

TSS, Inc.
Form 10-K
March 30, 2016

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

FORM 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2015

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission file number: **001-33627**

TSS, INC.

(Exact name of registrant as specified in its charter)

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Delaware
(State or other jurisdiction
of incorporation or organization)

20-2027651
(I.R.S. Employer
Identification No.)

110 E. Old Settlers Road
Round Rock, TX
(Address of principal executive offices)

78664
(Zip Code)

Registrant's telephone number, including area code
(512)-310-1000

Securities registered pursuant to Section 12(b) of the Exchange Act: None

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

Common Stock, \$.0001 par value

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

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

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

Indicate by check mark whether the registrant has submitted electronically 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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer

Accelerated filer

Smaller reporting company

Non-accelerated filer
[Do not check if a
smaller
reporting company]

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

As of June 30, 2015, the aggregate market value of the registrant's voting and non-voting Common Stock held by non-affiliates of the registrant was approximately \$6,245,789. Such aggregate market value was computed by reference to the closing sale price of the Common Stock as reported on the OTCQB tier of OTC Markets Group, Inc., a centralized quotation service that collects and publishes market maker quotes for over-the-counter securities, on such date. For purposes of making this calculation only, the registrant has defined affiliates as including all directors, executive officers and stockholders owning more than 10% of the registrant's common stock, but excluding any institutional stockholders owning 10% or more of the registrant's common stock.

Number of shares of Common Stock outstanding as of March 30, 2016: 15,641,824

DOCUMENTS INCORPORATED BY REFERENCE

Certain portions of the registrant's Definitive Proxy Statement, relating to our 2016 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission not later than 120 days after the end of the 2015 fiscal year are incorporated by reference into Part III of this Annual Report on Form 10-K.

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TSS, INC.

ANNUAL REPORT ON FORM 10-K

For the Fiscal Year Ended December 31, 2015

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SAFE HARBOR STATEMENT UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

From time to time, we make oral and written statements that may constitute forward looking statements (rather than historical facts) as defined in the Private Securities Litigation Reform Act of 1995 or by the Securities and Exchange Commission (the SEC) in its rules, regulations and releases, including Section 27A of the Securities Act of 1933, as amended (the Securities Act), and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). We desire to take advantage of the safe harbor provisions in the Private Securities Litigation Reform Act of 1995 for forward-looking statements made from time to time, including, but not limited to, the forward-looking statements made in this Annual Report on Form 10-K (this Annual Report), as well as those made in other filings with the SEC.

Forward-looking statements can be identified by the use of forward-looking terminology such as believes, estimates, anticipates, expects, may, will, continue, forecast, foresee or other similar words. Such forward-looking statements are based on our management's current plans and expectations and are subject to risks, uncertainties and changes in plans that could cause actual results to differ materially from those described in the forward-looking statements. Important factors that could cause actual results to differ materially from those anticipated in our forward-looking statements include, but are not limited to, those described under Risk Factors set forth in Item 1A of this Annual Report.

We expressly disclaim any obligation to release publicly any updates or changes in our expectations or any changes in events, conditions, or circumstances on which any forward-looking statement is based.

As used herein, except as otherwise indicated by the context, the terms TSS, Company, we, us and our are used to refer to TSS, Inc. and our wholly-owned subsidiaries.

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PART I.

Item 1.

Business

Company Overview

TSS, Inc. is a provider of comprehensive services for the planning, design, development and maintenance of mission-critical facilities and information infrastructure as well as integration services. We provide a single-source solution for highly technical mission-critical facilities such as data centers, operation centers, network facilities, server rooms, security operations centers, communications facilities and the infrastructure systems that are critical to their function. Our services include technology consulting, design and engineering, project management, systems integration, system installations and facilities management

We were incorporated in Delaware in December 2004. As a holding company, we operate through our wholly owned subsidiaries, VTC, LLC d/b/a Total Site Solutions (VTC) and Innovative Power Systems, Inc. Our headquarters are in Round Rock, Texas, and we have offices in Columbia, Maryland, Dulles, Virginia, and Los Altos, California.

