

Bridgeline Digital, Inc.
Form 10-Q
August 14, 2017
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2017

OR

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

For the transition period from _____ to _____

Commission File Number 333-139298

Bridgeline Digital, Inc.

(Exact name of registrant as specified in its charter)

Delaware

State or other jurisdiction of incorporation or organization

52-2263942

IRS Employer Identification No.

80 Blanchard Road

Burlington, Massachusetts

01803

(Address of Principal Executive Offices) (Zip Code)

(781) 376-5555

(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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

| | | | | |
|-------------------------|-------------------|---|---------------------------|-------------------------|
| | | Non-accelerated filer | | |
| Large accelerated filer | Accelerated filer | (Do not check if a smaller reporting company) | Smaller reporting company | Emerging growth company |

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

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

The number of shares of Common Stock par value \$0.001 per share, outstanding as of August 11, 2017 was 4,200,848.

Bridgeline Digital, Inc.

Quarterly Report on Form 10-Q

For the Quarterly Period ended June 30, 2017

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Bridgeline Digital, Inc.

Quarterly Report on Form 10-Q

For the Quarterly Period ended June 30, 2017

Statements contained in this Report on Form 10-Q that are not based on historical facts are “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements may be identified by the use of forward-looking terminology such as “should,” “could,” “may,” “will,” “expect,” “believe,” “estimate,” “anticipate,” “intends,” “continue,” or similar terms or variations of those terms or the negative of those terms. These statements appear in a number of places in this Form 10-Q and include statements regarding the intent, belief or current expectations of Bridgeline Digital, Inc. Forward-looking statements are merely our current predictions of future events. Investors are cautioned that any such forward-looking statements are inherently uncertain, are not guaranties of future performance and involve risks and uncertainties. Actual results may differ materially from our predictions. Important factors that could cause actual results to differ from our predictions include the impact of the weakness in the U.S. and international economies on our business, our inability to manage our future growth effectively or profitably, fluctuations in our revenue and quarterly results, our license renewal rate, the impact of competition and our ability to maintain margins or market share, the limited market for our common stock, the volatility of the market price of our common stock, the ability to maintain our listing on the Nasdaq Capital market, the ability to raise capital, the performance of our products, our ability to respond to rapidly evolving technology and customer requirements, our ability to protect our proprietary technology, the security of our software, our dependence on our management team and key personnel, our ability to hire and retain future key personnel, or our ability to maintain an effective system of internal controls. Although we have sought to identify the most significant risks to our business, we cannot predict whether, or to what extent, any of such risks may be realized, nor is there any assurance that we have identified all possible issues which we might face. We assume no obligation to update our forward-looking statements to reflect new information or developments. We urge readers to review carefully the risk factors described in our Annual Report on Form 10-K for the fiscal year ended September 30, 2016 as well as in the other documents that we file with the Securities and Exchange Commission. You can read these documents at www.sec.gov.

Where we say “we,” “us,” “our,” “Company” or “Bridgeline Digital” we mean Bridgeline Digital, Inc.

PART I—FINANCIAL INFORMATION**Item 1. Condensed Consolidated Financial Statements.****BRIDGELINE DIGITAL, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS**

(Dollars in thousands, except share data)

(Unaudited)

| | June 30, 2017 | September 30, 2016 |
|---|--------------------------|-----------------------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$753 | \$ 661 |
| Accounts receivable and unbilled receivables, net | 3,056 | 2,549 |
| Prepaid expenses and other current assets | 405 | 381 |
| Total current assets | 4,214 | 3,591 |
| Equipment and improvements, net | 265 | 512 |
| Intangible assets, net | 334 | 548 |
| Goodwill | 12,641 | 12,641 |
| Other assets | 391 | 436 |
| Total assets | \$17,845 | \$ 17,728 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$1,287 | \$ 1,285 |
| Accrued liabilities | 841 | 946 |
| Accrued contingent consideration | - | 75 |
| Capital lease obligations | 9 | 45 |
| Deferred revenue | 1,629 | 1,360 |
| Total current liabilities | 3,766 | 3,711 |
| Debt | 2,344 | 2,115 |
| Other long term liabilities | 251 | 400 |
| Total liabilities | 6,361 | 6,226 |
| Commitments and contingencies | | |

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Stockholders' equity:

| | | |
|---|----------|-----------|
| Preferred stock - \$0.001 par value; 1,000,000 shares authorized; 236,438 at June 30, 2017 and 221,092 at September 30, 2016, issued and outstanding (liquidation preference \$2,435) | - | - |
| Common stock - \$0.001 par value; 50,000,000 shares authorized; 4,200,848 at June 30, 2017 and 3,725,542 at September 30, 2016, issued and outstanding | 21 | 19 |
| Additional paid-in capital | 65,656 | 64,202 |
| Accumulated deficit | (53,843) | (52,366) |
| Accumulated other comprehensive loss | (350) | (353) |
| Total stockholders' equity | 11,484 | 11,502 |
| Total liabilities and stockholders' equity | \$17,845 | \$ 17,728 |

The accompanying notes are an integral part of these condensed consolidated financial statements.

BRIDGELINE DIGITAL, INC.**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

(Dollars in thousands, except share and per share data)

(Unaudited)

| | Three Months Ended | | Nine Months Ended | |
|---|---------------------------|-------------|--------------------------|-------------|
| | June 30, | | June 30, | |
| | 2017 | 2016 | 2017 | 2016 |
| Net revenue: | | | | |
| Digital engagement services | \$2,121 | \$1,849 | \$6,298 | \$6,611 |
| Subscription and perpetual licenses | 1,711 | 1,530 | 5,018 | 4,575 |
| Managed service hosting | 242 | 317 | 743 | 985 |
| Total net revenue | 4,074 | 3,696 | 12,059 | 12,171 |
| Cost of revenue: | | | | |
| Digital engagement services | 1,297 | 1,221 | 3,569 | 4,111 |
| Subscription and perpetual licenses | 473 | 391 | 1,468 | 1,423 |
| Managed service hosting | 65 | 76 | 209 | 232 |
| Total cost of revenue | 1,835 | 1,688 | 5,246 | 5,766 |
| Gross profit | 2,239 | 2,008 | 6,813 | 6,405 |
| Operating expenses: | | | | |
| Sales and marketing | 1,193 | 1,212 | 3,661 | 3,528 |
| General and administrative | 801 | 1,035 | 2,395 | 2,660 |
| Research and development | 393 | 428 | 1,175 | 1,145 |
| Depreciation and amortization | 126 | 328 | 468 | 1,023 |
| Restructuring charges | 49 | 16 | 249 | 795 |
| Total operating expenses | 2,562 | 3,019 | 7,948 | 9,151 |
| Loss from operations | (323) | (1,011) | (1,135) | (2,746) |
| Interest and other expense, net | (9) | (287) | (122) | (867) |
| Loss on inducement of convertible notes | - | (726) | - | (726) |
| Loss before income taxes | (332) | (2,024) | (1,257) | (4,339) |
| Provision for income taxes | - | 8 | 13 | 46 |
| Net loss | (332) | (2,032) | (1,270) | (4,385) |
| Dividends on convertible preferred stock | (71) | (33) | (207) | (97) |
| Net loss applicable to common shareholders | \$(403) | \$(2,065) | \$(1,477) | \$(4,482) |
| Net loss per share attributable to common shareholders: | | | | |
| Basic and diluted | \$(0.10) | \$(1.03) | \$(0.36) | \$(3.28) |
| Number of weighted average shares outstanding: | | | | |
| Basic and diluted | 4,195,900 | 2,003,006 | 4,129,481 | 1,367,021 |

The accompanying notes are an integral part of these condensed consolidated financial statements.

BRIDGELINE DIGITAL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(Dollars in thousands)

(Unaudited)

| | Three Months | | Nine Months | |
|---|---------------------|-------------|--------------------|-------------|
| | Ended | | Ended | |
| | June 30, | | June 30, | |
| | 2017 | 2016 | 2017 | 2016 |
| Net Loss | \$ (332) | \$ (2,032) | \$ (1,270) | \$ (4,385) |
| Net change in foreign currency translation adjustment | - | 3 | 3 | 3 |
| Comprehensive loss | \$ (332) | \$ (2,029) | \$ (1,267) | \$ (4,382) |

The accompanying notes are an integral part of these condensed consolidated financial statements.

BRIDGELINE DIGITAL, INC.**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Dollars in thousands, except share data)

(Unaudited)

| | Nine Months Ended June 30, 2017 2016 | |
|--|--|-----------|
| Cash flows from operating activities: | | |
| Net loss | \$(1,270) | \$(4,385) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Provision for deferred taxes | - | 31 |
| Loss on disposal of fixed assets | 48 | 31 |
| Amortization of intangible assets | 214 | 322 |
| Loss on inducement of convertible notes | - | 726 |
| Depreciation | 216 | 608 |
| Other amortization | 84 | 459 |
| Capitalized interest expense | - | 204 |
| Stock-based compensation | 433 | 204 |
| Changes in operating assets and liabilities | | |
| Accounts receivable and unbilled receivables | (507) | 479 |
| Prepaid expenses and other assets | (22) | 173 |
| Accounts payable and accrued liabilities | (188) | (119) |
| Deferred revenue | 269 | (127) |
| Other liabilities | (100) | (115) |
| Total adjustments | 447 | 2,876 |
| Net cash used in operating activities | (823) | (1,509) |
| Cash flows from investing activities: | | |
| Purchase of equipment and improvements | (18) | (24) |
| Software development capitalization costs | (41) | (104) |
| Net cash used in investing activities | (59) | (128) |
| Cash flows from financing activities: | | |
| Proceeds from issuance of 533,337 shares of common stock upon conversion of term notes, net of issuance costs | - | 1,574 |
| Proceeds from issuance of common stock of 427,073 shares in FY2017 and 136,000 shares in FY2016, net of issuance costs | 853 | 669 |
| Proceeds from bank term loan | - | 500 |
| Proceeds from term notes from stockholders | - | 1,000 |
| Borrowing on bank line of credit | 1,859 | 108 |
| Payments on bank term loan | - | (750) |

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| | | |
|--|---------|---------|
| Payments on bank line of credit | (1,630) | (963) |
| Contingent acquisition payments | (75) | (317) |
| Principal payments on capital leases | (36) | (291) |
| Net cash provided by financing activities | 971 | 1,530 |
| Effect of exchange rate changes on cash and cash equivalents | 3 | 3 |
| Net increase/(decrease) in cash and cash equivalents | 92 | (104) |
| Cash and cash equivalents at beginning of period | 661 | 337 |
| Cash and cash equivalents at end of period | \$753 | \$233 |
| Supplemental disclosures of cash flow information: | | |
| Cash paid for: | | |
| Interest | \$93 | \$187 |
| Income taxes | \$17 | \$11 |
| Non cash investing and financing activities: | | |
| Conversion of subordinated convertible notes (principal) | \$- | \$570 |
| Conversion of term notes (principal) | \$- | \$3,000 |
| Accrued dividends on convertible preferred stock | \$207 | \$97 |

The accompanying notes are an integral part of these condensed consolidated financial statements.

BRIDGELINE DIGITAL, INC.

NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except share and per share data)

1. Description of Business

Overview

Bridgeline Digital, The Digital Engagement Company™, helps customers maximize the performance of their full digital experience from websites and intranets to online stores. Bridgeline's iAPPS® platform deeply integrates Web Content Management, eCommerce, eMarketing, Social Media management, and Web Analytics to help marketers deliver digital experiences that attract, engage and convert their customers across all channels. Bridgeline's iAPPS platform combined with its digital services assists customers in maximizing on-line revenue, improving customer service and loyalty, enhancing employee knowledge, and reducing operational costs. Our iAPPSds ("distributed subscription"), is a platform that empowers large franchise and multi-unit organizations with state-of-the-art web engagement management while providing superior oversight of corporate branding. iAPPSds deeply integrates content management, eCommerce, eMarketing and web analytics and is a self-service web platform that is offered to each authorized franchise or dealer for a monthly subscription fee.

The iAPPS platform is delivered through a cloud-based SaaS ("Software as a Service") multi-tenant business model, whose flexible architecture provides customers with state of the art deployment providing maintenance, daily technical operation and support; or via a traditional perpetual licensing business model, in which the iAPPS software resides on a dedicated server in either the customer's facility or hosted by Bridgeline via a cloud-based hosted services model or a Tier 1 facility.

