims for relief or other benefits under any federal, state, or local statute, ordinance, regulation, or rule of decision; all claims for benefits, wages, bonuses, commissions, compensation, expense reimbursements, disbursements, renewals, severance pay, attorneys’ fees, liquidated damages, punitive damages, and costs; and all other known and unknown claims (collectively, the “**Released Claims**”).

The Released Claims do not include a release of any claims or rights that cannot be waived by law. Also excluded from the Released Claims is your right to file: (i) a lawsuit to challenge the effectiveness of a release of claims under the ADEA pursuant to the Older Workers Benefit Protection Act, or (ii) a charge filed with an administrative agency, but you acknowledge and agree that you cannot recover any monetary or injunctive relief pursuant to such charge.

It is important for you to understand that if you sign this Agreement, you will be releasing legal claims, whether those claims are valid or not.

3. Non-Disclosure of Confidential Information. In exchange for the Severance Payment, you further agree that you will not directly or indirectly disclose to anyone, or use for your own benefit or the benefit of anyone other than the AudioEye, any “**Company Confidential Information**” that you have received through your employment with AudioEye, until such time as such Company Confidential Information becomes generally disclosed or known, or readily ascertainable by proper means, by persons unrelated to AudioEye. Company Confidential Information means confidential, proprietary information or trade secrets of the Released Parties, including without limitation the following: (i) client and vendor and potential client and vendor lists and information; (ii) worker, employee, and independent contractor lists and information; (iii) AudioEye’s internal practices and procedures; (iv) strategic planning, development, purchasing, finance, sales, marketing, personnel, promotion, distribution, and business activities; (v) passwords, source code, computer programs, formulae, tools, and systems; (vi) AudioEye’s past and present research; (vii) all other information that you have a reasonable basis to consider confidential or that is treated by AudioEye as confidential; and (viii) all information having independent economic value to AudioEye that is not generally disclosed or known to, and not readily ascertainable by proper means by, persons who can obtain economic value from its disclosure or use, whether or not the information is specifically marked as confidential on its face.

You further agree that, if it appears that you will be compelled by law or judicial process to disclose any Company Confidential Information, then you will notify AudioEye in writing immediately upon your receipt of a subpoena or other legal process.

Notwithstanding the above or any provision of this Agreement or any other agreement executed by you to the contrary, there shall be no restriction on your ability to (a) report violations of any law or regulation; (b) provide truthful testimony or information pursuant to subpoena, court order, or similar legal process; (c) provide truthful information to government or regulatory agencies; or (d) otherwise engage in whistleblower activity protected by the Securities Exchange Act of 1934, as amended (the “**Exchange Act**”), the Dodd-Frank Wall Street Reform and Consumer Protection Act, or any rules or regulations issued thereunder, including, without limitation, Exchange Act Rule 21F-17. In addition, 18 U.S.C. § 1833(b) provides, in part: “(1) An individual shall not be held criminally or civilly liable under any Federal or State trade secret law for the disclosure of a trade secret that (A) is made (i) in confidence to a Federal, State, or local government official, either directly or indirectly, or to an attorney; and (ii) solely for the purpose of reporting or investigating a suspected violation of law; or (B) is made in a complaint or other document filed in a lawsuit or other proceeding, if such filing is made under seal. (2) An individual who files a lawsuit for retaliation by an employer for reporting a suspected violation of law may disclose the trade secret to the attorney of the individual and use the trade secret information in the court proceeding, if the individual (A) files any document containing the trade secret under seal; and (B) does not disclose the trade secret, except pursuant to court order.” Nothing in this Agreement, any other agreement executed by you, or any AudioEye policy is intended to conflict with this statutory protection.

4. **Injunctive Relief.** You agree that damages alone cannot compensate AudioEye in the event of a violation of Section 3 and that, if such violation should occur, injunctive relief will be essential for the protection of AudioEye and its successors and assigns. Accordingly, you agree that, in the event you violate or breach or threaten to violate or breach any of the provisions of Section 3, then AudioEye will be entitled to obtain injunctive relief against you, in addition to such further or other relief as may be available at equity or law. Obtainment of an injunction by AudioEye will not be considered an election of remedies or a waiver of any right to assert any other remedies that AudioEye has at law or in equity, including but not limited to AudioEye's right to recover the Severance Payment, and to collect actual, statutory, and exemplary damages. No waiver of any breach or violation shall be implied from forbearance or failure by AudioEye to take action.

5. **Non-Admission.** There is no implication or admission of liability or wrongdoing by AudioEye or the Released Parties with respect to any and all matters related to your employment or the cessation of that employment, nor may this Agreement be considered as an admission by AudioEye of any liability or violation of law.

6. **Governing Law.** This Agreement and all questions relating to its validity, interpretation, performance, and enforcement, will be governed by and construed in accordance with the internal laws, and not the law of conflicts, of the State of Arizona. Maricopa County Arizona Superior Court and the United States District Court for the District of Arizona will have exclusive jurisdiction concerning the matters addressed in this Agreement and covering any other disputes between you and AudioEye.

7. **Attorneys' Fees.** The prevailing party in any litigation to enforce this Agreement will recover all of such party's reasonable costs, expenses, and attorneys' fees from the other party.

8. **Entire Agreement.** Neither party has made any representations, warranties, inducements nor oral agreements except as expressly set forth in this Agreement. This Agreement, including the attached Exhibit "A" notice regarding Separation Information with the job titles and ages of all individuals eligible or selected for the layoff and the ages of all individuals in the same job classification or organizational unit who are not eligible or selected for the layoff, represents the entire agreement of the parties with respect to its subject matter, and this Agreement revokes and supersedes all agreements previously entered into by the parties with respect to the subject matter, except that nothing herein will supersede or preempt the post-employment rights and obligations in (i) your Employment Agreement, (ii) the Equity Agreements (as defined below), (iii) the AudioEye, Inc. Amended and Restated Insider Trading Policy, or (iv) the Employee Confidentiality and Invention Policy . In the event of a direct conflict between the terms of this Agreement and those agreements, then the terms of this Agreement will control.

The parties may not change, modify, or rescind this Agreement except in a writing, signed by both parties. Any attempt at oral modification of this Agreement shall be void and of no effect.

The attached Exhibit "B" sets forth any and all stock options, restricted stock units and any other rights to purchase capital stock or other securities of AudioEye which have been previously issued to you and which are outstanding immediately prior to the termination of your employment with AudioEye (collectively, the "**Equity Rights**"). Except as expressly provided in Exhibit "B," nothing in this Agreement shall alter or affect (i) any of such outstanding Equity Rights or the agreements pursuant to which they were issued (collectively, the "**Equity Agreements**"), (ii) Employee's rights or responsibilities with respect thereto, or (iii) AudioEye's rights with respect thereto.

9. Severability. The provisions of this Agreement are severable, and if any one or more of these provisions are held to be invalid or unenforceable, in whole or in part, the remaining provisions and any partially enforceable provisions will be binding and enforceable.