Our business is concentrated on the data center infrastructure and services market. This market is becoming increasingly dynamic as commerce moves to cloud-based solutions and as data storage requirements continue to escalate exponentially driven by video, mobility and big data requirements. These underlying macroeconomic trends are driving demand for increasingly efficient data center design, construction and operation, resulting in increasing capital expenditures in this market. We compete in large growing market segments often against larger competitors who have greater resources. We have been successful with several large customers in winning contracts and providing business to us under Master Service Agreements , and the loss of such customers could have a material negative effect on our results. We have focused our sales force on diversifying our customer base to reduce this risk and drive revenue growth.

We believe that as one of the few companies providing a single source for all phases of data center ownership, from design through construction, equipment deployment, operations, maintenance and decommissioning, we are uniquely positioned to capitalize on the continued growth and evolution in the data center market. The services we offer are applicable to traditional brick-and-mortar facilities and also to new modular form factors. We believe our ability to help customers lower the cost of operating their mission-critical facilities surpasses the type and scale of equipment or infrastructure being used by our customers. We are also working with IT equipment manufacturers to help them deploy their equipment into data centers, which enables us to establish relationships with their customers.

Beginning in 2013, we changed our business strategy to pivot the business focus from large, one-off data center design and build projects towards offerings such as our facilities management offering that provide greater recurring revenue streams from ongoing services. This shift also transitions us towards higher margin service lines to improve the profitability of the Company. As part of this strategy, we acquired our systems integration business in 2013 to broaden and diversify our service offering for the data center services market.

Service Offerings

We have developed a unique set of solution offerings whereby we provide a range of services that enable our customers and partners to more efficiently plan, develop, deploy and maintain data centers and their related assets. These solutions begin with strategies for the care of information technology assets that are being housed in the facility or modular data center, including power, cooling and heat rejection, as well as disaster recovery backup systems. We

assist our customers and partners in developing and implementing total cost of ownership models that enable them to design and build efficient data centers based on their available capital. Our operating expenses are not exclusively aligned to each service offering, as shared resources such as sales, marketing and general and administrative expenses support all services. Our solutions involve all aspects of the life cycle of both traditional and modular data centers and are described in more detail below.

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Consult:

During the initial phase of a data center project, we provide project development related services that typically include establishing project goals and a preliminary budget and schedules, setting technical parameters and requirements, and determining project team members and the overall requirements of the team.

Design and engineering consulting services typically include critical power and mechanical load calculations, mechanical design and engineering, high and medium voltage electrical design and engineering, communications and security systems design and engineering, physical vulnerability assessments, force protection design and bomb blast analyses, fire protection system design and engineering, facility systems equipment selection and facility commissioning and testing. These offerings also include post commissioning support of on-going operations.

Our strategy is intended to increase the amount of recurring revenues we generate from our existing customers, IT equipment partners, and major systems integrators. Our mission critical facilities experience and skills position us as a trusted advisor to our customers, and allow us to work on new opportunities as our customers grow and partners introduce us to new client opportunities.

Deploy:

Activities during this phase involve management of all the detailed preparations required for a successful deployment of a customer's data center or related equipment requirements. Our capabilities include project management, value engineering and design management, bid negotiation support, subcontractor pre-qualification and selection, long-lead equipment procurement, issuance of equipment and construction contracts, and refinement and management of project budgets and schedules. Our project managers mobilize the required expertise for the project, utilizing in-house superintendents, quality control and safety professionals, as well as qualified subcontractors and support personnel, some of which have historically been provided by affiliated or sub-contracted entities. Our project managers supervise work by project team members, including all aspects of the following: architecture and construction, electric power systems, heat rejection and cooling, energy management and controls, cooling tower systems, security systems, voice, data and network cabling, fire and life safety systems, and process piping and plumbing systems. Our project managers remain responsible for managing all aspects of the project until project completion and customer delivery.

