

Bridgeline Digital, Inc.  
Form 10-K  
December 21, 2017  
**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**Form 10-K**

(Mark One)

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

For the fiscal year ended September 30, 2017

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** **52-2263942**  
State or Other Jurisdiction of Incorporation IRS Employer Identification No.

**80 Blanchard Road**  
**Burlington, Massachusetts** **01803**  
(Address of Principal Executive Offices) (Zip Code)

**(781) 376-5555**  
(Registrant's telephone number)

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

Title of each class	Name of exchange on which registered
Common Stock, \$0.001 par value per share	The NASDAQ Stock Market, LLC

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

None

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer smaller reporting company, or emerging growth company. See definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company” and “emerging growth 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 aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant was approximately \$12,321,517 based on the closing price of \$4.17 of the issuer’s common stock, par value \$.001 per share, as reported by the NASDAQ Stock Market on March 31, 2017.

On December 12, 2017, there were 4,200,219 shares of the registrant’s common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE: Portions of the definitive proxy statement for our 2017 annual meeting of stockholders, which is to be filed within 120 days after the end of the fiscal year ended September 30, 2017, are incorporated by reference into Part III of this Form 10-K, to the extent described in Part III.

## Forward Looking Statement

*Statements contained in this Annual Report on Form 10-K 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-K 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, dependence on third parties, the security of our software and response to cyber security risks, our ability to meet our financial obligations and commitments, our dependence on our management team and key personnel, our ability to hire and retain future key personnel, our ability to maintain an effective system of internal controls, or our ability to respond to government regulations. 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 herein and in the other documents that we file with the Securities and Exchange Commission. You can read these documents at [www.sec.gov](http://www.sec.gov).*

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

## PART I

### Item 1. 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 Unbound (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.

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. In 2017, 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; and Tampa, FL. The Company has one wholly-owned subsidiary, Bridgeline Digital Pvt. Ltd. located in Bangalore, India.

### *Products and Services*

#### *Products*

##### *iAPPS Platform*

##### *Subscription and Perpetual Licenses*

iAPPS is available as either a SaaS or perpetual license and is reported as subscription and perpetual licenses in the accompanying consolidated financial statements.

The iAPPS platform provides a unified common set of shared software modules that are critical to today's mission critical websites, on-line stores, intranets, extranets, and portals. The iAPPS platform empowers companies and developers to create websites, web applications and online stores with advanced business logic, state-of-the-art graphical user interfaces, and improved quality.

The iAPPS platform is a Web Engagement Management (WEM) platform that unifies Content Management, eCommerce, eMarketing, and Analytic capabilities deep within the websites, intranets or online stores in which they reside, enabling customers to enhance and optimize the value of their web properties and better engage their website users. The iAPPS platform significantly enhances WEM and Customer Experience Management (CXM) capabilities.

The iAPPSds platform was built specifically to support the needs of multi-unit organizations and franchises. Bridgeline's cloud-based platform allows companies to execute local marketing plans, follow SEO best practices, drive eCommerce initiatives, and measure results with actionable analytics.

The iAPPS suite of products includes:

**iAPPS Experience Manager** is a marketing automation engine and content management system in one – delivering the digital experiences consumers demand. Centered on robust audience segmentation and list management, the tool allows marketers to easily create personalized customer journeys. Each iAPPS implementation incorporates a set of flexible templates and modules to get you started quickly in building your full digital experience with **iAPPS Pro**. From there, you can opt to further customize these templates and incorporate any necessary custom application integrations with **iAPPS Enterprise** to meet an organizations unique business needs.

**iAPPS Content Manager** allows non-technical users to create, edit, and publish content via a browser-based interface. The advanced, easy-to-use interface allows businesses to keep content and promotions fresh - whether for a public commercial site or a company intranet. iAPPS Content Manager handles the presentation of content based on a sophisticated indexing and security scheme that includes management of front-end access to online applications. The system provides a robust library functionality to manage permissions, versions and organization of different content types, including multimedia files and images. Administrators are able to easily configure a simple or advanced workflow. The system can accommodate the complexity of larger companies with strict regulatory policies. iAPPS Content Manager is uniquely integrated and unified with iAPPS Insights, iAPPS Commerce, and iAPPS Marketier; providing our customers with precise information, accurate results, expansion options, and stronger user adoption.

**iAPPS Commerce** is an online B2B and B2C eCommerce solution that allows users to maximize and manage all aspects of their domestic and international Commerce initiatives. The customizable dashboard provides customers with a real-time overview of the performance of their online stores, including sales trends, demographics, profit margins, inventory levels, inventory alerts, fulfillment deficiencies, average check out times, potential production issues, and delivery times. iAPPS Commerce also provides backend access to payment and shipping gateways. In combining iAPPS Commerce with iAPPS Insights and iAPPS Marketier, our customers can take their Commerce initiatives to an advanced level by personalizing their product offerings, improving their marketing effectiveness, providing value-added services and cross selling additional products. iAPPS Commerce is uniquely integrated and unified with iAPPS Insights, iAPPS Content Manager, and iAPPS Marketier; providing our customers with precise information, more accurate results, expansion options, and stronger user adoption.

**iAPPS Marketier** is a powerful online marketing management solution that helps marketers drive more qualified traffic to their sites through personalized and highly targeted marketing automation flows. Marketier's powerful feature set includes end-to-end campaign administration - from drag-and-drop landing pages with our flexible form builder to behavior-based drip email campaigns, add-on dynamic contact and distribution list management, event-based response marketing, wizard-driven email campaign creation, as well as built-in goal tracking tools to measure campaign effectiveness and ROI.

**iAPPS Insights** provides the ability to manage, measure and optimize web properties by recording detailed events and subsequently mine data within a web application for statistical analysis. Our customers have access to information regarding where their visitors are coming from, what content and products their viewers are most interested in, and how they navigate through a particular web application. Through user-definable web reports, iAPPS Insights provides deep insight into areas like visitor usage, content access, age of content, actions taken, event triggers, and reports on both client and server-side events. iAPPS Insight's smart recommendation engine uses this data and identifies actionable solutions enabling our customers to optimize site content and reach their digital campaign goals. There are over 20 standard web reports that come with iAPPS Insight. iAPPS Insight is uniquely integrated and unified with iAPPS Content Manager, iAPPS Commerce, and iAPPS Marketier; providing our customers with precise information, accurate results, expansion options, and stronger user adoption.

**iAPPS Social** is a social media management solution that empowers customers to easily set up customized watch lists tailored by social network, topic, or author to monitor relevant conversations happening on social media, popular websites and blogs. Customers can also prioritize and engage in conversations across the web and leverage the power of publishing content to department, dealer, franchise or other social media accounts.



**iAPPSds** is a web content management and eCommerce platform built specifically to support the needs of multi-unit organizations and franchises. 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 multi-unit organization for a monthly subscription fee. iAPPSds acts as a control center for a large organization's distributed websites enabling local content publishing that is managed through a workflow approval process that gives corporate marketing control of the brand and message. iAPPSds also supports responsive design that adapts to specific device screen sizes access a website, driving more positive user experiences and engagement. iAPPSds is a cloud based SaaS solution.

## *Services*

### *Revenue from Digital Engagement Services*

Revenue from all digital engagement services is reported as *digital engagement services* in the accompanying consolidated financial statements.

### *Digital Engagement Services*

Digital engagement services address specific customer needs such as digital strategy, web design and web development, usability engineering, information architecture, and Search Engine Optimization (SEO) for their mission critical web site, intranet or online store. Application development engagements are often sold as part of a multiple element arrangement that includes our software products, hosting arrangements (i.e. Managed Service Hosting) that provide for the use of certain hardware and infrastructure at one of our co-managed network operating centers, or retained professional services subsequent to completion of the application development.

### *Digital Strategy Services*

Bridgeline helps customers maximize the effectiveness of their online marketing activities to ensure that their web applications can be exposed to the potential customers that use search engines to locate products and services. Bridgeline's SEO services include competitive analysis, website review, keyword generation, proprietary leading page technology, ongoing registration, monthly reports, and monitoring. Bridgeline's web analytics experts offer consulting and assistance in implementing iAPPS Insights or any other type of web analytics package.