10. Time to Consider and Revoke. You may take 45 calendar days from your receipt of this Agreement to accept and sign the Agreement. You also have the right to revoke this Agreement for any reason within seven calendar days after you have signed it by email delivery of a written notice of revocation to me. You further acknowledge that you understand that the Agreement will not become effective or enforceable unless and until you have not revoked it by email delivery of a written notice of revocation to me, and the applicable revocation period has expired.

11. Acknowledgment. You acknowledge and agree that: (1) AudioEye has not made any promises, covenants, representations, or warranties to you or anyone else other than those explicitly set forth in this Agreement, and further acknowledge and agree that you have not received, relied upon, or been induced, coerced, or unduly influenced to enter into this Agreement by any statements, promises, covenants, or representations other than the ones set forth in this Agreement; (2) you have been given a reasonable period of time to consider this Agreement; (3) you have had the opportunity to consult with and be advised by legal counsel, and have had the opportunity to make whatever investigation or inquiry that you might have deemed necessary or desirable in connection with the subject matter of this Agreement prior to its execution; (4) this Agreement is written in a manner understandable to you, and you have read and understood all sections and paragraphs of this Agreement; (5) you have relied on your own judgment and the advice of your attorneys (if you have consulted with legal counsel) regarding the consideration for and the terms of this Agreement; and (6) you have executed this Agreement voluntarily, on the advice of counsel (if you have consulted with legal counsel), and with full knowledge and understanding of its contents.

This offer made in this Agreement is effective only until 5:00 p.m. on the 46th day after you receive it. If you decide to accept the Severance Payment, please sign and date this Agreement where indicated below, and return it to me before that time, by email at sbarot@audioeye.com. If you do not accept the offer by that time, then the offer of the Severance Payment will be withdrawn.

AGREED to this 21st day of January, 2020.

Todd Bankofier

/s/ Todd Bankofier

AGREED to this 21st day of January, 2020.

AUDIOEYE, INC.

By: */s/ Sachin Barot*

Print Name: Sachin Barot

Title: Chief Financial Officer

EXHIBIT A

**SEPARATION INFORMATION
PURSUANT TO OLDER WORKERS BENEFIT PROTECTION ACT**

1. Decisional Unit

The group of employees from which layoff and retention decisions were made:

Enterprise Sales Team

2. Eligibility Factors

Factors considered in making layoff and retention decisions within the Decisional Unit:

These sales team members underperformed their sales targets last year, and AudioEye is consolidating its direct sales force in the locations of its existing corporate offices, with the exception of one sales person who is focusing primarily on accounts within the State of California.

3. Time Limit

A separation and release agreement must be signed and returned within 45 days after receipt by the employee, and the employee may revoke the agreement within 7 days after signing.

4. Individual Data

(a) Job titles and ages of those selected for layoff from the Decisional Unit:

Account Executive	58
Account Executive	51
Chief Revenue Officer	60
VP of Kiosk Sales	50

(b) Job titles and ages of those not selected for layoff from the Decisional Unit:

Sales Associate	22
Sales Associate	23
Director of Sales	28
Senior Account Executive	43
Account Executive	46
Account Executive	35

EXHIBIT B
OUTSTANDING STOCK PURCHASE RIGHTS

<u>Type of Security</u>	<u>Grant Date</u>	<u>Number of Shares Exercisable Immediately Prior to Termination</u>	<u>Exercise Price Per Share</u>	<u>Expiration Date Immediately Prior to Termination</u>
NSO	01/15/2016	80,000	\$0.95	01/15/2021 ⁽¹⁾
NSO	06/03/2019	0 ⁽²⁾	6.53	01/17/2020 ⁽²⁾
Warrant	04/15/2016	800	6.25	04/14/2021

(1) Reflects the last day to exercise these options pursuant to the terms thereof.

(2) Provided the Agreement becomes effective as provided in Section 10, then effective as of the Termination Date, (i) the vesting of these options shall be accelerated in full such that the options shall become vested and exercisable as to the 8,691 shares subject thereto and (ii) the expiration date for such accelerated options shall be extended from 90 days following the Termination Date through January 17, 2021.

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in the Registration Statements on Form S-8 (No. 333-190871, 333-195471, 333-200170, 333-231760, and 333-232568) of our report dated March 27, 2020 relating to the financial statements of AudioEye, Inc. and its subsidiary (the "Company"), appearing in this Annual Report on Form 10-K of the Company for the year ended December 31, 2019. Our report contains an explanatory paragraph regarding the Company's ability to continue as a going concern.

/s/ MaloneBailey, LLP
www.malonebailey.com
Houston, Texas
March 27, 2020

CERTIFICATION UNDER SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Dr. Carr Bettis, Principal Executive Officer of AudioEye, Inc. (the "Registrant"), certify that:

1. I have reviewed this Annual Report on Form 10-K for the fiscal year ended December 31, 2019 of AudioEye, Inc. (the "Annual Report");

2. Based on my knowledge, this Annual Report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this Annual Report;

3. Based on my knowledge, the financial statements, and other financial information included in this Annual Report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this Annual Report;

4. The Registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under my supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to me by others within those entities, particularly during the period in which this Annual Report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under my supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this Annual Report my conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this Annual Report based on such evaluation; and

(d) Disclosed in this report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter (the Registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and

5. The Registrant's other certifying officer and I have disclosed, based on my most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of the Registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

Date: March 30, 2020

By: /s/ Dr. Carr Bettis
Name: Dr. Carr Bettis
Title: Executive Chairman
(Principal Executive Officer)

CERTIFICATION UNDER SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Sachin Barot, Principal Financial Officer of AudioEye, Inc. (the "Registrant"), certify that:

1. I have reviewed this Annual Report on Form 10-K for the fiscal year ended December 31, 2019 of AudioEye, Inc. (the "Annual Report");
2. Based on my knowledge, this Annual Report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this Annual Report;
3. Based on my knowledge, the financial statements, and other financial information included in this Annual Report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this Annual Report;
4. The Registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under my supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to me by others within those entities, particularly during the period in which this Annual Report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under my supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this Annual Report my conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this Annual Report based on such evaluation; and
 - (d) Disclosed in this report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter (the Registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and
5. The Registrant's other certifying officer and I have disclosed, based on my most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of the Registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

Date: March 30, 2020

By: /s/ Sachin Barot

Name: Sachin Barot

Title: Chief Financial Officer

CERTIFICATION UNDER SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the filing by AudioEye, Inc. (the "Registrant") of its Annual Report on Form 10-K for the fiscal year ended December 31, 2019 (the "Annual Report") with the Securities and Exchange Commission, I, Dr. Carr Bettis, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to the best of my knowledge:

(i) The Annual Report fully complies with the requirements of Section 13(a) or Section 15(d), as applicable, of the Securities Exchange Act of 1934, as amended; and

(ii) The information contained in the Annual Report fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

Date: March 30, 2020

By: /s/ Dr. Carr Bettis
Name: Dr. Carr Bettis
Title: Executive Chairman
(Principal Executive Officer)

A signed original of this written statement required by Section 906 has been provided to the Registrant and will be retained by the Registrant and furnished to the Securities and Exchange Commission or its staff upon request.