The iAPPS Platform is an award-winning application recognized around the globe. Our teams of Microsoft Gold® certified developers have won over 100 industry related awards. Recently, our Marketing Automation platform was named a 2017 SIIA CODiE Award finalist in the Best Marketing Solution category. In 2016, *CIO Review* selected iAPPS as one of the 20 Most Promising Digital Marketing Solution Providers. This followed accolades from the SIIA (Software and Information Industry Association), which recognized iAPPS Content Manager with the 2015 SIIA CODiE Award for Best Web Content Management Platform. Also in 2015, *EContent* magazine named iAPPS Digital Engagement Platform to its Trendsetting Products list. The list of 75 products and platforms was compiled by EContent's editorial staff, and selections were based on each offering's uniqueness and importance to digital publishing, media, and marketing. We were also recognized in 2015 as a strong performer by Forrester Research, Inc in its independence report, "The Forrester Wave™: Through-Channel Marketing Automation Platforms, Q3 2015." Also, in recent years, our iAPPS Content Manager and iAPPS Commerce products were selected as finalists for the 2014,

2013, and 2012 CODiE Awards for Best Content Management Solution and Best Electronic Commerce Solution, globally. In 2014 and 2013, Bridgeline Digital won twenty-five Horizon Interactive Awards for outstanding development of web applications and websites. Also in 2013, the Web Marketing Association sponsored Internet Advertising Competition honored Bridgeline Digital with three awards for iAPPS customer websites and B2B Magazine selected Bridgeline Digital as one of the Top Interactive Technology companies in the United States. KMWorld Magazine Editors selected Bridgeline Digital as one of the 100 Companies That Matter in Knowledge Management and also selected iAPPS as a Trend Setting Product in 2013.

Bridgeline Digital was incorporated under the laws of the State of Delaware on August 28, 2000.

Locations

The Company's corporate office is located in Burlington, Massachusetts. The Company maintains regional field offices serving the following geographical locations: Boston, MA; Chicago, IL; Denver, CO; San Luis Obispo, CA; and Tampa, FL. The Company has one wholly-owned subsidiary, Bridgeline Digital Pvt. Ltd. located in Bangalore, India.

Reverse Stock Split

On June 29, 2017, the Company's Shareholders and the Board of Directors approved a reverse stock split pursuant to which all classes of our issued and outstanding shares of common stock at the close of business on such date were combined and reconstituted into a smaller number of shares of common stock in a ratio of 1 share of common stock for every 5 shares of common stock ("1-for-5 reverse stock split"). The 1-for-5 reverse stock split is effective as of close of business on July 24, 2017 and the Company's stock began trading on a split-adjusted basis on July 25, 2017.

BRIDGELINE DIGITAL, INC.

NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except share and per share data)

The reverse stock split reduces the number of shares of the Company's common stock currently outstanding from approximately 21 million shares to approximately 4.2 million shares. Proportional adjustments have been made to the conversion and exercise prices of the Company's outstanding convertible preferred stock, warrants, restricted stock awards, and stock options, and to the number of shares issued and issuable under the Company's Stock Incentive Plans. Upon the effectiveness of the 1-for-5 reverse stock split, each five shares of the Company's issued and outstanding common stock have been automatically combined and converted into one issued and outstanding share of common stock, par value \$.001. The Company did not issue any fractional shares in connection with the reverse stock split. Instead, fractional share interests were rounded up to the next largest whole share. The reverse stock split does not modify the rights or preferences of the common stock. The number of authorized shares of the Company's common stock remains at 50 million shares and the par value remains \$0.001.

The accompanying unaudited interim condensed consolidated financial statements and footnotes have been retroactively adjusted to reflect the effects of the 1-for-5 reverse stock split.

Liquidity

The Company has incurred operating losses and used cash in its operating activities for the past several years. Cash was used to fund acquisitions to broaden our geographic footprint, develop new products, and build infrastructure. However, during the past two fiscal years and continuing into the current fiscal year, the Company has executed on a restructuring plan that included a reduction of workforce and office space, which significantly reduced operating expenses and improved gross margins.

The Company has a Loan and Security Agreement with Heritage Bank of Commerce ("Heritage Bank"). The Heritage Bank Loan and Security Agreement ("Heritage Agreement") was set to expire on June 9, 2018, however, On June 10, 2017, the Company was able to extend the maturity date to June 15, 2019. The Heritage Agreement currently provides for \$2.5 million of revolving credit advances and may be used for acquisitions and working capital purposes. The credit advances may not exceed the monthly borrowing base capacity, which will fluctuate based on monthly accounts receivable balances. The Company may request credit advances if the borrowing capacity is more than the current outstanding loan advance, and must pay down the outstanding loan advance if it exceeds the borrowing capacity. As of June 30, 2017, the Company had an outstanding balance under the Heritage Agreement of \$2.3 million. Also, on May 19, 2017, the Company filed a Registration Statement on Form S-3 with the Securities and Exchange Commission in relation to the registration of securities of the Company having an aggregate public offering price of

up to \$10 million. The determinate number of shares of common stock, preferred stock, warrants, and units of any combination thereof (collectively, the “Securities”) may be offered and sold from time to time, but shall not exceed \$10 million in total.

The Company has made significant cost reductions over the past two years and the current fiscal year revenues are comparable to the previous fiscal year’s. While there can be no assurances that the anticipated sales will be achieved for fiscal 2017, the Company’s management believes it will have an appropriate cost structure to support the revenues that will be achieved. As such, management believes that the Company will provide sufficient cash flows to fund its operations in the ordinary course of business through at least the next twelve months. In addition, the ability to raise funds through its credit line with Heritage Bank and through the sales of securities may be helpful to the Company if the anticipated sales levels are not achieved or it cannot reduce operating expenses to account for any shortfalls.

BRIDGELINE DIGITAL, INC.

NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except share and per share data)

2. Summary of Significant Accounting Policies

Basis of Presentation and Principles of Consolidation

The condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant inter-company accounts and transactions have been eliminated in consolidation.

Unaudited Interim Financial Information

The accompanying interim Condensed Consolidated Balance Sheets as of June 30, 2017 and September 30, 2016, and the interim Condensed Consolidated Statements of Operations, Comprehensive Loss, and Cash Flows for the three and nine months ended June 30, 2017 and 2016 are unaudited. The unaudited interim condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("US GAAP"), and with the same instructions to Form 10-Q and Regulation S-X, and in the opinion of the Company's management have been prepared on the same basis as the audited consolidated financial statements as of and for the year ended September 30, 2016. These interim condensed consolidated financial statements include all adjustments, consisting of normal recurring adjustments and accruals, necessary for the fair presentation of the Company's financial position at June 30, 2017 and September 30, 2016 and its results of operations and cash flows for the three and nine months ended June 30, 2017 and 2016. The results for the three and nine months ended June 30, 2017 are not necessarily indicative of the results to be expected for the year ending September 30, 2017. The accompanying September 30, 2016 Condensed Consolidated Balance Sheet has been derived from the audited financial statements at that date, but does not include all of the information and footnotes required by US GAAP for complete financial statements.

Subsequent Events

The Company evaluated subsequent events through the date of this filing and concluded there were no material subsequent events requiring adjustment to or disclosure in these interim condensed consolidated financial statements,

except as already disclosed in these financial statements.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (“ASU”) No. 2014-09, Revenue from Contracts with Customers: Topic 606 (ASU 2014-09), to supersede nearly all existing revenue recognition guidance under U.S. GAAP. The core principle of ASU 2014-09 is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration that is expected to be received for those goods or services. ASU 2014-09 defines a five step process to achieve this core principle and, in doing so, it is possible more judgment and estimates may be required within the revenue recognition process than required under existing U.S. GAAP including identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. In July 2015, the FASB approved a one-year delay in the effective date. ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. Management is currently evaluating the impact of the adoption of ASU 2014-09 on its consolidated financial statements.

BRIDGELINE DIGITAL, INC.

NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except share and per share data)

In November 2015, the FASB issued ASU 2015-17, Balance Sheet Classification of Deferred Taxes, (the “Update”), which eliminates the current requirement to present deferred tax liabilities and assets as current and noncurrent in a classified balance sheet. Instead, entities will be required to classify all deferred tax assets and liabilities as noncurrent. The Update is effective for financial statements issued for annual periods beginning after December 15, 2016 and interim periods within those annual periods. Management does not expect the adoption of this Update to have a material impact on its consolidated financial position, results of operations or cash flows.

In February 2016, the FASB issued ASU No. 2016-02, which is guidance on accounting for leases. ASU No. 2016-02 requires lessees to recognize most leases on their balance sheets for the rights and obligations created by those leases. The guidance requires enhanced disclosures regarding the amount, timing, and uncertainty of cash flows arising from leases and will be effective for interim and annual periods beginning after December 15, 2018. Early adoption is permitted. The guidance requires the use of a modified retrospective approach. The Company is evaluating the impact of the guidance on its consolidated financial position, results of operations and related disclosures.

In March 2016, the FASB issued ASU No. 2016-09, which amended guidance related to employee share-based payment accounting. The new guidance simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. For public companies, the amendments in this standard are effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. Early adoption is permitted. Management does not expect the adoption of this Standard to have a material impact on our consolidated financial position, results of operations or cash flows.

In August 2016, the FASB issued ASU 2016-15, which is intended to reduce diversity in practice in how certain transactions are classified in the statement of cash flows, specifically certain cash receipts and cash payments. The standard is effective for public business entities financial statements issued for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted, provided that all of the amendments are adopted in the same period. The guidance requires application using a retrospective method. Management does not expect the adoption of this Standard to have a material impact on our consolidated cash flows.

In November 2016, the FASB issued ASU No. 2016-18 which requires entities to include in their cash and cash-equivalent balances in the statement of cash flows those amounts that are deemed to be restricted cash and restricted cash equivalents. As a result, companies will no longer present transfers between cash and cash equivalents,

and restricted cash and restricted cash equivalents in the statement of cash flows. The guidance is effective for annual and interim periods beginning after December 15, 2017. Early adoption of ASU 2016-18 is permitted, including adoption in an interim period. Management is currently evaluating the adoption of ASU 2016-18 on its consolidated financial statements.

In January 2017, the FASB issued ASU No. 2017-04 to simplify the accounting for goodwill impairment. The guidance removes Step 2 of the goodwill impairment test, which requires a hypothetical purchase price allocation. A goodwill impairment will now be the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. The guidance will be applied prospectively and is effective for annual reporting periods ending December 31, 2020 and thereafter with early adoption permitted. Management is currently evaluating the impact of the new guidance on its consolidated financial statements.

In January 2017, the FASB issued ASU No. 2017-01, which amended the existing FASB Accounting Standards Codification Topic 805 Business Combinations. The standard provides additional guidance to assist entities with evaluating 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 is effective for annual periods beginning after December 15, 2017, including interim periods within those annual periods, with early adoption permitted. Management is currently evaluating the impact of the new guidance on its consolidated financial statements.

All other Accounting Standards Updates issued but not yet effective are not expected to have a material effect on the Company's future financial statements.

BRIDGELINE DIGITAL, INC.

NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except share and per share data)

3. Accounts Receivable and Unbilled Receivables

Accounts receivable and unbilled receivables consists of the following:

| | As of June 30, 2017 | As of September 30, 2016 |
|---|--|---|
| Accounts receivable | \$3,127 | \$ 2,627 |
| Unbilled receivables | 62 | 60 |
| Subtotal | 3,189 | 2,687 |
| Allowance for doubtful accounts | (133) | (138) |
| Accounts receivable and unbilled receivables, net | \$3,056 | \$ 2,549 |

4. Fair Value Measurement and Fair Value of Financial Instruments

The Company's other financial instruments consist principally of accounts receivable, accounts payable, and debt. The Company believes the recorded values for accounts receivable and accounts payable approximate current fair values as of June 30, 2017 and September 30, 2016 because of their nature and durations. The carrying value of debt instruments also approximates fair value as of June 30, 2017 and September 30, 2016 based on acceptable valuation methodologies which use market data of similar size and situated debt issues. The Company no longer has any other assets or liabilities to be measured at fair value on a recurring basis as of June 30, 2017.

Assets and liabilities to be measured at fair value on a recurring basis as of September 30, 2016 consisted only of contingent acquisition consideration, as follows:

September 30, 2016

| | Level 1 | Level 2 | Level 3 | Total |
|--------------------------------------|--------------------|--------------------|--------------------|--------------|
| Liabilities: | | | | |
| Contingent acquisition consideration | - | - | \$ 75 | \$ 75 |
| Total Liabilities | - | - | \$ 75 | \$ 75 |

The Company determines the fair value of acquisition-related contingent consideration based on assessment of the probability that the Company would be required to make such future payments. Changes to the fair value of contingent consideration are recorded in general and administrative expenses.

BRIDGELINE DIGITAL, INC.

NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except share and per share data)

The following table provides a roll forward of the fair value, as determined by Level 3 inputs, of the contingent consideration.

Changes in the fair value of the contingent consideration liability were as follows:

| | Contingent Consideration |
|-------------------------------------|-------------------------------------|
| Balance, October 1, 2016 | \$ 75 |
| Payment of contingent consideration | (75) |
| Balance, June 30, 2017 | \$ - |

5. Intangible Assets

The components of intangible assets are as follows:

| | As of June 30, 2017 | As of September 30, 2016 |
|--------------------------|--|---|
| Domain and trade names | \$ 10 | \$ 10 |
| Customer related | 232 | 392 |
| Non-compete agreements | 92 | 146 |
| Balance at end of period | \$ 334 | \$ 548 |

Total amortization expense related to intangible assets for the three months ended June 30, 2017 and 2016 was \$71 and \$108, respectively, and \$214 and \$322 for the nine months ended June 30, 2017 and 2016, respectively. Amortization expense related to intangible assets is reflected in operating expenses on the Condensed Consolidated Statements of Operations. The estimated amortization expense for fiscal years 2017 (remaining), 2018, and 2019 is \$71, \$242, and \$21, respectively.