Management of the installation portion of facility projects is typically the longest in duration when compared to other project phases. In addition, this portion has the largest number of outside influences that can impact project goals and objectives, such as weather, non-performance of subcontractors, equipment deliveries, unexpected project changes from the owner, and influence from local authorities and utility providers. Therefore, experience, skill and mission focus are critical during the project installation period.

To assist our customers with IT-equipment deployment in their data centers we provide what we call systems integration services. We provide integrated technology services and software tools designed to accelerate the delivery of complex information technology solutions. These services include custom configuration of a broad scope of information technology products including client products, enterprise products, clusters and modular containers. The integration of this equipment is performed to our customer specifications and test criteria. We are generally not responsible for the performance of the related equipment in the field. In addition, we provide warehousing of high value equipment such as servers, switches and other information technology hardware that are generally provided on a consignment basis. Occasionally, we will procure and resell the information technology hardware for our customers.

Manage:

We provide a comprehensive maintenance and service offering designed to ensure that the multiple systems critical to sustaining on-line applications in technologically intensive facilities and modular data centers remain operational and functional. Typical facilities management services include overall management of the post-construction facility maintenance program, on-site staffing of technical engineering positions (*e.g.*, electricians, HVAC mechanics, control technicians and voice/data technicians), and management of non-technical subcontracted services (*e.g.*, security, landscaping, janitorial, pest control, snow removal, carpentry, painting and general maintenance services).

Increasingly, data centers are being constructed in a

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modular format, whereby information technology, power and other related assets are deployed in pre-integrated solutions. Modular data centers may have lower overall cost of delivery, lower energy consumption and shorter deployment schedules compared to traditional data centers. We have developed a team to deploy and maintain high-density modular data centers. Our on-site maintenance services provide additional project revenue for us and also position us for involvement in any new facility planning, design and construction initiatives that the customer undertakes.

In addition, we have a 24X7 Network Operations Center in Columbia, Maryland that has the capability of remotely monitoring our data center service contract customers' facilities for systems operations and emergency events that could lead to outages. Temperature levels, humidity, electrical connectivity, power usage and fire alarm conditions are among the items monitored. The system maintains all site documentation for repairs and maintenance performed on each critical piece of equipment covered under our services. The information is useful to our customers in assessing operational efficiency and causes of failure, and enables them to make critical decisions on repair or replacement strategies based on the operating history of the monitored systems.

Our facilities maintenance service contracts are typically one to four years in duration with cancellation clauses for nonperformance, and are typically billed annually in advance. Our service contracts take different forms including fixed-price equipment maintenance with optional comprehensive warranty to fix failures, ticket based service with contracted rates in a master service agreement, comprehensive facility services agreements that include on site staffing, scheduled equipment maintenance and nontechnical facility services, and direct contracts for additional moves, add and change work within a facility.

As computer density increased and data centers evolved into the use of modular form factors, we found that we could leverage our facilities maintenance experience and infrastructure by offering maintenance service of modules being deployed into new data centers. Our design services continue to evolve to support changing data center requirements. Ultimately, we started working with IT vendors to help them in the design and integration of their IT equipment into modular data centers, which typically leads to ongoing maintenance contracts as these modular systems deploy.

The margins on our facilities maintenance and systems integration businesses are significantly higher than our traditional consulting and project management activities. We continue to support the entire line of services as it provides multiple points of value for our customers, and provision of some services will lead to higher levels of our more profitable service offerings as we expand our service footprint with existing customers. Since 2013 we have been focusing our sales activities on growing our maintenance and integration services, and re-aligning our cost structure to reflect this change in focus.

Customers

Our customers include IT equipment companies, United States government and homeland defense agencies and private sector businesses that in some cases are the end users of the facility or in other cases are providing a facility to a government or commercial end user.

Three customers comprised 65% and 60% of our total revenue for the years ended December 31, 2015 and 2014, respectively.