CERTIFICATION UNDER SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the filing by AudioEye, Inc. (the "Registrant") of its Annual Report on Form 10-K for the fiscal year ended December 31, 2019 (the "Annual Report") with the Securities and Exchange Commission, I, Sachin Barot, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to the best of my knowledge:

(i) The Annual Report fully complies with the requirements of Section 13(a) or Section 15(d), as applicable, of the Securities Exchange Act of 1934, as amended; and

(ii) The information contained in the Annual Report fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

Date: March 30, 2020

By: /s/ Sachin Barot
Name: Sachin Barot
Title: Chief Financial Officer

A signed original of this written statement required by Section 906 has been provided to the Registrant and will be retained by the Registrant and furnished to the Securities and Exchange Commission or its staff upon request.

AudioEye, Inc.
Resolutions of the Board of Directors

**Authorizing the Ratification of the Issuance of 175,000 shares of the Company's
Series A Convertible Preferred Stock on May 1, 2015**

WHEREAS, pursuant to the certificate of incorporation of the Company, as amended by the Certificate of Amendment of the Certificate of Incorporation of the Company, as filed with the Secretary of State of the State of Delaware (the "Secretary of State") on March 27, 2014, the Company was authorized to issue 10,000,000 shares of Preferred Stock, par value \$0.00001 per share, of the Company, with such designations, preferences, rights, qualifications, limitations or restrictions thereof as shall be stated and expressed in the resolution or resolutions adopted by the Board;

WHEREAS, on April 24, 2015, the Board purported to authorize a capital raise, pursuant to which the Board purported to authorize the Company to offer, issue, sell and deliver a minimum of 50,000 and a maximum of 150,000 shares of Series A Convertible Preferred Stock, par value \$0.00001 per share, of the Company (the "Series A Preferred Stock"), with authorization to increase the maximum to up to 200,000 shares of Series A Preferred Stock, the terms of which were set forth on a term sheet provided to the Board;

WHEREAS, on May 1, 2015, the Company purported to sell and issue an aggregate of 175,000 shares of Series A Preferred Stock (the "Preferred Stock Issuance");

WHEREAS, in connection with the Preferred Stock Issuance, the Company filed the Certificate of Designations of Series A Preferred Stock (the "Certificate of Designations") with the Secretary of State on May 4, 2015, which authorized the issuance of 150,000 shares of Series A Preferred Stock;

WHEREAS, between May 22, 2016 to June 27, 2018, an aggregate of 4,437,639 shares of shares of Common Stock, par value \$0.00001, of the Company ("Common Stock") (or approximately 177,506 shares of Common Stock after giving effect to the Company's 1-for-25 reverse stock split market effective as of August 8, 2018) were issued upon conversion of 70,000 shares of Series A Preferred in accordance with the terms of the Certificate of Designations;

WHEREAS, the Board has determined that the Preferred Stock Issuance may constituted a defective corporate act (as defined in Section 204(h) of the General Corporation Law) and the shares of Series A Preferred Stock and Common Stock issued in connection therewith may constitute shares of putative stock (as defined in Section 204(h) of the General Corporation Law) due to (i) the failure of the Board to have duly approved the Certificate of Designations in the manner required by Section 151 of the General Corporation Law and (ii) the failure of the Certificate of Designations to have authorized a sufficient number of shares of Series A Preferred Stock and to have been filed and become effective prior to the Preferred Stock Issuance (collectively, the "Stock Issuance Failures of Authorization");

WHEREAS, the Board has determined that the filing and effectiveness of the Certificate of Designations constitutes an inaccurate record of the corporation action therein and requires correction; and

WHEREAS, the Board has determined that it is advisable and in the best interests of the Company and its stockholders to ratify the Preferred Stock Issuance and, in connection therewith, to approve the filing of a certificate of validation in the form prescribed by Section 204 of the General Corporation Law in respect thereof (the "Stock Issuance Certificate of Validation"), each pursuant to and in accordance with Section 204 of the General Corporation Law.

NOW, THEREFORE, BE IT RESOLVED, that the Preferred Stock Issuance is the defective corporate act to be ratified hereby.

RESOLVED, FURTHER, that the Preferred Stock Issuance involved the issuance of an aggregate of 175,000 shares of Series A Preferred Stock on May 1, 2015 and the issuance of 4,437,639 shares of Common Stock (or approximately 177,506 shares of Common Stock after giving effect to the Company's 1-for-25 reverse stock split market effective as of August 8, 2018) between May 22, 2016 to June 27, 2018 upon the conversion of an aggregate of 70,000 shares of Series A Preferred Stock in accordance with the terms of the Certificate of Designations, all of which constitute shares of putative stock.

RESOLVED, FURTHER, that the nature of the failures of authorization in respect of the Preferred Stock Issuance are the Stock Issuance Failures of Authorization.

RESOLVED, FURTHER, that the Board hereby approves, adopts and authorizes, in all respects, the ratification of the Preferred Stock Issuance pursuant to and in accordance with Section 204 of the DGCL.

RESOLVED, FURTHER, that the Board hereby approves the execution and filing with the Secretary of State a certificate of correction in the form attached hereto as Exhibit A (the "Certificate of Correction").

RESOLVED, FURTHER, that the Board hereby approves the execution and filing with the Secretary of State a certificate of validation in the form attached hereto as Exhibit B (the "Certificate of Validation").

RESOLVED, FURTHER, that the officers of the Company be, and each of them hereby is, authorized, empowered and directed, for and on behalf of the Company, to execute and file, or cause to be filed, with the Secretary of State the Certificate of Correction and the Certificate of Validation.

RESOLVED, that the officers of the Company be, and each hereby is, authorized, empowered and directed, for and on behalf of the Company, to deliver a notice of the ratification of the Preferred Stock Issuance and putative stock set forth herein in the form and containing the information required by Section 204 of the DGCL.

RESOLVED, that, any time before the relevant validation effective time in respect of the ratification of any of the defective corporate acts identified herein, the Board may abandon the ratification of such act or acts.

RESOLVED, that the officers of the Company are hereby authorized and directed, on behalf and in the name of the Company, to make all such arrangements, to do and perform all such acts and things, including, without limitation, soliciting appropriate consents or waivers from stockholders, and to execute and deliver all such instruments, certificates and other documents as they may deem necessary or appropriate in order to effectuate fully the purpose of each and all of the foregoing resolutions and the transactions contemplated thereby, and the undersigned hereby ratify and confirm any and all actions taken heretofore and hereafter by such officers to accomplish such purposes.