6. Goodwill

For fiscal 2016, the Company performed the annual assessment of goodwill during the fourth quarter of 2016 and concluded that goodwill was not impaired. In estimating fair value, the Company performed a discounted cash flow analysis on the reporting unit to determine fair value. The inputs to the discounted cash flow model are considered level 3 in the fair value hierarchy. The impairment test performed by the Company indicated that the estimated fair value of the reporting unit was more than its corresponding carrying amount. As a result of the analyses performed, the Company assessed that goodwill was not impaired. The Company did not have an impairment charge in the nine months ended June 30, 2017.

7. Restructuring

During the fiscal 2015 and 2016 and through the first half of the current fiscal year, the Company's management approved, committed to and initiated plans to restructure and further improve efficiencies by implementing cost reductions in line with expected decreases in revenue. The Company renegotiated several office leases and relocated to smaller space, while also negotiating sub-leases for the original space. In addition, the Company executed a general work-force reduction and recognized costs for severance and termination benefits. These restructuring charges and accruals require estimates and assumptions, including contractual rental commitments or lease buy-outs for vacated office space and related costs, and estimated sub-lease income. The Company's sub-lease assumptions include the rates to be charged to a sub-tenant and the timing of the sub-lease arrangement. All of the vacated lease space is currently contractually occupied by a new sub-tenant for the remaining life of the lease. In the second quarter of fiscal 2017, the Company initiated a plan to shut down its operations in India. All of these estimates and assumptions will be monitored on a quarterly basis for changes in circumstances with the corresponding adjustments reflected in the consolidated statement of operations.

BRIDGELINE DIGITAL, INC.

NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except share and per share data)

As part of these restructuring initiatives, the Company recorded restructuring expenses of \$49 thousand and \$16 thousand in the three months ended June 30, 2017 and 2016, respectively, and \$249 thousand and \$795 thousand in the nine months ended June 30, 2017 and 2016, respectively.

The following table summarizes the restructuring activity for the nine months ended June 30, 2017:

| | Employee Severance and Benefits | Facility Related and Other Costs | Total |
|---|--|---|--------------|
| Balance at beginning of period, October 1, 2016 | \$ 193 | \$ 247 | \$ 440 |
| Charges to operations | - | 31 | \$ 31 |
| Cash disbursements | (99) | (71) | \$(170) |
| Changes in estimates | - | - | \$- |
| Balance at end of period, December 31, 2016 | \$ 94 | \$ 207 | \$ 301 |
| Charges to operations | - | 169 | 169 |
| Cash disbursements | (104) | (124) | (228) |
| Changes in estimates | - | - | - |
| Accretion expense | 10 | - | 10 |
| Balance at end of period, March 31, 2017 | \$ - | \$ 252 | \$ 252 |
| Charges to operations | - | 49 | 49 |
| Cash disbursements | - | (110) | (110) |
| Changes in estimates | - | - | - |
| Balance at end of period, June 30, 2017 | \$ - | \$ 191 | \$ 191 |

The components of the accrued restructuring liabilities is as follows:

| | As of June 30, 2017 | As of September 30, 2016 |
|----------------------------------|--|---|
| Facility related and other costs | \$ 145 | \$ 195 |
| Employee related | - | 193 |
| Other | 46 | 52 |
| Total | \$ 191 | \$ 440 |

As of June 30, 2017, \$130 was reflected in Accrued Liabilities and \$61 in Other Long Term Liabilities in the Condensed Consolidated Balance Sheet. As of September 30, 2016, \$331 was reflected in Accrued Liabilities and \$109 in Other Long Term Liabilities in the Condensed Consolidated Balance Sheet.

BRIDGELINE DIGITAL, INC.

NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except share and per share data)

8. Debt

Debt at June 30, 2017 and September 30, 2016 consists of the borrowings on the bank line of credit.

Line of Credit

In June 2016, the Company replaced its Loan and Security Agreement with BridgeBank (the “Bridgebank Agreement”) with a new Loan and Security Agreement with Heritage Bank of Commerce. The Heritage Agreement had an original term of 24 months and was to expire on June 9, 2018, however the maturity date was extended on August 10, 2017 to June 15, 2019. The annual commitment fee was 0.4% of the commitment amount in the first year and 0.2% in the second year, and will be \$6 in 2018 and thereafter. Borrowings are secured by all of the Company’s assets and all of the Company’s intellectual property. The Company will be required to comply with certain financial and reporting covenants including an Asset Coverage Ratio and an Adjusted EBITDA metric. The Heritage Agreement currently provides for up to \$2.5 million of revolving credit advances which may be used for acquisitions and working capital purposes. Borrowings are limited to the lesser of (i) \$2.5 million and (ii) 75% of eligible receivables as defined. The Company can borrow up to \$1.0 million in out of formula borrowings for specified periods of time. The borrowings or credit advances may not exceed the monthly borrowing base capacity, which will fluctuate based on monthly accounts receivable balances. The Company may request credit advances if the borrowing capacity is more than the current outstanding loan advance, and must pay down the outstanding loan advance if it exceeds the borrowing capacity. Borrowings accrue interest at Wall Street Journal Prime Rate plus 1.75%, (currently 5.50%). As of June 30, 2017 and September 30, 2016, the Company had an outstanding balance under the Heritage Agreement of \$2.3 million and \$2.1million, respectively. All financial covenants were met for the quarter ended June 30, 2017.

An amendment to the Heritage Agreement (“First Amendment”) was executed on August 15, 2016 and included a waiver for the Adjusted EBITDA metric for the quarter ended June 30, 2016. The First Amendment also included a decrease in the revolving line of credit from \$3.0 million to \$2.5 million and the Adjusted EBITDA metric for the quarter ended September 30, 2016. The First Amendment also included a minimum cash requirement of \$500 in the Company’s accounts at Heritage, which was waived for the period ended September 30, 2016. On December 14, 2016,

a second amendment to the Heritage Agreement (“Second Amendment”) was executed. The Second Amendment included a minimum cash requirement of \$250 in the Company’s accounts at Heritage and the Adjusted EBITDA metrics for fiscal 2017. As of June 30, 2017, the Company had an outstanding balance under the Heritage Agreement of \$2.3 million. All financial covenants were met for the quarter ended June 30, 2017. On August 10, 2017, a third amendment to the Heritage Agreement (“Third Amendment”) was executed. The Third Amendment included an extension to the maturity date to June 15, 2019, a facility fee of \$6 due June 9, 2018, and a reduction of the unconditional guaranty from the Company’s Director and Shareholder. (see below)

Similar to the Bridgebank Agreement, a Director and Shareholder of the Company, Michael Taglich, signed an unconditional guaranty (the “Guaranty”) and promise to pay Heritage Bank all indebtedness in an amount not to exceed \$2 million in connection with the out of formula borrowings. On August 10, 2017, per the terms of the Third Amendment, the Guaranty was reduced from \$2.0 million to \$1.5 million. Under the terms of the Guaranty, the Guarantor authorizes Lender, without notice or demand and without affecting its liability hereunder, from time to time to: (a) renew, compromise, extend, accelerate, or otherwise change the time for payment, or otherwise change the terms, of the Indebtedness or any part thereof, including increase or decrease of the rate of interest thereon, or otherwise change the terms of the Indebtedness; (b) receive and hold security for the payment of this Guaranty or any Indebtedness and exchange, enforce, waive, release, fail to perfect, sell, or otherwise dispose of any such security; (c) apply such security and direct the order or manner of sale thereof as Lender in its discretion may determine; and (d) release or substitute any Guarantor or any one or more of any endorsers or other guarantors of any of the Indebtedness.

To secure all of Guarantor's obligations hereunder, Guarantor assigns and grants to Lender a security interest in all moneys, securities, and other property of Guarantor now or hereafter in the possession of Lender, all deposit accounts of Guarantor maintained with Lender, and all proceeds thereof. Upon default or breach of any of Guarantor's obligations to Lender, Lender may apply any deposit account to reduce the Indebtedness, and may foreclose any collateral as provided in the Uniform Commercial Code and in any security agreements between Lender and Guarantor.

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9. Other Long Term Liabilities

Deferred Rent

In connection with the lease in Massachusetts, the Company made an investment in leasehold improvements at this location of approximately \$1.4 million, of which approximately \$657 was funded by the landlord. The capitalized leasehold improvements are being amortized over the initial life of the lease. The improvements funded by the landlord are treated as lease incentives. Accordingly, the funding received from the landlord was recorded as a fixed asset addition and a deferred rent liability on the Condensed Consolidated Balance Sheets. As of June 30, 2017, \$151 was reflected in Accrued Liabilities and \$82 is reflected in Other Long Term Liabilities on the Consolidated Balance Sheet. As of September 30, 2016, \$141 was reflected in Accrued Liabilities and \$197 is reflected in Other Long Term Liabilities on the Consolidated Balance Sheet. The deferred rent liability is being amortized as a reduction of rent expense over the life of the lease.

10. Shareholders' Equity

Preferred Stock

On October 27, 2014, the Company sold 200,000 shares of Series A convertible preferred stock (the "Preferred Stock") at a purchase price of \$10.00 per share for gross proceeds of \$2.0 million in a private placement. Net proceeds to the Company after offering expenses were approximately \$1.8 million. The shares of Preferred Stock may be converted, at the option of the holder at any time, into such number of shares of common stock ("Conversion Shares") equal (i) to the number of shares of Preferred Stock to be converted, multiplied by the stated value of \$10.00 (the "Stated Value") and (ii) divided by the conversion price in effect at the time of conversion. The current conversion price is \$16.25, and is subject to adjustment in the event of stock splits or stock dividends. Any accrued but unpaid dividends on the shares of Preferred Stock to be converted shall also be converted in common stock at the conversion price. A mandatory

provision also may provide that the Company will have the right to require the holders to convert shares of Preferred Stock into Conversion Shares if (i) the Company's common stock has closed at or above \$32.50 per share for ten consecutive trading days and (ii) the Conversion Shares are (A) registered for resale on an effective registration statement or (B) may be resold pursuant to Rule 144. As of June 30, 2017, a total of 1,636 preferred shares have been converted to 1,007 shares of common stock.

In the event of any liquidation, dissolution, or winding up of the Company, the holders of shares of Preferred Stock will be entitled to receive in preference to the holders of common stock, the amount equal to the stated value per share of Series A Preferred Stock plus declared and unpaid dividends, if any. After such payment has been made, the remaining assets of the Company will be distributed ratably to the holders of common stock.

The Company may pay dividends in cash or Preferred Stock. Effective January 1, 2017, cumulative dividends are payable at a rate of 12% per year, as after two years, any Preferred Stock dividends increase from 6% to 12.0% per year. If the Company does not pay the dividends in cash, then the Company may pay dividends in any quarter by delivery of additional shares of Preferred Stock ("PIK Election"). If the Company shall make the PIK Election with respect to the dividend payable, it shall deliver a number of shares of Preferred Stock equal to (A) the aggregate dividend payable to such holder as of the end of the quarter divided by (B) the lesser of (x) the then effective Conversion Price or (y) the average VWAP for the five (5) consecutive Trading Days prior to such dividend payment date. The Company shall have the right to force conversion of the Preferred Stock into shares of Common Stock at any time after the Common Stock trades in excess of \$32.50 per share. The Preferred Shares shall vote with the Common on an as converted basis.

As of June 30, 2017, the Company has issued 38,074 preferred convertible shares (PIK shares) to the preferred shareholders of which 16,982 shares were issued in fiscal 2017. The Company elected to declare a PIK dividend for the next quarterly payment due July 1, 2017. The total PIK dividend declared for July 1, 2017 is 7,098 preferred stock shares at a dividend rate of 12%.

BRIDGELINE DIGITAL, INC.

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(Dollars in thousands, except share and per share data)

Common Stock

On November 3, 2016, the Company entered into Securities Purchase Agreements (“November 2016 Private Placement”) with certain institutional and accredited investors (the “Purchasers”) to sell an aggregate total of 427,073 shares of common stock for \$2.40 per share (the “Purchaser Shares”) for gross proceeds of \$1.0 million. The Company’s President and CEO (Roger Kahn) and two of the Company’s directors (Michael Taglich and Robert Taglich) purchased shares of common stock in this private offering. Roger Kahn purchased 17,200 common shares and Michael and Robert Taglich each purchased 30,770 common shares. Also, as additional consideration, the Company issued to the Purchasers, warrants to purchase an aggregate total of 213,538 shares common stock (the “Purchaser Warrant Shares”).

On February 3, 2017, the Company issued 36,826 shares of restricted common stock at \$3.15 to four members of its Board of Directors in lieu of cash payments for their annual services as board members. The shares vest in equal installments on a monthly basis through the end of the service period of September 30, 2017. The aggregate fair value of the shares is \$116 and is being expensed over the service period. The amount of expense recognized as of June 30, 2017 is \$87. In June 2017, the Company’s CEO and President (Roger Kahn) elected to receive common stock in lieu of a \$20,000 cash payment for a bonus earned for the first half of the fiscal year. He received 7,273 fully vested restricted shares with a fair value price per share of \$2.75.

