AGREE REALTY CORP
Form 10-Q
April 24, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

Mark One

x Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended March 31, 2017, or

¨ Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission File Number 1-12928

AGREE REALTY CORPORATION

(Exact name of registrant as specified in its charter)

Maryland	38-3148187
State or Other Jurisdiction of Incorporation or Organization	(I.R.S. Employer Identification No.)

70 E. Long Lake Road, Bloomfield Hills, Michigan 48304

(Address of Principal Executive Offices)

Registrant's telephone number, including area code: **(248) 737-4190**

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 x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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 ý	Accelerated Filer o	Non-accelerated Filer o (Do not check if a smaller reporting company)	Smaller reporting company o	Emerging growth company o

If an emerging growth company, indicated 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. o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ¨ No x

As of April 21, 2017, the Registrant had 26,219,680 shares of common stock, $0.0001 par value, outstanding.

AGREE REALTY CORPORATION

Index to Form 10-Q

AGREE REALTY CORPORATION

CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per-share data)

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

	March 31, 2017 (Unaudited)	December 31, 2016
ASSETS		
Real Estate Investments		
Land	$ 319,935	$ 309,687
Buildings	737,605	703,506
Less accumulated depreciation	(73,657)	(69,696)
	983,883	943,497
Property under development	8,414	6,764
Net Real Estate Investments	992,297	950,261
Cash and Cash Equivalents	2,300	33,395
Accounts Receivable - Tenants, net of allowance of $50 for possible losses at March 31, 2017 and December 31, 2016	13,069	11,535
Unamortized Deferred Expenses		
Credit facility finance costs, net of accumulated amortization of $127 and $1,262 at March 31, 2017 and December 31, 2016, respectively	1,456	1,552
Leasing costs, net of accumulated amortization of $717 and $677 at March 31, 2017 and December 31, 2016, respectively	1,575	1,227
Lease intangibles, net of accumulated amortization of $29,103 and $25,666 at March 31, 2017 and December 31, 2016, respectively	140,652	139,871
Interest Rate Swaps	1,561	1,409
Other Assets	5,330	2,722

Total Assets	$ 1,158,240	$ 1,141,972

See accompanying notes to consolidated financial statements.

1

AGREE REALTY CORPORATION

CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per-share data)

	March 31, 2017 (Unaudited)	December 31, 2016
LIABILITIES		
Mortgage Notes Payable, net	$ 68,539	$ 69,067
Unsecured Term Loans, net	158,557	158,679
Senior Unsecured Notes, net	159,198	159,176
Unsecured Revolving Credit Facility	29,000	14,000
Dividends and Distributions Payable	13,151	13,124
Deferred Revenue	1,650	1,823
Accrued Interest Payable	2,671	2,210
Accounts Payable and Accrued Expenses		
Capital expenditures	61	677
Operating	4,956	4,866
Lease intangibles, net of accumulated amortization of $8,087 and $7,078 at March 31, 2017 and December 31, 2016, respectively	30,702	30,047
Interest Rate Swaps	1,404	1,994
Deferred Income Taxes	705	705
Tenant Deposits	94	94
Total Liabilities	470,688	456,462
STOCKHOLDERS' EQUITY		
Common stock, $.0001 par value, 45,000,000 shares authorized, 26,219,680 and 26,164,977 shares issued and outstanding, respectively	3	3
Preferred Stock, $.0001 par value per share, 4,000,000 shares authorized Series A junior participating preferred stock, $.0001 par value, 200,000 authorized, no shares issued	-	-

and outstanding		
Additional paid-in-capital	711,753	712,069
Dividends in excess of net income	(26,962)	(28,558)
Accumulated other comprehensive income (loss)	195	(536)
Total Stockholders' Equity - Agree Realty Corporation	684,989	682,978
Non-controlling interest	2,563	2,532
Total Equity	687,552	685,510
Total Liabilities and Equity	$ 1,158,240	$ 1,141,972

See accompanying notes to consolidated financial statements.

2

AGREE REALTY CORPORATION

CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

(In thousands, except share and per-share data)

(Unaudited)

	Three Months Ended March 31, 2017	Three Months Ended March 31, 2016
Revenues		
Minimum rents	$24,014	$18,491
Percentage rents	212	183
Operating cost reimbursement	2,344	1,589
Other income	(10)	(39)
Total Revenues	26,560	20,224
Operating Expenses		
Real estate taxes	1,808	1,123
Property operating expenses	797	573
Land lease payments	163	163
General and administrative	2,603	2,045
Depreciation and amortization	7,025	5,085
Total Operating Expenses	12,396	8,989
Income from Operations	14,164	11,235
Other (Expense) Income		
Interest expense, net	(4,138)	(3,649)
Gain (Loss) on sale of assets	4,742	-
Net Income	14,768	7,586
Less Net Income Attributable to Non-Controlling Interest	193	125
Net Income Attributable to Agree Realty Corporation	$14,575	$7,461
Net Income Per Share Attributable to Agree Realty Corporation		
Basic	$0.56	$0.36
Diluted	$0.56	$0.36
Other Comprehensive Income		
Net income	$14,768	$7,586
Other Comprehensive Income (Loss) - Gain (Loss) on Interest Rate Swaps	741	(2,935)

Total Comprehensive Income	15,509	4,651
Comprehensive Income Attributable to Non-Controlling Interest	(203)	(77)
Comprehensive Income Attributable to Agree Realty Corporation	$15,306	$4,574
Weighted Average Number of Common Shares Outstanding - Basic:	25,953,097	20,438,729
Weighted Average Number of Common Shares Outstanding - Diluted:	26,009,120	20,480,140

See accompanying notes to consolidated financial statements.

3

AGREE REALTY CORPORATION

CONSOLIDATED STATEMENT OF EQUITY

(In thousands, except share and per-share data)

(Unaudited)

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Dividends in excess of net income	Accumulated Other Comprehensive Income (Loss)	Non-Controlling Interest	Total Equity
Balance, December 31, 2016	26,164,977	$ 3	$ 712,069	$ (28,558)	$ (536)	$ 2,532	$ 685,510
Issuance of common stock, net of issuance costs	3,245	-	150	-	-	-	150
Repurchase of common shares	(23,580)	-	(1,095)	-	-	-	(1,095)
Issuance of restricted stock under the Omnibus Incentive Plan	75,038	-	-	-	-	-	-
Forfeiture of restricted stock	-	-	-	-	-	-	-
Vesting of restricted stock	-	-	629	-	-	-	629
Dividends and distributions declared for the period	-	-	-	(12,979)	-	(172)	(13,151)
Other comprehensive income (loss) - change in fair value of interest rate swaps	-	-	-	-	731	10	741
Net income	-	-	-	14,575	-	193	14,768
Balance, March 31, 2017	26,219,680	$ 3	$ 711,753	$ (26,962)	$ 195	$ 2,563	$ 687,552

See accompanying notes to consolidated financial statements.

4

AGREE REALTY CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Three Months Ended March 31, 2017	March 31, 2016
Cash Flows from Operating Activities		
Net income	$ 14,768	$ 7,586
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	4,510	3,378
Amortization	2,515	1,707
Amortization from financing and credit facility costs	241	170
Stock-based compensation	629	708
(Gain) loss on sale of assets	(4,742)	-
(Increase) decrease in accounts receivable	(1,608)	(389)
(Increase) decrease in other assets	(440)	262
Increase (decrease) in accounts payable	(590)	2,202
Increase (decrease) in deferred revenue	(173)	(116)
Increase (decrease) in accrued interest	461	1,015
Increase (decrease) in tenant deposits	-	10
Net Cash Provided by Operating Activities	15,571	16,533
Cash Flows from Investing Activities		
Acquisition of real estate investments and other assets	(53,680)	(33,486)
Development of real estate investments and other assets (including capitalized interest of $67 in 2017 and $7 in 2016)	(2,937)	(6,203)
Payment of leasing costs	(389)	(39)
Net proceeds from sale of assets	10,182	-
Net Cash Used In Investing Activities	(46,824)	(39,728)
Cash Flows from Financing Activities		
Proceeds from common stock offerings, net	150	1,992
Repurchase of common shares	(1,095)	(703)
Unsecured revolving credit facility borrowings	39,000	42,000
Unsecured revolving credit facility repayments	(24,000)	-
Payments of mortgage notes payable	(590)	(9,300)
Payments of unsecured term loans	(179)	-
Dividends paid	(12,952)	(9,596)
Distributions to non-controlling interest	(172)	(162)
Payments for financing costs	(4)	(37)

Net Cash Provided by Financing Activities	158	24,194
Net Increase (Decrease) in Cash and Cash Equivalents	(31,095)	999
Cash and Cash Equivalents, beginning of period	33,395	2,712
Cash and Cash Equivalents, end of period	$ 2,300	$ 3,711
Supplemental Disclosure of Cash Flow Information		
Cash paid for interest (net of amounts capitalized)	$ 3,618	$ 2,484
Supplemental Disclosure of Non-Cash Investing and Financing Activities		
Shares issued under equity incentive plans (in dollars)	$ 3,648	$ 3,059

See accompanying notes to consolidated financial statements.

AGREE REALTY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2017

(Unaudited)

Note 1 – Organization

Agree Realty Corporation, a Maryland corporation, is a fully integrated real estate investment trust (“REIT”) primarily focused on the ownership, acquisition, development and management of retail properties net leased to industry leading tenants. The Company was founded in 1971 by its current Executive Chairman, Richard Agree, and our common stock was listed on the New York Stock Exchange (“NYSE”) in 1994.

Our assets are held by, and all of our operations are conducted through, directly or indirectly, Agree Limited Partnership (the “Operating Partnership”), of which Agree Realty Corporation is the sole general partner and in which it held a 98.7% interest as of March 31, 2017. Under the partnership agreement of the Operating Partnership, Agree Realty Corporation, as the sole general partner, has exclusive responsibility and discretion in the management and control of the Operating Partnership.

The terms “Agree Realty,” the "Company," “Management,” "we,” “our” or "us" refer to Agree Realty Corporation and all of its consolidated subsidiaries, including the Operating Partnership.

Note 2 – Summary of Significant Accounting Policies

Basis of Accounting and Principles of Consolidation

The accompanying unaudited consolidated financial statements for the three months ended March 31, 2017 have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for audited financial statements. The unaudited consolidated financial statements reflect all adjustments which are, in the opinion of management, necessary for a fair presentation of the results for the interim period presented. Operating results for the three months ended March 31, 2017 may not be indicative of the results that may be expected for the year ending December 31, 2017. Amounts as of December 31, 2016 included in the consolidated financial statements have been derived from the audited consolidated financial statements as of that date. The unaudited consolidated financial statements, included herein, should be read in conjunction with the consolidated financial statements and notes thereto, as well as Management's Discussion and Analysis of Financial Condition and Results of Operations, in our Form 10-K for the year ended December 31, 2016.

The unaudited consolidated financial statements include the accounts of the Company, the Operating Partnership and its wholly-owned subsidiaries. All material intercompany accounts and transactions have been eliminated.

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles (“GAAP”) requires management to make estimates and assumptions that affect the reported amounts of (1) assets and liabilities and the disclosure of contingent assets and liabilities as of the date of the financial statements, and (2) revenues and expenses during the reporting period. Actual results could differ from those estimates.

Reclassification

Certain reclassifications of prior period amounts have been made in the consolidated financial statements and footnotes in order to conform to the current presentation. Prepaid rents are presented on the Balance Sheet as Deferred Revenue; in previously filed reports prepaid rents were presented in Accounts Payable - Operating. The classification of below-market lease intangibles are presented net of accumulated amortization as a Liability; in previously filed reports below-market lease intangibles were presented in Unamortized Deferred Expenses: Lease Intangibles net from in-place and above-market lease intangibles.

AGREE REALTY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2017

(Unaudited)

Segment Reporting

The Company is primarily in the business of acquiring, developing and managing retail real estate which is considered to be one reporting segment. The Company has no other reportable segments.

Real Estate Investments

The Company records the acquisition of real estate at cost, including acquisition and closing costs. For properties developed by the Company, all direct and indirect costs related to planning, development and construction, including interest, real estate taxes and other miscellaneous costs incurred during the construction period, are capitalized for financial reporting purposes and recorded as property under development until construction has been completed. Properties classified as “held for sale” are recorded at the lower of their carrying value or their fair value, less anticipated selling costs.

Accounting for Acquisitions of Real Estate

The acquisition of property for investment purposes is typically accounted for as an asset acquisition. The Company allocates the purchase price to land, building and identified intangible assets and liabilities, based in each case on their relative estimated fair values and without giving rise to goodwill. Intangible assets and liabilities represent the value of in-place leases and above- or below-market leases. In making estimates of fair values, the Company may use a number of sources, including data provided by independent third parties, as well as information obtained by the Company as a result of our due diligence, including expected future cash flows of the property and various characteristics of the markets where the property is located.