### *Usability Design*

By integrating usability into traditional development life cycles, we believe our usability experts can significantly enhance a user's experience. Our usability professionals provide the following services: usability audits, information architecture, process analysis and optimization, interface design and user testing. Our systematic and user-centered approach to application development focuses on developing applications that are intuitive, accessible, engaging, and effective. Our goal is to produce a net effect of increased traffic, improved visitor retention, increased user productivity, reduced user error, lower support cost, and reduced long-term development cost.

*Information Architecture*

Information Architecture is a design methodology focused on structuring information to ensure that users can find the appropriate data and can complete their desired transactions within a website or application. Understanding users and the context in which users will be initiating with a web application is central to information architecture. Information architects try to put themselves in the position of a typical user of an application to better understand a user's characteristics, behaviors, intentions and motivations. At the same time, the information architect develops an understanding of a web application's functionality and data structures. The understanding of these components enables the architect to make customer centric decisions about the end user and then translate those decisions into site maps, wire frames and clickable prototypes.

Information architecture forms the foundation of a web application's usability. The extent to which a web application is user-friendly and is widely adopted by a user base is primarily dependent on the success of the information architecture. Information architecture defines how well users can navigate through a website or application and how easily they can find the desired information or function. As digital engagement becomes more standard and commoditized, information architecture will increase as a differentiator for application developers.

### ***Managed Service Hosting***

#### *Revenue from Managed Service Hosting*

Revenue from managed service hosting is reported as *managed service hosting* in the accompanying consolidated financial statements.

A large number of our customers engage Bridgeline to host and manage the mission critical web sites and web stores we develop. Through our partnership with Amazon Web Services, we provide 24/7 application monitoring, emergency response, version control of application control, load balancing, managed firewall security and virus protection services, and secure UDS environments. We provide shared hosting, dedicated hosting, and SaaS hosting for our customers.

### **Sales and Marketing**

#### *Overview*

Bridgeline employs a direct sales force to sell enterprise iAPPS engagements and each sale takes on average 3-6 months to complete. Our direct sales force focuses its efforts selling to mid-sized and large companies. These companies are generally categorized in the following vertical markets: financial services, retail brand names, health services and life sciences, technology (software and hardware), credit unions and regional banks, as well as associations and foundations.

Bridgeline also employs a direct sales force to sell iAPPSds engagements to franchises and multi-unit organizations. Each sale in the iAPPSds vertical market takes on average approximately one year to complete.

### *Strategic Alliances*

We have dedicated business development professionals whose mission is to identify and establish strategic alliances for iAPPS and iAPPSds. We maintain a strategic alliance with UPS Logistics, which began in 2012. Bridgeline and UPS Logistics signed a multi-year agreement to offer B2B and B2C eCommerce web stores with an end-to-end eCommerce offering comprised of Bridgeline's eCommerce Fulfilled™ solution and UPS Logistics and fulfillment services. The combined Bridgeline and UPS Logistics offering provides customers with the ability to manage the eCommerce and supply chain fulfillment needs and was designed to benefit mid-market and larger online web stores who seek end to end solutions.

Also in 2012, Bridgeline signed a multi-year agreement with The UPS Stores, a national franchise network of over 4,500 locations who license the iAPPSds platform.

We continue to pursue other significant strategic alliances that will enhance the sales and distribution opportunities of iAPPS related intellectual property.

### *Engagement Methodology*

We use an accountable, strategic engagement process developed specifically for target companies that require a technology based professional approach. We believe it is critical to qualify each opportunity and to assure our skill set and tools match up well with customer's needs. As an essential part of every engagement, we believe our engagement methodology streamlines our customer qualification process, strengthens our customer relationships, ensures our skill set and tools match the customer's needs, and results in the submission of targeted proposals.

*Organic Growth from Existing Customer Base*

We have specific proactive programs that consistently market our iAPPS platform and interactive development capabilities. Our business development professionals seek ongoing business opportunities within our existing customer base and within other operating divisions or subsidiaries of our existing customer base.

*New Customer Acquisition*

We identify customers within our vertical expertise (financial services, franchise/dealer networks, retail brand names, health services and life sciences, high technology, credit unions and regional banks, as well as associations and foundations). Our business development professionals create an annual territory plan identifying various strategies to engage our target customers.

*Customer Retention Programs*

We use digital marketing capabilities when marketing to our customer base. We make available via email and on our website Bridgeline authored Whitepapers, featured case studies, and/or Company related announcements to our customers on a bimonthly basis. We also host educational on-line webinars, face to face seminars and training.

*New Lead Generation Programs*

We generate targeted leads and new business opportunities by leveraging on-line marketing strategies. We receive leads by maximizing the SEO capabilities of our own website. Through our website, we provide various educational Whitepapers and promote upcoming on-line seminars. In addition, we utilize banner advertisements on various independent newsletters and paid search advertisements that are linked to our website. We also participate and exhibit at targeted events.

*Social Media Programs*

We market Bridgeline's upcoming events, Whitepapers, blogs, case studies, digital product tutorials, announcements, and related articles frequently on leading social media platforms such as Twitter, LinkedIn, YouTube and Facebook.

### **Acquisitions**

There were no acquisitions during the fiscal years ended September 30, 2017 and 2016.

### **Research and Development**

We have a strong commitment to research and development activities focusing on creating new products and innovations, product enhancements, and funding future market opportunities. In fiscal 2017 and 2016, research and development expenses were \$1.6 million, or 10% of revenues for both periods.

### **Employees**

We have 67 employees worldwide as of September 30, 2017. All of these employees are full time employees.

## Customers

We primarily serve the following vertical markets that we believe have a history of investing in information technology enhancements and initiatives as follows:

- Financial Services
- Franchises/Multi-unit Organizations
- Retail Brand Names
- Health Services and Life Sciences
- Technology (software and hardware)
- Credit Unions and Regional Banks
- Associations and Foundations

For the year ended September 30, 2017, two customers each generated approximately 12% of our revenue. For the year ended September 30, 2016, one customer generated approximately 10% of our revenue.

## Competition

The markets for our products and services, including software for web content management, eCommerce platform software, eMarketing software, web analytics software and digital engagement services are highly competitive, fragmented, and rapidly changing. Barriers to entry in such markets remain relatively low. The markets are significantly affected by new product introductions and other market activities of industry participants. With the introduction of new technologies and market entrants, we expect competition to persist and intensify in the future.

We believe we compete adequately with others and we distinguish ourselves from our competitors in a number of ways:

We believe our competitors generally offer their web application software typically as a single point of entry type product (such as content management only, or commerce only) as compared to the deeply integrated approach as provided by the iAPPS platform.

We believe our competitors can generally only deploy their solutions in either a Cloud/SaaS environment or in a dedicated server environment. The iAPPS platform's architecture is flexible and is capable of being deployed in either a Cloud/SaaS or dedicated server environment.



We believe the majority of our competitors do not provide interactive technology development services that complement their software products. Our ability to develop mission critical web sites and online stores on our own deeply integrated iAPPS platform provides a quality end-to-end solution that distinguishes us from our competitors.

We believe the interface of the iAPPS platform has been designed for ease of use without substantial technical skills.

Finally, we believe the iAPPS platform offers a competitive price-to-functionality ratio when compared to our competitors.

### **Available Information**

This Annual Report on Form 10-K, as well as our quarterly reports on Form 10-Q and current reports on Form 8-K, along with any amendments to those reports, are made available upon request, on our website [www.bridgeline.com](http://www.bridgeline.com) as soon as reasonably practicable after such material is electronically filed with or furnished to the Securities and Exchange Commission. Copies of the following are also available through our website on the “About Us - Investor Information” page and are available in print to any shareholder who requests it:

Code of Business Ethics

Committee Charters for the following Board Committees:

- o Nominating and Corporate Governance Committee
  
- o Audit Committee
  
- o Compensation Committee

The public may read and copy any materials that we file with the SEC at the SEC’s Public Reference Room at 450 Fifth Street, N.W., Washington, D.C. 20549. Information regarding the SEC’s Public Reference Room can be obtained by calling the SEC at 1-800-SEC-0330. The SEC also maintains an Internet site that contains reports, proxy and information statements, and other information and can be found at <http://www.sec.gov>.