Registration Rights and Piggyback Registration

The Company and the Purchasers also entered into a Registration Rights Agreement, wherein the Company agreed to file a registration statement (“Registration” or “Form S-3”) to register the Purchaser Shares and Purchaser Warrant Shares under the Securities Act of 1933, as amended. The Registration was filed with the Securities and Exchange Commission on November 14, 2016 and further amended on December 23, 2016. A total of 348,334 Purchaser Shares and 174,167 Purchaser Warrant Shares were registered with the Form S-3 filing. Roger Kahn, Michael Taglich, and Robert Taglich did not participate in the Registration.

Also included in the Registration were other securities that had been purchased prior to the November 2016 Private Placement, namely private placements of our common stock and warrants to purchase common stock. As a part of these private placement transactions, the Company had offered certain investors piggyback registration rights such

that, in the event the Company filed a registration statement to register its securities under the Securities Act, the shares of common stock issued or issuable to those investors would be eligible to also be included in the registration statement to be registered under the Securities Act. Accordingly, in addition to the Purchaser Shares and Purchaser Warrants from the November 2016 Private Placement, 616,533 common shares and warrants were included in the registration statement pursuant to these previously granted piggyback registration rights. In total, the Registration included 1,139,033 shares of common stock and warrants to purchase common stock. Net proceeds to the Company after the completion of the November 2016 Private Placement and the Form S-3 was \$853.

Contingent Consideration

In connection with the acquisition of ElementsLocal on August 1, 2013, the Company issued 21,058 common shares to the sellers of ElementsLocal. In addition, contingent consideration not to exceed 13,539 shares of Bridgeline Digital common stock was contingently issuable to the sellers of ElementsLocal. The contingent consideration was payable quarterly over the 12 consecutive calendar quarters following the acquisition, contingent upon the acquired business achieving certain revenue targets. As of June 30, 2017, the stockholders of ElementsLocal earned the full earnout of 13,539 shares of common stock, of which the final earnout shares totaling 1,129 were issued in November 2016.

Stock Incentive Plans

The Company has granted common stock, common stock warrants, and common stock option awards (the “Equity Awards”) to employees, consultants, advisors and debt holders of the Company and to former owners and employees of acquired companies that have become employees of the Company. On April 29, 2016, the stockholders approved a new stock incentive plan, The 2016 Stock Incentive Plan (the “2016 Plan”). The 2016 Plan replaced an older plan that had expired in August 2016. The 2016 Plan authorizes the award of incentive stock options, non-statutory stock options, restricted stock, unrestricted stock, performance shares, stock appreciation rights and any combination thereof to employees, officers, directors, consultants, independent contractors and advisors of the Company. Initially, a total of 500,000 shares of the Company’s Common Stock will be reserved for issuance under this new plan. As of June 30, 2017, there are 280,834 shares available for future issuance.

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Common Stock Warrants

The Company typically issues warrants to individual investors and placement agents to purchase shares of the Company's common stock in connection with private placement fund raising activities. Warrants may also be issued to individuals or companies in exchange for services provided for the company. The warrants are typically exercisable six months after the issue date, expire in five years, and contain a cashless exercise provision and piggyback registration rights.

As of June 30, 2017, the total warrants outstanding were issued as follows: 227,655 warrants were issued to the placement agents in connection with private placements and 231,938 warrants were issued to individual investors in connection with private placements, and 80,000 warrants were issued to a Director/Shareholder for debt issuances and bank guarantees. Warrants have been issued to certain directors and officers for their participation in some private placements, debt issuances and bank guarantees. Included in the total warrants outstanding are warrants to purchase 8,600 shares of common stock issued to the Company's President and CEO, Roger Kahn, in connection with the November 2016 Private Placement, in which he purchased shares of common stock. Also included in the total warrants outstanding are warrants to purchase 151,032 shares of common stock issued to Michael Taglich. Michael Taglich is a member of the Board of Directors and a shareholder. Michael Taglich has been issued warrants in connection with his participation as an investor in private offerings and issuance of loans to the Company. He has also guaranteed \$2.0 million (subsequently reduced to \$1.5 million as of August 10, 2017) in connection with the Company's out of formula borrowings on its credit facility. Also included in the total warrants outstanding are warrants to purchase 62,156 shares of common stock issued to Robert Taglich. Robert Taglich was a member of the Board of Directors until June 29, 2017. Robert Taglich has been issued warrants in connection with his participation as an investor in private offerings of the Company. Michael Taglich and Robert Taglich are also the principals of Taglich Brothers, Inc who have been the placement agents for many of the Company's private placements.

In connection with the November 2016 Private Placement, the Company issued to the Purchasers warrants to purchase an aggregate total of 213,538 shares common stock. Each Purchaser Warrant Share expires five and one-half years from the date of issuance and is exercisable for \$3.50 per share beginning six-months from the date of issuance, or May 9, 2017. The warrants expire May 9, 2022. Purchaser Warrant Shares were also issued to Roger Kahn 8,600 shares and Michael and Robert Taglich 15,385 shares each.

On January 7, 2015, Bridgeline also entered into a side letter with Michael Taglich pursuant to which Bridgeline agreed in the event the Bank Guaranty remains outstanding for a period of more than 12 months, on each anniversary of the date of issuance of the Guaranty while the Guaranty remains outstanding Bridgeline will issue Michael Taglich a warrant to purchase 6,000 shares of common stock, which warrant shall contain the same terms as the warrant issued to Michael Taglich on January 7, 2015. Since the Guaranty was still outstanding at December 31, 2016, a warrant to purchase 6,000 shares of common stock was issued to Michael Taglich in January 2017 at a price of \$20.00.

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(Dollars in thousands, except share and per share data)

Total warrants outstanding as of June 30, 2017, were as follows:

| Description | Issue Date | Shares | Price | Expiration |
|----------------------|-------------------|----------------|--------------|-------------------|
| Investors | 6/19/2013 | 18,400 | \$31.25 | 6/19/2018 |
| Placement Agent | 6/19/2013 | 9,200 | \$31.25 | 6/19/2018 |
| Placement Agent | 9/30/2013 | 6,157 | \$32.50 | 9/30/2018 |
| Placement Agent | 11/6/2013 | 3,078 | \$32.50 | 11/6/2018 |
| Placement Agent | 3/28/2014 | 12,800 | \$26.25 | 3/28/2019 |
| Placement Agent | 10/28/2014 | 12,308 | \$16.25 | 10/28/2019 |
| Director/Shareholder | 12/31/2014 | 12,000 | \$20.00 | 12/31/2019 |
| Director/Shareholder | 2/12/2015 | 12,000 | \$20.00 | 2/12/2020 |
| Director/Shareholder | 5/12/2015 | 12,000 | \$20.00 | 5/12/2020 |
| Director/Shareholder | 7/21/2015 | 32,000 | \$8.75 | 7/21/2018 |
| Director/Shareholder | 12/31/2015 | 6,000 | \$20.00 | 12/31/2020 |
| Placement Agent | 5/17/2016 | 86,778 | \$3.65 | 5/17/2021 |
| Placement Agent | 5/11/2016 | 53,334 | \$3.75 | 5/11/2021 |
| Placement Agent | 7/15/2016 | 44,000 | \$4.60 | 7/15/2021 |
| Investors | 11/9/2016 | 213,538 | \$3.50 | 5/9/2022 |
| Director/Shareholder | 12/31/2016 | 6,000 | \$20.00 | 12/31/2021 |
| Total | | 539,593 | | |

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Summary of Option and Warrant Activity and Outstanding Shares

| | Stock Options | | Stock Warrants | |
|---------------------------------|----------------------|--|-----------------------|--|
| | Options | Weighted Average Exercise Price | Warrants | Weighted Average Exercise Price |
| Outstanding, September 30, 2016 | 448,584 | \$ 7.55 | 328,752 | \$ 11.69 |
| Granted | 20,200 | \$ 3.45 | 219,538 | \$ 3.95 |
| Exercised | - | \$ - | - | - |
| Forfeited or expired | (14,780) | \$ 15.65 | (8,697) | \$ 35.00 |
| Outstanding, June 30, 2017 | 454,004 | \$ 7.10 | 539,593 | \$ 8.16 |

11. Net Loss Per Share

Basic and diluted net loss per share is computed as follows:

| (in thousands, except per share data) | Three Months Ended June 30, | | Nine Months Ended June 30, | |
|--|--|-------------|---|-------------|
| | 2017 | 2016 | 2017 | 2016 |
| Net loss | \$(332) | \$(2,032) | \$(1,270) | \$(4,385) |
| Accrued dividends on convertible preferred stock | (71) | (33) | (207) | (97) |
| Net loss applicable to common shareholders | \$(403) | \$(2,065) | \$(1,477) | \$(4,482) |
| Weighted average common shares outstanding - basic | 4,196 | 2,003 | 4,129 | 1,367 |
| Effect of dilutive securities | - | - | - | - |
| Weighted average common shares outstanding - diluted | 4,196 | 2,003 | 4,129 | 1,367 |

Net loss per share attributable to common shareholders:

Basic and diluted \$(0.10) \$(1.03) \$(0.36) \$(3.28)

Basic net loss per share is computed by dividing net loss available to common shareholders by the weighted average number of common shares outstanding. Diluted net income per share is computed using the weighted average number of common shares outstanding during the period plus the dilutive effect of outstanding stock options and warrants and preferred stock using the “treasury stock” method. The computation of diluted earnings per share does not include the effect of outstanding stock options and warrants that are anti-dilutive.

For the three and nine months ended June 30, 2017, there were no options to purchase shares of the Company’s common stock considered as dilutive, as the options were all valued at less than the current market price. Warrants to purchase 539,593 shares of common stock and the Series A convertible preferred stock shares have also been excluded as they are anti-dilutive to the Company’s net loss.

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For the three and nine months ended June 30, 2016, there were no options to purchase shares of the Company's common stock considered as dilutive, as the options were all valued at less than the current market price. Warrants to purchase 144,657 shares of common stock and contingent shares to be issued in connection with prior acquisitions of ElementsLocal have also been excluded as they are anti-dilutive to the Company's net loss. Also, excluded in the computation of diluted loss per share are the Series A convertible preferred stock shares as they are anti-dilutive to the Company's net loss.

12. Income Taxes

There was no income tax expense for the three months ended June 30, 2017. Income tax expense was \$8 for the three months ended June 30, 2016 and \$13 and \$46 for the nine months ended June 30, 2017 and 2016, respectively. Income tax expense consists of the estimated liability for federal and state income taxes owed by the Company, including the alternative minimum tax. Net operating loss carry forwards are estimated to be sufficient to offset additional taxable income for all periods presented.

The Company does not provide for U.S. income taxes on the undistributed earnings of its Indian subsidiary, which the Company considers to be a permanent investment.

13. Related Party Transactions

Michael Taglich is a member of the Company's Board of Directors. Robert Taglich was also a member of the Board of Directors until he resigned as a Director on June 29, 2017. Michael Taglich is the Chairman and President of Taglich Brothers, Inc. a New York based securities firm, which he co-founded with his brother Robert. Robert Taglich is Senior Director of Taglich Brothers, Inc. The Taglich Brothers, Inc. were the Placement Agents for many of the Company's private offerings in 2012, 2013, 2014, and 2016. They were also the Placement Agent for the Company's \$3.0 million subordinated debt offering in 2013 and the Series A Preferred stock sale in 2015. Michael Taglich

beneficially owns approximately 24% of Bridgeline stock. Michael Taglich has also guaranteed \$2.0 million (subsequently reduced to \$1.5 million as of August 10, 2017) in connection with the Company's out of formula borrowings on its credit facility with Heritage Bank. Robert Taglich beneficially owns approximately 8% of Bridgeline stock.

14. Legal Proceedings

The Company is subject to ordinary routine litigation and claims incidental to its business. As of June 30, 2017, the Company was not engaged with any material legal proceedings.

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

This section contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in the forward-looking statements as a result of a variety of factors and risks including the impact of the weakness in the U.S. and international economies on our business, our inability to manage our future growth effectively or profitably, fluctuations in our revenue and quarterly results, our license renewal rate, the impact of competition and our ability to maintain margins or market share, the limited market for our common stock, the ability to maintain our listing on the Nasdaq Capital Market, the volatility of the market price of our common stock, the ability to raise capital, the performance of our products, our ability to respond to rapidly evolving technology and customer requirements, our ability to protect our proprietary technology, the security of our software, our dependence on our management team and key personnel, our ability to hire and retain future key personnel, or our ability to maintain an effective system of internal controls. These and other risks are more fully described herein and in our other filings with the Securities and Exchange Commission.

This section should be read in combination with the accompanying audited consolidated financial statements and related notes prepared in accordance with United States generally accepted accounting principles.