Sales and Marketing

Our marketing approach emphasizes expertise in information technology hardware systems, energy consumption, real estate matters and facilities planning and operation. This marketing approach allows the customer to contract for comprehensive facilities services or to contract separately for each individual project phase. Our marketing program seeks to capitalize on our industry standing, including our existing relationships and our reputation based on our performance on completed projects. We also seek to enhance our name recognition through the use of trade shows, technical seminars, direct mailings and the media. A key part of our selling strategy is entering into master service agreements with multiple partners and co-selling our range of services to the end-user customers of our partners, leveraging their customer relationships and broadening the scope of potential customers for us.

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Our headcount in sales and marketing has fluctuated as we have worked to align the skill sets with our evolving service offering, leverage partner relationships and increase the consultative capability of our sales organization. We have implemented certain marketing activities including investment in an upgraded customer relationship management software to more efficiently manage our sales and marketing activities.

Maintaining key alliances is also crucial to sales development and growth and often provides us with introductions to the customers of our alliance partners. These alliances reside with various information technology consulting firms, specialty mission-critical engineering firms, application service providers and internet service providers. Key alliance opportunities also reside in other firms within the market sector such as equipment manufacturers, product suppliers, property management firms, developers, information technology system integrators and firmware providers. We have key strategic alliances with large information technology corporations to provide engineering, design, construction management services, systems integration, modular solutions and facility management services.

Competition

The mission-critical information technology solutions market is large, fragmented and highly competitive. We compete for contracts based on the strength of our customer relationships, successful past performance record, significant technical expertise, specialized knowledge and broad service offerings. We often compete against divisions of large design and build construction and real estate firms and information technology service and equipment providers of various sizes. Some of these competitors are large, well-established companies that have broader geographic scope and greater financial and other resources than us. In some cases, because of diverse requirements, we frequently collaborate with these and other competitors for large projects. We expect competition in the mission-critical information technology services sector to continue to increase in the future.

Because of the breadth of services that we provide, we face many different competitors some of which are our customers or vendors. An example of some of our competitors include the following:

Data center assessment CSC, Emerson, large IT OEMS (IBM, HP, etc.) and consulting firms (Accenture, etc.)
Data center design Syska Hennesey, Flour, Jacobs Engineering
Data center construction DPR Construction, Holder Construction, Skanska, Structure Tone
Modular data center design and configuration IO, AST/Schneider, Skanska, Emerson
Data center rack and modular IT integration Quanta, Jabil, Avnet, Supermicro
Modular deployment McKinstry, Lee Technologies
Data center facilities and modular maintenance Lee Technologies, McKinstry, JLL, CBRE

We believe that, while we face large and small competitors across the spectrum of our service offering, we are uniquely positioned to provide services to IT and facilities across both modular and traditional data center markets. We believe by providing a single source solution focused in the data center market we provide our customers an integrated solution cost effectively.

Employees

At December 31, 2015, we had 90 full-time employees. Our future success will depend significantly on our ability to attract, retain and motivate qualified personnel. We are not a party to any collective bargaining agreement and we have not experienced any strikes or work stoppages. We consider our relationship with our employees to be satisfactory.

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Available Information

We file annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and proxy statements relating to our annual stockholders meeting with the Securities and Exchange Commission (SEC). Copies of these filings, including amendments to such filings are available, free of charge, on our website, www.totalsitesolutions.com, as soon as reasonably practicable after such material is electronically filed with, or furnished to, the SEC. Information contained on our website is not and should not be deemed to be a part of this Annual Report or a part of any other report or filing with the SEC. All reports that we file with the SEC are available to read and copy at the SEC s Public Reference Room at 100 F Street, NE, Washington, DC 20549, on official business days during the hours of 10:00 am to 3:00 pm. You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an internet site at www.sec.gov that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC.

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Item 1A.