## **Item 1A. Risk Factors**

*This report contains forward-looking statements that involve risks and uncertainties, such as statements of our objectives, expectations and intentions. The cautionary statements made in this report are applicable to all forward-looking statements wherever they appear in this report. Our actual results could differ materially from those discussed herein. In addition to the risks discussed in “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” our business is subject to the risks set forth below.*

*We operate in a rapidly changing environment that involves certain risks and uncertainties, some of which are beyond our control. The risks described below are not the only risks we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial may also materially adversely affect our business, financial condition and/or operating results.*

*If we are unable to manage our future growth efficiently, our business, liquidity, revenues and profitability may suffer.*

We anticipate that continued expansion of our core business will require us to address potential market opportunities. For example, we may need to expand the size of our research and development, sales, corporate finance or operations staff. There can be no assurance that our infrastructure will be sufficiently flexible and adaptable to manage our projected growth or that we will have sufficient resources, human or otherwise, to sustain such growth. If we are unable to adequately address these additional demands on our resources, our profitability and growth might suffer. Also, if we continue to expand our operations, management might not be effective in expanding our physical facilities and our systems, and our procedures or controls might not be adequate to support such expansion. Our inability to manage our growth could harm our business and decrease our revenues.

We may also require additional funding to further expand our operations. We currently 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. We also depend on other sources of financing and this 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.

*Our revenue and quarterly results may fluctuate, which could adversely affect our stock price.*

We have experienced, and may in the future experience, significant fluctuations in our quarterly operating results that may be caused by many factors. These factors include:

changes in demand for our products;  
introduction, enhancement or announcement of products by us or our competitors;  
market acceptance of our new products;  
the growth rates of certain market segments in which we compete;  
size and timing of significant orders;  
budgeting cycles of customers;  
mix of products and services sold;  
changes in the level of operating expenses;  
completion or announcement of acquisitions; and  
general economic conditions in regions in which we conduct business.

***The length of our sales cycle can fluctuate significantly which could result in significant fluctuations in license revenues being recognized from quarter to quarter.***

The decision by a customer to purchase our products often involves the development of a complex implementation plan across a customer's business. This process often requires a significant commitment of resources both by prospective customers and us. Given the significant investment and commitment of resources required in order to implement our software, it may take several months, or even several quarters, for marketing opportunities to materialize. If a customer's decision to purchase our products is delayed or if the installation of our products takes longer than originally anticipated, the date on which we may recognize revenues from these sales would be delayed. Such delays and fluctuations could cause our revenues to be lower than expected in a particular period and we may not be able to adjust our costs quickly enough to offset such lower revenue, potentially negatively impacting our results of operations.

***A reduction in our license renewal rate could reduce our revenue.***

Our customers have no obligation to renew their subscription licenses, and some customers have elected not to do so. Our license renewal rates may decline or fluctuate as a result of a number of factors, including customer dissatisfaction with our products and services, our failure to update our products to maintain their attractiveness in the market, or constraints or changes in budget priorities faced by our customers. A decline in license renewal rates could cause our revenue to decline which would have a material adverse effect on our operations.

***We face intense and growing competition, which could result in price reductions, reduced operating margins and loss of market share.***

We operate in a highly competitive marketplace and generally encounter intense competition to create and maintain demand for our services and to obtain service contracts. If we are unable to successfully compete for new business and license renewals, our revenue growth and operating margins may decline. The market for our iAPPS platform (Content Manager, Insights, eCommerce, Marketier, Social) and web development services are competitive and rapidly changing. Barriers to entry in such markets are relatively low. With the introduction of new technologies and market entrants, we expect competition to intensify in the future. Some of our principal competitors offer their products at a lower price, which may result in pricing pressures. Such pricing pressures and increased competition generally could result in reduced sales, reduced margins or the failure of our product and service offerings to achieve or maintain more widespread market acceptance.

The web development/services market is highly fragmented with a large number of competitors and potential competitors. Our prominent public company competitors are Big Commerce, Salesforce (Commerce Cloud), Episerver, Hubspot, Sitecore and Adobe (Experience Manager). We face competition from customers and potential customers who develop their own applications internally. We also face competition from potential competitors that are substantially larger than we are and who have significantly greater financial, technical and marketing resources, and established direct and indirect channels of distribution. As a result, they are able to devote greater resources to the development, promotion and sale of their products than we can.

***There may be a limited market for our common stock which may make it more difficult for you to sell your stock and which may reduce the market price of our common stock.***

The average shares traded per day in fiscal 2017 was approximately 26,000 shares per day compared to approximately 38,000 for fiscal 2016 and 3,000 for fiscal 2015. Our average trading volume of our common stock can be very sporadic and may impair the ability of holders of our common stock to sell their shares at the time they wish to sell them or at a price that they consider reasonable. A low trading volume may also reduce the fair market value of the

shares of our common stock. Accordingly, there can be no assurance that the price of our common stock will reflect our actual value. There can be no assurance that the daily trading volume of our common stock will increase or improve either now or in the future.

***The market price of our common stock is volatile which could adversely affect your investment in our common stock.***

The market price of our common stock is volatile and could fluctuate significantly for many reasons, including, without limitation: as a result of the risk factors listed in this annual report on Form 10-K; actual or anticipated fluctuations in our operating results; and general economic and industry conditions. During fiscal 2017, the closing price of our common stock as reported by NASDAQ fluctuated between \$2.12 and \$4.55. We are required to meet certain financial criteria in order to maintain our listing on the NASDAQ Capital Market. One such requirement is that we maintain a minimum closing bid price of at least \$1.00 per share for our common stock. If we fail this requirement then NASDAQ will issue a notice that we are not in compliance and we will need to take corrective actions in order to not be delisted. Such corrective actions could be a reverse stock split.

***If our products fail to perform properly due to undetected errors or similar problems, our business could suffer, and we could face product liability exposure.***

We develop and sell complex web engagement software which may contain undetected errors or bugs. Such errors can be detected at any point in a product's life cycle, but are frequently found after introduction of new software or enhancements to existing software. We continually introduce new products and new versions of our products. Despite internal testing and testing by current and potential customers, our current and future products may contain serious defects. If we detect any errors before we ship a product, we might have to delay product shipment for an extended period of time while we address the problem. We might not discover software errors that affect our new or current products or enhancements until after they are deployed, and we may need to provide enhancements to correct such errors. Therefore, it is possible that, despite our testing, errors may occur in our software. These errors could result in the following:

- harm to our reputation;
- lost sales;
- delays in commercial release;
- product liability claims;
- contractual disputes;
- negative publicity;
- delays in or loss of market acceptance of our products;
- license terminations or renegotiations; or
- unexpected expenses and diversion of resources to remedy errors.

Furthermore, our customers may use our software together with products from other companies. As a result, when problems occur, it might be difficult to identify the source of the problem. Even when our software does not cause these problems, the existence of these errors might cause us to incur significant costs, divert the attention of our technical personnel from our product development efforts, impact our reputation, or cause significant customer relations problems.

***Technology and customer requirements evolve rapidly in our industry, and if we do not continue to develop new products and enhance our existing products in response to these changes, our business could suffer.***

We will need to continue to enhance our products in order to maintain our competitive position. We may not be successful in developing and marketing enhancements to our products on a timely basis, and any enhancements we develop may not adequately address the changing needs of the marketplace. Overlaying the risks associated with our existing products and enhancements are ongoing technological developments and rapid changes in customer requirements. Our future success will depend upon our ability to develop and introduce in a timely manner new products that take advantage of technological advances and respond to new customer requirements. The development of new products is increasingly complex and uncertain, which increases the risk of delays. We may not be successful

in developing new products and incorporating new technology on a timely basis, and any new products may not adequately address the changing needs of the marketplace. Failure to develop new products and product enhancements that meet market needs in a timely manner could have a material adverse effect on our business, financial condition and operating results.