EXHIBIT A

**CERTIFICATE OF CORRECTION
TO THE
CERTIFICATE OF DESIGNATIONS
SERIES A CONVERTIBLE PREFERRED STOCK
OF AUDIOEYE, INC.**

AudioEye, Inc., a corporation organized and existing under and by virtue of the General Corporation Law of the State of Delaware (the "Corporation"), does hereby certify as follows:

1. The name of the Corporation is AudioEye, Inc.

2. The Certificate of Designations Series A Convertible Preferred Stock of the Corporation (the "Certificate of Designations") filed with the Secretary of State of the State of Delaware on May 4, 2015 is an inaccurate record of the corporate action taken therein in that the Certificate of Designations was not duly approved and adopted in accordance with the General Corporation Law of the State of Delaware (the "General Corporation Law"), and, therefore, the Certificate of Designations requires correction as permitted by Section 103(f) of the General Corporation Law.

3. The Certificate of Designations is therefore null and void and of no effect.

IN WITNESS WHEREOF, the Corporation has caused this Certificate of Correction to be signed by its authorized officer this ____ day of March, 2020.

AUDIOEYE, INC.

By: _____
Name:
Title:

EXHIBIT B

**CERTIFICATE OF VALIDATION
OF
AUDIOEYE, INC.**

Pursuant to Section 204 of the
General Corporation Law of the State of Delaware

AudioEye, Inc., a corporation organized and existing under the laws of the State of Delaware (the "Corporation"), certifies as follows:

1. The defective corporate act that is the subject of this Certificate of Validation is the issuance of 175,000 shares of the Corporation's Series A Convertible Preferred Stock, par value \$0.00001 per share (the "Series A Preferred Stock"), on May 1, 2015 (the "Preferred Stock Issuance").
2. The nature of the failures of authorization in respect of the Preferred Stock Issuance was: (i) the failure of the Board to have duly approved the Certificate of Designations in the manner required by Section 151 of the General Corporation Law of the State of Delaware (the "General Corporation Law") and (ii) the failure of the Certificate of Designations to have authorized a sufficient number of shares of Series A Preferred Stock and to have been filed and become effective prior to the issuance of the stock.
3. The defective corporate act that is the subject of this Certificate of Validation was duly ratified in accordance with Section 204 of General Corporation Law pursuant to resolutions of the Board of Directors of the Corporation adopted on March 27, 2020.
4. The Certificate of Designations of Series A Convertible Preferred Stock was previously filed under Section 103 of the General Corporation Law on May 4, 2015 and such certificate requires change, both as to the effective date and the number of shares authorized, to give effect to the defective corporate acts that are the subject of this Certificate of Validation. A certificate containing all of the information required to be included under Section 151 of the General Corporation Law to give effect to the Preferred Stock Issuance is attached hereto as Exhibit A. Such certificate shall be deemed to have become effective as of May 1, 2015.

[Signature Page Follows]

IN WITNESS WHEREOF, the Corporation has caused this Certificate of Validation to be executed by its duly authorized officer as of this ____ day of March, 2020.

AUDIOEYE, INC.

By: _____
Name:
Title:

EXHIBIT A

**CERTIFICATE OF DESIGNATIONS
SERIES A CONVERTIBLE PREFERRED STOCK
OF AUDIOEYE, INC.**

(pursuant to Section 151 of the Delaware General Corporation Law)

AudioEye, Inc., a corporation organized and existing under the laws of the State of Delaware (the "Corporation"), hereby certifies that the Board of Directors of the Corporation (the "Board of Directors" or the "Board") pursuant to authority of the Board of Directors under Section 151 of the Delaware General Corporation Law ("DGCL"), and in accordance with the provisions of its Certificate of Incorporation and Bylaws, adopted a resolution on April 24, 2015, which authorizes a series of the Corporation's Preferred Stock, par value \$0.00001 per share designated Series A Convertible Preferred Stock (the "Preferred Stock"):

RESOLVED, that a series of Preferred Stock in the Corporation, having the rights, preferences, privileges and restrictions, and the number of shares constituting such series and the designation of such series, set forth below be, and it hereby is, authorized by the Board of Directors of the Corporation pursuant to authority given by the Corporation's Certificate of Incorporation.

NOW, THEREFORE, BE IT RESOLVED, that the Board of Directors hereby fixes and determines the number of shares constituting, and the rights, preferences, privileges and restrictions relating to, a new series of Preferred Stock designated Series A Convertible Preferred Stock as follows:

Section 1. Definitions. For the purposes hereof, the following terms shall have the following meanings:

"**Affiliate**" means any Person that, directly or indirectly through one or more intermediaries, controls or is controlled by or is under common control with a Person, as such terms are used in and construed under Rule 405 of the Securities Act.

"**Alternate Consideration**" shall have the meaning set forth in Section 7(d).

"**Board of Directors**" means the board of directors of the Corporation.

"**Business Day**" means any day except any Saturday, any Sunday, any day which is a federal legal holiday in the United States or any day on which banking institutions in the State of New York are authorized or required by law or other governmental action to close.

"**Certificate of Designations**" means this Certificate of Designations of the Series A Convertible Preferred Stock

"**Closing**" means the closing of the purchase and sale of the Securities pursuant to of the Purchase Agreement.

“**Commission**” means the United States Securities and Exchange Commission.

“**Common Stock**” means the Corporation’s common stock, par value \$0.00001 per share, and stock of any other class of securities into which such securities may hereafter be reclassified or changed.

“**Conversion Date**” shall have the meaning set forth in Section 6(a).

“**Conversion Price**” shall have the meaning set forth in Section 6(b).

“**Conversion Shares**” means, collectively, the shares of Common Stock issuable upon conversion of the shares of Preferred Stock in accordance with the terms hereof.

“**Corporation**” means AudioEye, Inc., a Delaware corporation.

“**Dividend Payment Date**” shall have the meaning set forth in Section 2.

“**Exchange Act**” means the Securities Exchange Act of 1934, as amended, and the rules and regulations promulgated thereunder.

“**Fundamental Transaction**” shall have the meaning set forth in Section 7(d).

“**GAAP**” means United States generally accepted accounting principles.

“**Holder**” shall mean a holder of the Preferred Stock, and “**Holder**s” shall mean multiple or all, as the context requires, holders of the Preferred Stock.

“**Junior Securities**” means the Common Stock and all other Common Stock Equivalents of the Corporation other than those securities which are explicitly senior or *pari passu* to the Preferred Stock in dividend rights or liquidation preference.

“**Liquidity Event**” means (i) any liquidation, dissolution or winding up of the Company, whether voluntary or involuntary, (ii) any sale of all or substantially all of the Company’s assets, or (iii) any other transaction that results in the Company’s stockholders immediately prior to such transaction holding less than 50% of the voting power of the surviving entity.

“**Liquidity Preference**” shall have the meaning set forth in Section 5.

“**Notice of Conversion**” shall have the meaning set forth in Section 6(a).

“**Original Issue Date**” means the date of the first issuance of any shares of the Preferred Stock regardless of the number of transfers of any particular shares of Preferred Stock and regardless of the number of certificates which may be issued to evidence such Preferred Stock.

“**Person**” means an individual or corporation, partnership, trust, incorporated or unincorporated association, joint venture, limited liability company, joint stock company, government (or an agency or subdivision thereof) or other entity of any kind.

“**Preferred Stock**” shall have the meaning set forth in Section 2.