RISK FACTORS

Our business involves a number of risks, some of which are beyond our control. The risks and uncertainties described below are not the only ones we face. Such factors could have a significant impact on our business, operating results and financial condition. We believe the most significant of these risks and uncertainties are as follows:

Our independent registered public accounting firm's report contains an explanatory paragraph that expresses substantial doubt about our ability to continue as a going concern

Our consolidated financial statements included in this annual report have been prepared on the basis that we will continue to operate as a going concern. Accordingly, assets and liabilities are recorded on the basis that we will be able to realize our assets and discharge our liabilities in the normal course of business. Our history of operating losses, declining current ratio and stockholders' deficit may, by themselves, cause uncertainty about our ability to continue to operate our business as a going concern. Note 1 to our consolidated financial statements describes the actions we have taken and could take to improve our liquidity.

Our business plans and our assumptions around the adequacy of our liquidity are based on estimates regarding expected revenues and future costs and our ability to secure additional sources of funding if needed. However, our revenue may not meet our expectations or our costs may exceed our estimates. Further, our estimates may change and future events or developments may also affect our estimates. Any of these factors may change our expectation of cash usage in 2016 or significantly affect our level of liquidity, which may require us to seek additional financing or take other measures to reduce our operating costs or obtain funding in order to continue operating. Any action to reduce operating costs may negatively affect our range of products and services that we offer or our ability to deliver such products and services, which could materially impact our financial results depending on the level of cost reductions taken. We are seeking additional funding to support ongoing operations. We have no arrangement or commitments for any financing, and financing may not be available when needed on terms favorable to us, or at all.

In its audit report on our financial statements, our independent registered public accounting firm noted that we have suffered recurring losses, have a net working capital deficiency, and a deficiency of stockholders' equity. As a result of these conditions, the audit report contains an explanatory paragraph that raises substantial doubt about our ability to continue as a going concern.

Our inability to maintain sufficient availability under our revolving credit facility or sufficient access to capital markets to replace that facility when it matures would have a significant impact on our business.

We currently maintain a revolving credit facility with Bridge Bank, National Association that expires in May 2016. Borrowings under this facility are collateralized by substantially all of our assets. The amount of available borrowings fluctuates based on the underlying asset-borrowing base, which is 80% of our eligible trade accounts receivable. At December 31, 2015 we had \$2.16 million outstanding under this facility. In addition to cash on hand, cash flow from operations and our vendor financing facility, this bank facility provides us with the liquidity we require to meet our operating, investing and financing needs. The failure to replace the existing credit facility upon its maturity with a comparable credit facility that provides similar amounts of liquidity for the Company would have a material negative impact on our overall liquidity, financial and operating results.

Our independent registered public accounting firm's report contains an explanatory paragraph that expresses subs

We may not have sufficient financial resources to carry out our strategy; we may need to issue debt or use our stock to seek additional funding.

We may not have sufficient financial resources to carry out our strategy. As described above, we may need to secure additional capital in the future to improve our liquidity in order to carry out our business plan. The amounts involved in any such transaction, individually or in the aggregate, may be material. To the extent that we raise additional capital through the sale of equity securities, the issuance of such securities could result in dilution to our existing stockholders. If we raise additional funds through the issuance of debt securities, the terms of such debt could impose additional restrictions on our operations. Additional capital, if required, may not be available on acceptable terms, if at all. A failure to obtain additional financing could have a material adverse impact our business, financial condition and earnings.

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We incurred a net loss in 2015 and 2014 and we may experience net losses in the future.

We experienced net losses of \$2.2 million and \$2.8 million for the years ended December 31, 2015 and 2014, respectively. Although we have had multiple profitable quarters in the last two years including most recently in the fourth quarter of 2015, we have had a history of fluctuating operating results, including a history of annual net losses from inception through 2009 and from 2012 through 2015. Although we have made efforts to align costs with sales and gross margin volume, there can be no guarantee that we will be successful in sustaining or increasing profitability in 2016 or beyond. The uncertainty of a rapidly changing competitive marketplace has created a volatile and challenging business climate, which may continue to negatively impact our customers and their spending and investment decisions. We may not be able to generate the level of revenue necessary to achieve and maintain sustainable profitability, particularly as we continue to incur significant sales and marketing and administrative expenses. Any failure to maintain and grow our revenue volumes would adversely affect our business, financial condition and operating results.