In allocating the fair value of the identified intangible assets and liabilities of an acquired property, in-place lease intangibles are valued based on the Company’s estimates of costs related to tenant acquisition and the carrying costs that would be incurred during the time it would take to locate a tenant if the property were vacant, considering current market conditions and costs to execute similar leases at the time of the acquisition. Above and below market lease intangibles are recorded based on the present value of the difference between the contractual amounts to be paid pursuant to the leases at the time of acquisition of the real estate and the Company’s estimate of current market lease rates for the property, measured over a period equal to the remaining non-cancelable term of the lease.

The fair value of identified intangible assets and liabilities acquired is amortized to depreciation and amortization over the remaining term of the related leases.

Cash and Cash Equivalents

The Company considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. Cash and cash equivalents consist of cash and money market accounts. The account balances periodically exceed the Federal Deposit Insurance Corporation ("FDIC") insurance coverage, and as a result, there is a concentration of credit risk related to amounts on deposit in excess of FDIC insurance coverage. We had $1.6 million and $32.4 million in cash as of March 31, 2017 and December 31, 2016, respectively, in excess of the FDIC insured limit.

Accounts Receivable – Tenants

The Company reviews its rent receivables for collectability on a regular basis, taking into consideration changes in factors such as the tenant's payment history, the financial condition of the tenant, business conditions in the industry in which the tenant operates and economic conditions in the area where the property is located. In the event that the collectability of a receivable with respect to any tenant is in doubt, a provision for uncollectible amounts will be established or a direct write-off of the specific rent receivable will be made. For accrued rental revenues related to the straight-line method of reporting rental revenue, the Company performs a periodic review of receivable balances to assess the risk of uncollectible amounts and establish appropriate provisions.

The Company's leases provide for reimbursement from tenants for common area maintenance ("CAM"), insurance, real estate taxes and other operating expenses ("Operating Cost Reimbursement Revenue"). A portion of our Operating Cost Reimbursement Revenue is estimated each period and is recognized as revenue in the period the recoverable costs are incurred and accrued. Receivables from Operating Cost Reimbursement Revenue are included in our Accounts Receivable - Tenants line item in our consolidated balance sheets. The balance of unbilled Operating Cost Reimbursement Receivable at March 31, 2017 and December 31, 2016 was $0.6 million and $1.1 million, respectively.

AGREE REALTY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2017

(Unaudited)

In addition, many of the Company’s leases contain rent escalations for which we recognize revenue on a straight-line basis over the non-cancelable lease term. This method results in rental revenue in the early years of a lease being higher than actual cash received, creating a straight-line rent receivable asset which is included in the Accounts Receivable - Tenants line item in our consolidated balance sheets. The balance of straight-line rent receivables at March 31, 2017 and December 31, 2016 was $10.3 million and $9.6 million, respectively. To the extent any of the tenants under these leases become unable to pay their contractual cash rents, the Company may be required to write down the straight-line rent receivable from those tenants, which would reduce operating income.

Sales Tax

The Company collects various taxes from tenants and remits these amounts, on a net basis, to the applicable taxing authorities.

Unamortized Deferred Expenses

Deferred expenses include debt financing costs related to the line of credit, leasing costs and lease intangibles, and are amortized as follows: (i) debt financing costs related to the line of credit on a straight-line basis to interest expense over the term of the related loan, which approximates the effective interest method; (ii) leasing costs on a straight-line basis to depreciation and amortization over the term of the related lease entered into; and (iii) lease intangibles on a straight-line basis to depreciation and amortization over the remaining term of the related lease acquired.

The following schedule summarizes the Company’s amortization of deferred expenses for the three months ended March 31, 2017 and 2016 (in thousands):

	Three Months Ended	
	March 31, 2017	March 31, 2016

Credit Facility Financing Costs	$99	$53
Leasing Costs	$40	$22
Lease Intangibles	$2,428	$1,685
Total	$2,567	$1,760

The following schedule represents estimated future amortization of deferred expenses as of March 31, 2017 (in thousands):

Year Ending December 31,	2017 (remaining)	2018	2019	2020	2021	Thereafter	Total
Credit Facility Financing Costs	$ 296	$380	$379	$380	$21	$ -	$1,456
Leasing Costs	121	167	178	185	169	755	1,575
Lease Intangibles	7,616	9,876	9,422	9,158	8,874	65,004	109,950
Total	$ 8,033	$10,423	$9,979	$9,723	$9,064	$ 65,759	$112,981

Earnings per Share

Earnings per share have been computed by dividing the net income after allocation to unvested restricted stock by the weighted average number of common shares outstanding. Diluted earnings per share is computed by dividing net income by the weighted average common shares and potentially dilutive common shares outstanding in accordance with the treasury stock method.

The following is a reconciliation of the denominator of the basic net earnings per common share computation to the denominator of the diluted net earnings per common share computation for each of the periods presented:

AGREE REALTY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2017

(Unaudited)

	Three Months Ended March 31, 2017	March 31, 2016
Weighted average number of common shares outstanding	26,182,994	20,666,806
Less: Unvested restricted stock	(229,897)	(228,077)
Weighted average number of common shares outstanding used in basic earnings per share	25,953,097	20,438,729
Weighted average number of common shares outstanding used in basic earnings per share	25,953,097	20,438,729
Effect of dilutive securities: restricted stock	56,023	41,411
Weighted average number of common shares outstanding used in diluted earnings per share	26,009,120	20,480,140

Income Taxes

The Company has elected to be taxed as a REIT under the Internal Revenue Code of 1986, as amended (the “Internal Revenue Code”). As a REIT, the Company generally will not be subject to federal income tax provided it continues to satisfy certain tests concerning the Company’s sources of income, the nature of its assets, the amounts distributed to its stockholders, and the ownership of Company stock. Management believes the Company has qualified and will continue to qualify as a REIT. Notwithstanding the Company’s qualification for taxation as a REIT, the Company is subject to certain state and local taxes on its income and real estate.

The Company has established taxable REIT subsidiaries (“TRS”) pursuant to the provisions of the Internal Revenue Code. The Company’s TRS entities are able to engage in activities resulting in income that would be non-qualifying income for a REIT. As a result, certain activities of the Company which occur within its TRS entities are subject to federal and state income taxes. As of March 31, 2017 and December 31, 2016, the Company had accrued a deferred income tax amount of $705,000. In addition, the Company recognized no income tax expense for the three months ended March 31, 2017 and 2016, respectively.

Fair Values of Financial Instruments

The Company's estimates of fair value of financial and non-financial assets and liabilities are based on the framework established in the fair value accounting guidance. The framework specifies a hierarchy of valuation inputs which was established to increase consistency, clarity and comparability in fair value measurements and related disclosures. The guidance describes a fair value hierarchy based upon three levels of inputs that may be used to measure fair value, two of which are considered observable and one that is considered unobservable. The following describes the three levels:

Level 1 – Valuation is based upon quoted prices in active markets for identical assets or liabilities.

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

Level 3 – Valuation is generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include option pricing models, discounted cash flow models and similar techniques.

Recent Accounting Pronouncements

In January 2017, the Financial Accounting Standards Board ("FASB") issued ASU No. 2017-01, "Business Combinations: Clarifying the Definition of a Business" ("ASU 2017-01"). The objective of ASU 2017-01 is to clarify the definition of a business by adding guidance on how entities should evaluate whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The definition of a business affects many areas of accounting including acquisitions, disposals, goodwill, and consolidation. ASU 2017-01 will be effective for public business entities for fiscal years beginning after December 15, 2017, including interim periods in the year of adoption. Early adoption is permitted for any interim or annual period. The Company is in the process of determining the impact that the implementation of ASU 2017-01 will have on the Company's financial statements.

AGREE REALTY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2017

(Unaudited)

In February 2016, the FASB issued ASU No. 2016-02 “Leases” (“ASU 2016-02”). The new standard creates Topic 842, Leases, in FASB *Accounting Standards Codification* (FASB ASC) and supersedes FASB ASC 840, *Leases.* ASU 2016-02 requires a lessee to recognize the assets and liabilities that arise from leases (operating and finance). However, for leases with a term of 12 months or less, a lessee is permitted to make an accounting policy election not to recognize lease assets and lease liabilities. The main difference between the existing guidance on accounting for leases and the new standard is that operating leases will now be recorded in the statement of financial position as assets and liabilities. The new standard requires lessors to account for leases using an approach that is substantially equivalent to existing guidance for sales-type leases and operating leases. ASU 2016-02 is expected to impact the Company’s consolidated financial statements as the Company has certain operating land lease arrangements for which it is the lessee. GAAP requires only capital (finance) leases to be recognized in the statement of financial position, and amounts related to operating leases largely are reflected in the financial statements as rent expense on the income statement and in disclosures to the financial statements. ASU 2016-02 is effective for annual reporting periods (including interim periods within those periods) beginning after December 15, 2018. Early adoption is permitted. The Company is in the process of determining the impact that the implementation of ASU 2016-02 will have on the Company’s financial statements. We anticipate there will be an immaterial impact for the leases in which the Company is the lessor and/or the lessee.

In May 2014, with subsequent updates issued in August 2015 and March, April and May 2016, the FASB issued ASU No. 2014-09 “Revenue from Contracts with Customers (Topic 606)” (“ASU 2014-09”). ASU 2014-09 was developed to enable financial statement users to better understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. The update’s core principle is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Companies are to use a five-step contract review model to ensure revenue is recognized, measured and disclosed in accordance with this principle. ASU 2014-09, as updated, is effective for fiscal years and interim periods beginning after December 15, 2017. The Company is in the process of engaging a professional services firm to assist in the implementation of ASU 2014-09 and has not currently selected a transition method. In addition we are in the process of determining the impact that the implementation of ASU 2014-09, as updated, will have on the Company’s financial statements and it is considered likely the implementation will change the Company’s disclosures.

Note 3 – Real Estate Investments

Real Estate Portfolio

The Company's real estate investments consisted of the following as of March 31, 2017 and December 31, 2016 (in thousands, except number of properties):

	March 31, 2017	December 31, 2016
Number of Properties	377	366
Gross Leasable Area (in square feet)	7,326	7,033
Land	$319,935	$ 309,687
Buildings	737,605	703,506
Property under Development	8,414	6,764
Gross Real Estate Investments	$1,065,954	$ 1,019,957
Less Accumulated Depreciation	$(73,657)	(69,696)
Net Real Estate Investments	$992,297	$ 950,261

10

AGREE REALTY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2017

(Unaudited)

Investments

During the three months ended March 31, 2017, the Company acquired 11 retail net lease assets for approximately $53.2 million, which includes acquisition and closing costs. These properties are located in 9 states and are leased to 12 different tenants operating in 8 diverse retail sectors for a weighted average lease term of approximately 10.6 years.

The aggregate first quarter 2017 acquisitions were allocated $12.6 million to land, $35.6 million to buildings and improvements, and $5.0 million to lease intangibles and other assets. The acquisitions were all cash purchases and there were no contingent considerations associated with these acquisitions.

None of the Company's acquisitions during the first three months of 2017 caused any new or existing tenant to comprise 10% or more of its total assets or generate 10% or more of its total annualized base rent at March 31, 2017.

Developments

During the first quarter of 2017, construction continued on the Company's two development and Partner Capital Solutions ("PCS") projects with anticipated total project costs of approximately $12.3 million. These projects consist of the Company's first ground-up development for Camping World in Georgetown, Kentucky, and the redevelopment and expansion of an existing property in Boynton Beach, Florida for Orchard Supply Hardware.

For the three months ended March 31, 2017, the Company has four development or PCS projects completed or currently under construction. Total anticipated project costs for those developments are approximately $21.5 million and include the following completed or commenced projects:

AGREE REALTY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2017

(Unaudited)

Tenant	**Location**	**Lease Structure**	**Lease Term**	**Actual or Anticipated Rent Commencement**	**Status**
Camping World	Tyler, TX	Build-to-Suit	20 Years	Q1 2017	Completed
Burger King(1)	Heber, UT	Build-to-Suit	20 Years	Q1 2017	Completed
Orchard Supply	Boynton Beach, FL	Build-to-Suit	15 Years	Q3 2017	Under Construction
Camping World	Georgetown, KY	Build-to-Suit	20 Years	Q3 2017	Under Construction

(1) Franchise restaurants operated by Meridian Restaurants Unlimited, LC.

Dispositions

During the three months ended March 31, 2017, the Company sold a Walgreens property in Ann Arbor, Michigan for net proceeds of $10.2 million. The Company recorded a net gain of approximately $4.7 million on the sale. There were no other dispositions for the three months ended March 31, 2017.