Overview

Bridgeline Digital, The Digital Engagement Company™, helps customers maximize the performance of their full digital experience from websites and intranets to online stores. Bridgeline’s iAPPS® platform deeply integrates Web Content Management, eCommerce, eMarketing, Social Media management, and Web Analytics to help marketers deliver digital experiences that attract, engage and convert their customers across all channels. Bridgeline’s iAPPS platform combined with its digital services assists customers in maximizing on-line revenue, improving customer service and loyalty, enhancing employee knowledge, and reducing operational costs. Our iAPPSds (“distributed subscription”), is a platform that empowers large franchise and multi-unit organizations with state-of-the-art web engagement management while providing superior oversight of corporate branding. iAPPSds deeply integrates content management, eCommerce, eMarketing and web analytics and is a self-service web platform that is offered to each authorized franchise or dealer for a monthly subscription fee.

The iAPPS platform is delivered through a cloud-based SaaS (“Software as a Service”) multi-tenant business model, whose flexible architecture provides customers with state of the art deployment providing maintenance, daily technical operation and support; or via a traditional perpetual licensing business model, in which the iAPPS software resides on a dedicated server in either the customer’s facility or via a cloud-based hosted services model or a Tier 1 facility.

The iAPPS Platform is an award-winning application recognized around the globe. Our teams of Microsoft Gold© certified developers have won over 100 industry related awards. Recently, our Marketing Automation platform was named a 2017 SIIA CODiE Award finalist in the Best Marketing Solution category. In 2016, *CIO Review* selected iAPPS as one of the 20 Most Promising Digital Marketing Solution Providers. This followed accolades from the SIIA (Software and Information Industry Association), which recognized iAPPS Content Manager with the 2015 SIIA CODiE Award for Best Web Content Management Platform. Also in 2015, *EContent* magazine named iAPPS Digital Engagement Platform to its Trendsetting Products list. The list of 75 products and platforms was compiled by EContent's editorial staff, and selections were based on each offering's uniqueness and importance to digital publishing, media, and marketing. We were also recognized in 2015 as a strong performer by Forrester Research, Inc in its independence report, "The Forrester Wave™: Through-Channel Marketing Automation Platforms, Q3 2015." Also, in recent years, our iAPPS Content Manager and iAPPS Commerce products were selected as finalists for the 2014, 2013, and 2012 CODiE Awards for Best Content Management Solution and Best Electronic Commerce Solution, globally. In 2014 and 2013, Bridgeline Digital won twenty-five Horizon Interactive Awards for outstanding development of web applications and websites. Also in 2013, the Web Marketing Association sponsored Internet Advertising Competition honored Bridgeline Digital with three awards for iAPPS customer websites and B2B Magazine selected Bridgeline Digital as one of the Top Interactive Technology companies in the United States. KMWorld Magazine Editors selected Bridgeline Digital as one of the 100 Companies That Matter in Knowledge Management and also selected iAPPS as a Trend Setting Product in 2013.

Bridgeline Digital was incorporated under the laws of the State of Delaware on August 28, 2000.

Locations

The Company's corporate office is located in Burlington, Massachusetts. The Company maintains regional field offices serving the following geographical locations: Boston, MA; Chicago, IL; Denver, CO; San Luis Obispo, CA; and Tampa, FL. The Company has one wholly-owned subsidiary, Bridgeline Digital Pvt. Ltd. located in Bangalore, India.

Reverse Stock Split

On June 29, 2017, the Company's Shareholders and the Board of Directors approved a reverse stock split pursuant to which all classes of our issued and outstanding shares of common stock at the close of business on such date were combined and reconstituted into a smaller number of shares of common stock in a ratio of 1 share of common stock for every 5 shares of common stock ("1-for-5 reverse stock split"). The 1-for-5 reverse stock split is effective as of close of business on July 24, 2017 and the Company's stock began trading on a split-adjusted basis on July 25, 2017.

The reverse stock split reduces the number of shares of the Company's common stock currently outstanding from approximately 21 million shares to approximately 4.2 million shares. Proportional adjustments have been made to the conversion and exercise prices of the Company's outstanding convertible preferred stock, warrants, restricted stock awards, and stock options, and to the number of shares issued and issuable under the Company's Stock Incentive Plans. Upon the effectiveness of the 1-for-5 reverse stock split, each five shares of the Company's issued and outstanding common stock have been automatically combined and converted into one issued and outstanding share of common stock, par value \$.001. The Company did not issue any fractional shares in connection with the reverse stock split. Instead, fractional share interests were rounded up to the next largest whole share. The reverse stock split does not modify the rights or preferences of the common stock. The number of authorized shares of the Company's common stock remains at 50 million shares and the par value remains \$0.001.

All financial information has been retroactively adjusted to reflect the effects of the 1-for-5 reverse stock split.

Customer Information

We currently have over 3,000 active customers. For the three months ended June 30, 2017, two customers represented approximately 16% and 11% of the Company's total revenue and for the nine months ended June 30, 2017, two customers represented approximately 14% and 11% of the Company's total revenue. For the three months ended June 30, 2016, one customer represented approximately 10% of the Company's total revenue and for the nine months ended June 30, 2016, there were no customers that represented more than 10% of the Company's total revenue.

Results of Operations for the Three and Months Ended June 30, 2017 compared to the Three and Nine Months Ended June 30, 2016

Total revenue for the three months ended June 30, 2017 was \$4.1 million compared with \$3.7 million for the three months ended June 30, 2016. We had a net loss of \$332 thousand for the three months ended June 30, 2017 compared with net loss of \$2.0 million for the three months ended June 30, 2016. Net loss per share applicable to common shareholders was (\$0.10) for the three months ended June 30, 2017 and (\$1.05) for the three months ended June 30, 2016.

Total revenue for the nine months ended June 30, 2017 was \$12.1 million compared with \$12.2 million for the nine months ended June 30, 2016. We had a net loss of \$1.3 million for the nine months ended June 30, 2017 compared with net loss of \$4.4 million for the nine months ended June 30, 2016. Net loss per share applicable to common shareholders was (\$0.36) for the nine months ended June 30, 2017 and (\$3.30) for the nine months ended June 30, 2016.

Results of Operations

| | Three Months Ended June 30, 2017 | | Three Months Ended June 30, 2016 | | | | Nine Months Ended June 30, 2017 | | Nine Months Ended June 30, 2016 | | | |
|---|----------------------------------|--------|----------------------------------|--------|--------|--------|---------------------------------|--------|---------------------------------|--------|----------|--------|
| | \$ | % | \$ | % | \$ | % | \$ | % | \$ | % | \$ | % |
| | Change | Change | Change | Change | Change | Change | Change | Change | Change | Change | Change | Change |
| Net revenue: | | | | | | | | | | | | |
| Digital engagement services | \$ 2,121 | | \$ 1,849 | | 272 | 15 % | \$ 6,298 | | \$ 6,611 | | (313) | (5%) |
| <i>% of total net revenue</i> | 52 % | | 50 % | | | | 52 % | | 54 % | | | |
| Subscription and perpetual licenses | 1,711 | | 1,530 | | 181 | 12 % | 5,018 | | 4,575 | | 443 | 10 % |
| <i>% of total net revenue</i> | 42 % | | 41 % | | | | 42 % | | 38 % | | | |
| Managed service hosting | 242 | | 317 | | (75) | (24%) | 743 | | 985 | | (242) | (25%) |
| <i>% of total net revenue</i> | 6 % | | 9 % | | | | 6 % | | 8 % | | | |
| Total net revenue | \$ 4,074 | | \$ 3,696 | | \$ 378 | 10 % | \$ 12,059 | | \$ 12,171 | | \$(112) | (1%) |
| Cost of revenue: | | | | | | | | | | | | |
| Digital engagement costs | 1,297 | | 1,221 | | 76 | 6 % | 3,569 | | 4,111 | | (542) | (13%) |
| <i>% of digital engagement services revenue</i> | 61 % | | 66 % | | | | 57 % | | 62 % | | | |
| Subscription and perpetual licenses | 473 | | 391 | | 82 | 21 % | 1,468 | | 1,423 | | 45 | 3 % |
| <i>% of subscription and perpetual revenue</i> | 28 % | | 26 % | | | | 29 % | | 31 % | | | |
| Managed service hosting | 65 | | 76 | | (11) | (14%) | 209 | | 232 | | (23) | (10%) |
| <i>% of managed service hosting revenue</i> | 27 % | | 24 % | | | | 28 % | | 24 % | | | |
| Total cost of revenue | 1,835 | | 1,688 | | 147 | 9 % | 5,246 | | 5,766 | | (520) | (9%) |
| Gross profit | \$ 2,239 | | \$ 2,008 | | \$ 231 | 12 % | \$ 6,813 | | \$ 6,405 | | \$ 408 | 6 % |
| Gross profit margin | 55 % | | 54 % | | | | 56 % | | 53 % | | | |
| Operating expenses: | | | | | | | | | | | | |
| Sales and marketing | 1,193 | | 1,212 | | (19) | (2%) | 3,661 | | 3,528 | | 133 | 4 % |
| <i>% of total revenue</i> | 29 % | | 33 % | | | | 30 % | | 29 % | | | |
| General and administrative | 801 | | 1,035 | | (234) | (23%) | 2,395 | | 2,660 | | (265) | (10%) |
| <i>% of total revenue</i> | 20 % | | 28 % | | | | 20 % | | 22 % | | | |
| Research and development | 393 | | 428 | | (35) | (8%) | 1,175 | | 1,145 | | 30 | 3 % |
| <i>% of total revenue</i> | 10 % | | 12 % | | | | 10 % | | 9 % | | | |
| Depreciation and amortization | 126 | | 328 | | (202) | (62%) | 468 | | 1,023 | | (555) | (54%) |
| <i>% of total revenue</i> | 3 % | | 9 % | | | | 4 % | | 8 % | | | |

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| | | | | | | | | | |
|--|------------------|--------------------|-----------------|----------------|----------|--------------------|--------------------|-----------------|----------------|
| Restructuring charges | 49 | 16 | 33 | 206 | % | 249 | 795 | (546) | (69%) |
| % of total revenue | 1 | % | 0 | % | | 2 | % | 7 | % |
| Total operating expenses | 2,562 | 3,019 | (457) | (15%) | | 7,948 | 9,151 | (1,203) | (13%) |
| Loss from operations | (323) | (1,011) | 688 | (68%) | | (1,135) | (2,746) | 1,611 | (59%) |
| Interest and other expense, net | (9) | (287) | 278 | (97%) | | (122) | (867) | 745 | (86%) |
| Loss on inducement of convertible notes | - | (726) | 726 | (100%) | | - | (726) | 726 | (100%) |
| Loss before income taxes | (332) | (2,024) | 1,692 | (84%) | | (1,257) | (4,339) | 3,082 | (71%) |
| Provision for income taxes | - | 8 | (8) | (100%) | | 13 | 46 | (33) | (72%) |
| Net loss | \$ (332) | \$ (2,032) | \$ 1,700 | (84%) | | \$ (1,270) | \$ (4,385) | \$ 3,115 | (71%) |
| Non-GAAP Measure: | | | | | | | | | |
| Adjusted EBITDA | \$ 49 | \$ (575) | \$ 624 | (109%) | | \$ 81 | \$ (484) | \$ 565 | (117%) |

Revenue

Our revenue is derived from three sources: (i) digital engagement services (ii) subscription and perpetual licenses and (iii) managed service hosting.

Digital Engagement Services

Digital engagement services revenue is comprised primarily of iAPPS digital engagement related services, such as professional services to implement our software solutions, recurring services, and training. Revenue from digital engagement services increased \$272 thousand, or 15%, to \$2.1 million for the three months ended June 30, 2017 compared to \$1.8 million for the three months ended June 30, 2016. Digital engagement services revenue as a percentage of total revenue increased to 52% from 50% for the three months ended June 30, 2017 compared to the three months ended June 30, 2016. The increase in iAPPS digital engagements services revenues is a result of increased billable utilization and implementation services related to new iAPPS engagements.

Revenue from digital engagement services decreased \$313 thousand, or 5%, to \$6.3 million for the nine months ended June 30, 2017 compared to \$6.6 million for the nine months ended June 30, 2016. Digital engagement services revenue as a percentage of total revenue decreased to 52% from 54% for the nine months ended June 30, 2017 compared to the nine months ended June 30, 2016. The decreases are attributable to a lower than desired billable utilization and a higher beginning backlog at the start of the previous fiscal year.

Subscription and Perpetual Licenses

Revenue from subscription and perpetual licenses increased \$181 thousand, or 12%, to \$1.7 million for the three months ended June 30, 2017 compared to \$1.5 million for the three months ended June 30, 2016. Subscription and perpetual license revenue as a percentage of total revenue increased to 42% for the three months ended June 30, 2017 from 41% compared to the three months ended June 30, 2016. The increase as a percentage of revenues is attributable to iAPPS perpetual licenses sold in the quarter and an increase in SaaS license revenues.