***If we are unable to protect our proprietary technology and other intellectual property rights, our ability to compete in the marketplace may be substantially reduced.***

If we are unable to protect our intellectual property, our competitors could use our intellectual property to market products similar to our products, which could decrease demand for such products, thus decreasing our revenue. We rely on a combination of copyright, trademark and trade secret laws, as well as licensing agreements, third-party non-disclosure agreements and other contractual measures to protect our intellectual property rights. These protections may not be adequate to prevent our competitors from copying or reverse-engineering our products. Our competitors may independently develop technologies that are substantially similar or superior to our technology. To protect our trade secrets and other proprietary information, we require employees, consultants, advisors and collaborators to enter into confidentiality agreements. These agreements may not provide meaningful protection for our trade secrets, know-how or other proprietary information in the event of any unauthorized use, misappropriation or disclosure of such trade secrets, know-how or other proprietary information. The protective mechanisms we include in our products may not be sufficient to prevent unauthorized copying. Existing copyright laws afford only limited protection for our intellectual property rights and may not protect such rights in the event competitors independently develop similar products. In addition, the laws of some countries in which our products are or may be licensed do not protect our products and intellectual property rights to the same extent as do the laws of the United States.

Policing unauthorized use of our products is difficult and litigation could become necessary in the future to enforce our intellectual property rights. Any litigation could be time consuming and expensive to prosecute or resolve, result in substantial diversion of management attention and resources, and materially harm our business or financial condition.

***If a third party asserts that we infringe upon its proprietary rights, we could be required to redesign our products, pay significant royalties or enter into license agreements.***

Claims of infringement are becoming increasingly common as the software industry develops and as related legal protections, including but not limited to patents, are applied to software products. Although we do not believe that our products infringe on the rights of third parties, a third party may assert that our technology or technologies of entities we acquire violates its intellectual property rights. As the number of software products in our markets increases and the functionality of these products further overlap, we believe that infringement claims will become more common. Any claims against us, regardless of their merit, could:

- be expensive and time consuming to defend;
- result in negative publicity;
- force us to stop licensing our products that incorporate the challenged intellectual property;
- require us to redesign our products;
- divert management's attention and our other resources; and/or
- require us to enter into royalty or licensing agreements in order to obtain the right to use necessary technologies, which may not be available on terms acceptable to us, if at all.

We believe that any successful challenge to our use of a trademark or domain name could substantially diminish our ability to conduct business in a particular market or jurisdiction and thus decrease our revenue and result in possible losses to our business.

***We depend on a third-party cloud platform provider to host our iAPPS SaaS environment and managed services business and if we were to experience a disruption in service, our business and reputation could suffer.***

We host our SaaS and managed hosting customers via a third-party, Amazon Web Services. If upon renewal date our third-party provider does not provide commercially reasonable terms, we may be required to transfer our services to a new provider, such as data center facility, and we may incur significant equipment costs and possible service interruption in connection with doing so. Interruptions in our services might reduce our revenue, cause us to issue credits or refunds to customers, subject us to potential liability, or harm our renewal rates.



***If our security measures or those of our third-party cloud computing platform provider are breached and unauthorized access is obtained to a customer's data, our services may be perceived as not being secure, and we may incur significant legal and financial exposure and liabilities.***

Security breaches could expose us to a risk of loss of our customers information, litigation and possible liability. While we have security measures in place, they may be breached as a result of third-party action, including intentional misconduct by computer hackers, employee error, malfeasance or otherwise and result in someone obtaining unauthorized access to our IT systems, our customers' data or our data, including our intellectual property and other confidential business information. Because the techniques used to obtain unauthorized access, or to sabotage systems, change frequently and generally are not recognized until launched against a target, we may be unable to implement adequate preventative measures. In addition, our customers may authorize third-party technology providers to access their customer data, and some of our customers may not have adequate security measures in place to protect their data that is stored on our services. Because we do not control our customers or third-party technology providers, or the processing of such data by third-party technology providers, we cannot ensure the integrity or security of such transmissions or processing. Malicious third parties may also conduct attacks designed to temporarily deny customers access to our services. Any security breach could result in a loss of confidence in the security of our services, damage our reputation, negatively impact our future sales, disrupt our business and lead to legal liability.

We rely on encryption and authentication technology from third parties to provide the security and authentication to effectively secure transmission of confidential information, including consumer payment card numbers. Such technology may not be sufficient to protect the transmission of such confidential information or these technologies may have material defects that may compromise the confidentiality or integrity of the transmitted data. Any imposition of liability, particularly liability that is not covered by insurance or is in excess of insurance coverage, could harm our reputation, business and operating results. We might be required to expend significant capital and other resources to protect further against security breaches or to rectify problems caused by any security breach, which, in turn could divert funds available for corporate growth and expansion or future acquisitions.

***Our debt obligations and operating lease commitments may adversely affect our financial condition and cash flows from operations.***

We maintain a \$2.5 million line of credit with our bank, Heritage Bank of Commerce. Additionally, we have contractual commitments in operating lease arrangements, which are not reflected on our consolidated balance sheets. Our ability to meet our expenses and debt obligations will depend on our future performance, which will be affected by financial, business, economic, regulatory and other factors. We will not be able to control many of these factors, such as economic conditions and governmental regulations. Further, our operations may not generate sufficient cash to enable us to service our debt or contractual obligations resulting from our leases. If we fail to make a payment on our debt, we could be in default on such debt. If we are at any time unable to generate sufficient cash flows from operations to service our indebtedness when payment is due, we may be required to attempt to renegotiate the terms of the instruments relating to the indebtedness, seek to refinance all or a portion of the indebtedness or obtain additional financing. There can be no assurance that we would be able to successfully renegotiate such terms, that any such refinancing would be possible or that any additional financing could be obtained on terms that are favorable or acceptable to us.

A failure to comply with the covenants and other provisions of our outstanding debt could result in events of default under such instruments, which could permit acceleration of all of our notes and borrowings under our revolving credit facility. Any required repayment of our notes or revolving credit facility as a result of a fundamental change or other acceleration would lower our current cash on hand such that we would not have those funds available for use in our business.

***We are dependent upon our management team and the loss of any of these individuals could harm our business.***

We are dependent on the efforts of our key management personnel. The loss of any of our key management personnel, or our inability to recruit and train additional key management and other personnel in a timely manner, could materially and adversely affect our business, operations and future prospects. We maintain a key man insurance policy covering our Chief Executive Officer.

*Because competition for highly qualified personnel is intense, we might not be able to attract and retain the employees we need to support our planned growth.*

We will need to increase the size and maintain the quality of our sales force, software development staff and professional services organization to execute our growth plans. To meet our objectives, we must attract and retain highly qualified personnel with specialized skill sets. Competition for qualified personnel can be intense, and we might not be successful in attracting and retaining them. Our ability to maintain and expand our sales, product development and professional services teams will depend on our ability to recruit, train and retain top quality people with advanced skills who understand sales to, and the specific needs of, our target customers. For these reasons, we have experienced, and we expect to again experience in the future, challenges in hiring and retaining highly skilled employees with appropriate qualifications for our business. In addition to hiring services personnel to meet our needs, we may also engage additional third-party consultants as contractors, which could have a negative impact on our financial results. If we are unable to hire or retain qualified personnel, or if newly hired personnel fail to develop the necessary skills or reach productivity slower than anticipated, it would be more difficult for us to sell our products and services, and we could experience a shortfall in revenue and not achieve our planned growth.

***Future acquisitions may be difficult to integrate into our existing operations, may disrupt our business, dilute stockholder value, divert management's attention, or negatively affect our operating results.***

We have acquired multiple businesses since our inception in 2000. Future acquisitions could involve substantial investment of funds or financings by issuance of debt or equity securities and could result in one-time charges and expenses and have the potential to either dilute the interests of existing shareholders or result in the issuance of or assumption of debt. Any such acquisition may not be successful in generating revenues, income or other returns to us, and the resources committed to such activities will not be available to us for other purposes. Moreover, if we are unable to access capital markets on acceptable terms or at all, we may not be able to consummate acquisitions, or may have to do so based upon less than optimal capital structure. Our inability to take advantage of growth opportunities for our business or to address risks associated with acquisitions or investments in businesses may negatively affect our operating results. Additionally, any impairment of goodwill or other intangible assets acquired in an acquisition or in an investment, or charges to earnings associated with any acquisition or investment activity, may materially reduce our earnings which, in turn, may have an adverse material effect on the price of our common stock.