Note 4 – Debt

In April 2015, FASB issued ASU 2015-03, which requires that debt issuance costs related to a recognized debt liability be presented on the balance sheet as a direct deduction from the gross carrying amount of that debt liability, consistent with debt discounts. We adopted ASU 2015-03, effective March 31, 2016, and applied the guidance retrospectively to our Mortgage Notes Payable, Unsecured Term Loans and Senior Unsecured Notes for all periods presented. Unamortized debt issuance costs of approximately $3.0 million and $3.1 million are included as an offset to the respective debt balances as of March 31, 2017 and December 31, 2016, respectively.

As of March 31, 2017, we had total gross indebtedness of $418.3 million, including (i) $69.4 million of mortgage notes payable; (ii) $159.9 million of unsecured term loans; (iii) $160.0 million of senior unsecured notes; and (iv) $29.0 million of borrowings under our Credit Facility.

Mortgage Notes Payable

As of March 31, 2017, the Company had total gross mortgage indebtedness of $69.4 million which was collateralized by related real estate with an aggregate net book value of $89.9 million. Including mortgages that have been swapped to a fixed interest rate, the weighted average interest rate on the Company's mortgage notes payable was 3.9%.

Mortgages payable consisted of the following (in thousands):

AGREE REALTY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2017

(Unaudited)

	March 31, 2017	December 31, 2016
Note payable in monthly installments of interest only at LIBOR plus 160 basis points, swapped to a fixed rate of 2.49% with a balloon payment due April 4, 2018; collateralized by related real estate and tenants' leases	$ 25,000	$ 25,000
Note payable in monthly installments of $153,838, including interest at 6.90% per annum, with the final monthly payment due January 2020; collateralized by related real estate and tenants’ leases	4,739	5,114
Note payable in monthly installments of $23,004, including interest at 6.24% per annum, with a balloon payment of $2,781,819 due February 2020; collateralized by related real estate and tenant lease	3,027	3,049
Note payable in monthly installments of interest only at 3.60% per annum, with a balloon payment due January 1, 2023; collateralized by related real estate and tenants' leases	23,640	23,640
Note payable in monthly installments of $35,673, including interest at 5.01% per annum, with a balloon payment of $4,034,627 due September 2023; collateralized by related real estate and tenant lease	5,253	5,294
Note payable in monthly installments of $91,675 including interest at 6.27% per annum, with a final monthly payment due July 2026; collateralized by related real estate and tenants’ leases	7,758	7,910
Total principal	69,417	70,007
Unamortized debt issuance costs	(878)	(940)
Total	$ 68,539	$ 69,067

Debt Maturities

The following table presents scheduled principal payments related to our debt as of March 31, 2017 (in thousands):

	Scheduled Principal	Balloon Payment	Total
Remainder of 2017	$ 2,378	$ -	$ 2,378
2018	3,337	25,000	28,337
2019	2,751	18,547	21,298
2020	1,092	37,775	38,867
2021 (1)	998	94,000	94,998
Thereafter	8,763	223,640	232,403
Total	$ 19,319	$ 398,962	$ 418,281

(1) *The balloon payment balance includes the balance outstanding under the Credit Facility as of March 31, 2017. The Credit Facility matures in January 2021, with options to extend the maturity for one year at the Company's election, subject to certain conditions.*

13

AGREE REALTY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2017

(Unaudited)

Senior Unsecured Notes

The following table presents the Senior Unsecured Notes balance net of unamortized debt issuance costs as of March 31, 2017, and December 31, 2016 (in thousands):

	March 31, 2017	December 31, 2016
2025 Senior Unsecured Note	$ 50,000	$ 50,000
2027 Senior Unsecured Note	50,000	50,000
2028 Senior Unsecured Note	60,000	60,000
Total Principal	160,000	160,000
Unamortized debt issuance costs	(802)	(824)
Total	$ 159,198	$ 159,176

In May 2015, the Company completed a private placement of $100.0 million principal amount of senior unsecured notes. The senior unsecured notes were sold in two series; $50.0 million of 4.16% notes due in May 2025 and $50.0 million of 4.26% notes due in May 2027. The weighted average term of the senior unsecured notes is 11 years and the weighted average interest rate is 4.21%.

In July 2016, the Company completed a private placement of $60.0 million principal amount of senior unsecured notes. The senior unsecured notes bear a fixed interest rate of 4.42% per annum and mature in July 2028.

Unsecured Term Loan Facilities

The following table presents the Unsecured Term Loans balance net of unamortized debt issuance costs as of March 31, 2017 and December 31, 2016 (in thousands):

	March 31, 2017	December 31, 2016
2019 Term Loan	$ 19,864	$ 20,044
2020 Term Loan	35,000	35,000
2021 Term Loan	65,000	65,000
2023 Term Loan	40,000	40,000
Total Principal	159,864	160,044
Unamortized debt issuance costs	(1,307)	(1,365)
Total	$ 158,557	$ 158,679

The amended and restated credit agreement, described below, extended the maturity dates of the $65.0 million unsecured term loan facility and $35.0 million unsecured term loan facility (together, the "2024 Term Loan Facilities") to January 2024. In connection with entering into the amended and restated credit agreement, the prior notes evidencing the existing $65.0 million unsecured term loan facility and $35.0 million unsecured term loan facility were canceled and new notes evidencing the 2024 Term Loan Facilities were executed. Borrowings under the unsecured 2024 Term Loan Facilities bear interest at a variable LIBOR plus 1.65% to 2.35%, depending on the Company's leverage ratio. The Company utilized existing interest rate swaps to effectively fix the LIBOR rate (Refer to Note 7-Derivative Instruments and Hedging Activity).

In August 2016, the Company entered into a $20.3 million unsecured amortizing term loan that matures in May 2019 (the "2019 Term Loan"). Borrowings under the 2019 Term Loan are priced at LIBOR plus 170 basis points. In order to fix LIBOR on the 2019 Term Loan at 1.92% until maturity, the Company had an interest rate swap agreement in place, which was assigned by the lender under the Mortgage Note to the 2019 Term Loan lender. As of March 31, 2017, $19.9 million was outstanding under the 2019 Term Loan bearing an all-in interest rate of 3.62%.

In July 2016, the Company completed a $40.0 million unsecured term loan facility that matures in July 2023 (the "2023 Term Loan"). Borrowings under the 2023 Term Loan are priced at LIBOR plus 165 to 225 basis points, depending on the Company's leverage. The Company entered into an interest rate swap to fix LIBOR at 1.40% until maturity. As of March 31, 2017, $40.0 million was outstanding under the 2023 Term Loan, which is subject to an all-in interest rate of 3.05%.

AGREE REALTY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2017

(Unaudited)

Senior Unsecured Revolving Credit Facility

In December 2016, the Company amended and restated the credit agreement that governs the Company's senior unsecured revolving credit facility and the Company's unsecured term loan facility to increase the aggregate borrowing capacity to $350.0 million. The agreement provides for a $250.0 million unsecured revolving credit facility, a $65.0 million unsecured term loan facility and a $35.0 million unsecured term loan facility (Referenced above as the 2024 Term Loan Facilities). The unsecured revolving credit facility matures in January 2021 with options to extend the maturity date to January 2022. The 2024 Term Loan Facilities mature in January 2024. The Company has the ability to increase the aggregate borrowing capacity under the credit agreement up to $500.0 million, subject to lender approval. Borrowings under the revolving credit facility bear interest at LIBOR plus 1.30% to 1.95%, depending on the Company’s leverage ratio. Additionally, the Company is required to pay an unused commitment fee at an annual rate of 0.15% or 0.25% of the unused portion of the revolving credit facility, depending on the amount of borrowings outstanding. The credit agreement contains certain financial covenants, including a maximum leverage ratio, a minimum fixed charge coverage ratio, and a maximum percentage of secured debt to total asset value. As of March 31, 2017 and December 31, 2016, the Company had $29.0 million and $14.0 million of outstanding borrowings under the revolving credit facility, respectively, bearing weighted average interest rates of approximately 2.2% and 1.9%, respectively. As of March 31, 2017, $221.0 million was available for borrowing under the revolving credit facility and the Company was in compliance with the credit agreement covenants.

Concurrent with the amendment and restatement of the Company’s senior unsecured revolving credit facility, conforming changes were made to the 2023 Term Loan and 2019 Term Loan.

Note 5 – Common Stock

On May 6, 2015, the Company implemented a $100.0 million at-the-market equity program (“ATM program”) by entering into multiple equity distribution agreements through which the Company may, from time to time, sell shares of common stock. The Company uses the proceeds generated from its ATM program for general corporate purposes including funding our investment activity, the repayment or refinancing of outstanding indebtedness, working capital and other general purposes.

During the three months ended March 31, 2017, the Company did not issue any shares of common stock under its ATM program. The Company had approximately $36.2 million remaining under the ATM program as of March 31, 2017.

In March 2015, the Company filed, and the SEC declared effective, a shelf registration statement that expires in March 2018. The securities covered by this registration statement cannot exceed $500.0 million in the aggregate and include common stock, preferred stock, depositary shares and warrants. The Company may periodically offer one or more of these securities in amounts, prices and on terms to be announced when and if these securities are offered. The specifics of any future offerings, along with the use of proceeds of any securities offered, will be described in detail in a prospectus supplement, or other offering materials, at the time of any offering.

AGREE REALTY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2017

(Unaudited)

Note 6 – Dividends and Distribution Payable

On February 27, 2017, the Company declared a dividend of $0.495 per share for the quarter ended March 31, 2017. The holders of limited partnership interests in the Operating Partnership ("OP Units") were entitled to an equal distribution per OP Unit held as of March 31, 2017. The dividends and distributions payable were recorded as liabilities on the Company's consolidated balance sheet at March 31, 2017. The dividend has been reflected as a reduction of stockholders' equity and the distribution has been reflected as a reduction of the limited partners' non-controlling interest. These amounts were paid on April 14, 2017.

Note 7 – Derivative Instruments and Hedging Activity

The Company is exposed to certain risks arising from both its business operations and economic conditions. The Company principally manages its exposures to a wide variety of business and operational risks through management of its core business activities. The Company manages economic risk, including interest rate, liquidity and credit risk primarily by managing the amount, sources and duration of its debt funding and, to a limited extent, the use of derivative instruments. For additional information regarding the leveling of our derivatives (Refer to Note 9- Fair Value Measurements).

The Company's objective in using interest rate derivatives is to manage its exposure to interest rate movements and add stability to interest expense. To accomplish this objective, the Company uses interest rate swaps as part of its interest rate risk management strategy. Interest rate swaps designated as cash flow hedges involve the receipt of variable rate amounts from a counterparty in exchange for the Company making fixed rate payments over the life of the agreement without exchange of the underlying notional amount.

In April 2012, the Company entered into an amortizing forward-starting interest rate swap agreement to hedge against changes in future cash flows resulting from changes in interest rates on $22.3 million in variable-rate borrowings. Under the terms of the interest rate swap agreement, the Company receives from the counterparty interest on the notional amount based on 1 month LIBOR and pays to the counterparty a fixed rate of 1.92%. This swap effectively converted $22.3 million of variable-rate borrowings to fixed-rate borrowings from July 1, 2013 to May 1, 2019. As of

March 31, 2017, this interest rate swap was valued as a liability of approximately $0.2 million.

In December 2012, the Company entered into interest rate swap agreements to hedge against changes in future cash flows resulting from changes in interest rates on $25.0 million in variable-rate borrowings. Under the terms of the interest rate swap agreement, the Company receives from the counterparty interest on the notional amount based on 1 month LIBOR and pays to the counterparty a fixed rate of 0.89%. This swap effectively converted $25.0 million of variable-rate borrowings to fixed-rate borrowings from December 6, 2012 to April 4, 2018. As of March 31, 2017, this interest rate swap was valued as an asset of approximately $0.1 million.

In September 2013, the Company entered into an interest rate swap agreement to hedge against changes in future cash flows resulting from changes in interest rates on $35.0 million in variable-rate borrowings. Under the terms of the interest rate swap agreement, the Company receives from the counterparty interest on the notional amount based on 1 month LIBOR and pays to the counterparty a fixed rate of 2.20%. This swap effectively converted $35.0 million of variable-rate borrowings to fixed-rate borrowings from October 3, 2013 to September 29, 2020. As of March 31, 2017, this interest rate swap was valued as a liability of approximately $0.6 million.

AGREE REALTY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2017

(Unaudited)

In July 2014, the Company entered into interest rate swap agreements to hedge against changes in future cash flows resulting from changes in interest rates on $65.0 million in variable-rate borrowings. Under the terms of the interest rate swap agreement, the Company receives from the counterparty interest on the notional amount based on 1 month LIBOR and pays to the counterparty a fixed rate of 2.09%. This swap effectively converted $65.0 million of variable-rate borrowings to fixed-rate borrowings from July 21, 2014 to July 21, 2021. As of March 31, 2017, this interest rate swap was valued as a liability of approximately $0.7 million.