We have substantial amounts of goodwill and other intangibles, and changes in future business conditions could cause these assets to become impaired, requiring substantial write-downs that would adversely affect our operating results.

We have substantial amounts of goodwill and other intangibles resulting from prior acquisitions of businesses, including the acquisition of the systems integration business from arvato digital services, LLC in 2013. Under generally accepted accounting principles, we do not amortize goodwill and intangible assets acquired in a purchase business combination that are determined to have indefinite useful lives, but instead review them annually (or more frequently if impairment indicators arise) for impairment. We are amortizing certain other intangibles over their useful lives. To the extent we determine that such assets have been impaired, we will write-down their carrying value on our consolidated balance sheet and book an impairment charge in our consolidated statement of operations. During each of the years ended December 31, 2015 and 2014, we conducted such analyses that resulted in no impairment. The net carrying value of goodwill and other indefinite lived intangibles totaled \$1.9 million at December 31, 2015 and 2014, respectively. The net carrying value of finite lived intangible assets totaled \$0.8 million and \$1.0 million at December 31, 2015 and 2014, respectively.

We derive a significant portion of our revenues from a limited number of customers.

We derive and believe that we will continue to derive in the near term a significant portion of our revenues from a limited number of customers. To the extent that any significant customer uses less of our services or terminates its relationship with us, our revenues could decline significantly, which could have a material adverse effect on our financial condition and results of operations. Three customers comprised 65% and 60% of total revenues for the years ended December 31, 2015 and 2014, respectively.

Most of our contracts may be canceled on short notice, so our revenue and potential profits are not guaranteed.

Most of our contracts are cancelable on short notice by the customer either at its convenience or upon our default. If one of our customers terminates a contract at its convenience, then we typically are able to recover only costs incurred or committed, settlement expenses and profit on work completed prior to termination, which could prevent us from recognizing all of our potential revenue and profit from that contract. If one of our customers terminates the contract due to our default, we could be liable for excess costs incurred by the customer in re-procuring services from another source, as well as other costs. Many of our contracts, including our service agreements, are periodically open to bid.

We may not be the successful bidder on our existing contracts that are re-bid. We also provide a portion of our services on a non-recurring, project-by-project basis. We could experience a reduction in our revenue, profitability and liquidity if our customers cancel a significant number of contracts, we fail to win a significant number of our existing contracts upon re-bid or we complete the required work under a significant number of our non-recurring projects and cannot replace them with similar projects. In addition, we provide services under certain master service agreements. If these agreements are terminated, we would be unable to provide on-going services to those customers.

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A significant portion of our projects are accounted for on the percentage-of-completion method, and if actual results vary from the assumptions made in estimating percentage-of-completion, our revenue and income could be reduced.

We generally recognize revenue for a significant portion of our projects using the percentage-of-completion method. Under the percentage-of-completion method, we record revenue as work on the contract progresses. The cumulative amount of revenue recorded on a contract at a specified point in time is equal to that percentage of total revenue that incurred costs to date bear to the estimated total expected contract costs. The percentage-of-completion method therefore relies on accurate estimates of total expected contract costs. Contract revenue and total cost estimates are reviewed and revised periodically as the work progresses. Adjustments are reflected in contract revenue in the fiscal period when such estimates are revised. Estimates are based on management's reasonable assumptions and experience, but are only estimates. Variation between actual results and estimates on a large project or on a number of smaller projects could be material. We immediately recognize the full amount of the estimated loss on a contract when our estimates indicate such a loss. Any such loss would reduce our revenue and income.

We submit change orders to our customers for work we perform beyond the scope of some of our contracts. If our customers do not approve these change orders, our results of operations could be adversely impacted.

We typically submit change orders under some of our contracts for payment of work performed beyond the initial contractual requirements. The applicable customers may not approve or may contest these change orders and we cannot assure you that these claims will be approved in whole, in part or at all. If these claims are not approved, our net income and results of operations could be adversely impacted.