“**Purchase Agreement**” means the Securities Purchase Agreement among the Corporation and the original Holders, as amended, modified or supplemented from time to time in accordance with its terms for the purchase and sale of the Preferred Stock.

“**Redemption Price**” shall have the meaning set forth in Section 8(a).

“**Rule 144**” means Rule 144 promulgated by the Commission pursuant to the Securities Act, as such Rule may be amended from time to time, or any similar rule or regulation hereafter adopted by the Commission having substantially the same effect as such Rule.

“**Securities**” means the Preferred Stock and the Underlying Shares subject to the Purchase Agreement.

“**Securities Act**” means the Securities Act of 1933, as amended, and the rules and regulations promulgated thereunder.

“**Share Delivery Date**” shall have the meaning set forth in Section 6(c).

“**Stated Value**” shall have the meaning set forth in Section 2.

“**Subsidiary**” means any subsidiary of the Corporation.

“**Successor Entity**” shall have the meaning set forth in Section 7(d).

“**Trading Day**” means a day on which the principal Trading Market is open for business.

“**Trading Market**” means any of the following markets or exchanges on which the Common Stock is listed or quoted for trading on the date in question: the NYSE MKT LLC, the Nasdaq Capital Market, the Nasdaq Global Market, the Nasdaq Global Select Market, the New York Stock Exchange, OTC Markets, or the OTC Bulletin Board (or any successors to any of the foregoing).

“**Transaction Documents**” means this Certificate of Designations, the Purchase Agreement, all exhibits and schedules thereto and hereto and any other documents or agreements executed in connection with the transactions contemplated pursuant to the Purchase Agreement.

“**Transfer Agent**” means Corporate Stock Transfer, Inc., the current transfer agent of the Corporation, and any successor transfer agent of the Corporation.

“**Underlying Shares**” means the shares of Common Stock issued and issuable upon conversion of the Preferred Stock.

“VWAP” means, for any date, the price determined by the first of the following clauses that applies: (a) if the Common Stock is then listed or quoted on a Trading Market, the daily volume weighted average price of the Common Stock for such date (or the nearest preceding date) on the Trading Market on which the Common Stock is then listed or quoted as reported by Bloomberg L.P. (based on a Trading Day from 9:30 a.m. (New York City time) to 4:02 p.m. (New York City time)), (b) if the OTC Bulletin Board is not a Trading Market, the volume weighted average price of the Common Stock for such date (or the nearest preceding date) on the OTC Bulletin Board, (c) if the Common Stock is not then listed or quoted for trading on the OTC Bulletin Board and if prices for the Common Stock are then reported in the “Pink Sheets” published by Pink OTC Markets, Inc. (or a similar organization or agency succeeding to its functions of reporting prices), the most recent bid price per share of the Common Stock so reported, or (d) in all other cases, the fair market value of a share of Common Stock as determined by an independent appraiser selected in good faith by the Holders of a majority in interest of the Preferred Stock then outstanding and reasonably acceptable to the Corporation, the fees and expenses of which shall be paid by the Corporation.

Section 2. Designation, Amount and Par Value. The series of Preferred Stock shall be designated as its Series A Convertible Preferred Stock (the “Preferred Stock”) and the number of shares so designated shall be 200,000 (which shall not be subject to increase without the written consent of Holders representing at least 67% of the Preferred Stock based on Liquidity Preference). Each share of Preferred Stock shall have a par value of \$0.00001 per share and a stated value equal to \$10.00 (the “Stated Value”). Preferred Stock represents equity interests in the Corporation and shall not give rise to a claim for payment of a principal amount at a particular date.

Section 3. Dividends.

The Holders shall be entitled to receive, when, as and if declared by the Board of Directors of the Corporation out of funds legally available therefore, cumulative dividends at the annual rate of 5% of the Stated Value per share of the Preferred Stock. To the extent declared, such dividends shall be payable in cash quarterly, on the last day of each quarter, beginning June 30, 2015 (each of such dates being a “Dividend Payment Date”). Such dividends shall accrue on each such share commencing on the date of issue, and shall accrue from day to day, whether or not earned or declared.

(a) So long as any shares of Preferred Stock remain outstanding, neither the Corporation nor any subsidiary thereof shall redeem, purchase or otherwise acquire directly or indirectly any material amount of Junior Securities.

Section 4. Voting Rights. On any matter presented to the stockholders of the Corporation for their action or consideration at any meeting of stockholders of the Corporation (or by written consent of stockholders in lieu of meeting), each holder of outstanding shares of Preferred Stock shall be entitled to cast the number of votes equal to the number of whole shares of Common Stock into which the shares of Preferred Stock held by such holder are convertible as of the record date for determining stockholders entitled to vote on such matter. Except as provided by law or by the other provisions of the Certificate of Designations, holders of the Preferred Stock shall vote together with the holders of Common Stock, as a single class. Notwithstanding the foregoing, as long as any shares of Preferred Stock are outstanding, the Corporation shall not, without the affirmative vote of the Holders of at least 75% in Stated Value of Preferred Stock then outstanding, except as may be necessary to increase the authorized shares of Common Stock in order to account for any increase in the number of shares issuable upon conversion of the Preferred Stock, (a) purchase or redeem any capital stock other than stock repurchased from former employees or consultants in connection with the cessation of their employment services, at the lower of fair market value or cost, or (b) amend, alter or repeal any provision of its certificate of incorporation or other charter documents in a manner that adversely affects any rights of the Holders.

Section 5. Liquidation Rights. In the event of any Liquidity Event, holders of each share of Preferred Stock shall be entitled to be paid out of the assets or surplus funds of the Corporation legally available for distribution to holders of the Corporation's capital stock of all classes (whether such assets are capital, surplus, or earnings) and subject to the liquidating preference of the holders of any other series of Preferred Shares which may be on parity or senior in right of preference to the Preferred Stock and before any sums shall be paid or any assets or surplus funds distributed among the holders of Common Stock, an amount equal to the Stated Value plus accrued dividends as to such share (the "Liquidity Preference"). If the assets of the Corporation shall be insufficient to permit the payment in full to holders of the Preferred of the preferential amount set forth in this Section 5, then the entire assets of the Corporation available for such distribution shall be distributed ratably among the holders of the Preferred in accordance with the aggregate liquidation preference of the shares of Preferred Stock held by each of them.

Section 6. Conversion.