In June 2016, the Company entered into an interest rate swap agreement to hedge against changes in future cash flows resulting from changes in interest rates on $40.0 million in variable-rate borrowings. Under the terms of the interest rate swap agreement, the Company receives from the counterparty interest on the notional amount based on 1 month LIBOR and pays to the counterparty a fixed rate of 1.40%. This swap effectively converted $40.0 million of variable-rate borrowings to fixed-rate borrowings from August 1, 2016 to July 1, 2023. As of March 31, 2017, this interest rate swap was valued as an asset of approximately $1.5 million.

Companies are required to recognize all derivative instruments as either assets or liabilities at fair value on the balance sheet. The Company has designated these derivative instruments as cash flow hedges. As such, the effective portion of changes in the fair value of the derivatives designated and that qualify as cash flow hedges is recorded as a component of other comprehensive income (loss). The ineffective portion of the change in fair value of the derivative instrument is recognized directly in interest expense. For the three months ended March 31, 2017 and 2016, the Company has not recorded any hedge ineffectiveness in earnings. Amounts in accumulated other comprehensive income (loss) related to derivatives will be reclassified to interest expense as interest payments are made on the Company’s variable-rate debt. During the next twelve months, the Company estimates that an additional $1.0 million will be reclassified as an increase to interest expense.

The Company had the following outstanding interest rate derivatives that were designated as cash flow hedges of interest rate risk (in thousands, except number of instruments):

	Number of Instruments		Notional	
Interest Rate		December 31,		December 31,

Derivatives	March 31, 2017	2016	March 31, 2017	2016
Interest Rate Swap	5	5	$184,864	$ 185,044

17

AGREE REALTY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2017

(Unaudited)

The table below presents the estimated fair value of the Company’s derivative financial instruments, as well as their classification in the consolidated balance sheets (in thousands).

	Asset Derivatives			
	March 31, 2017		December 31, 2016	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives designated as cash flow hedges:				
Interest Rate Swaps	Other Assets	$ 1,561	Other Assets	$ 1,409

	Liability Derivatives			
	March 31, 2017		December 31, 2016	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives designated as cash flow hedges:				
Interest Rate Swaps	Other Liabilities	$ 1,404	Other Liabilities	$ 1,994

The table below displays the effect of the Company’s derivative financial instruments in the consolidated statements of operations and other comprehensive loss for the three and nine months ending March 31, 2017 and 2016 (in thousands).

Derivatives in Cash Flow Hedging Relationships	Amount of Income/(Loss) Recognized in OCI on Derivative (Effective Portion)		Location of Income/(Loss) Reclassifed from Accumulated OCI into Income (Effective Portion)	Amount of Income/(Loss) Reclassified from Accumulated OCI into Expense (Effective Portion)	
Three months ended March 31	2017	2016		2017	2016

Interest rate swaps	$ 741	$ (2,935)	Interest Expense	$ (464)	$ (524)

Credit-risk-related Contingent Features

The Company has agreements with two of its derivative counterparties that contain a provision where the Company could be declared in default on its derivative obligations if repayment of the underlying indebtedness is accelerated by the lender due to the Company's default on the indebtedness.

As of March 31, 2017, the fair value of derivatives in a net liability position related to these agreements, which includes accrued interest but excludes any adjustment for nonperformance risk, was $1.2 million. As of March 31, 2017, the Company has not posted any collateral related to these net liability positions. If the Company had breached any of these provisions as of March 31, 2017, it could have been required to settle its obligations under the agreements at their termination value of $1.2 million.

Although the derivative contracts are subject to master netting arrangements, which serve as credit mitigants to both us and our counterparties under certain situations, we do not net our derivative fair values or any existing rights or obligations to cash collateral on the consolidated balance sheets.

AGREE REALTY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2017

(Unaudited)

The table below presents a gross presentation of the effects of offsetting and a net presentation of the Company's derivatives as of March 31, 2017 and December 31, 2016. The gross amounts of derivative assets or liabilities can be reconciled to the Tabular Disclosure of Fair Values of Derivative Instruments above, which also provides the location that derivative assets and liabilities are presented on the consolidated balance sheets (in thousands):

As of March 31, 2017

				Gross Amounts Not Offset in the Statement of Financial Position		
	Gross Amounts of Recognized Assets	Gross Amounts Offset in the Statement of Financial Position	Net Amounts of Assets presented in the statement of Financial Position	Financial Instruments	Cash Collateral Received	Net Amount
Derivatives	$ 1,561	$ -	$ 1,561	$ (89)	$ -	$ 1,472

Offsetting of Derivative Liabilities

As of March 31, 2017

				Gross Amounts Not Offset in the Statement of Financial Position		
	Gross Amounts of Recognized Liabilities	Gross Amounts Offset in the Statement of Financial Position	Net Amounts of Liabilities presented in the statement of Financial Position	Financial Instruments	Cash Collateral Received	Net Amount
Derivatives	$ 1,404	$ -	$ 1,404	$ (89)	$ -	$ 1,315

Offsetting of Derivative Assets

As of December 31, 2016

	Gross Amounts of Recognized Assets	Gross Amounts Offset in the Statement of Financial Position	Net Amounts of Assets presented in the statement of Financial Position	Gross Amounts Not Offset in the Statement of Financial Position		
				Financial Instruments	Cash Collateral Received	Net Amou
Derivatives	$1,409	$-	$1,409	$(50)	$-	$1,359

As of December 31, 2016

	Gross Amounts of Recognized Liabilities	Gross Amounts Offset in the Statement of Financial Position	Net Amounts of Liabilities presented in the statement of Financial Position	Gross Amounts Not Offset in the Statement of Financial Position		
				Financial Instruments	Cash Collateral Received	Net Amount
Derivatives	$ 1,994	$ -	$ 1,994	$ (50)	$ -	$ 1,944

Note 8 – Discontinued Operations

There were no properties classified as discontinued operations for the three months ended March 31, 2017.

AGREE REALTY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2017

(Unaudited)

Note 9 – Fair Value Measurements

Assets and Liabilities Measured at Fair Value

The Company accounts for fair values in accordance with FASB Accounting Standards Codification Topic 820 *Fair Value Measurements and Disclosure* (ASC 820). ASC 820 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. ASC 820 applies to reported balances that are required or permitted to be measured at fair value under existing accounting pronouncements; accordingly, the standard does not require any new fair value measurements of reported balances.

ASC 820 emphasizes that fair value is a market-based measurement, not an entity-specific measurement. Therefore, a fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability. As a basis for considering market participant assumptions in fair value measurements, ASC 820 establishes a fair value hierarchy that distinguishes between market participant assumptions based on market data obtained from sources independent of the reporting entity (observable inputs that are classified within Levels 1 and 2 of the hierarchy) and the reporting entity's own assumptions about market participant assumptions (unobservable inputs classified within Level 3 of the hierarchy).

Level 1 inputs utilize quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access. Level 2 inputs are inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs may include quoted prices for similar assets and liabilities in active markets, as well as inputs that are observable for the asset or liability (other than quoted prices), such as interest rates, foreign exchange rates, and yield curves that are observable at commonly quoted intervals. Level 3 inputs are unobservable inputs for the asset or liability, which are typically based on an entity's own assumptions, as there is little, if any, related market activity. In instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls, is based on the lowest level input that is significant to the fair value measurement in its entirety. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability.

Derivative Financial Instruments

Currently, the Company uses interest rate swap agreements to manage its interest rate risk. The valuation of these instruments is determined using widely accepted valuation techniques including discounted cash flow analysis on the expected cash flows of each derivative. This analysis reflects the contractual terms of the derivatives, including the period to maturity, and uses observable market-based inputs, including interest rate curves.

To comply with the provisions of ASC 820, the Company incorporates credit valuation adjustments to appropriately reflect both its own nonperformance risk and the respective counterparty's nonperformance risk in the fair value measurements. In adjusting the fair value of its derivative contracts for the effect of nonperformance risk, the Company has considered the impact of netting and any applicable credit enhancements, such as collateral postings, thresholds, mutual puts, and guarantees.

Although the Company has determined that the majority of the inputs used to value its derivatives fall within Level 2 of the fair value hierarchy, the credit valuation adjustments associated with its derivatives utilize Level 3 inputs, such as estimates of current credit spreads to evaluate the likelihood of default by itself and its counterparties. However, as of March 31, 2017, the Company has assessed the significance of the impact of the credit valuation adjustments on the overall valuation of its derivative positions and has determined that the credit valuation adjustments are not significant to the overall valuation of its derivatives. As a result, the Company has determined that its derivative valuations in their entirety are classified in Level 2 of the fair value hierarchy.

AGREE REALTY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2017

(Unaudited)

The table below presents the Company’s assets and liabilities measured at fair value on a recurring basis as of March 31, 2017, aggregated by the level in the fair value hierarchy within which those measurements fall (in thousands):

	Quoted Prices in Active Markets for Identical Assets and Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance at March 31, 2017
Asset:				
Interest rate swaps	$ -	$ 1,561	$ -	$ 1,561
Liability:				
Interest rate swaps	$ -	$ 1,404	$ -	$ 1,404

	Quoted Prices in Active Markets for Identical Assets and Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance at December 31, 2016
Asset:				
Interest rate swaps	$ -	$ 1,409	$ -	$ 1,409
Liability:				
Interest rate swaps	$ -	$ 1,994	$ -	$ 1,994

The carrying values of cash and cash equivalents, receivables and accounts payable and accrued liabilities are reasonable estimates of their fair values because of the short maturity of these financial instruments.

The Company estimated the fair value of our debt based on our incremental borrowing rates for similar types of borrowing arrangements with the same remaining maturity and on the discounted estimated future cash payments to be made for other debt. The discount rate used to calculate the fair value of debt approximates current lending rates for loans and assume the debt is outstanding through maturity. Since such amounts are estimates that are based on limited available market information for similar transactions, there can be no assurance that the disclosed value of any financial instrument could be realized by immediate settlement of the instrument.

Fixed rate debt (including variable rate debt swapped to fixed through derivatives) with carrying values of $386.3 million and $386.9 million as of March 31, 2017 and December 31, 2016, respectively, had fair values of approximately $400.3 million and $401.4 million, respectively. Variable rate debt's fair value is estimated to be the carrying values of $29.0 million and $14.0 million as of March 31, 2017 and December 31, 2016, respectively.

Note 10 – Equity Incentive Plan

The Company estimates the fair value of restricted stock grants at the date of grant and amortizes those amounts into expense on a straight line basis or amount vested, if greater, over the appropriate vesting period.

As of March 31, 2017, there was $8.3 million of total unrecognized compensation costs related to the outstanding restricted stock, which is expected to be recognized over a weighted average period of 3.8 years. The Company used 0% for both the discount factor and forfeiture rate for determining the fair value of restricted stock.

The holder of a restricted stock award is generally entitled at all times on and after the date of issuance of the restricted shares to exercise the rights of a stockholder of the Company, including the right to vote the shares and the right to receive dividends on the shares.

Restricted stock activity is summarized as follows:

	Shares Outstanding	Weighted Average Grant Date Fair Value
Unvested restricted stock at December 31, 2016	227,532	$ 33.02

Restricted stock granted	75,038	$	48.62
Restricted stock vested	(72,673)	$	30.47
Restricted stock forfeited	-		
Unvested restricted stock at March 31, 2017	229,897	$	38.92

Note 11 – Subsequent Events

In connection with the preparation of its financial statements, the Company has evaluated events that occurred subsequent to March 31, 2017 through the date on which these financial statements were available to be issued to determine whether any of these events required disclosure in the financial statements.

There were no reportable subsequent events or transactions.

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

The following should be read in conjunction with the Interim Consolidated Financial Statements of Agree Realty Corporation (the “Company”), including the respective notes thereto, which are included in this Quarterly Report on Form 10-Q.