Revenue from subscription and perpetual licenses increased \$443 thousand, or 10%, to \$5.0 million for the nine months ended June 30, 2017 compared to \$4.6 million for the nine months ended June 30, 2016. The increases are primarily due to iAPPS perpetual licenses sold in the nine months June 30, 2017. Subscription and perpetual license

revenue as a percentage of total revenue increased to 42% for the nine months ended June 30, 2017 from 38% compared to the nine months ended June 30, 2016. The increase as a percentage of revenues is attributable to the increases to iAPPS perpetual licenses and increases in SaaS license revenues.

Managed Service Hosting

Revenue from managed service hosting decreased \$75 thousand, or 24%, to \$242 thousand for the three months ended June 30, 2017 compared to \$317 thousand for the three months ended June 30, 2016. Managed services revenue as a percentage of total revenue decreased to 6% for the three months ended June 30, 2017 from 9% compared to the three months ended June 30, 2016. The decreases are due a concentrated effort to discontinue hosting services to non-iAPPS customers, the majority of whom were obtained through previous acquisitions, as well as some attrition from existing iAPPS customers.

Revenue from managed service hosting decreased \$242 thousand, or 25%, to \$743 thousand for the nine months ended June 30, 2017 compared to \$985 thousand for the nine months ended June 30, 2016. Managed services revenue as a percentage of total revenue decreased to 6% for the nine months ended June 30, 2017 from 8% compared to the nine months ended June 30, 2016. The decreases are attributable to the decrease in non-iAPPS customer hosting contracts as described above.

Costs of Revenue

Total cost of revenue increased \$147 thousand to \$1.8 million or 9% for the three months ended June 30, 2017 compared to \$1.7 million for the three months ended June 30, 2016. Total cost of revenue decreased \$520 thousand to \$5.3 million or 9% for the nine months ended June 30, 2017 compared to \$5.8 million for the nine months ended June 30, 2016.

The gross profit margin improved to 55% for the three months ended June 30, 2017 compared to 54% for the three months ended June 30, 2016, as well as improved to 56% for the nine months ended June 30, 2017 compared to 53% for the nine months ended June 30, 2016. The improvement in the gross profit margin for the three and nine months ended June 30, 2017 compared to the comparable periods is attributable to reductions in facilities and overhead costs combined with an increase in utilization from a more efficient billable services team.

Cost of Digital Engagement Services

Cost of digital engagement services revenue consists of employee-related costs and overhead for our professional services team and subcontractor fees. Cost of digital engagement services increased \$76 thousand, or 6%, to \$1.3 million for the three months ended June 30, 2017 compared to \$1.2 million for the three months ended June 30, 2016. The increase in the cost of digital engagement services for the three months ended June 30, 2017 compared to the prior period is due to costs for third-party subcontractors. The cost of digital engagement services as a percentage of digital engagement services revenue decreased to 61% from 66% for the three months ended June 30, 2017 compared to the three months ended June 30, 2016. The decrease in the percentage of digital engagement services for the three months ended June 30, 2017 compared to the prior period is due to a reduction in facilities and overhead costs.

Cost of digital engagement services decreased \$542 thousand, or 13%, to \$3.6 million for the nine months ended June 30, 2017 compared to \$4.1 million for the nine months ended June 30, 2016. The cost of digital engagement services as a percentage of digital engagement services revenue decreased to 57% from 62% for the nine months ended June 30, 2017 compared to the nine months ended June 30, 2016. The decreases for the nine months ended June 30, 2017 compared to the prior period is due to a reduction in facilities and overhead costs.

Cost of Subscription and Perpetual License

Cost of subscription and perpetual licenses consists of expenses related to licensing our software and providing support, the costs of network operations centers, amortization expense associated with capitalized software, and certain licensing fees paid for the use of third party technology. Also included are employee-related costs and overhead for personnel to support our platforms. Cost of subscription and perpetual licenses increased \$82 thousand, or 21%, to \$473 thousand for the three months ended June 30, 2017 compared to \$391 thousand for the three months ended June 30, 2016. The cost of subscription and perpetual licenses as a percentage of subscription and perpetual license revenue increased to 28% from 26% compared to the three months ended June 30, 2016. The increases are due to the costs to transition our network operations center from a co-managed facility at Internap to a cloud-based model with Amazon Web Services.

Cost of subscription and perpetual licenses increased \$45 thousand, or 3%, to \$1.5 million for the nine months ended June 30, 2017 compared to \$1.4 million for the nine months ended June 30, 2016. The increases are due to the costs to transition our network operations center from a co-managed facility at Internap to a cloud-based model with Amazon Web Services. The cost of subscription and perpetual licenses as a percentage of subscription and perpetual license revenue decreased to 29% from 31% compared to the nine months ended June 30, 2016. The decreases are due to cessation of amortization costs related to the capitalization of software, partially offset by costs to transition our network operations center from a co-managed facility at Internap to a cloud-based model with Amazon Web Services.

Cost of Managed Service Hosting

Cost of managed service hosting consists of expenses related to hosting our customer's software, mainly the costs for our network operations centers. Cost of managed service hosting decreased \$11 thousand, or 14%, to \$65 thousand for the three months ended June 30, 2017 compared to \$76 thousand for the three months ended June 30, 2016. Cost of managed service hosting decreased \$23 thousand, or 10%, to \$209 thousand for the nine months ended June 30, 2017 compared to \$232 thousand for the nine months ended June 30, 2016. The decreases for the three and nine months ended June 30, 2017 compared to the prior periods are attributable to a decrease in non-iAPPS hosting customers and the corresponding costs to support them.

The cost of managed services as a percentage of managed services revenue increased to 27% from 24% compared to the three months ended June 30, 2016 and increased to 28% from 24% compared to the nine months ended June 30, 2016. The percentage increases are attributable to the decreases in hosting revenues in proportion to fixed costs for our third party hosting providers.

Operating Expenses

Sales and Marketing Expenses

Our sales and marketing expenses primarily include employee-related costs and overhead for our sales and marketing personnel, sales commissions, advertising and marketing programs, and travel. Sales and marketing expenses decreased \$19 thousand to \$1.2 million, or 2%, for the three months ended June 30, 2017 compared to \$1.2 for the three months ended June 30, 2016. The decreases for the three months ended June 30, 2017 compared to the three months ended June 30, 2016 are attributable to decreases in compensation. Sales and marketing expenses represented 29% and 33% of total revenue for the three months ended June 30, 2017 and 2016, respectively.

Sales and marketing expenses increased \$133 thousand to \$3.7 million, or 4%, for the nine months ended June 30, 2017 compared to \$3.5 million for the nine months ended June 30, 2016. Sales and marketing expenses represented 30% and 29% of total revenue for the nine months ended June 30, 2017 and 2016, respectively. The increases for the nine months ended June 30, 2017 compared to the nine months ended June 30, 2016 are attributable to increases in sales personnel and marketing expenses in order to create and build a direct and inside sales team to position the Company for growth.

General and Administrative Expenses

Our general and administrative expenses include the employee-related costs and overhead for our corporate, finance, information technology, human resources, and legal personnel. Also included are costs for outside professional services, including accounting and legal fees, and bad debt expenses. General and administrative expenses decreased \$234 thousand, or 23%, to \$801 thousand for the three months ended June 30, 2017 compared to \$1.0 million for the three months ended June 30, 2016. General and administrative expenses represented 20% and 28% of total revenue for the three months ended June 30, 2017 and 2016, respectively. The decrease in expense for the three months ended June 30, 2017 compared to the three months ended June 30, 2016 was due to decreases in bad debt expenses and overhead.

General and administrative expenses decreased \$265 thousand, or 10%, to \$2.46 million for the nine months ended June 30, 2017 compared to the \$2.7 million for the nine months ended June 30, 2016. General and administrative expenses represented 20% and 22% of total revenue for the nine months ended June 30, 2017 and 2016, respectively. The decrease in expense for the nine months ended June 30, 2017 compared to the nine months ended June 30, 2016 was due to decreases in headcount and overhead costs.

Research and Development

Our research and development expenses consist principally of employee-related costs and overhead. Research and development expense decreased \$35 thousand, or 8%, to \$393 thousand for the three months ended June 30, 2017 compared to \$428 thousand for the three months ended June 30, 2016. Research and development expenses represented 10% and 12% of total revenue for the three months ended June 30, 2017 and 2016, respectively. The decreases in research and development expense for the three months ended June 30, 2017 compared to the three months ended June 30, 2016 is due to a decrease in salaries and benefits.

Research and development expense increased \$30 thousand, or 3%, to \$1.2 million for the nine months ended June 30, 2017 compared to \$1.1 million for the nine months ended June 30, 2016. Research and development expenses represented 10% and 9% of total revenue for the nine months ended June 30, 2017 and 2016, respectively. The increases in research and development expense for the nine months ended June 30, 2017 compared to the nine months ended June 30, 2016 is due to an increase in salaries and benefits.

Depreciation and Amortization

Depreciation and amortization expense decreased \$202 thousand, or 62% to \$126 for the three months ended June 30, 2017 compared to \$328 thousand for the three months ended June 30, 2016 and decreased \$555 thousand, or 54%, to \$468 thousand for the nine months ended June 30, 2017 compared to \$1.0 million for the nine months ended June 30, 2016. Depreciation and amortization represented 3% and 9% of revenue for the three months ended June 30, 2017 and 2016, respectively, and 4% and 8% of total revenue for the nine months ended June 30, 2017 and 2016, respectively. Depreciation and amortization has decreased due to asset retirements related to the termination and closing of offices, as well as reductions in capital expenditures as a result in transitioning to Amazon Web Services.

Restructuring Expenses

During the fiscal 2015 and 2016 and through the current fiscal year, the Company's management approved, committed to and initiated plans to restructure and further improve efficiencies by implementing cost reductions in line with expected decreases in revenue. The restructuring efforts included the renegotiation of several office leases and relocations to smaller spaces, while also negotiating sub-leases for the original space. In addition, the Company executed a general work-force reduction and recognized costs for severance and termination benefits. In the second quarter of fiscal 2017, the Company initiated a plan to shut down its operations in India. As part of these restructuring initiatives, we recorded \$49 thousand and \$16 thousand in the three months ended June 30, 2017 and 2016, respectively, and \$249 thousand and \$795 thousand in the nine months ended June 30, 2017 and 2016, respectively.

Net Loss

Loss from operations

The loss from operations was (\$323) thousand for three months ended June 30, 2017, compared to a loss of (\$1.1) million in the prior period and a loss of (\$1.1) million for the nine months ended June 30, 2017 compared to a loss of (\$2.8) million for the prior year. Operating expenses decreased \$457 thousand or 15% for the three months ended June 30, 2017 compared to the three months ended June 30, 2016 and decreased (\$1.2) million or 13% for the nine months ended June 30, 2017 compared to the nine months ended June 30, 2016. We have made concerted efforts to bring our operating expenses in line with projected revenues.

Income Taxes

There was no provision for income tax expense for the three months ended June 30, 2017. The provision for income tax expense was \$8 thousand for the three months ended June 30, 2016. The provision for income tax expense was \$13 thousand and \$46 thousand for the nine months ended June 30, 2017 and 2016, respectively. Income tax expense represents the estimated liability for federal and state income taxes owed, including the alternative minimum tax. We have net operating loss carryforwards and other deferred tax benefits that are available to offset future taxable income.

Adjusted EBITDA

We also measure our performance based on a non-GAAP (“Generally Accepted Accounting Principles”) measurement of earnings before interest, taxes, depreciation and amortization, and before stock-based compensation expense, restructuring charges, and losses on disposal of fixed assets (“Adjusted EBITDA”).

We believe this non-GAAP financial measure of Adjusted EBITDA is useful to management and investors in evaluating our operating performance for the periods presented and provide a tool for evaluating our ongoing operations.

Adjusted EBITDA, however, is not a measure of operating performance under GAAP and should not be considered as an alternative or substitute for GAAP profitability measures such as (i) income from operations and net income, or (ii) cash flows from operating, investing and financing activities, both as determined in accordance with GAAP. Adjusted EBITDA as an operating performance measure has material limitations since it excludes the financial statement impact of income taxes, net interest expense, amortization of intangibles, depreciation, loss on disposal of fixed assets, restructuring charges, other amortization and stock-based compensation, and therefore does not represent an accurate measure of profitability. As a result, Adjusted EBITDA should be evaluated in conjunction with net income for a complete analysis of our profitability, as net income includes the financial statement impact of these items and is the most directly comparable GAAP operating performance measure to Adjusted EBITDA. Our definition of Adjusted EBITDA may also differ from and therefore may not be comparable with similarly titled measures used by other companies, thereby limiting its usefulness as a comparative measure. Because of the limitations that Adjusted EBITDA has as an analytical tool, investors should not consider it in isolation, or as a substitute for analysis of our operating results as reported under GAAP.