***Increasing government regulation could affect our business and may adversely affect our financial condition.***

We are subject not only to regulations applicable to businesses generally, but also to laws and regulations directly applicable to electronic commerce. In addition, an inability to satisfy the standards of certain voluntary third-party certification bodies that our customers may expect, such as an attestation of compliance with the Payment Card Industry (PCI) Data Security Standards, may have an adverse impact on our business and results. Further, there are various statutes, regulations, and rulings relevant to the direct email marketing and text-messaging industries, including the Telephone Consumer Protection Act (TCPA) and related Federal Communication Commission (FCC) orders. The interpretation of many of these statutes, regulations, and rulings is evolving in the courts and administrative agencies and an inability to comply may have an adverse impact on our business and results. If in the future we are unable to achieve or maintain industry-specific certifications or other requirements or standards relevant to our customers, it may harm our business and adversely affect our results. We may also expand our business in countries that have more stringent data protection laws than those in the United States, and such laws may be inconsistent across jurisdictions and are subject to evolving and differing interpretations. Additionally, both laws regulating privacy and third-party products purporting to address privacy concerns could negatively affect the functionality of, and demand for, our products and services, thereby reducing our revenue.

Federal, state, and foreign governments may adopt laws and regulations applicable to our business. Any such legislation or regulation could dampen the growth of the Internet and decrease its acceptance. If such a decline occurs, companies may choose in the future not to use our products and services. Any new laws or regulations in the following areas could affect our business:

user privacy;

the pricing and taxation of goods and services offered over the Internet;  
the content of websites;  
copyrights;  
consumer protection, including the potential application of “do not call” registry requirements on customers and consumer backlash in general to direct marketing efforts of customers;  
the online distribution of specific material or content over the Internet; or  
the characteristics and quality of products and services offered over the Internet.

*We have never paid dividends and we do not anticipate paying dividends in the future.*

We have never paid cash dividends and do not believe that we will pay any cash dividends on our common stock in the future. Since we have no plan to pay cash dividends, an investor would only realize income from his investment in our shares if there is a rise in the market price of our common stock, which is uncertain and unpredictable.

**Item 1B. Unresolved Staff Comments**

Not required.

**Item 2. Properties.**

The following table lists our offices, all of which are leased:

<b>Geographic Location</b>	<b>Address</b>	<b>Size</b>
Bangalore, India	Bagmane Tech Park	2,617 square feet
Boston, Massachusetts	Bangalore 560 093 80 Blanchard Road	professional office space 21,136 square feet,
Chicago, Illinois	Burlington, Massachusetts 01803 30 N. LaSalle Street, 20th Floor	professional office space 4,880 square feet,
Denver, Colorado	Chicago, IL 60602 1600 Broadway, Suite 1600	professional office space 702 square feet,
Tampa, Florida	Denver, CO 80202 5321 Primrose Lake Circle	professional office space 2,380 square feet
	Tampa, FL 33647	professional office space

**Item 3. 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.

**Item 4. Mine Safety Disclosures**

Not applicable.

**PART II****Item 5. Market for Common Equity, Related Stockholder Matters and Issuer Purchase of Equity Securities.**

The following table sets forth, for the periods indicated, the range of high and low sale prices for our common stock. Our common stock trades on the NASDAQ Capital Market under the symbol BLIN.

<b>Year Ended September 30, 2017</b>	<b>High</b>	<b>Low</b>
Fourth Quarter	\$3.12	\$2.12
Third Quarter	\$4.15	\$2.65
Second Quarter	\$4.55	\$3.11
First Quarter	\$3.95	\$2.26

<b>Year Ended September 30, 2016</b>	<b>High</b>	<b>Low</b>
Fourth Quarter	\$5.45	\$3.80
Third Quarter	\$7.75	\$3.65
Second Quarter	\$5.30	\$3.10
First Quarter	\$6.65	\$5.30

We have not declared or paid cash dividends on our common stock and do not plan to pay cash dividends to our common shareholders in the near future. During fiscal 2017 and 2016, we did issue stock dividends to holders of our Series A preferred stock. As of December 12, 2017, our common stock was held of record by approximately 2,100 shareholders. Most of the Company's stock is held in street name through one or more nominees.

**Recent Sales of Unregistered Securities; Use of Proceeds From Registered Securities**

The following summarizes all sales of our unregistered securities during the year ended September 30, 2017 for which more information is disclosed on our Form 8-Ks. 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.

- (1) During the year ended September 30, 2017, the Company granted 28,400 stock options at a weighted average exercise price of \$3.16 per share under its 2016 Stock Option Plan.

The stock option 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. Selected Financial Data.**

Not required.



## **Item 7. 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 and response to cyber security risks, our ability to meet our financial obligations and commitments, our dependence on our management team and key personnel, our ability to hire and retain future key personnel, our ability to maintain an effective system of internal controls, or our ability to respond to government regulations. 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™, enables its customers to maximize the performance of their mission critical websites, intranets, and online stores. Bridgeline’s Unbound (iAPPS®) platform deeply integrates Web Content Management, eCommerce, eMarketing, Social Media management, and Web Analytics to help marketers deliver online experiences that attract, engage and convert their customers across all digital 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. The iAPPSds (“distributed subscription”) product is a platform that empowers franchise and large dealer networks 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 by Bridgeline via cloud-based hosted services model.

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. In 2017, 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.” 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; 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 was 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 reduced 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 were 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 \$.001. Our consolidated financial statements have been retroactively adjusted to reflect the effects of the 1-for-5 reverse stock split.

### *Sales and Marketing*

Bridgeline employs a direct sales force and each sale takes on average 2-6 months to complete. Each franchise/multi-unit organization sale takes on average one year to complete. Our direct sales force focuses its efforts selling to medium-sized and large companies. These companies are generally categorized in the following vertical markets: (i) financial services; (ii) franchises/multi-unit organizations; (iii) retail brand names; (iv) health services and life sciences; (v) technology (software and hardware); (vi) credit unions and regional banks and (vii) associations and foundations. We have five sales geographic locations in the United States.

We have business development professionals dedicated to identifying and establishing strategic alliances for iAPPS and iAPPSds. We have maintained a strategic alliance with UPS Logistics since 2012. Bridgeline and UPS Logistics signed a multi-year agreement to offer B2B and B2C eCommerce web stores with an end-to-end eCommerce offering comprised of Bridgeline's eCommerce Fulfilled™ solution and UPS Logistics and fulfillment services. The combined Bridgeline and UPS Logistics offering provides customers with the ability to manage the eCommerce and supply chain fulfillment needs and was designed to benefit mid-market and larger online web stores who seek end to end solutions.

We continue to pursue significant strategic alliances that will enhance the sales and distribution opportunities of iAPPS related intellectual property.

### *Acquisitions*

Bridgeline will continue to evaluate expanding its distribution of iAPPS and its interactive development capabilities through acquisitions. We may make additional acquisitions in the foreseeable future. These potential acquisitions will be consistent with our iAPPS platform distribution strategy and growth strategy by providing Bridgeline with new geographical distribution opportunities, an expanded customer base, an expanded sales force and an expanded developer force. In addition, integrating acquired companies into our existing operations allows us to consolidate the finance, human resources, legal, marketing, research and development of the acquired businesses with our own internal resources, hence reducing the aggregate of these expenses for the combined businesses and resulting in improved operating results.

### ***Customer Information***

We currently have over 3,000 active customers. For the year ended September 30, 2017, two customers each represented approximately 12% of the Company's total revenue. For the year ended September 30, 2016, one customer represented approximately 10% of the Company's total revenue.

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

Total revenue for the fiscal year ended September 30, 2017 ("fiscal 2017") increased to \$16.3 million from \$15.9 million for the fiscal year ended September 30, 2016 ("fiscal 2016"). Loss from operations for fiscal 2017 was (\$1.4) million compared with loss from operations of (\$3.5) million for fiscal 2016. We had a net loss for fiscal 2017 of (\$1.6) million compared with a net loss of (\$7.8) million for fiscal 2016. In fiscal 2016, we converted \$3.0 million of secured subordinated debt to equity, which resulted in a non-cash inducement charge of \$3.4 million. Loss per share attributable to common shareholders for fiscal 2017 was (\$0.45) compared with loss per share attributable to common shareholders of (\$4.20) for fiscal 2016.