Cautionary Note Regarding Forward-Looking Statements

This report contains certain forward-looking statements within the meaning of 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”). The Company intends such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995 and includes this statement for purposes of complying with these safe harbor provisions. Forward-looking statements, which are based on certain assumptions and describe our future plans, strategies and expectations, are generally identifiable by use of the words “anticipate,” “estimate,” “should,” “expect,” “believe,” “intend,” “may,” “will,” “seek,” “could,” “project,” or similar expressions. Forward- statements in this report include information about possible or assumed future events, including, among other things, discussion and analysis of our future financial condition, results of operations, our strategic plans and objectives, occupancy and leasing rates and trends, liquidity and ability to refinance our indebtedness as it matures, anticipated expenditures of capital, and other matters. You should not rely on forward-looking statements since they involve known and unknown risks, uncertainties and other factors, which are, in some cases, beyond our control and which could materially affect actual results, performances or achievements. Factors which may cause actual results to differ materially from current expectations, include, but are not limited to: the global and national economic conditions and changes in general economic, financial and real estate market conditions; changes in our business strategy; risks that our acquisition and development projects will fail to perform as expected; the potential need to fund improvements or other capital expenditures out of operating cash flow; financing risks, such as the inability to obtain debt or equity financing on favorable terms or at all; the level and volatility of interest rates; our ability to re-lease space as leases expire; loss or bankruptcy of one or more of our major tenants; a failure of our properties to generate additional income to offset increases in operating expenses; our ability to maintain our qualification as a real estate investment trust (“REIT”) for federal income tax purposes and the limitations imposed on our business by our status as a REIT; and legislative or regulatory changes, including changes to laws governing REITs. The factors included in this quarterly report, including the documents incorporated by reference, and documents the Company subsequently files with the SEC and incorporates by reference, are not exhaustive and additional factors could adversely affect its business and financial performance. For a discussion of additional risk factors, see the factors included under the caption “Risk Factors” in the Company’s most recent Annual Report on Form 10-K. All forward-looking statements are based on information that was available, and speak only, as of the date on which they were made. Except as required by law, the Company disclaims any obligation to review or update these forward–looking statements to reflect events or circumstances as they occur.

Overview

The Company is a fully integrated REIT primarily focused on the ownership, acquisition, development and management of retail properties net leased to industry leading tenants. The Company was founded in 1971 by its current Executive Chairman, Richard Agree, and our common stock was listed on the New York Stock Exchange ("NYSE") in 1994. The Company's assets are held by, and all of its operations are conducted through, directly or indirectly, Agree Limited Partnership (the "Operating Partnership"), of which the Company is the sole general partner and in which it held a 98.7% interest as of March 31, 2017.

As of March 31, 2017, the Company's portfolio consisted of 377 properties located in 43 states and totaling approximately 7.3 million square feet of gross leasable area. As of March 31, 2017, the portfolio was approximately 99.6% leased and had a weighted average remaining lease term of approximately 10.6 years. Substantially all of the Company's tenants are subject to net lease agreements. A net lease typically requires the tenant to be responsible for minimum monthly rent and property operating expenses including property taxes, insurance and maintenance.

First Quarter 2017 Highlights

During the three months ended March 31, 2017, the Company acquired 11 retail net lease assets for approximately $53.2 million, which includes acquisition and closing costs. These properties are located in 9 states and are 100% leased to 12 different tenants operating in 8 diverse retail sectors for a weighted average lease term of approximately 10.6 years. The underwritten weighted average capitalization rate on the Company's first quarter 2017 acquisitions was approximately 7.6%.

During the three months ended March 31, 2017, the Company sold a Walgreens property in Ann Arbor, Michigan for net proceeds of $10.2 million. The Company recorded a net gain of approximately $4.7 million on the sale.

Recent Accounting Pronouncements

Refer to Note 2 to the March 31, 2017, Interim Consolidated Financial Statements.

Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles (“GAAP”) requires the Company’s management to use judgment in the application of accounting policies, including making estimates and assumptions. Management bases estimates on the best information available at the time, its experience, and on various other assumptions believed to be reasonable under the circumstances. These estimates 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 periods. If management’s judgment or interpretation of the facts and circumstances relating to various transactions or other matters had been different, it is possible that different accounting principles would have been applied, resulting in a different presentation of the interim consolidated financial statements. From time to time, the Company may re-evaluate its estimates and assumptions. In the event estimates or assumptions prove to be different from actual results, adjustments are made in subsequent periods to reflect more current estimates and assumptions about matters that are inherently uncertain. A summary of the Company’s critical accounting policies is included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2016. The Company has not made any material changes to these policies during the periods covered by this quarterly report.

Results of Operations

Comparison of Three Months Ended March 31, 2017 to Three Monom" width="1%" style="BORDER-BOTTOM: black 2px solid">

—

—

Balance outstanding and exercisable at March 31, 2016

2,850,000

$

0.05

6.84

Stock Warrants

A summary of the status of the Company’s outstanding stock warrants and changes during the three months ended March 31, 2016 is as follows:

	Number of Warrants	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)
Balance at January 1, 2016	5,000	$ 4.50	1.36
Granted	—	—	—
Exercised	—	—	—
Forfeited	—	—	—
Cancelled	—	—	—
Balance outstanding at March 31, 2016	5,000	$ 4.50	1.11

The following table summarizes the Company’s stock warrants outstanding at March 31, 2016:

	Warrants Outstanding			Warrants Exercisable	
Exercise Price	Number Outstanding at March 31, 2016	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable at March 31, 2016	Weighted Average Exercise Price
4.50	5,000	1.11 Years	4.50	5,000	4.50
$ 4.50	5,000	1.11 Years	$ 4.50	5,000	$ 4.50

-11-

Table of Contents

ORBITAL TRACKING CORP. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
FOR THE THREE MONTHS ENDED MARCH 31, 2016
(Unaudited)

NOTE 4 – PREPAID EXPENSES

Prepaid expenses amounted to $538,135 at March 31, 2016. Prepaid expenses include prepayments in cash for professional fees, prepayments in equity instruments which are being amortized over the terms of their respective agreements. Amortization of the prepaid expense will be included in professional fees. The current portion consists primarily of costs paid for future services which will occur within a year. Prepaid expense current portion and long-term portion were $396,510 and $141,625, as of March 31, 2016. For the year ended December 31, 2015, prepaid expense current portion and long-term portion were $191,677 and $189,968, respectively.

NOTE 5 – INTANGIBLE ASSETS

On February 19, 2015, the Company purchased an intangible asset valued at $250,000 for 1,000,000 shares of common stock. Amortization of customer contracts will be included in general and administrative expenses. The Company began amortizing the customer contracts in January 2015. Amortization expense for the three months ended March 31, 2016 was $6,250. Future amortization of intangible assets is as follows:

2016	18,750
2017	25,000
2018	25,000
2019	25,000
2020 and thereafter	125,000
Total	$ 218,750

NOTE 6 - PROPERTY AND EQUIPMENT

Property and equipment consisted of the following:

	March 31, 2016	December 31, 2015
Office furniture and fixtures	$ 92,040	$ 95,434
Computer equipment	24,968	24,766
Appliques	2,160,096	2,160,096
Website development	96,577	92,399
Less accumulated depreciation	(221,199)	(154,002)
Total	$ 2,152,482	$ 2,218,693

Depreciation expense was $69,529 for the three months ended March 31, 2016. For the three months ended March 31, 2015 depreciation expense was $8,655.

Table of Contents

NOTE 7 - INVENTORIES

At March 31, 2016 and December 31, 2015, inventories consisted of the following:

	March 31, 2016	December 31, 2015
Finished goods	$312,660	$251,518
Less reserve for obsolete inventory	-	-
Total	$312,660	$251,518

For the three months ended March 31, 2016 and the year ended December 31, 2015, the Company did not make any change for reserve for obsolete inventory.

NOTE 8 - RELATED PARTY TRANSACTIONS

The Company has received financing from the Company's Chief Executive Officer. No formal repayment terms or arrangements existed prior to February 19, 2015, when as part of the Share Exchange Agreement, the Company entered into a note with David Phipps where the stockholder loans bear no interest and are due February 19, 2017. The accounts payable due to related party includes advances for inventory due to David Phipps. Total payments due to David Phipps as of March 31, 2016 and December 31, 2015 are $48,419 and $74,051, respectively.

Also, as part of the Share Exchange Agreement entered into on February 19, 2015, Mr. Phipps received a payment of $25,000 as compensation for transition services that he provided.

The Company employs three individuals who are related to Mr. Phipps, of which earned gross wages totaled $15,299 for the three months ended March 31, 2016.

NOTE 9 - COMMITMENTS AND CONTINGENCIES

Employment Agreements

On February 19, 2015, Orbital Satcom entered into an employment agreement with Mr. Phipps, whereby Mr. Phipps agreed to serve as the President of Orbital Satcom for a period of two years, subject to renewal, in consideration for an annual salary of $180,000. Additionally, under the terms of the employment agreement, Mr. Phipps shall be eligible for an annual bonus if the Company meets certain criteria, as established by the Board of Directors. Mr. Phipps remains the sole director of GTCL following the closing of the Share Exchange. Mr. Phipps and the Company entered into an Indemnification Agreement at the closing.

The Company entered into an employment agreement with Ms. Carlise on June 9, 2015. The agreement has a term of one year, and shall automatically be extended for additional terms of one year each. The agreement provides for an annual base salary of $72,000. In addition to the base salary Ms. Carlise shall be eligible to receive an annual cash bonus if the Company meets or exceeds criteria adopted by the Compensation Committee of the Board of Directors and shall be eligible for grants of awards under stock option or other equity incentive plans of the Company.

On December 28, 2015, the Company amended her employment agreement. Effective December 1, 2015, the term of Ms. Carlise's employment was extended to December 1, 2016 from June 9, 2016, her annual salary was increased to $140,000 from $72,000 and she agreed to devote her full business time to the Company. The term of the Original Agreement, as amended by the Amendment, shall automatically extend for additional terms of one year each, unless either party gives prior written notice of non-renewal to the other party no later than 60 days prior to the expiration of the initial term or the then current renewal term, as applicable.

On February 26, 2016, the Board of Directors of Orbital Tracking Corp., a Nevada corporation ("Orbital" or the "Company"), entered into a new executive employment agreement, (Employment Agreement) with its Chief Executive Officer and President, David Phipps and terminated the original employment agreement dated February 19, 2015, at a base salary of $144,000 and £ 48,000 per annum, to be effective as of January 20, 2016, for a term of two years from effective date. In addition to the base salary Executive shall be entitled to receive an annual cash bonus in an amount equal to up to fifty (50%) percent of his then-current Base Salary, if the Company meets or exceeds criteria adopted by the Compensation Committee of the Board of the Company.

Litigation

From time to time, the Company may become involved in litigation relating to claims arising out of our operations in the normal course of business. The Company is not currently involved in any pending legal proceeding or litigation and, to the best of our knowledge, no governmental authority is contemplating any proceeding to which the Company is a party or to which any of the Company's properties is subject, which would reasonably be likely to have a material adverse effect on the Company's business, financial condition and operating results.

Table of Contents

NOTE 10– DERIVATIVE LIABILITY

In June 2008, a FASB approved guidance related to the determination of whether a freestanding equity-linked instrument should be classified as equity or debt under the provisions of FASB ASC Topic No. 815-40, Derivatives and Hedging – Contracts in an Entity's Own Stock. The adoption of this requirement will affect accounting for convertible instruments and warrants with provisions that protect holders from declines in the stock price ("down-round" provisions). Warrants with such provisions are no longer recorded in equity and are reclassified as a liability.

Instruments with down-round protection are not considered indexed to a company's own stock under ASC Topic 815, because neither the occurrence of a sale of common stock by the company at market nor the issuance of another equity-linked instrument with a lower strike price is an input to the fair value of a fixed-for-fixed option on equity shares.

In connection with the issuance of its 6% convertible debentures and related warrants, the Company has determined that the terms of the convertible warrants include down-round provisions under which the exercise price could be affected by future equity offerings. Accordingly, the warrants are accounted for as liabilities at the date of issuance and adjusted to fair value through earnings at each reporting date. The Company has recognized derivative liabilities of $3,916 and $4,355 at March 31, 2016 and December 31, 2015, respectively. The gain resulting from the decrease in fair value of this convertible instrument was $439 and $580 for the three months ended March 31, 2016 and the year ended December 31, 2015, respectively. Weighted average term is 1.11 years.

The convertible notes are accounted for as liabilities at the date of issuance and adjusted to fair value through earnings at each reporting date. The Company recorded amortization for the discount to the convertible notes of $75,626 at March 31, 2016. As of March 31, 2016 and December 31, 2015, the Company has unamortized discount balance of $526,889 and $602,515, respectively. The Company has recognized derivative liabilities of $105,413 and $614,036 at March 31, 2016 and December 31, 2015, respectively. The gain (loss) resulting from the decrease (increase) in fair value of this convertible instrument was $464,066 and ($64,035) for the three months ended March 31, 2016 and the year ended December 31, 2015, respectively. Weighted average term is 1.94 years.

The Company used the following assumptions for determining the fair value of the convertible instruments granted under the Black-Scholes option pricing model:

	March 31, 2016
Expected volatility	312%
Expected term - years	1.94
Risk-free interest rate	0.73%
Expected dividend yield	0%

NOTE 11 - CONCENTRATIONS

Customers:

No customer accounted for 10% or more of the Company's revenues during the three months ended March 31, 2016 and 2015.

Suppliers:

The following table sets forth information as to each supplier that accounted for 10% or more of the Company's purchases for the three months ended March 31, 2016 and 2015.