The following table reconciles net loss (which is the most directly comparable GAAP operating performance measure) to Adjusted EBITDA (in thousands):

| | Three Months Ended June 30, 2017 | | Nine Months Ended June 30, 2016 | |
|---|---|------------|--|------------|
| Net loss | \$ (332) | \$ (2,032) | \$ (1,270) | \$ (4,385) |
| Provision for income tax | - | 8 | 13 | 46 |
| Interest expense, net | 29 | 287 | 94 | 867 |
| Loss on inducement of convertible notes | - | 726 | - | 726 |
| Amortization of intangible assets | 71 | 108 | 214 | 323 |
| Depreciation | 53 | 169 | 216 | 608 |
| Restructuring charges | 49 | 16 | 249 | 795 |
| Loss on disposal of fixed assets | - | - | 48 | - |
| Other amortization | 18 | 68 | 84 | 328 |
| Stock based compensation | 161 | 75 | 433 | 208 |
| Adjusted EBITDA | \$49 | \$ (575) | \$81 | \$ (484) |

Adjusted EBITDA for the quarter ended June 30, 2017 increased significantly compared to the quarter ended June 30, 2016. For the nine months ended June 30, 2017 compared to the nine months ended June 30, 2016, gross profit and gross margin have improved and operating expenses have significantly decreased driving the improvement in Adjusted EBITDA.

Liquidity and Capital Resources

Cash Flows

Operating Activities

Cash used in operating activities was \$823 thousand for the nine months ended June 30, 2017 compared to cash used in operating activities of \$1.5 million for the nine months ended June 30, 2016. We have significantly reduced operating expenses, and therefore reduced liabilities.

Investing Activities

Cash used in investing activities was \$59 thousand for the nine months ended June 30, 2017 compared to \$128 thousand for the nine months ended June 30, 2016. In the nine months ended June 30, 2017, we purchased \$18 thousand of computer equipment and capitalized \$41 thousand in costs related to iAPPS software development.

Financing Activities

Cash provided by financing activities was \$971 thousand for the nine months ended June 30, 2017 compared to \$1.5 million for the nine months ended June 30, 2016. Cash provided by financing activities for the nine months ended June 30, 2017 is primarily attributable to the sale and registration of 427,073 shares of common stock in November 2016, which raised a net \$853 thousand in funds for current and future operations. We also borrowed \$1.9 million on our line of credit with Heritage Bank. Partially offsetting these proceeds, we made payments of \$1.6 million on the Heritage Bank line of credit, contingent acquisition payments of \$75 thousand and capital lease payments of \$36 thousand.

Capital Resources and Liquidity Outlook

In the first quarter of fiscal 2017, we entered into Securities Purchase Agreements with certain institutional and accredited investors to sell an aggregate total of 427,073 shares of our common stock for \$2.40 per share. Concurrently, we filed a Form S-3 to register the majority of these shares, as well as shares purchased in previous private offerings. In total, we received net proceeds of \$853 thousand as a result of these transactions. The proceeds will be used to fund current and future operations. In the quarter ended June 30, 2017, we also filed a Registration Statement on Form S-3 with the Securities and Exchange Commission in relation to the registration of securities of the Company having an aggregate public offering price of up to \$10 million. The determinate number of shares of common stock, preferred stock, warrants, and units of any combination thereof (collectively, the “Securities”) may be offered and sold from time to time, but shall not exceed \$10 million in total. We anticipate that sales of these securities may provide funds for working capital. Also, in June 2017, we extended our line of credit with Heritage Bank of Commerce to June 15, 2019.

We believe that the proceeds from the November 2016 Private Placement, cash generated from operations, and proceeds from our bank line of credit and future sales of Securities will be sufficient to fund the Company’s working capital and capital expenditure needs in the foreseeable future. We have a borrowing facility with Heritage Bank from which we can borrow, and this line is subject to financial covenants that must be met. It is not certain that all or part of this line will be available to us in the future; and other sources of financing may not be available to us in a timely basis if at all, or on terms acceptable to us. If we fail to obtain acceptable funding when needed, we may not have sufficient resources to fund our normal operations, and this would have a material adverse effect on our business.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements, financings or other relationships with unconsolidated entities or other persons, other than our operating leases and contingent acquisition payments.

We currently do not have any variable interest entities. We do not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. Therefore, we are not materially exposed to any financing, liquidity, market or credit risk that could arise if we had engaged in such relationships.

Commitments and Contingencies

As of June 30, 2017, we have no material commitments or contingencies, other than those disclosed in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on December 19, 2016.

Critical Accounting Policies

Critical Accounting Policies

These critical accounting policies and estimates by our management should be read in conjunction with Note 2 *Summary of Significant Accounting Policies* to the Consolidated Financial Statements that were prepared in accordance with accounting principles generally accepted in the United States of America (“US GAAP”) and filed with our Annual Report on Form 10-K filed with the Securities and Exchange Commission on December 19, 2016.

The preparation of financial statements in accordance US GAAP requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses in the reporting period. We regularly make estimates and assumptions that affect the reported amounts of assets and liabilities. The most significant estimates included in our financial statements are the valuation of accounts receivable and long-term assets, including intangibles, goodwill and deferred tax assets, stock-based compensation, amounts of revenue to be recognized on service contracts in progress, unbilled receivables, and deferred revenue. We base our estimates and assumptions on current facts, historical experience and various other factors that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities and the accrual of costs and expenses that are not readily apparent from other sources. The actual results experienced by us may differ materially and adversely from our estimates. To the extent there are material differences between our estimates and the actual results, our future results of operations will be affected.

We consider the following accounting policies to be both those most important to the portrayal of our financial condition and those that require the most subjective judgment:

Revenue recognition;

Allowance for doubtful accounts;

Accounting for cost of computer software to be sold, leased or otherwise marketed;

Accounting for goodwill and other intangible assets; and

Accounting for stock-based compensation.

Revenue Recognition

Overview

We enter into arrangements to sell digital engagement services (professional services), software licenses or combinations thereof. Revenue is categorized into (i) digital engagement services; (ii) subscriptions and perpetual licenses; and (iii) managed service hosting. We recognize revenue as required by the *Revenue Recognition* Topic of the Codification. Revenue is generally recognized when all of the following conditions are satisfied: (1) there is persuasive evidence of an arrangement; (2) delivery has occurred or the services have been provided to the customer; (3) the amount of fees to be paid by the customer is fixed or determinable; and (4) the collection of the fees is reasonably assured. Billings made or payments received in advance of providing services are deferred until the period these services are provided.

We maintain a reseller channel to supplement our direct sales force for our iAPPS platform. Resellers are generally located in territories where we do not have a direct sales force. Customers generally sign a license agreement directly with us. Revenue from perpetual licenses sold through resellers is recognized upon delivery to the end user as long as evidence of an arrangement exists, collectability is probable, and the fee is fixed and determinable. Revenue for subscription licenses is recognized monthly as the services are delivered.

Digital Engagement Services

Digital engagement services include professional services primarily related to the Company's web development solutions that address specific customer needs such as digital strategy, information architecture and usability engineering, .Net development, rich media development, back end integration, search engine optimization, quality assurance and project management.

Digital engagement services are contracted for primarily on a time and materials basis and to a lesser extent on a fixed price basis. For time and materials contracts, revenues are recognized as the services are performed. For fixed price engagements, after assigning the relative selling price to the elements of the arrangement, the Company applies the proportional performance model (if not subject to contract accounting) to recognize revenue based on cost incurred in relation to total estimated cost at completion. The Company has determined that labor costs are the most appropriate measure to allocate revenue among reporting periods, as they are the primary input when providing application development services. Customers are invoiced monthly or upon the completion of milestones. For milestone based projects, since milestone pricing is based on expected hourly costs and the duration of such engagements is relatively short, this input approach principally mirrors an output approach under the proportional performance model for revenue recognition on such fixed priced engagements.

Digital engagement services also include professional services contracted for on a retainer basis or for a certain amount of hours each month. Such arrangements generally provide for a guaranteed availability of a number of professional services hours each month on a "use it or lose it" basis. For retained professional services sold on a stand-alone basis we recognize revenue as the services are delivered or over the term of the contractual retainer period. These arrangements do not require formal customer acceptance and do not grant any future right to labor hours contracted for but not used.

Subscriptions and Perpetual Licenses

The Company licenses its software on either a perpetual or subscription basis. Customers may license the software on a subscription basis, which can be described as "Software as a Service" or "SaaS". SaaS is a model of software deployment where an application is hosted as a service provided to customers across the Internet. Subscription agreements include access to the Company's software application via an internet connection, the related hosting of the application, and PCS. Customers receive automatic updates and upgrades, and new releases of the products as soon as they become available. Customers cannot take possession of the software. Subscription agreements are typically thirty-six month term arrangements that automatically renew unless either party terminates upon 90 days' notice of renewal. Revenue is recognized monthly as the services are delivered. Set up fees paid by customers in connection with subscription services are deferred and recognized ratably over the longer of the life of subscription period or the expected lives of customer relationships. We continue to evaluate the length of the amortization period of the set up fees as we gain more experience with customer contract renewals.

Customers who license the software on a perpetual basis receive rights to use the software for an indefinite time period and an option to purchase Post-Customer Support (“PCS”). For arrangements that consist of a perpetual license and PCS, as long as Vendor Specific Objective Evidence (“VSOE”) exists for the PCS, then PCS revenue is recognized ratably on a straight-line basis over the period of performance and the perpetual license is recognized on a residual basis. Under the residual method, the fair value of the undelivered elements are deferred and the remaining portion of the arrangement fee is allocated to the delivered elements and recognized as revenue, assuming all other revenue recognition criteria have been met.

Managed Service Hosting

Managed service hosting includes hosting arrangements that provide for the use of certain hardware and infrastructure for those customers who do not wish to host our applications independently. Hosting agreements are typically annual arrangements that provide for termination for convenience by either party generally upon 30-days’ notice. Revenue is recognized monthly as the hosting services are delivered. Set up fees paid by customers in connection with managed hosting services are deferred and recognized ratably over the longer of the life of the hosting period or the expected lives of customer relationships. We continue to evaluate the length of the amortization period of the set up fees as we gain more experience with customer contract renewals.

Multiple Element Arrangements

In accounting for multiple element arrangements, we follow either ASC Topic 605-985 *Revenue Recognition Software* or ASC Topic 605-25 *Revenue Recognition Multiple Element Arrangements*, as applicable.

In October 2009, the FASB issued Accounting Standards Update No. 2009-13, *Revenue Recognition: Multiple-Deliverable Revenue Arrangements* (“ASU 2009-13”). ASU 2009-13 provides amendments to certain paragraphs of previously issued ASC Subtopic 605-25 – *Revenue Recognition: Multiple-Deliverable Revenue Arrangements*. In accordance with ASU 2009-13, each deliverable within a multiple-deliverable revenue arrangement is accounted for as a separate unit of accounting if both of the following criteria are met (1) the delivered item has value to the customer on a standalone basis and (2) for an arrangement that includes a right of return relative to the delivered item, delivery or performance of the delivered item is considered probable and within our control. If the deliverables do not meet the criteria for being a separate unit of accounting then they are combined with a deliverable that does meet that criterion. The accounting guidance also requires that arrangement consideration be allocated at the inception of an arrangement to all deliverables using the relative selling price method. The accounting guidance also establishes a selling price hierarchy for determining the selling price of a deliverable. We determine selling price using VSOE, if it exists; otherwise, we use Third-party Evidence (“TPE”). If neither VSOE nor TPE of selling price exists for a unit of accounting, we use Estimated Selling Price (“ESP”).

VSOE is generally limited to the price at which we sell the element in a separate stand-alone transaction. TPE is determined based on the prices charged by our competitors for a similar deliverable when sold separately. It is difficult for us to obtain sufficient information on competitor pricing, so we may not be able to substantiate TPE. If we cannot establish selling price based on VSOE or TPE then we will use ESP. ESP is derived by considering the selling price for similar services and our ongoing pricing strategies. The selling prices used in our allocations of arrangement consideration are analyzed at minimum on an annual basis and more frequently if our business necessitates a more timely review. We have determined that we have VSOE on our SaaS offerings, certain application development services, managed hosting services, and PCS because we have evidence of these elements sold on a stand-alone basis.

When the Company licenses its software on a perpetual basis in a multiple element arrangement that arrangement typically includes PCS and application development services, we follow the guidance of ASC Topic 605-985. In assessing the hierarchy of relative selling price for PCS, we have determined that VSOE is established for PCS. VSOE for PCS is based on the price of PCS when sold separately, which has been established via annual renewal rates. Similarly, when the Company licenses its software on a perpetual basis in a multiple element arrangement that also includes managed service hosting (“hosting”), we have determined that VSOE is established for hosting based on the price of the hosting when sold separately, which has been established based on renewal rates of the hosting contract. Revenue recognition for perpetual licenses sold with application development services are considered on a case by case basis. The Company has not established VSOE for perpetual licenses or fixed price development services and therefore in accordance with ASC Topic 605-985, when perpetual licenses are sold in multiple element arrangements including application development services where VSOE for the services has not been established, the license revenue is deferred and recognized using contract accounting. The Company has determined that services are not essential to the functionality of the software and it has the ability to make estimates necessary to apply proportional performance model. In those cases where perpetual licenses are sold in a multiple element arrangement that includes application development services where VSOE for the services has been established, the license revenue is recognized under the residual method and the application services are recognized upon delivery.