### **Highlights of Fiscal 2017**

Our net loss improved from (\$7.8) million in fiscal 2016 to (\$1.6) million in fiscal 2017.

Total revenue increased 3% in fiscal 2017 compared to fiscal 2016.

Subscription and perpetual license revenue increased 12% to \$6.8 million for fiscal 2017.

Licenses and Managed Hosting comprised 48% of revenue in fiscal 2017 compared to 46% in fiscal 2016.

Cost of revenue decreased \$122 thousand reflecting our commitment to align costs to revenue expectations.

Gross Margin improved to 56% in fiscal 2017 compared to 54% in fiscal 2016.

Operating expenses decreased \$1.6 million also reflecting our cost control initiatives.

RESULTS OF OPERATIONS (dollars in thousands)	Years Ended September 30,		\$ Change	% Change	
	2017	2016			
<b>Revenue</b>					
Digital engagement services					
iAPPS digital engagement services	\$8,498	\$8,520	\$(22 )	(0 )	(%)
% of total revenue	52 %	54 %			
Subscription and perpetual licenses	6,788	6,084	704	12	(%)
% of total revenue	42 %	38 %			
Managed service hosting	1,007	1,291	(284 )	(22 )	(%)
% of total revenue	6 %	8 %			
<b>Total revenue</b>	<b>16,293</b>	<b>15,895</b>	<b>398</b>	<b>3</b>	<b>(%)</b>
<b>Cost of revenue</b>					
Digital engagement services					
iAPPS digital engagement cost	4,911	5,143	(232 )	(5 )	(%)
% of iAPPS digital engagement revenue	58 %	60 %			
Subscription and perpetual licenses	1,969	1,835	134	7	(%)
% of subscription and perpetual licenses revenue	29 %	30 %			
Managed service hosting	280	304	(24 )	(8 )	(%)
% of managed service hosting	28 %	24 %			
Total cost of revenue	7,160	7,282	(122 )	(2 )	(%)
<b>Gross profit</b>	<b>9,133</b>	<b>8,613</b>	<b>520</b>	<b>6</b>	<b>(%)</b>
<b>Gross profit margin</b>	<b>56 %</b>	<b>54 %</b>			
<b>Operating expenses</b>					
Sales and marketing	4,807	4,934	(127 )	(3 )	(%)
% of total revenue	30 %	31 %			
General and administrative	3,256	3,456	(200 )	(6 )	(%)
% of total revenue	20 %	22 %			
Research and development	1,587	1,578	9	1	(%)
% of total revenue	10 %	10 %			
Depreciation and amortization	582	1,309	(727 )	(56 )	(%)
% of total revenue	4 %	8 %			
Restructuring expenses	286	879	(593 )	(67 )	(%)
% of total revenue	2 %	6 %			
<b>Total operating expenses</b>	<b>10,518</b>	<b>12,156</b>	<b>(1,638 )</b>	<b>(13 )</b>	<b>(%)</b>
% of total revenue	65 %	76 %			
Loss from operations	(1,385 )	(3,543 )	2,158	(61 )	(%)
Interest and other expense, net	(201 )	(914 )	713	(78 )	(%)
Loss on inducement of debt (convertible notes)	-	(3,414 )	3,414	100	(%)
Loss before income taxes	(1,586 )	(7,871 )	6,285	(80 )	(%)
Provision (benefit) for income taxes	16	(47 )	63	(134 )	(%)
<b>Net loss</b>	<b>\$(1,602 )</b>	<b>\$(7,824 )</b>	<b>\$6,222</b>	<b>(80 )</b>	<b>(%)</b>

Non-GAAP Measure  
Adjusted EBITDA

**\$122**      **\$(785 )**      **\$907**      **(116 %)**

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## Revenue

Total revenue for the fiscal year ended September 30, 2017 increased \$398 thousand, or 3%, to \$16.3 million from \$15.9 million in fiscal 2016. 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 of iAPPS digital engagement services and other digital engagement services generated from non-iAPPS related engagements. Total revenue from digital engagement services remained constant at \$8.5 million for both fiscal 2017 and fiscal 2016.

Digital engagement services revenue as a percentage of total revenue decreased to 52% in fiscal 2017 from 54% in fiscal 2016. The decreases as a percentage of revenue is due to the increases in license revenues.

### *Subscription and Perpetual Licenses*

Revenue from subscription (SaaS) and perpetual licenses increased \$704 thousand, or 12%, to \$6.8 million in fiscal 2017 from \$6.1 million in fiscal 2016. Subscription and perpetual license revenue as a percentage of total revenue increased to 42% in fiscal 2017 from 38% in fiscal 2016. The increases are attributable to the increase in demand from both iAPPS perpetual licenses and iAPPS SaaS license revenues.

### *Managed Service Hosting*

Revenue from managed service hosting decreased \$284 thousand, or 22%, to \$1.0 million in fiscal 2017 from \$1.3 million in fiscal 2016. The decreases are due to 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.

Managed services revenue as a percentage of total revenue decreased to 6% in fiscal 2017 from 8% in fiscal 2016. The decreases are due to most of our new engagements being subscription based licenses (SaaS) rather than perpetual licenses, for which customers typically purchase hosting.

## **Cost of Revenue**

Total cost of revenue for the fiscal year ended September 30, 2017 decreased \$122 thousand, or 2%, to \$7.2 million from \$7.3 million in fiscal 2016. The gross profit margin improved to 56% for the fiscal year ended September 30, 2017 compared to 54% for the fiscal year ended September 30, 2016. The improvement in the gross profit margin for fiscal 2017 compared to fiscal 2016 is attributable primarily to reductions in facilities and overhead costs.

### *Cost of Digital Engagement Services*

Cost of digital engagement services decreased \$232 thousand, or 5%, to \$4.9 million in fiscal 2017 from \$5.1 million in fiscal 2016. The cost of total digital engagement services as a percentage of total digital engagement services revenue decreased to 58% in fiscal 2017 from 60% in fiscal 2016. The decreases are attributable to aligning labor costs with expected revenues and the focus on reducing our facility and overhead costs.

### *Cost of Subscription and Perpetual License*

Cost of subscription and perpetual licenses increased \$134 thousand, or 7%, to \$2.0 million in fiscal 2017 compared to \$1.8 million in fiscal 2016. The increase is due to the costs incurred 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% in fiscal 2017 from 30% in fiscal 2016. The decrease is due to cessation of amortization costs related to the capitalization of internally developed 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 decreased \$24 thousand, or 8%, in fiscal 2017 to \$280 thousand compared to \$304 thousand in fiscal 2016. The cost of managed services as a percentage of managed services revenue increased to 28% in fiscal 2017 from 24% in fiscal 2016. The decreases are attributable to a decrease in non-iAPPS hosting customers and the corresponding costs to support them.

#### **Gross Profit**

Gross profit increased \$520 thousand, or 6%, in fiscal 2017 to \$9.1 million compared to \$8.6 million in fiscal 2016. The increase is primarily attributable to the increase in iAPPS SaaS licenses revenue, as well as, the result of a number of improvements we have made with our facilities and services organization.

#### **Operating Expenses**

##### *Sales and Marketing Expenses*

Sales and marketing expenses decreased \$127 thousand, or 3%, to \$4.8 million in fiscal 2017 from \$4.9 million in fiscal 2016. The decrease is primarily attributable to decreases in headcount and facility costs and travel related expenditures, partially offset by increases in marketing expenses. Sales and marketing expense as a percentage of total revenue decreased slightly to 30% in fiscal 2017 compared to 31% in fiscal 2016.

##### *General and Administrative Expenses*

General and administrative expenses decreased \$200 thousand, or 6%, to \$3.3 million in fiscal 2017 from \$3.5 million in fiscal 2016. General and administrative expense as a percentage of revenue decreased to 20% in fiscal 2017 compared to 22% in fiscal 2016. The decreases are attributable to decreases in headcount and overall administration expenses.

#### *Research and Development*

Research and development expense remained constant at \$1.6 million for both fiscal 2017 and fiscal 2016. Research and development expense as a percentage of total revenue was 10% for both periods.