	March 31, 2016			March 31, 2015		
Globalstar Europe	$	92,123	13.5%	$	3,768	0.8%
Network Innovations	$	176,668	25.9 %	$	178,818	39.8 %

Table of Contents

NOTE 12 - SUBSEQUENT EVENTS

On April 1, 2016, the Company issued an aggregate of 98,400 shares of common stock upon the conversion of 9,840 shares of Series E Preferred Stock.

On April 5, 2016, the Company issued an aggregate of 208,530 shares of common stock upon the conversion of 20,853 shares of Series C Preferred Stock.

On April 12, 2016, the Company issued an aggregate of 125,000 shares of common stock upon the conversion of 6,250 shares of Series D Preferred Stock.

On April 18, 2016, the Company issued an aggregate of 650,000 shares of common stock upon the conversion of 32,500 shares of Series D Preferred Stock.

On April 21, 2016, the Company issued an aggregate of 400,000 shares of common stock upon the conversion of 20,000 shares of Series D Preferred Stock.

On April 22, 2016, the Company issued an aggregate of 900,000 shares of common stock upon the conversion of 45,000 shares of Series D Preferred Stock.

On April 27, 2016, the Company issued an aggregate of 200,000 shares of common stock upon the conversion of 10,000 shares of Series D Preferred Stock.

On May 2, 2016, the Company issued an aggregate of 92,840 shares of common stock upon the conversion of 9,284 shares of Series E Preferred Stock.

On May 4, 2016 the Company issued an aggregate of 5,560 shares of common stock upon the conversion of 556 shares of Series E Preferred Stock.

Table of Contents

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

The following information should be read in conjunction with the consolidated financial statements and the notes thereto contained elsewhere in this report. Statements made in this Item 2, "Management's Discussion and Analysis or Plan of Operation," and elsewhere in this 10-Q that do not consist of historical facts, are "forward-looking statements." Statements accompanied or qualified by, or containing words such as "may," "will," "should," "believes," "expects," "intends," "plans," "projects," "estimates," "predicts," "potential," "outlook," "forecast," "anticipates," "presume," and "assume" constitute forward-looking statements, and as such, are not a guarantee of future performance. The statements involve factors, risks and uncertainties, the impact or occurrence of which can cause actual results to differ materially from the expected results described in such statements. Risks and uncertainties can include, among others, fluctuations in general business cycles and changing economic conditions; changing product demand and industry capacity; increased competition and pricing pressures; advances in technology that can reduce the demand for the Company's products, as well as other factors, many or all of which may be beyond the Company's control. Consequently, investors should not place undue reliance upon forward-looking statements as predictive of future results. The Company disclaims any obligation to update the forward-looking statements in this report.

You should read the following information in conjunction with our financial statements and related notes contained elsewhere in this report. You should consider the risks and difficulties frequently encountered by early-stage companies, particularly those engaged in new and rapidly evolving markets and technologies. Our limited operating history provides only a limited historical basis to assess the impact that critical accounting policies may have on our business and our financial performance.

We encourage you to review our periodic reports filed with the SEC and included in the SEC's Edgar database, including the annual report on Form 10-K filed for the year ended December 31, 2015, filed on March 30, 2016.

Corporate Information

On January 22, 2015, the Company changed its name to "Orbital Tracking Corp." from "Great West Resources, Inc." pursuant to a merger with a newly-formed wholly owned subsidiary.

On March 28, 2014, the Company merged with a newly-formed wholly-owned subsidiary of the Company solely for the purpose of changing its state of incorporation to Nevada from Delaware, effecting a 1:150 reverse split of its common stock, and changing its name to Great West Resources, Inc. in connection with the plans to enter into the business of potash mining and exploration. During late 2014 the Company abandoned its efforts to enter the potash business.

The Company was originally incorporated in 1997 as a Florida corporation. On April 21, 2010, the Company merged with and into a newly-formed wholly-owned subsidiary for the purpose of changing its state of incorporation to Delaware, effecting a 2:1 forward split of its common stock, and changing its name to EClips Media Technologies, Inc. On April 25, 2011, the Company changed its name to "Silver Horn Mining Ltd." pursuant to a merger with a newly-formed wholly-owned subsidiary.

Global Telesat Communications Limited ("GTCL") was formed under the laws of England and Wales in 2008. On February 19, 2015, the Company entered into a share exchange agreement with GTCL and all of the holders of the outstanding equity of GTCL pursuant to which GTCL became a wholly owned subsidiary of the Company.

For accounting purposes, this transaction is being accounted for as a reverse acquisition and has been treated as a recapitalization of Orbital Tracking Corp. with Global Telesat Communications Limited considered the accounting acquirer, and the financial statements of the accounting acquirer became the financial statements of the registrant. The completion of the Share Exchange resulted in a change of control. The Share Exchange was accounted for as a reverse acquisition and re-capitalization. The GTCL Shareholders obtained approximately 39% of voting control on the date of Share Exchange. GTCL was the acquirer for financial reporting purposes and the Orbital Tracking Corp. was the acquired company. The consolidated financial statements after the acquisition include the balance sheets of both companies at historical cost, the historical results of GTCL and the results of the Company from the acquisition date. All share and per share information in the accompanying consolidated financial statements and footnotes has been retroactively restated to reflect the recapitalization.

The Company is a provider of satellite based hardware, airtime and related services both in the United States and internationally. We sell equipment and airtime for use on all of the major satellite networks including Globalstar, Inmarsat, Iridium and Thuraya and operate a short-term rental service for customers who desire to use our equipment for a limited time period. Our acquisition of GTCL in February 2015 expanded our global satellite based infrastructure and business, which was first launched in December 2014 through the purchase of certain contracts.

Through GTCL, we believe we are one of the largest providers in Europe of retail satellite based hardware, airtime and services through various ecommerce storefronts, and one of the largest providers of personal satellite tracking devices. Our customers include businesses, the U.S. and foreign governments, non-governmental organizations and private consumers. By enabling wireless communications in areas not served or underserved by terrestrial wireless and wireline networks and in circumstances where terrestrial networks are not operational due to natural or man-made disasters, we seek to meet our customers' increasing desire for connectivity. Our principal focus is on growing our existing satellite based hardware, airtime and related services business line and developing our own tracking devices for use by retail customers worldwide.

Table of Contents

Recent Transactions

On January 22, 2015, the Company changed its name to "Orbital Tracking Corp." from "Great West Resources, Inc." The Company effectuated the name change through a short-form merger pursuant to Chapter 92A of the Nevada Revised Statutes where a subsidiary formed solely for the purpose of the name change was merged with and into the Company, with the Company as the surviving corporation in the merger. The merger had the effect of amending the Company's Articles of Incorporation to reflect its new legal name.

On February 19, 2015, the Company filed with the Secretary of State of the State of Nevada a Certificate of Designation for the Series E Convertible Preferred Stock, setting forth the rights, powers, and preferences of the Series E Convertible Preferred Stock. Pursuant to the Series E Certificate of Designation, the Company designated 8,746,000 shares of its blank check preferred stock as Series E Convertible Preferred Stock. Each share of Series E Convertible Preferred Stock has a stated value equal to its par value of $0.0001 per share. In the event of a liquidation, dissolution or winding up of the Company, the holder of the Series E Convertible Preferred Stock would have preferential payment and distribution rights over any other class or series of capital stock that provide for Series E Convertible Preferred Stock's preferential payment and over our common stock. The Series E Convertible Preferred is convertible into ten (10) shares of the Company's common stock. The Company is prohibited from effecting the conversion of the Series E Convertible Preferred Stock to the extent that, as a result of such conversion, the holder beneficially owns more than 4.99%, in the aggregate, of the issued and outstanding shares of common stock calculated immediately after giving effect to the issuance of shares of common stock upon the conversion of the Series E Convertible Preferred Stock. Each share of Series E Convertible Preferred Stock entitles the holder to vote on all matters voted on by holders of common stock as a single class. With respect to any such vote, each share of Series E Convertible Preferred Stock entitles the holder to cast ten (10) votes per share of Series E Convertible Preferred Stock owned at the time of such vote, subject to the 4.99% beneficial ownership limitation.

On February 19, 2015, the Company entered into a share exchange agreement with Global Telesat Communications Limited, a Private Limited Company formed under the laws of England and Wales ("GTCL") and all of the holders of the outstanding equity of GTCL (the "GTCL Shareholders"). Upon closing of the transactions contemplated under the share exchange agreement, the GTCL Shareholders transferred all of the issued and outstanding equity of GTCL to the Company in exchange for (i) an aggregate of 2,540,000 shares of the common stock of the Company and 8,746,000 shares of the newly issued Series E Convertible Preferred Stock of the Company (the "Series E Preferred Stock") with each share of Series E Preferred Stock convertible into ten shares of common stock, (ii) a cash payment of $375,000 and (iii) a one-year promissory note in the amount of $122,536. Such exchange caused GTCL to become a wholly owned subsidiary of the Company.

Also on February 19, 2015, David Phipps, the founder, principal owner and sole director of GTCL and the former founder and president of GTC, was appointed President of Orbital Satcom. Following the transaction, Mr. Phipps was appointed Chief Executive Officer and Chairman of the Board of Directors of the Company. The acquisition of GTCL expands the Company's global satellite based business and enables the Company to operate as a vertically integrated satellite services business with experienced management operating from additional locations in Poole, England in the United Kingdom and Aventura, Florida.

On February 19, 2015, the Company issued to Mr. Rector, the former Chief Executive Officer, Chief Financial Officer and director of the Company, 850,000 shares of common stock and a seven year immediately vested option to purchase 2,150,000 shares of common stock at a purchase price of $0.05 per share as compensation for services provided to the Company.

On February 19, 2015, the Company sold an aggregate of 550,000 units at a per unit purchase price of $2.00, in a private placement to certain accredited investors for gross proceeds of $1,100,000. Each unit consists of: forty (40) shares of the Company's common stock or, at the election of any purchaser who would, as a result of purchase of units become a beneficial owner of five (5%) percent or greater of the outstanding common stock of the Company, four (4) shares of the Company's Series C Convertible Preferred Stock, par value $0.0001 per share, with each share convertible into ten (10) shares of common stock. The Company sold 15,000 units consisting of an aggregate of 600,000 shares of common stock and 535,000 units consisting of an aggregate of 2,140,000 shares of Series C Convertible Preferred Stock.

On February 19, 2015, the Company issued an aggregate of 1,675,000 shares of common stock to certain current consultants, former consultants and employees. These shares consist of (i) 250,000 shares of common stock issued to a consultant as compensation for services relating to the provision of satellite tracking hardware and related services, sales and lead generation, valued at $12,500 (ii) 1 million shares of common stock issued to a consultant as compensation for the design and delivery of dual mode gsm/Globalstar Simplex tracking devices and related hardware and intellectual property, valued at $50,000 (iii) 250,000 shares of common stock, subject to a one year lock up, issued to the Company's controller, valued at $12,500 and (iv) 175,000 shares of common stock issued to MJI in full satisfaction of outstanding debts of $175,000. MJI agreed to sell only up to 5,000 shares per day and the Company has a nine month option to repurchase these shares at a purchase price of $0.75 per share.

On June 18, 2015, the Company issued an aggregate of 150,000 shares of its common stock, valued at $0.79 per share, or $118,500 to an investor relations consultant for compensation of services.

On October 13, 2015, the Company through its wholly owned subsidiary, Orbital Satcom Corp, purchased from World Surveillance Group, Inc., and its wholly owned subsidiary, Global Telesat Corp the "Globalstar" license and equipment, which it had previously leased. On December 10, 2014, the Company, entered into a License Agreement with World Surveillance Group, Inc., and its wholly owned subsidiary, Global Telesat Corp, by which the Company had an irrevocable non-exclusive license to use certain equipment, consisting of Appliques for a term of ten years. Appliques are demodulator and RF interfaces located at various ground stations for gateways. The Company issued 2,222,222 common shares, valued at $1 per share based on the quoted trading price on date of issuance, or $2,222,222. The company reflected the license as an asset on its balance sheet with a ten-year amortization, the term of the license. On October 13, 2015, the Company acquired the license for additional consideration of $125,000 in cash. The Company valued the asset at $2,160,016, which is the unamortized balance of the Appliques License, $2,043,010 plus the consideration of $125,000.

Table of Contents

On December 21, 2015, the Company entered into a Placement Agent Agreement with Chardan Capital Markets LLC, as Agent, pursuant to which the Placement Agent agreed to serve as the non-exclusive placement agent for the Company in connection with any private placement from December 21, 2015 through January 15, 2017. The Company agreed to pay the Placement Agent a cash fee of $50,000 and issue the Placement agent 250,000 shares of common stock following the issuance of at least $900,000 of securities prior to the expiration of the term of the Placement Agent Agreement. On December 28, 2015, upon closing of the note purchase and Series F subscription agreements, the Company paid the respective fees and issued the common shares.