(a) Conversion at Option of Holder. Each share of Preferred Stock shall be convertible, at any time and from time to time from and after the Original Issue Date at the option of the Holder thereof, into that number of shares of Common Stock determined by dividing the Stated Value plus any accrued dividends with respect to such share by the Conversion Price. Holders shall effect conversions by providing the Corporation with the form of conversion notice attached hereto as Annex A (a "Notice of Conversion"). Each Notice of Conversion shall specify the number of shares of Preferred Stock to be converted, the number of shares of Preferred Stock owned prior to the conversion at issue, the number of shares of Preferred Stock owned subsequent to the conversion at issue and the date on which such conversion is to be effected, which date may not be prior to the date the applicable Holder delivers by facsimile such Notice of Conversion to the Corporation (such date, the "Conversion Date"). If no Conversion Date is specified in a Notice of Conversion, the Conversion Date shall be the date that such Notice of Conversion to the Corporation is deemed delivered hereunder. The calculations and entries set forth in the Notice of Conversion shall control in the absence of manifest or mathematical error. To effect conversions of shares of Preferred Stock, a Holder shall not be required to surrender the certificate(s) representing the shares of Preferred Stock to the Corporation unless (i) the full or remaining number of shares of Preferred Stock represented by such certificate are being converted or (ii) such Holder has provided the Corporation with prior written notice (which notice may be included in a Notice of Conversion) requesting reissuance of a certificate representing the remaining shares of Preferred Stock upon physical surrender of any certificate representing the shares of Preferred Stock being converted. Each Holder and the Corporation shall maintain records showing the number of shares of Preferred Stock so converted by such Holder and the dates of such conversions or shall use such other method, reasonably satisfactory to such Holder and the Corporation, so as not to require physical surrender of the certificate representing the shares of Preferred Stock upon each such conversion. In the event of any dispute or discrepancy, such records of the Corporation establishing the number of shares of Preferred Stock to which the record holder is entitled shall be controlling and determinative in the absence of manifest error. Shares of Preferred Stock converted into Common Stock in accordance with the terms hereof shall be canceled and shall not be reissued.

(b) Conversion Price. The per share conversion price for the Preferred Stock shall equal the greater of (a) \$0.15 or (b) the average of 90% of the closing prices of the Company's Common Stock for the five Trading Days immediately preceding the initial Closing plus any accrued dividends with respect to such share, subject to adjustment herein (the "Conversion Price").

(c) Mechanics of Conversion.

(i) Delivery of Certificate Upon Conversion. Not later than three (3) Trading Days after each Conversion Date (the "Share Delivery Date"), the Corporation shall deliver, or cause to be delivered, to the converting Holder a certificate or certificates representing the number of Conversion Shares being acquired upon the conversion of the Preferred Stock. If requested by the Holder, the Corporation shall use its best efforts to deliver any certificate or certificates required to be delivered by the Corporation under this Section 6 electronically through the Depository Trust Company or another established clearing corporation performing similar functions.

(ii) Reservation of Shares Issuable Upon Conversion. The Corporation covenants that it will at all times reserve and keep available out of its authorized and unissued shares of Common Stock for the sole purpose of issuance upon conversion of the Preferred Stock as herein provided, not less than such aggregate number of shares of the Common Stock as shall (subject to the terms and conditions set forth in the respective Purchase Agreement) be issuable (taking into account the adjustments and restrictions of Section 7) upon the conversion of the then outstanding shares of Preferred Stock. The Corporation covenants that all shares of Common Stock that shall be so issuable shall, upon issue, be duly authorized, validly issued, fully paid and nonassessable.

(iii) Fractional Shares. No fractional shares or scrip representing fractional shares shall be issued upon the conversion of the Preferred Stock. As to any fraction of a share which the Holder would otherwise be entitled to purchase upon such conversion, the Corporation shall at its election, either pay a cash adjustment in respect of such final fraction in an amount equal to such fraction multiplied by the Conversion Price or round up to the next whole share.

(iv) Transfer Taxes. The issuance of certificates for shares of the Common Stock on conversion of this Preferred Stock shall be made without charge to any Holder for any documentary stamp or similar taxes that may be payable in respect of the issue or delivery of such certificates, provided that the Corporation shall not be required to pay any tax that may be payable in respect of any transfer involved in the issuance and delivery of any such certificate upon conversion in a name other than that of the Holders of such shares of Preferred Stock and the Corporation shall not be required to issue or deliver such certificates unless or until the Person or Persons requesting the issuance thereof shall have paid to the Corporation the amount of such tax or shall have established to the satisfaction of the Corporation that such tax has been paid.

Section 7. Certain Adjustments.

(a) Stock Dividends and Stock Splits. If the Corporation, at any time while this Preferred Stock is outstanding: (i) pays a stock dividend or otherwise makes a distribution or distributions payable in shares of Common Stock on shares of Common Stock or any other Common Stock Equivalents (which, for avoidance of doubt, shall not include any shares of Common Stock issued by the Corporation upon conversion of this Preferred Stock), (ii) subdivides outstanding shares of Common Stock into a larger number of shares, (iii) combines (including by way of a reverse stock split) outstanding shares of Common Stock into a smaller number of shares, or (iv) issues, in the event of a reclassification of shares of the Common Stock, any shares of capital stock of the Corporation, then the Conversion Price shall be multiplied by a fraction of which the numerator shall be the number of shares of Common Stock (excluding any treasury shares of the Corporation) outstanding immediately before such event, and of which the denominator shall be the number of shares of Common Stock outstanding immediately after such event. Any adjustment made pursuant to this Section 7(a) shall become effective immediately after the record date for the determination of stockholders entitled to receive such dividend or distribution and shall become effective immediately after the effective date in the case of a subdivision, combination or reclassification.

(b) Subsequent Rights Offerings. If the Corporation, at any time while the Preferred Stock is outstanding, shall issue rights, options or warrants to all holders of Common Stock (and not proportionately to the Holders) entitling them to subscribe for or purchase shares of Common Stock at a price per share that is lower than the VWAP on the record date for such issuance, and do not offer the same rights to the Holders, then the Holder will be entitled to acquire, upon conversion of the Preferred Stock, such rights, options or warrants which the Holder could have acquired if the Holder had held the number of shares of Common Stock acquirable upon complete conversion of such Holder's Preferred Stock (without regard to any limitations on the conversion of such Preferred Stock) immediately before the date on which a record is taken for the issuance of such rights, options or warrants, or, if no such record is taken, the date as of which the record holders of shares of Common Stock are to be determined for the issuance of such rights, options or warrants.

(c) Pro Rata Distributions. If the Corporation, at any time while the Preferred Stock is outstanding, distributes to all holders of Common Stock (and not to the Holders) evidences of its indebtedness or assets (including cash and cash dividends) or rights or warrants to subscribe for or purchase any security, then in each such case the Conversion Price shall be adjusted by multiplying such Conversion Price in effect immediately prior to the record date fixed for determination of stockholders entitled to receive such distribution by a fraction of which the denominator shall be the VWAP determined as of the record date mentioned above, and of which the numerator shall be such VWAP on such record date less the then fair market value at such record date of the portion of such assets or evidence of indebtedness or rights or warrants so distributed applicable to one outstanding share of the Common Stock as determined by the Board of Directors of the Corporation in good faith. In either case the adjustments shall be described in a statement delivered to the Holders describing the portion of assets or evidences of indebtedness so distributed or such subscription rights applicable to one share of Common Stock. Such adjustment shall be made whenever any such distribution is made and shall become effective immediately after the record date mentioned above.