We may not accurately estimate the costs associated with services provided under fixed-price contracts, which could impair our financial performance.

Approximately 85% of our revenue is derived from fixed price contracts. Under these contracts, we set the price of our services and assume the risk that the costs associated with our performance may be greater than we anticipated. Our profitability is therefore dependent upon our ability to estimate accurately the costs associated with our services. These costs may be affected by a variety of factors, such as lower than anticipated productivity, conditions at the work sites differing materially from what was anticipated at the time we bid on the contract, and higher than expected costs of materials and labor. Certain agreements or projects could have lower margins than anticipated or losses if actual costs for contracts exceed our estimates, which could reduce our profitability and liquidity.

Failure to properly manage projects may result in costs or claims.

Our engagements often involve relatively large scale, highly complex projects. The quality of our performance on such projects depends in large part upon our ability to manage the customer relationship, to manage effectively the project and to deploy appropriate resources, including third-party contractors and our own personnel, in a timely manner. Any defects, errors or failure to meet customers' expectations could result in claims for substantial damages against us. We currently maintain comprehensive general liability, umbrella, and professional liability insurance policies. We cannot be certain that the insurance coverage we carry to cover such claims will be adequate to protect us from the full impact of such claims. Moreover, in certain instances, we guarantee customers that we will complete a

project by a scheduled date or that the project will achieve certain performance standards. If the project experiences a performance problem, we may not be able to recover the additional costs we will incur, which could exceed revenues realized from a project. Finally, if we underestimate the resources or time we need to complete a project with capped or fixed fees, our operating results could be seriously harmed.

We may choose, or be required, to pay our subcontractors even if our customers do not pay or delay paying us for the related services.

We use subcontractors to perform portions of our services and to manage work flow. In some cases, we pay our subcontractors before our customers pay us for the related services. If we choose, or are required, to pay our subcontractors for work performed for customers who fail to pay, or delay paying us for the related work, we could experience a decrease in profitability and liquidity.

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We operate in a highly competitive industry, which could reduce our growth opportunities, revenue and operating results.

The mission-critical information technology industry in which we operate is highly competitive and continues to become more competitive. We often compete against divisions of large design build construction and real estate firms and other information technology consulting and integration companies, including several that are large domestic companies that may have financial, technical and marketing resources that exceed our own. These larger competitors have an infrastructure and support greater than ours, and accordingly, we continue to experience some price pressure as some companies are willing to take on projects at lower margins. Our competitors may develop the expertise, experience and resources to provide services that are equal or superior in both price and quality to our services, and we may not be able to maintain or enhance our competitive position. Our size often prevents us from bidding on larger, more profitable projects, which significantly reduces our growth opportunities. Although our customers currently outsource a significant portion of these services to us and our competitors, we can offer no assurance that our existing or prospective customers will continue to outsource specialty contracting services to us in the future.

The industries we serve have experienced and may continue to experience rapid technological, structural and competitive changes that could reduce the need for our services and adversely affect our revenues.

The mission-critical information technology industry is characterized by rapid technological change, intense competition and changing consumer and data center needs. We generate a significant portion of our revenues from customers in the mission-critical information technology industry. New technologies, or upgrades to existing technologies by customers, could reduce the need for our services and adversely affect our revenues and profitability. Improvements in existing technology may allow companies to improve their networks without physically upgrading them. Reduced demand for our services or a loss of a significant customer could adversely affect our results of operations, cash flows and liquidity.

We may be unable to obtain sufficient bonding capacity to support certain service offerings.

Some of our contracts, particularly with managing construction related-activities, require performance and payment bonds. Bonding capacity for construction projects has become increasingly difficult to obtain, and bonding companies are denying or restricting coverage to an increasing number of contractors. Companies that have been successful in renewing or obtaining coverage have sometimes been required to post additional collateral to secure the same amount of bonds which would reduce availability under any credit facility. We may not be able to maintain a sufficient level of bon