On December 28, 2015, the Company filed with the Secretary of State of the State of Nevada a Certificate of Designation for the Series F Convertible Preferred Stock, setting forth the rights, powers, and preferences of the Series F Convertible Preferred Stock. Pursuant to the Series F Certificate of Designation, the Company designated 1,100,000 shares of its blank check preferred stock as Series F Convertible Preferred Stock. Each share of Series F Convertible Preferred Stock has a stated value equal to its par value of $0.0001 per share. In the event of a liquidation, dissolution or winding up of the Company, the holder of the Series F Convertible Preferred Stock would have preferential payment and distribution rights over any other class or series of capital stock that provide for Series F Convertible Preferred Stock's preferential payment and over our common stock. The Series F Convertible Preferred is convertible into one (1) share of the Company's common stock. The Company is prohibited from effecting the conversion of the Series F Convertible Preferred Stock to the extent that, as a result of such conversion, the holder beneficially owns more than 4.99%, in the aggregate, of the issued and outstanding shares of common stock calculated immediately after giving effect to the issuance of shares of common stock upon the conversion of the Series F Convertible Preferred Stock. Each share of Series F Convertible Preferred Stock entitles the holder to vote on all matters voted on by holders of common stock as a single class. With respect to any such vote, each share of Series F Convertible Preferred Stock entitles the holder to cast one (1) vote per share of Series F Convertible Preferred Stock owned at the time of such vote, subject to the 4.99% beneficial ownership limitation.

On December 28, 2015, the Company entered into separate subscription agreements with accredited investors relating to the issuance and sale of $550,000 of shares of Series F convertible preferred stock at a purchase price of $0.50 per share. The Preferred F Shares are convertible into shares of common stock based on a conversion calculation equal to the stated value of such Preferred F Share divided by the conversion price. The stated value of each Preferred F Share is $0.50 and the initial conversion price is $0.50 per share, each subject to adjustment for stock splits, stock dividends, recapitalizations, combinations, subdivisions or other similar events. Subject to certain specified exceptions, in the event the Company issues securities at a per share price less than the conversion price for a period of two years from the closing, each holder will be entitled to receive from the Company additional shares of common stock such that the holder shall hold that number of conversion shares, in total, had such holder purchased the Preferred F Shares with a conversion price equal to the lower price issuance.

On December 28, 2015, the Company entered into separate note purchase agreements with accredited investors relating to the issuance and sale of an aggregate of $605,000 in principal amount of original issue discount convertible notes for an aggregate purchase price of $550,000.

The Notes mature on December 28, 2017. The Company must repay 1/24th of the principal of the Notes each month commencing January 18, 2016. The Notes do not bear interest except that all overdue and unpaid principal bears interest at a rate equal to the lesser of 18% per year or the maximum rate permitted by applicable law. The Notes are convertible into common stock at the option of the holder at a conversion price of $1.00, subject to adjustment for stock splits, stock dividends, recapitalizations, combinations, subdivisions or other similar events; provided however, that the principal and interest, if any, on the Notes may not be converted to the extent that, as a result of such conversion, the holder would beneficially own more than 4.99% of the number of shares of common stock outstanding immediately after giving effect to the issuance of shares of common stock upon conversion of the Notes. Subject to certain specified exceptions, in the event the Company issues securities at a per share price less than the conversion price for a period of one year from the closing, each holder will be entitled to receive from the Company additional shares of common stock such that the holder shall hold that number of conversion shares, in total, had such holder purchased the Notes with a conversion price equal to the lower price issuance.

Pursuant to the Subscription Agreement and Note Purchase Agreement, the Company agreed to use its reasonable best efforts to effectuate the increase of its authorized shares of common stock from 200,000,000 shares of common stock to 750,000,000 shares of common stock on or prior to January 31, 2016. The Company’s shareholders on March 5, 2016, approved the increase in authorized common and preferred shares. $350,000 of the proceeds from the sale of Preferred F Shares and the Notes are intended to be utilized for public relations and expenses associated with publications, reports and communications with shareholders and others concerning the company's business. The Subscription Agreement provides the purchasers of the Preferred F Shares with a 100% right of participation in all future securities offerings of the Company, subject to customary exceptions.

On December 28, 2015 the Company and Theresa Carlise, its Chief Financial Officer, amended her employment agreement, dated June 9, 2015. Pursuant to the Amendment, which is effective December 1, 2015, the term of Ms. Carlise’s employment was extended to December 1, 2016 from June 9, 2016, her annual salary was increased to $140,000 from $72,000 and she agreed to devote her full business time to the Company. The term of the Original Agreement, as amended by the Amendment, shall automatically extend for additional terms of one year each, unless either party gives prior written notice of non-renewal to the other party no later than 60 days prior to the expiration of the initial term or the then current renewal term, as applicable.

Also on December 28, 2015, the Company issued Ms. Carlise options to purchase up to 500,000 shares of common stock and issued Hector Delgado, a director of the Company, options to purchase up to 200,000 shares of common stock. The options were issued outside of the Company’s 2014 Equity Incentive Plan and are not governed by the Plan. The options have an exercise price of $0.05 per share, vest immediately, and have a term of ten years.

Table of Contents

On January 15, 2016, the Company engaged IRTH Communications LLC., for a term of 12 months to provide investor relations, public relations, internet development, communication and consulting services. As consideration for its services, IRTH will receive from the Corporation a monthly fee of $7,500 and as a single one-time retainer payment, $100,000 worth of shares of the Company's common stock; calculated by the average closing price of the Company's common stock on its principal exchange for the 10 (ten) trading days immediately prior to the execution of this Agreement; which shares shall be Restricted Securities, pursuant to the provisions of Rule 144. As additional compensation, in the event the Company, during or within two (2) years after the term of this Agreement, receives investment monies (debt, equity or a combination thereof) from investor(s) introduced to the Company by IRTH as described herein, Company agrees to pay IRTH a finder's fee equal to three percent (3%) of all gross monies invested by investor(s) and received by Company.

On February 11, 2016, the Company issued 136,612 shares of its common stock, valued at $0.60 per share, or $81,967, to IRTH Communications LLC for services, as disclosed above.

On March 3, 2016, the Company entered into an Executive Employment Agreement with David Phipps, its Chairman, President and Chief Executive Officer, effective January 1, 2016. Under the Employment Agreement, Mr. Phipps will serve as the Company's Chief Executive Officer and President, and receive an annual base salary equal to the sum of $144,000 and $48,000. Mr. Phipps is also eligible for bonus compensation in an amount equal to up to fifty (50%) percent of his then-current base salary if the Company meets or exceeds criteria adopted by the Compensation Committee, if any, or Board and equity awards as may be approved in the discretion of the Compensation Committee or Board. Also on March 3, 2016 and effective January 1, 2016, the Corporation's wholly owned subsidiary Orbital Satcom Corp. and Mr. Phipps terminated an employment agreement between them dated February 19, 2015 pursuant to which Mr. Phipps was employed as President of Orbital Satcom for an annual base salary of $180,000. The other terms of the Original Agreement are identical to the terms of the Employment Agreement. Mr. Phipps remains the President of Orbital Satcom.

Results of Operations for the Three Months Ended March 31, 2016 compared to the Three Months Ended March 31, 2015

Revenue. Sales for the three months ended March 31, 2016 consisted primarily of sales of satellite phones, accessories and airtime plans. For the three months ended March 31, 2016, revenues generated were approximately $1,295,264 compared to approximately $799,698 of revenues for the three months ended March 31, 2015, an increase in total revenues of $495,566 or 62.0%. Factors relative to the increase in revenue are; an increase in comparable revenue of 35.8% and 204.9% for its wholly owned subsidiaries, Global Telesat Communication Ltd and Orbital Satcom Corp., for the three months ended March 30, 2016. Total sales for Global Telesat Communications Ltd. were $922,223 for the three months ended March 31, 2016 as compared to $679,112 for the three months ended March 31, 2015, an increase of $243,111 or 35.8%. Total sales for Orbital Satcom Corp. were $367,771 for the three months ended March 31, 2016 as compared to $120,586 for the three months ended March 31, 2015, an increase of $247,185 or 205%. The Company attributes the increases in revenue to its increased presence in a number of international e-commerce storefronts, the introduction of GTC's new mobile friendly website, and it being awarded a contract for lone worker trackers from the UK Forestry Commission.

Cost of Sales. During the three months ended March 31, 2016, cost of revenues increased to $856,920 compared to $573,311 for the three months ended March 31, 2015, an increase of $283,609 or 49.5%. We expect our cost of revenues to continue to increase during fiscal 2016 and beyond, as we expand our operations and begin generating additional revenues under our current business. However, we are unable at this time to estimate the amount of the expected increases. Gross profit margins during the three months March 31, 2016 were 33.8% as compared to 28.3% for the comparable period in the prior year. The increase in gross profit is attributable to the Company being awarded a high volume contract to supply SPOT Gen3, which is one of our most profitable products to UK Forestry

Commission.

Operating Expenses. Total operating expenses for the three months ended March 31, 2016 were $742,020, an increase of $102,652, or 16.6%, from total operating expenses for the three months ended March 31, 2015 of $639,368. Factors contributing to the increase are described below.

Selling, general and administrative expenses were $184,775 and $175,647 for the three months ended March 31, 2016 and 2015, respectively, an increase of $9,128 or 5.2%. The increase for the three months ended March 30, 2016, was due to variable expenses which increase with additional revenue.

Salaries, wages and payroll taxes were $173,855 and $75,327, for the three months ended March 31, 2016 and 2015, respectively, an increase of $98,528, or 130.8% The company has added additional personnel to accommodate and support its revenue goals and compliance needs for reporting as a public company, as well as, build its infrastructure for future growth and opportunities.

Stock-based compensation was $0 and $151,563, for the three months ended March 31, 2016 and 2015. On February 19, 2015, the Company issued options to its former Chief Executive Officer, valued using the Black-Scholes option pricing model at $107,500, as well as issued stock as compensation to its Controller and certain consultants.

Professional fees were $300,568 and $166,371 for the three months ended March 31, 2016 and 2015, respectively, an increase of $134,197, or 80.7%. The increase during the three months ended March 31, 2016 as compared to the same period in 2015 were primarily attributable to fees incurred for investor awareness, fees associated with the compliance requirements of public companies are included in Professional fees, as well as fees associated with raising capital.

Table of Contents

Depreciation and amortization expenses were $82,822 and $70,460 for the three months ended March 31, 2016 and 2015, respectively, an increase of $12,362 or 17.5%. The increase during the 2016 period was primarily attributable the depreciation associated with the purchase of Appliques for $2.1 million in October of 2015 and for to increases in intangible assets and the associated amortization.

We expect our expenses in each of these areas to continue to increase during fiscal 2016 and beyond as we expand our operations and begin generating additional revenues under our current business. However, we are unable at this time to estimate the amount of the expected increases.

Total Other (Income) Expense. Our total other (income) expenses were $(363,622) compared to $9,001 during the three months ended March 31, 2016 and 2015 respectively, a decrease of $372,623. The decrease is primarily attributed to changes in the fair value of derivative instruments and offset by interest expense the increase recognized due to exchange rate variances.

Net Income (Loss)

We recorded net income before income tax of $59,946, for the three months ended March 31, 2016 as compared to a net loss of $421,982, for the three months ended March 31, 2015. The increase in income is a result of the factors as described above.

Comprehensive (Loss) Income

We recorded a gain (loss) for foreign currency translation adjustments for the three months ended March 31, 2016 and 2015, of $2,039 and ($424), respectively. The fluctuations of the increase/decrease is primarily attributed to the increase recognized due to exchange rate variances.

Liquidity and Capital Resources

Liquidity is the ability of a company to generate funds to support its current and future operations, satisfy its obligations, and otherwise operate on an ongoing basis. At March 31, 2016, we had a cash balance of $391,322. Our working capital is $585,964 at March 31, 2016.

Our current assets at March 31, 2016 decreased by approximately 11.9% from December 31, 2015 and included cash, accounts receivable and inventory.

Our current liabilities at March 31, 2016 decreased by 24.4% from December 31, 2015 and included our accounts payable, derivative liabilities and deferred revenue and other liabilities in the ordinary course of our business.

Operating Activities

Net cash flows used in operating activities for the three months ended March 31, 2016 amounted to $469,469 and were primarily attributable to our net income of $59,946, total amortization expense of $155,967, depreciation of $69,529, and offset by change in fair value of derivative liabilities of $464,505 and net change in asset and liabilities of $290,662, primarily attributable to an increase in accounts receivable of $118,924, increase in inventory of $61,142, decrease in unbilled revenue of $9,398, increase in prepaid expense of $130,585, increase in other current assets of $2,676, increase in accounts payable of $7,272 and an increase in deferred revenue of $5,996.