(d) Fundamental Transaction. If, at any time while this Preferred Stock is outstanding, (i) the Corporation, directly or indirectly, in one or more related transactions effects any merger or consolidation of the Corporation with or into another Person, (ii) the Corporation, directly or indirectly, effects any sale, lease, license, assignment, transfer, conveyance or other disposition of all or substantially all of its assets in one or a series of related transactions, (iii) any, direct or indirect, purchase offer, tender offer or exchange offer (whether by the Corporation or another Person) is completed pursuant to which holders of Common Stock are permitted to sell, tender or exchange their shares for other securities, cash or property and has been accepted by the holders of 50% or more of the outstanding Common Stock, (iv) the Corporation, directly or indirectly, in one or more related transactions effects any reclassification, reorganization or recapitalization of the Common Stock or any compulsory share exchange pursuant to which the Common Stock is effectively converted into or exchanged for other securities, cash or property, (v) the Corporation, directly or indirectly, in one or more related transactions consummates a stock or share purchase agreement or other business combination (including, without limitation, a reorganization, recapitalization, spin-off or scheme of arrangement) with another Person whereby such other Person acquires more than 50% of the outstanding shares of Common Stock (not including any shares of Common Stock held by the other Person or other Persons making or party to, or associated or affiliated with the other Persons making or party to, such stock or share purchase agreement or other business combination and excluding shares acquired upon conversion of any currently outstanding convertible securities in accordance with the terms thereof as in effect on the date hereof) (each a “Fundamental Transaction”), then, upon any subsequent conversion of this Preferred Stock, the Holder shall have the right to receive, for each Conversion Share that would have been issuable upon such conversion immediately prior to the occurrence of such Fundamental Transaction, the number of shares of Common Stock of the successor or acquiring corporation or of the Corporation, if it is the surviving corporation, and any additional consideration (the “Alternate Consideration”) receivable as a result of such Fundamental Transaction by a holder of the number of shares of Common Stock for which this Preferred Stock is convertible immediately prior to such Fundamental Transaction. For purposes of any such conversion, the determination of the Conversion Price shall be appropriately adjusted to apply to such Alternate Consideration based on the amount of Alternate Consideration issuable in respect of one share of Common Stock in such Fundamental Transaction, and the Corporation shall apportion the Conversion Price among the Alternate Consideration in a reasonable manner reflecting the relative value of any different components of the Alternate Consideration. If holders of Common Stock are given any choice as to the securities, cash or property to be received in a Fundamental Transaction, then the Holder shall be given the same choice as to the Alternate Consideration it receives upon any conversion of this Preferred Stock following such Fundamental Transaction. To the extent necessary to effectuate the foregoing provisions, any successor to the Corporation or surviving entity in such Fundamental Transaction shall file a new Certificate of Designations with the same terms and conditions and issue to the Holders new preferred stock consistent with the foregoing provisions and evidencing the Holders’ right to convert such preferred stock into Alternate Consideration. The Corporation shall cause any successor entity in a Fundamental Transaction in which the Corporation is not the survivor (the “Successor Entity”) to assume in writing all of the obligations of the Corporation under this Certificate of Designations and the other Transaction Documents (as defined in the Purchase Agreement) in accordance with the provisions of this Section 7(d) pursuant to written agreements in form and substance reasonably satisfactory to the Holder and approved by the Holder (without unreasonable delay) prior to such Fundamental Transaction and shall, at the option of the holder of this Preferred Stock, deliver to the Holder in exchange for this Preferred Stock a security of the Successor Entity evidenced by a written instrument substantially similar in form and substance to this Preferred Stock which is convertible for a corresponding number of shares of capital stock of such Successor Entity (or its parent entity) equivalent to the shares of Common Stock acquirable and receivable upon conversion of this Preferred Stock (without regard to any limitations on the conversion of this Preferred Stock) prior to such Fundamental Transaction, and with a conversion price which applies the conversion price hereunder to such shares of capital stock (but taking into account the relative value of the shares of Common Stock pursuant to such Fundamental Transaction and the value of such shares of capital stock, such number of shares of capital stock and such conversion price being for the purpose of protecting the economic value of this Preferred Stock immediately prior to the consummation of such Fundamental Transaction), and which is reasonably satisfactory in form and substance to the Holder. Upon the occurrence of any such Fundamental Transaction, the Successor Entity shall succeed to, and be substituted for (so that from and after the date of such Fundamental Transaction, the provisions of this Certificate of Designation and the other Transaction Documents referring to the “Corporation” shall refer instead to the Successor Entity), and may exercise every right and power of the Corporation and shall assume all of the obligations of the Corporation under this Certificate of Designation and the other Transaction Documents with the same effect as if such Successor Entity had been named as the Corporation herein.

(e) Calculations. All calculations under this Section 7 shall be made to the nearest cent or the nearest 1/100th of a share, as the case may be. For purposes of this Section 7, the number of shares of Common Stock deemed to be issued and outstanding as of a given date shall be the sum of the number of shares of Common Stock (excluding any treasury shares of the Corporation) issued and outstanding.

(f) Notice to the Holders.

(i) Adjustment to Conversion Price. Whenever the Conversion Price is adjusted pursuant to any provision of this Section 7, the Corporation shall promptly deliver to each Holder a notice setting forth the Conversion Price after such adjustment and setting forth a brief statement of the facts requiring such adjustment.

(ii) Notice to Allow Conversion by Holder. If (A) the Corporation shall declare a dividend (or any other distribution in whatever form) on the Common Stock, (B) the Corporation shall declare a special nonrecurring cash dividend on or a redemption of the Common Stock, (C) the Corporation shall authorize the granting to all holders of the Common Stock of rights or warrants to subscribe for or purchase any shares of capital stock of any class or of any rights, (D) the approval of any stockholders of the Corporation shall be required in connection with any reclassification of the Common Stock, any consolidation or merger to which the Corporation is a party, any sale or transfer of all or substantially all of the assets of the Corporation, or any compulsory share exchange whereby the Common Stock is converted into other securities, cash or property or (E) the Corporation shall authorize the voluntary or involuntary dissolution, liquidation or winding up of the affairs of the Corporation, then, in each case, the Corporation shall cause to be filed at each office or agency maintained for the purpose of conversion of this Preferred Stock, and shall cause to be delivered to each Holder at its last address as it shall appear upon the stock books of the Corporation, at least ten (10) calendar days prior to the applicable record or effective date hereinafter specified, a notice stating (x) the date on which a record is to be taken for the purpose of such dividend, distribution, redemption, rights or warrants, or if a record is not to be taken, the date as of which the holders of the Common Stock of record to be entitled to such dividend, distributions, redemption, rights or warrants are to be determined or (y) the date on which such reclassification, consolidation, merger, sale, transfer or share exchange is expected to become effective or close, and the date as of which it is expected that holders of the Common Stock of record shall be entitled to exchange their shares of the Common Stock for securities, cash or other property deliverable upon such reclassification, consolidation, merger, sale, transfer or share exchange, provided that the failure to deliver such notice or any defect therein or in the delivery thereof shall not affect the validity of the corporate action required to be specified in such notice. To the extent that any notice provided hereunder constitutes, or contains, material, non-public information regarding the Corporation or any of the Subsidiaries, the Corporation shall simultaneously file such notice with the Commission pursuant to a Current Report on Form 8-K. The Holder shall remain entitled to convert the Preferred Stock (or any part hereof) during the 10-day period commencing on the date of such notice through the effective date of the event triggering such notice except as may otherwise be expressly set forth herein.