In determining VSOE for the digital engagement services element, the separability of the services from the software license and the value of the services when sold on a standalone basis are considered. The Company also considers the categorization of the services, the timing of when the services contract was signed in relation to the signing of the perpetual license contract and delivery of the software, and whether the services can be performed by others. The Company has concluded that its application development services are not required for the customer to use the product but, rather enhance the benefits that the software can bring to the customer. In addition, the services provided do not result in significant customization or modification of the software and are not essential to its functionality, and can also be performed by the customer or a third party. If an application development services arrangement does qualify for separate accounting, the Company recognizes the perpetual license on a residual basis. If an application development services arrangement does not qualify for separate accounting, the Company recognizes the perpetual license under the proportional performance model as described above.

When subscription arrangements are sold with application development services, the Company uses its judgment as to whether the application development services qualify as a separate unit of accounting. When subscription service arrangements involve multiple elements that qualify as separate units of accounting, the Company allocates arrangement consideration in multiple-deliverable arrangements at the inception of an arrangement to all deliverables based on the relative selling price model in accordance with the selling price hierarchy, which includes: (i) VSOE when available; (ii) TPE if VSOE is not available; and (iii) ESP if neither VSOE or TPE is available. For those subscription arrangements sold with multiple elements whereby the application development services do not qualify as a separate unit of accounting, the application services revenue is recognized ratably over the subscription period. Subscriptions also include a PCS component, and the Company has determined that the two elements cannot be separated and must be recognized as one unit over the applicable service period. Set up fees paid by customers in connection with subscription arrangements are deferred and recognized ratably over the longer of the life of the hosting period or the expected lives of customer relationships, which generally range from two to three years. We continue to evaluate the length of the amortization period of the set up fees as we gain more experience with customer contract renewals and our newer product offerings.

Customer Payment Terms

Payment terms with customers typically require payment 30 days from invoice date. Payment terms may vary by customer but generally do not exceed 45 days from invoice date. Invoicing for digital engagement services are either monthly or upon achievement of milestones and payment terms for such billings are within the standard terms described above. Invoicing for subscriptions and hosting are typically issued monthly and are generally due in the month of service. The Company's subscription and hosting agreements provide for refunds when service is interrupted for an extended period of time and are reserved for in the month in which they occur if necessary.

Our digital engagement services agreements with customers do not provide for any refunds for services or products and therefore no specific reserve for such is maintained. In the infrequent instances where customers raise a concern over delivered products or services, we have endeavored to remedy the concern and all costs related to such matters have been insignificant in all periods presented.

Warranty

Certain arrangements include a warranty period, which is generally 30 days from the completion of work. In hosting arrangements, we provide warranties of up-time reliability. We continue to monitor the conditions that are subject to the warranties to identify if a warranty claim may arise. If we determine that a warranty claim is probable, then any related cost to satisfy the warranty obligation is estimated and accrued. Warranty claims to date have been immaterial.

Reimbursable Expenses

In connection with certain arrangements, reimbursable expenses are incurred and billed to customers and such amounts are recognized as both revenue and cost of revenue.

Allowance for Doubtful Accounts

We maintain an allowance for doubtful accounts which represents estimated losses resulting from the inability, failure or refusal of our clients to make required payments.

We analyze historical percentages of uncollectible accounts and changes in payment history when evaluating the adequacy of the allowance for doubtful accounts. We use an internal collection effort, which may include our sales and services groups as we deem appropriate. Although we believe that our allowances are adequate, if the financial condition of our clients deteriorates, resulting in an impairment of their ability to make payments, or if we underestimate the allowances required, additional allowances may be necessary, resulting in increased expense in the period in which such determination is made.

Accounting for Cost of Computer Software to be Sold, Leased or Otherwise Marketed

We charge research and development expenditures for technology development to operations as incurred. However, in accordance with Codification 985-20 *Costs of Software to be Sold Leased or Otherwise Marketed*, we capitalize certain software development costs subsequent to the establishment of technological feasibility. Based on our product development process, technological feasibility is established upon completion of a working model. Certain costs incurred between completion of a working model and the point at which the product is ready for general release is capitalized if significant. Once the product is available for general release, the capitalized costs are amortized in cost of sales.

Accounting for Goodwill and Intangible Assets

Goodwill is tested for impairment annually during the fourth quarter of every year and more frequently if events and circumstances indicate that the asset might be impaired. In assessing goodwill for impairment, an entity has the option to assess qualitative factors to determine whether events or circumstances indicate that it is not more likely than not that the fair value of a reporting unit is less than its carrying amount. We assess goodwill at the consolidated level as one reporting unit. If this is the case, then performing the quantitative two-step goodwill impairment test is unnecessary. An entity can choose not to perform a qualitative assessment for any or all of its reporting units, and proceed directly to the use of the two-step impairment test. In assessing qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount, we assess relevant events and circumstances that may impact the fair value and the carrying amount of a reporting unit. The identification of relevant events and circumstances and how these may impact a reporting unit's fair value or carrying amount involve significant judgments by management. These judgments include the consideration of macroeconomic conditions, industry and market considerations, cost factors, overall financial performance, events which are specific to Bridgeline, and trends in the market price of our common stock. Each factor is assessed to determine whether it impacts the impairment test positively or negatively, and the magnitude of any such impact.

For fiscal 2016, the Company performed the annual assessment of goodwill during the fourth quarter of 2016 and concluded that it was not more likely than not that the fair values of the reporting units were less than their carrying amounts. In estimating fair value, the Company performed a discounted cash flow analysis on the reporting unit to determine fair value. The inputs to the discounted cash flow model are considered level 3 in the fair value hierarchy. The impairment test performed by the Company indicated that the estimated fair value of the reporting unit was more than its corresponding carrying amount. As a result of the analyses performed, the Company assessed that goodwill was not impaired.

Accounting for Stock-Based Compensation

At June 30, 2017, we maintained stock-based compensation plans which are more fully described in Note 12 to the Consolidated Financial Statements of our Annual Report on Form 10-K filed with the Securities and Exchange Commission on December 19, 2016.

The Company accounts for stock compensation awards in accordance with the *Compensation-Stock Compensation* Topic of the Codification. Share-based payments (to the extent they are compensatory) are recognized in our consolidated statements of operations based on their fair values.

We recognize stock-based compensation expense for share-based payments issued or assumed after October 1, 2006 that are expected to vest on a graded, accelerated basis over the service period of the award, which is generally three years. We recognize the fair value of the unvested portion of share-based payments granted prior to October 1, 2006 over the remaining service period, net of estimated forfeitures. In determining whether an award is expected to vest, we use an estimated, forward-looking forfeiture rate based upon our historical forfeiture rate and reduce the expense over the recognition period. Estimated forfeiture rates are updated for actual forfeitures quarterly. We also consider, each quarter, whether there have been any significant changes in facts and circumstances that would affect our forfeiture rate. Although we estimate forfeitures based on historical experience, actual forfeitures in the future may differ. In addition, to the extent our actual forfeitures are different than our estimates, we record a true-up for the difference in the period that the awards vest, and such true-ups could materially affect our operating results.

We estimate the fair value of employee stock options using the Black-Scholes-Merton option valuation model. The fair value of an award is affected by our stock price on the date of grant as well as other assumptions including the estimated volatility of our stock price over the term of the awards and the estimated period of time that we expect employees to hold their stock options. The risk-free interest rate assumption we use is based upon United States treasury interest rates appropriate for the expected life of the awards. We use the historical volatility of our publicly traded options in order to estimate future stock price trends. In order to determine the estimated period of time that we expect employees to hold their stock options, we use historical trends of employee turnovers. Our expected dividend rate is zero since we do not currently pay cash dividends on our common stock and do not anticipate doing so in the foreseeable future. The aforementioned inputs entered into the option valuation model we use to fair value our stock awards are subjective estimates and changes to these estimates will cause the fair value of our stock awards and related stock-based compensation expense we record to vary.

We record deferred tax assets for stock-based awards that result in deductions on our income tax returns, based on the amount of stock-based compensation recognized and the statutory tax rate in the jurisdiction in which we will receive a tax deduction.

Item 3. Qualitative and Quantitative Disclosures About Market Risk.

Not required.

Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports filed under the *Securities Exchange Act of 1934*, as amended, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to our management, including our President and Chief Executive Officer (Principal Executive Officer) and our Executive Vice President and Chief Financial Officer (Principal Financial and Accounting Officer), as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, as ours are designed to do, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

As of June 30, 2017 we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective in enabling us to record, process, summarize and report information required to be included in our periodic filings with the Securities and Exchange Commission within the required time period.

Changes in Internal Control over Financial Reporting

There have been no changes in our internal controls over financial reporting that occurred during the quarter ended June 30, 2017 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings.

From time to time we are subject to ordinary routine litigation and claims incidental to our business. We are not currently involved in any legal proceedings that we believe are material beyond those previously disclosed in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on December 19, 2016.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

The following summarizes all sales of our unregistered securities during the quarter ended June 30, 2017. The securities in the below-referenced transactions were (i) issued without registration and (ii) were subject to restrictions under the Securities Act and the securities laws of certain states, in reliance on the private offering exemptions contained in Sections 4(2), 4(6) and/or 3(b) of the Securities Act and on Regulation D promulgated there under, and in reliance on similar exemptions under applicable state laws as transactions not involving a public offering. Unless stated otherwise, no placement or underwriting fees were paid in connection with these transactions.

Common Stock

In June 2017, the Company's CEO and President elected to receive common stock in lieu of a \$20,000 cash payment for a bonus earned for the first half of the fiscal year. He received 7,273 fully vested restricted shares with a fair value price per share of \$2.75.

Stock Options

During the fiscal quarter ended June 30, 2017, the Company granted 10,000 stock options under The 2016 Stock Incentive Plan at a weighted average exercise price of \$3.80 per share.

The securities were issued exclusively to our directors, executive officers and employees. The issuance of options and the shares of common stock issuable upon the exercise of such options as described above were issued pursuant to

written compensatory plans or arrangements with our employees, directors and consultants, in reliance on the exemptions from the registration provisions of the Securities Act set forth in Section 4(2) thereof relative to sales by an issuer not involving any public offering, to the extent an exemption from such registration was required.

Item 6. Exhibits.

Exhibit No. Description of Document

| | |
|----------|--|
| 3.1(i) | Amended and Restated Certificate of Incorporation (incorporated by reference to Exhibit 3.1 to our Quarterly Report on Form 10-Q filed on May 15, 2013) |
| 3.1(ii) | Certificate of Amendment to Amended and Restated Certificate of Incorporation, dated May 4, 2015 (incorporated by reference to Exhibit 3.1 to our Current Report on Form 8-K filed on May 5, 2015) |
| 3.1(iii) | Certificate of Designations of the Series A Convertible Preferred Stock (incorporated by reference to Exhibit 3.1 to our Current Report on Form 8-K filed on November 4, 2014) |
| 3.1(iv) | Amended and Restated By-laws (incorporated by reference to Exhibit 3.1 to our Quarterly Report on Form 10-Q filed on February 17, 2015) |
| 3.1 (v) | Certificate of Amendment to Amended and Restated Certificate of Incorporation, dated July 24, 2017 (incorporated by reference to Exhibit 3.1 to our Current Report on Form 8-K filed on July 24, 2017) |
| 4.1(i) | Registration Rights Agreement, dated November 3, 2016, by and between Bridgeline Digital, Inc. and the Investors party thereto (incorporated by reference to Exhibit 10.3 to our Current Report on Form 8-K Filed on November 4, 2016) |
| 4.1(ii) | Registration Rights Agreement, as amended on June 30, 2017 filed with the Securities and Exchange Commission on May 19, 2017 |
| 10.1 | Third Amendment to the Loan and Security Agreement between Bridgeline Digital, Inc and Heritage Bank of Commerce |
| 10.2 | First Amendment to Affirmation of Guaranty between Michael N. Taglich and Heritage Bank of Commerce |
| 31.1 | Certification required by Rule 13a-14(a) or Rule 15d-14(a). |
| 31.2 | Certification required by Rule 13a-14(a) or Rule 15d-14(a). |
| 32.1 | Certification required by Rule 13a-14(b) or Rule 15d-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. §1350). |
| 32.2 | Certification required by Rule 13a-14(b) or Rule 15d-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. §1350). |
| 101.INS* | XBRL Instance |

- 101.SCH* XBRL Taxonomy Extension Schema
- 101.CAL* XBRL Taxonomy Extension Calculation
- 101.DEF* XBRL Taxonomy Extension Definition
- 101.LAB* XBRL Taxonomy Extension Labels
- 101.PRE* XBRL Taxonomy Extension Presentation

*Management compensatory plan

**XBRL information is furnished and not filed or a part of a registration statement or prospectus for purposes of sections 11 and 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Bridgeline Digital, Inc.
(Registrant)

August 14, 2017 /s/ Roger Kahn
Roger Kahn

Date **President and Chief Executive Officer**
(Principal Executive Officer)

August 14, 2017 /s/ Michael Prinn
Michael Prinn

Date **Executive Vice President and Chief Financial Officer**
(Principal Financial and Accounting Officer)

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