#### *Depreciation and Amortization*

Depreciation and amortization expense decreased by \$727 thousand, or 56%, to \$582 thousand in fiscal 2017 from \$1.3 million in fiscal 2016. This decrease is primarily attributable to retirement of fixed assets in relation to a reduction of office space during fiscal 2016 and continuing into 2017, as well as, a reduction in capital expenditure purchases in fiscal 2017. Depreciation and amortization as a percentage of total revenue decreased to 4% in fiscal 2017 from 8% in fiscal 2016.

#### *Goodwill Impairment*

We performed our annual assessment of goodwill for both fiscal 2017 and fiscal 2016 and concluded that there was no impairment loss for either period.

### *Restructuring Expenses*

Commencing in fiscal 2015 and through fiscal 2017, 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.

In total, charges of \$286 thousand and \$879 thousand were recorded to restructuring expenses for fiscal 2017 and fiscal 2016 in the consolidated statement of operations. The charges consist of the total lease expenses less sub-lease rental income, other miscellaneous lease termination costs, loss on disposal of fixed assets, and costs for severance and termination benefits.

### **Loss from Operations**

The loss from operations was (\$1.4) million for fiscal 2017 compared to a loss from operations of (\$3.5) million for fiscal 2016, an improvement of \$2.2 million or 61%.

### *Provision for Income Taxes*

We recorded income tax expense of \$16 thousand for fiscal 2017 compared to a net benefit for income tax expense of \$47 thousand for fiscal 2016. Income tax expense represents the estimated liability for Federal, state and foreign income taxes owed by the Company, including the alternative minimum tax. The Company has net operating loss carryforwards and other deferred tax benefits that are available to offset future taxable income. A valuation allowance is established if it is more likely than not that all or a portion of the deferred tax asset will not be realized. Accordingly, the Company has established a full valuation allowance against its net deferred tax assets at September 30, 2017 and 2016.

The Federal net operating loss (NOL) carryforward of approximately \$27 million as of September 30, 2017 expires on various dates through 2037. Internal Revenue Code Section 382 places a limitation on the amount of taxable income which can be offset by NOL carryforwards after a change in control of a loss corporation. Generally, after a change in control, a loss corporation cannot deduct NOL carryforwards in excess of the Section 382 limitation. Due to these “change of ownership” provisions, utilization of NOL carryforwards may be subject to an annual limitation regarding their utilization against taxable income in future periods. The Company has not performed a Section 382 analysis. However, if performed, Section 382 may be found to limit potential future utilization of our NOL carryforwards.

## **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 inducement of debt charges, stock-based compensation expense, impairment of goodwill and intangible assets, and restructuring charges (“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 provides 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, loss on inducement of debt, amortization of intangibles, depreciation, 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 EBITDA, and EBITDA to Adjusted EBITDA:

	Years Ended	
	September 30,	
	2017	2016
Net loss	\$(1,602)	\$(7,824)
Benefit for income taxes	16	(47 )
Interest expense, net	128	914
Amortization of intangible assets	285	480
Depreciation	256	707
EBITDA	(917 )	(5,770)
Loss on inducement of debt (convertible notes)	-	3,414
Restructuring expenses	286	879
Loss on disposal of fixed assets	94	-
Other amortization	100	372
Stock-based compensation	559	320
Adjusted EBITDA	\$122	\$(785 )

Adjusted EBITDA was \$122 thousand for fiscal 2017 compared with (\$785) thousand for fiscal 2016. This was primarily due to the improvement in revenue growth and gross margin improvement along with our focus on reducing expenses.

## Liquidity and Capital Resources

### *Cash Flows*

#### *Operating Activities*

Cash used in operating activities was \$940 thousand for fiscal 2017 compared to cash used in operating activities of \$2.7 million for fiscal 2016. This improvement was driven by higher accounts receivables collections and the increase in operating income.

*Investing Activities*

Cash used in investing activities was \$93 thousand for fiscal 2017 compared with \$165 thousand for fiscal 2016. The decrease was primarily due to a significant reduction in purchases of capital equipment and software in fiscal 2017 than in fiscal 2016 due to the transition from our Network Operations Center to a cloud-based Amazon Web Services model.



### *Financing Activities*

Cash provided by financing activities was \$1.1 million for fiscal 2017 compared with \$3.2 million for fiscal 2016. In fiscal 2017, we raised a net of \$852 thousand from sales of common stock and had net borrowings on our bank line of credit of \$385 thousand. At September 30, 2017, we had an outstanding balance under our credit line with Heritage Bank of \$2.5 million.

### *Capital Resources and Liquidity Outlook*

On October 10, 2017, the Company entered into a Loan and Security Agreement (the “Loan Agreement”) with Montage Capital II, L.P. (“Montage”). The Loan Agreement has a thirty-six (36) month term which expires on October 10, 2020. The Loan Agreement provides for up to \$1.5 million of borrowing in the form of a non-revolving term loan which may be used by the Company for working capital purposes (the “Loan”). \$1.0 million of borrowing was advanced on the date of closing (the “First Tranche”). An additional \$500 thousand of borrowing will be available at the Company’s option in the event that the Company achieves certain financial milestones and is otherwise in compliance with its loan covenants (the “Second Tranche”). Borrowings bear interest at the rate of 12.75% per annum. The Company paid a fee of \$33 thousand to Montage at closing. Interest only payments are due and payable during the first nine months of the Loan. Commencing on July 1, 2018, the Company shall be obligated to make principal payments of \$26 thousand per month if only the First Tranche has been received and \$39 thousand if the Company has received both the First Tranche and the Second Tranche. All remaining principal and interest shall be due and payable at maturity. Borrowings are secured by a second position lien on all the Company’s assets including intellectual property and general intangibles. Pursuant to the Loan Agreement, the Company is also required to comply with certain financial covenants. The Loan is subordinate to the Company’s senior debt facility with Heritage Bank of Commerce (“Heritage Bank”).

We believe that our existing cash, the proceeds from the Montage loan, cash generated from operations, and our borrowing capacity from the Heritage Bank line of credit will be sufficient and it is probable that we will meet our working capital, capital expenditure and debt repayment needs over the next twelve months from the issuance date of this filing. Our borrowing facility with Heritage Bank 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.

### *Inflation*

Inflationary increases can cause pressure on wages and the cost of benefits offered to employees. We believe that the relatively moderate rates of inflation in recent years have not had a significant impact on our operations.

***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.

***Contractual Obligations***

We lease our facilities in the United States and India. We have no future commitments that extend past fiscal 2020.

The following summarizes our contractual obligations:

(in thousands)	<b>For the Years Ended September 30,</b>			
<b>Payment obligations by year</b>	<b>FY18</b>	<b>FY19</b>	<b>FY20</b>	<b>Total</b>
Line of credit	\$-	\$2,500	\$ -	\$2,500
Operating Leases (a)	452	116	24	592
	\$452	\$2,616	\$ 24	\$3,092

(a) Net of sublease income

### **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”).

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*

The Company enters into arrangements to sell digital engagement services (professional services), software licenses or combinations thereof. Revenue is categorized into (i) digital engagement services; (ii) managed service hosting; and (iii) subscriptions and perpetual licenses.

The Company recognizes 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.

The Company maintains a reseller channel to supplement our direct sales force for our iAPPS platform. Resellers are generally located in territories where the Company does 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 on either a fixed price or time and materials basis. For its 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. For time and materials contracts, revenues are recognized as the services are provided.

Digital engagement services also include retained professional services contracted for on an "on call" basis or for a certain number 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 the Company recognizes 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 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 is 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.

Customers may also 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 either annual or month-to-month arrangements that provide for termination for convenience by either party upon 90 days’ notice. 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. The Company continues to evaluate the length of the amortization period of the set up fees as it gains more experience with customer contract renewals.

### *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 either annual or month-to-month 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 life of the hosting period.

### *Multiple Element Arrangements*

In accounting for multiple element arrangements, the Company follows 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. The Company determines selling price using VSOE, if it exists; otherwise, it uses Third-party Evidence ("TPE"). If neither VSOE nor TPE of selling price exists for a unit of accounting, the Company uses Estimated Selling Price ("ESP").