Section 8. Redemption.

(a) Optimal Company Redemption. Subject to the terms hereof, at any time the Corporation shall be entitled to redeem any or all of the outstanding shares of Preferred Stock (the "Optional Company Redemption") at a per share price equal to 125% of the Stated Value plus accumulated dividends (such amount, the "Redemption Price"), payable in cash; provided that the Corporation shall have funds legally available for such payment.

(b) Notice of Optional Company Redemption. Notice of any Optional Company Redemption of shares of Preferred Stock, specifying the time and place of redemption and the Redemption Price (a “Redemption Notice”), shall be sent by courier or first class overnight mail, pre-paid, to each holder of Preferred Stock to be redeemed, at the address for such holder shown on the Company’s records, not more than sixty (60) nor less than ten (10) days prior to the Redemption Date. If, in any case, less than all of the shares of Preferred Stock then owned by such holder are to be redeemed, the Redemption Notice shall also specify the number of shares which are to be redeemed; provided, however, that no failure to give such Redemption Notice nor any defect therein shall affect the validity of the procedure for the redemption of any shares of Preferred Stock to be redeemed except as to the holder to whom the Corporation has failed to give said Redemption Notice or except as to the holder whose Redemption Notice was defective. Each such Redemption Notice shall state:

(i) the Redemption Date;

(ii) the Redemption Price;

(iii) the number of shares of Preferred Stock to be redeemed and, if fewer than all the shares of Preferred Stock held by a holder are to be redeemed, the number of shares thereof to be redeemed from such holder;

(iv) the manner and place or places at which payment for the shares of Preferred Stock to be redeemed will be made, upon presentation and surrender to the Corporation of the certificates evidencing the shares being redeemed; and

(v) that the rights of holders to convert shares of Preferred Stock being redeemed shall terminate at the close of business on the Redemption Date unless the Corporation defaults in the payment of the Redemption Price.

Upon mailing any such Redemption Notice, the Corporation shall become obligated to redeem at the Redemption Price on the Redemption Date all shares of Preferred Stock therein specified; provided, however, any redemption contemplated by any Redemption Notice may be conditioned upon the occurrence of one or more transactions or other events and the Redemption Date in such Redemption Notice may be the date on which such transaction is consummated or such other event occurs.

Section 9. Miscellaneous.

(a) Notices. Any and all notices or other communications or deliveries to be provided by the Holders hereunder including, without limitation, any Notice of Conversion, shall be in writing and delivered personally, by facsimile, or sent by a nationally recognized overnight courier service, addressed to the Corporation at 5210 E. Williams Circle, Suite 500, Tucson, Arizona 85711, facsimile number (520) 844-2989, or such other facsimile number or address as the Corporation may specify for such purposes by notice to the Holders delivered in accordance with this Section 10. Any and all notices or other communications or deliveries to be provided by the Corporation hereunder shall be in writing and delivered personally, by facsimile, or sent by a nationally recognized overnight courier service addressed to each Holder at the facsimile number or address of such Holder appearing on the books of the Corporation, or if no such facsimile number or address appears on the books of the Corporation, at the principal place of business of such Holder, as set forth in the Purchase Agreement. Any notice or other communication or deliveries hereunder shall be deemed given and effective on the earliest of (i) the date of transmission, if such notice or communication is delivered via facsimile at the facsimile number set forth in this Section prior to 5:30 p.m. (Arizona time) on any date, (ii) the next Trading Day after the date of transmission, if such notice or communication is delivered via facsimile at the facsimile number set forth in this Section on a day that is not a Trading Day or later than 5:30 p.m. (Arizona time) on any Trading Day, (iii) the second Trading Day following the date of mailing, if sent by U.S. nationally recognized overnight courier service, or (iv) upon actual receipt by the party to whom such notice is required to be given.

(b) Absolute Obligation. Except as expressly provided herein, no provision of this Certificate of Designations shall alter or impair the obligation of the Corporation, which is absolute and unconditional, to pay dividends, as applicable, on the shares of Preferred Stock at the time, place, and rate, and in the coin or currency, herein prescribed.

(c) Lost or Mutilated Preferred Stock Certificate. If a Holder's Preferred Stock certificate shall be mutilated, lost, stolen or destroyed, the Corporation shall execute and deliver, in exchange and substitution for and upon cancellation of a mutilated certificate, or in lieu of or in substitution for a lost, stolen or destroyed certificate, a new certificate for the shares of Preferred Stock so mutilated, lost, stolen or destroyed, but only upon receipt of evidence of such loss, theft or destruction of such certificate, and of the ownership hereof reasonably satisfactory to the Corporation.

(d) Governing Law. All questions concerning the construction, validity, enforcement and interpretation of this Certificate of Designations shall be governed by and construed and enforced in accordance with the internal laws of the State of Delaware, without regard to the principles of conflict of laws thereof. If any party shall commence an action or proceeding to enforce any provisions of this Certificate of Designation, then the prevailing party in such action or proceeding shall be reimbursed by the other party for its attorneys' fees and other costs and expenses incurred in the investigation, preparation and prosecution of such action or proceeding.

(e) Waiver. Any waiver by the Corporation or a Holder of a breach of any provision of this Certificate of Designation shall not operate as or be construed to be a waiver of any other breach of such provision or of any breach of any other provision of this Certificate of Designations or a waiver by any other Holders. The failure of the Corporation or a Holder to insist upon strict adherence to any term of this Certificate of Designations on one or more occasions shall not be considered a waiver or deprive that party (or any other Holder) of the right thereafter to insist upon strict adherence to that term or any other term of this Certificate of Designation on any other occasion. Any waiver by the Corporation or a Holder must be in writing.

(f) Severability. If any provision of this Certificate of Designations is invalid, illegal or unenforceable, the balance of this Certificate of Designations shall remain in effect, and if any provision is inapplicable to any Person or circumstance, it shall nevertheless remain applicable to all other Persons and circumstances. If it shall be found that any interest or other amount deemed interest due hereunder violates the applicable law governing usury, the applicable rate of interest due hereunder shall automatically be lowered to equal the maximum rate of interest permitted under applicable law.

(g) Next Business Day. Whenever any payment or other obligation hereunder shall be due on a day other than a Business Day, such payment shall be made on the next succeeding Business Day.

(h) Headings. The headings contained herein are for convenience only, do not constitute a part of this Certificate of Designations and shall not be deemed to limit or affect any of the provisions hereof.

(i) Status of Converted Preferred Stock. If any shares of Preferred Stock shall be converted or reacquired by the Corporation, such shares shall resume the status of authorized but unissued shares of preferred stock and shall no longer be designated as Series A Convertible Preferred Stock.