Net cash flows used in operating activities for the three months ended March 31, 2015 amounted to $195,187 and were primarily attributable to our net loss of $421,982 offset by the fair value of options issued of $107,500 and stock based compensation of $42,500, total amortization expense of $61,805, depreciation of $8,655, and add back of change in fair value of derivative liabilities of $233 and net change in asset and liabilities of $1,880 primarily attributable to an increase in accounts receivable of $19,127, decrease in other current assets of $13,861 and an increase in accounts payable of $13,205.

Investing Activities

Net cash flows used in investing activities were ($3,318) and ($376,539) for the three months ended March 31, 2016 and 2015, respectively. We purchased property and equipment of $3,318 during the three months ended March 31, 2016. During the three months ended March 31, 2015, we used cash to pay $375,000 in connection with the Share Exchange Agreement, purchase of property and equipment of $32,473 and offset by $30,934 of cash acquired from acquisition.

Table of Contents

Financing Activities

Net cash flows (used in) provided by financing activities were ($101,259) and $1,038,192 for the three months ended March 31, 2016 and 2015, respectively. Net cash flows used in financing activities were $101,259 for the three months ended March 31, 2016. Net cash used in financing activities were repayments of related party payable and convertible notes payable of $25,632 and $75,626, respectively. During the three months ended March 31, 2015, we received net proceeds from the sale of our common stock and preferred stock of $1,097,500 offset by repayments of related party note payable of $59,308.

Off-Balance Sheet Arrangements

We do not currently have any 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 our stockholders.

Our company has not entered into any transaction, agreement or other contractual arrangement with an entity unconsolidated with us under which we have

- an obligation under a guarantee contract, although we do have obligations under certain sales arrangements including purchase obligations to vendors
- a retained or contingent interest in assets transferred to the unconsolidated entity or similar arrangement that serves as credit, liquidity or market risk support to such entity for such assets,
- any obligation, including a contingent obligation, under a contract that would be accounted for as a derivative instrument, or
- any obligation, including a contingent obligation, arising out of a variable interest in an unconsolidated entity that is held by us and material to us where such entity provides financing, liquidity, market risk or credit risk support to, or engages in leasing, hedging or research and development services with us.

Plan of Operation

Critical Accounting Policies and Estimates

Critical accounting estimates are those that management deems to be most important to the portrayal of our financial condition and results of operations, and that require management's most difficult, subjective or complex judgments, due to the need to make estimates about the effects of matters that are inherently uncertain. We have identified our critical accounting estimates which are discussed below.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosures of contingent assets and liabilities at the date of the financial statements and revenue and expenses during the reporting period. Actual results could differ from those estimates. The Company's significant estimates include the valuation of stock based charges, the valuation of derivatives and the valuation of inventory reserves.

Basis of Presentation and Principles of Consolidation

The consolidated financial statements are prepared in accordance with generally accepted accounting principles in the United States of America ("US GAAP") and the rules and regulations of the U.S Securities and Exchange

Commission for Interim Financial Information. All intercompany transactions and balances have been eliminated. All adjustments (consisting of normal recurring items) necessary to present fairly the Company's financial position as of March 31, 2016, and the results of operations and cash flows for the nine months ended March 31, 2016 have been included. The results of operations for the three months ended March 31, 2016 are not necessarily indicative of the results to be expected for the full year.

Accounts Receivable

The Company extends credit to its customers based upon a written credit policy. Accounts receivable are recorded at the invoiced amount and do not bear interest. The allowance for doubtful accounts is the Company’s best estimate for the amount of probable credit losses in the Company’s existing accounts receivable. The Company establishes an allowance of doubtful accounts based upon factors surrounding the credit risk of specific customers, historical trends, and other information. Receivable balances are reviewed on an aged basis and account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote. The Company does not require collateral on accounts receivable. As of March 31, 2016 and December 31, 2015, there is no allowance for doubtful accounts.

Table of Contents

Accounting for Derivative Instruments

Derivatives are required to be recorded on the balance sheet at fair value. These derivatives, including embedded derivatives in the Company's structured borrowings, are separately valued and accounted for on the Company's balance sheet. Fair values for exchange traded securities and derivatives are based on quoted market prices. Where market prices are not readily available, fair values are determined using market based pricing models incorporating readily observable market data and requiring judgment and estimates

Research and Development

Research and Development ("R&D") expenses are charged to expense when incurred. The Company has consulting arrangements which are typically based upon a fee paid monthly or quarterly. Samples are purchased that are used in testing, and are expensed when purchased. R&D costs also include salaries and related personnel expenses, direct materials, laboratory supplies, equipment expenses and administrative expenses that are allocated to R&D based upon personnel costs.

Foreign Currency Translation

The Company's reporting currency is US Dollars. The accounts of one of the Company's subsidiaries is maintained using the appropriate local currency, (Great British Pound) GTCL as the functional currency. All assets and liabilities are translated into U.S. Dollars at balance sheet date, shareholders' equity is translated at historical rates and revenue and expense accounts are translated at the average exchange rate for the year or the reporting period. The translation adjustments are deferred as a separate component of stockholders' equity, captioned as accumulated other comprehensive (loss) gain. Transaction gains and losses arising from exchange rate fluctuation on transactions denominated in a currency other than the functional currency are included in the statements of operations.

The relevant translation rates are as follows: for the three months ended March 31, 2016 closing rate at 1.438034 US$: GBP, average rate at 1.43284 US$: GBP, for the three months ended March 31, 2015 closing rate at 1.4834 US$: GBP, quarter average rate at 1.5155 and for the year ended 2015 closing rate at 1.47373 US$: GBP, average rate at 1.52855 US

Revenue Recognition and Unearned Revenue

The Company recognizes revenue from satellite services when earned, as services are rendered or delivered to customers. Equipment sales revenue is recognized when the equipment is delivered to and accepted by the customer. Only equipment sales are subject to warranty. Historically, the Company has not incurred significant expenses for warranties.

The Company's customers generally purchase a combination of our products and services as part of a multiple element arrangement. The Company's assessment of which revenue recognition guidance is appropriate to account for each element in an arrangement can involve significant judgment. This assessment has a significant impact on the amount and timing of revenue recognition.

Revenue is recognized when all of the following criteria have been met:

Persuasive evidence of an arrangement exists. Contracts and customer purchase orders are generally used to determine the existence of an arrangement.
Delivery has occurred. Shipping documents and customer acceptance, when applicable, are used to verify delivery.

The fee is fixed or determinable. We assess whether the fee is fixed or determinable based on the payment terms associated with the transaction and whether the sales price is subject to refund or adjustment.
Collectability is reasonably assured. We assess collectability based primarily on the creditworthiness of the customer as determined by credit checks and analysis, as well as the customer's payment history.

In accordance with ASC 605-25, Revenue Recognition — Multiple-Element Arrangements, based on the terms and conditions of the product arrangements, the Company believes that its products and services can be accounted for separately as its products and services have value to the Company's customers on a stand-alone basis. When a transaction involves more than one product or service, revenue is allocated to each deliverable based on its relative fair value; otherwise, revenue is recognized as products are delivered or as services are provided over the term of the customer contract.

Table of Contents

Property and Equipment

Property and equipment are carried at historical cost less accumulated depreciation. Depreciation is based on the estimated service lives of the depreciable assets and is calculated using the straight-line method. Expenditures that increase the value or productive capacity of assets are capitalized. Fully depreciated assets are retained in the property and equipment, and accumulated depreciation accounts until they are removed from service. When property and equipment are retired, sold or otherwise disposed of, the asset's carrying amount and related accumulated depreciation are removed from the accounts and any gain or loss is included in operations. Repairs and maintenance are expensed as incurred.

The estimated useful lives of property and equipment are generally as follows:

	Years
Office furniture and fixtures	4
Computer equipment	4
Appliques	10
Website development	4

Impairment of long-lived assets

The Company reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be fully recoverable, or at least annually. The Company recognizes an impairment loss when the sum of expected undiscounted future cash flows is less than the carrying amount of the asset. The amount of impairment is measured as the difference between the asset's estimated fair value and its book value. The Company did not consider it necessary to record any impairment charges during the periods ended March 31, 2016 and December 31, 2015, respectively.

Fair value of financial instruments

The Company adopted Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 820, "Fair Value Measurements and Disclosures", for assets and liabilities measured at fair value on a recurring basis. ASC 820 establishes a common definition for fair value to be applied to existing US GAAP that require the use of fair value measurements which establishes a framework for measuring fair value and expands disclosure about such fair value measurements.

ASC 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Additionally, ASC 820 requires the use of valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. These inputs are prioritized below:

Level 1: Observable inputs such as quoted market prices in active markets for identical assets or liabilities

Level 2: Observable market-based inputs or unobservable inputs that are corroborated by market data

Level 3: Unobservable inputs for which there is little or no market data, which require the use of the reporting entity's own assumptions.

The following table presents a reconciliation of the derivative liability measured at fair value on a recurring basis using significant unobservable input (Level 3) from January 1, 2016 to March 31, 2016:

	Conversion feature Derivative Liability	Warrant liability	Total
Balance at January 1, 2016	$614,036	$4,355	$618,391
Change in fair value included in earnings	(464,066)	(439)	(464,505)
Net effect on additional paid in capital	(44,558)	-	(44,558)
Balance at March 31, 2016	$105,412	$3,916	$109,328

The Company did not identify any other assets or liabilities that are required to be presented on the consolidated balance sheets at fair value in accordance with the accounting guidance. The carrying amounts reported in the balance sheet for cash, accounts payable, and accrued expenses approximate their estimated fair market value based on the short-term maturity of the instruments.

Table of Contents

Share-Based Payments

Compensation cost relating to share based payment transactions be recognized in the financial statements. The cost is measured at the grant date, based on the calculated fair value of the award, and is recognized as an expense over the employee's requisite service period (generally the vesting period of the equity award).

Recent Accounting Pronouncements

The Company does not believe that any recently issued accounting pronouncements will have a material impact on its financial statements.

ITEM 3. QUANTITATIVE AND QUALITIATIVE DISCLOSURES ABOUT MARKET RISK

As a smaller reporting company, as defined in Rule 12b-2 of the Exchange Act, we are not required to provide the information required by this Item.

ITEM 4. CONTROLS AND PROCEDURES.

We maintain "disclosure controls and procedures," as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the "Exchange Act"), that are designed to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in Securities and Exchange Commission rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer, to allow timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, management recognized that disclosure controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the disclosure controls and procedures are met. Additionally, in designing disclosure controls and procedures, our management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible disclosure controls and procedures. The design of any disclosure controls and procedures also is based in part upon 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.

With respect to the fiscal quarter ending March 31, 2016, under the supervision and with the participation of our management, we conducted an evaluation of the effectiveness of the design and operations of our disclosure controls and procedures. Based upon this evaluation, our management has concluded that our disclosure controls and procedures were not effective as of March 31, 2016 due to a lack of segregation of duties and the need for an updated accounting system. However, to the extent possible, we will implement procedures to assure that the initiation of transactions, the custody of assets and the recording of transactions will be performed by separate individuals. We believe that the foregoing steps will remediate the significant deficiency identified above, and we will continue to monitor the effectiveness of these steps and make any changes that our management deems appropriate.

Management is in the process of determining how best to change our current system and implement a more effective system to insure that information required to be disclosed in this quarterly report on Form 10-Q has been recorded, processed, summarized and reported accurately. Our management acknowledges the existence of this problem, and intends to develop procedures to address them to the extent possible given limitations in financial and manpower resources. While management is working on a plan, no assurance can be made at this point that the implementation of such controls and procedures will be completed in a timely manner or that they will be adequate once implemented.

Changes in Internal Controls

There have been no changes in our internal control over financial reporting during the fiscal quarter ended March 31, 2016 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

Table of Contents

PART II: OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

None.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

There were no unregistered securities sold by us during the quarter ended March 31, 2016 that were not otherwise disclosed by us in a Current Report on Form 8-K except as set forth below:

On February 11, 2016, the Company issued an aggregate of 136,612 shares of common stock calculated by the average closing price of the Company's common stock on its principal exchange for the 10 (ten) trading days immediately prior to the execution of the Agreement, or $100,000, to a investor relations consultant as compensation for services, which is amortized over the period of service.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURE

Not applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

31.1	Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002*
31.2	Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002*
32.1	Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002*
101.ins	XBRL Instance Document
101.sch	XBRL Taxonomy Schema Document
101.cal	XBRL Taxonomy Calculation Document
101.def	XBRL Taxonomy Linkbase Document
101.lab	XBRL Taxonomy Label Link base Document
101.pre	XBRL Taxonomy Presentation Link base Document

* Filed herein

Table of Contents

SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated: May 16, 2016	ORBITAL TRACKING CORP.	
	By:	/s/ David Phipps David Phipps Chief Executive Officer and Chairman (Principal Executive Officer)
		/s/ Theresa Carlise Chief Financial Officer, Treasurer and Secretary (Principal Financial Officer and Principal Accounting Officer)