VSOE is generally limited to the price at which the Company sells 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 the Company cannot establish selling price based on VSOE or TPE then it will use ESP. ESP is derived by considering the selling price for similar services and our ongoing pricing strategies. The selling prices used in allocations of arrangement consideration are analyzed at minimum on an annual basis and more frequently if business necessitates a more timely review. The Company has determined that it has VSOE on its SaaS offerings, certain application development services, managed hosting services, and PCS because it has 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. The Company continues to evaluate the length of the amortization period of the set up fees as it gains 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.

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### *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. We assess goodwill at the consolidated level as one reporting unit. 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. 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 2017 and 2016, the Company performed the annual assessment of goodwill during the fourth quarter of each year 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 fiscal 2016, we performed a quantitative step 1 analysis since a significant impairment was recorded in the prior fiscal year 2015. In estimating fair value, we performed a discounted cash flow analysis on the reporting unit to determine fair value. While there are inherent limitations in any valuation, management believes that using a Discounted Cash Flow Method is the most indicative of the fair value, or the price, that the Company would be sold at in an orderly transaction between market participants. 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 analysis performed, we assessed that goodwill was not impaired.

For fiscal 2017, we used 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 concluded that it was not more likely than not that the fair value of our reporting unit was less than the corresponding carrying amount, and therefore it was not necessary to perform the two-step impairment test. The key qualitative factors that led to our conclusion included the following: (i) access to capital (ii) market acceptance of our products (iii) improvements in financial metrics and (iv) market value of the Company.

Factors that could lead to a future impairment include material uncertainties such as operational, economic and competitive factors specific to the key assumptions underlying the fair value estimate we use in our impairment testing that have reasonable possibility of changing. This could include a significant reduction in projected revenues, a deterioration of projected financial performance, future acquisitions and/or mergers, and a decline in our market value as a result of a significant decline in our stock price.

### ***Accounting for Stock-Based Compensation***

At September 30, 2017, we maintained two stock-based compensation plans, one of which has expired but still contains vested and unvested stock options. The two plans are more fully described in Note 11 of these consolidated financial statements.

The Company accounts for stock-based compensation awards in accordance with the *Compensation-Stock* 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 straight-line 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 7A. Quantitative and Qualitative Disclosures About Market Risk.**

Not required.

**Item 8. Financial Statements and Supplementary Data.**

***Report of Independent Registered Public Accounting Firm***

To the Audit Committee of the  
Board of Directors and Shareholders of  
Bridgeline Digital, Inc.  
Burlington, MA

We have audited the accompanying consolidated balance sheets of Bridgeline Digital, Inc., and subsidiary (the “Company”) as of September 30, 2017 and 2016, and the related consolidated statements of operations, comprehensive loss, stockholders’ equity, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Bridgeline Digital, Inc. as of September 30, 2017 and 2016, and the consolidated results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

/s/ Marcum LLP

Marcum LLP

December 21, 2017

Boston, Massachusetts

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**BRIDGELINE DIGITAL, INC.****CONSOLIDATED BALANCE SHEETS**

(in thousands, except share and per data)

	<b>As of September 30,</b>	
	<b>2017</b>	<b>2016</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$748	\$661
Accounts receivable and unbilled receivables, net	3,026	2,549
Prepaid expenses and other current assets	352	381
Total current assets	4,126	3,591
Property and equipment, net	209	512
Intangible assets, net	263	548
Goodwill	12,641	12,641
Other assets	334	436
Total assets	\$17,573	\$17,728
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$1,241	\$1,285
Accrued liabilities	920	946
Accrued earnouts, current	-	75
Capital lease obligations	-	45
Deferred revenue	1,466	1,360
Total current liabilities	3,627	3,711
Debt	2,500	2,115
Other long term liabilities	172	400
Total liabilities	6,299	6,226
Commitments and contingencies		
Stockholders' equity:		
Preferred stock - \$0.001 par value; 1,000,000 shares authorized; 243,536 at September 30, 2017 and 221,092 at September 30, 2016, issued and outstanding (liquidation preference \$2,509 at September 30, 2017)	-	-
Common stock - \$0.001 par value; 50,000,000 shares authorized; 4,200,219 at September 30, 2017 and 3,725,863 at September 30, 2016, issued and outstanding	4	4
Additional paid-in capital	65,869	64,217
Accumulated deficit	(54,249)	(52,366)

Accumulated other comprehensive loss	(350 )	(353 )
Total stockholders' equity	11,274	11,502
Total liabilities and stockholders' equity	\$17,573	\$17,728

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

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

(in thousands, except share and per share data)

	<b>Years Ended</b>	
	<b>September 30,</b>	
	<b>2017</b>	<b>2016</b>
Net revenue:		
Digital engagement services	\$8,498	\$8,520
Subscription and perpetual licenses	6,788	6,084
Managed service hosting	1,007	1,291
Total net revenue	16,293	15,895
Cost of revenue:		
Digital engagement services	4,911	5,143
Subscription and perpetual licenses	1,969	1,835
Managed service hosting	280	304
Total cost of revenue	7,160	7,282
Gross profit	9,133	8,613
Operating expenses:		
Sales and marketing	4,807	4,934
General and administrative	3,256	3,456
Research and development	1,587	1,578
Depreciation and amortization	582	1,309
Restructuring expenses	286	879
Total operating expenses	10,518	12,156
Loss from operations	(1,385 )	(3,543 )
Interest and other expense, net	(201 )	(914 )
Loss on inducement of debt (convertible notes)	-	(3,414 )
Loss before income taxes	(1,586 )	(7,871 )
Provision(benefit) for income taxes	16	(47 )
Net loss	(1,602 )	(7,824 )
Dividends on convertible preferred stock	(281 )	(131 )
Net loss applicable to common shareholders	\$(1,883 )	\$(7,955 )
Net loss per share attributable to common shareholders:		
Basic and diluted	\$(0.45 )	\$(4.20 )
Number of weighted average shares outstanding:		
Basic and diluted	4,147,140	1,893,003

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



**BRIDGELINE DIGITAL, INC.**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS**

(in thousands)

	<b>Years Ended</b>	
	<b>September 30,</b>	
	<b>2017</b>	<b>2016</b>
Net Loss	\$(1,602)	\$(7,824)
Other Comprehensive Loss: Net change in foreign currency translation adjustment	3	3
Comprehensive loss	\$(1,599)	\$(7,821)

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

**BRIDGELINE DIGITAL, INC.****CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**

(in thousands)

	Preferred Stock		Common Stock		Additional Paid in Capital	Accumulated Deficit	Accumulated Other Comprehensive Loss		Total Stockholders' Equity
	Shares	Amount	Shares	Amount			Loss	Loss	
Balance at September 30, 2015	208	\$ -	920	\$ 1	\$ 50,438	\$ (44,411 )	\$ (356 )	\$ 5,672	
Issuance of common stock			1,109	1	3,714			3,715	
Conversion of term notes from shareholders, including accrued interest of \$204			868	1	3,203			3,204	
Conversion of 10% secured subordinated notes			800	1	2,999			3,000	
Inducement of debt (convertible notes)					3,414			3,414	
Stock-based compensation expense					214			214	
Issuance of common stock - contingent shares			5		-			-	
Issuance of common stock - restricted shares			24		106			106	
Stock dividends - issued	13				129	(98 )		31	
Stock dividends - declared						(33 )		(33 )	
Net loss						(7,824 )		(7,824 )	
Foreign currency translation							3	3	
Balance at September 30, 2016	221	\$ -	3,727	\$ 4	\$ 64,217	\$ (52,366 )	\$ (353 )	\$ 11,502	
Issuance of common stock			429	-	860			860	
Stock-based compensation expense					418			418	
Issuance of common stock - contingent shares			1		-			-	
Issuance of common stock - restricted shares			43		133			133	
Stock dividends - issued	24				241	(207 )		34	
Stock dividends - declared						(74 )		(74 )	
Preferred stock conversion to common	(1 )		1					-	
Net loss						(1,602 )		(1,602 )	
Foreign currency translation							3	3	
Balance at September 30, 2017	244	\$ -	4,201	\$ 4	\$ 65,869	\$ (54,249 )	\$ (350 )	\$ 11,274	

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

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

(in thousands)

	<b>Years Ended</b>	
	<b>September 30,</b>	
	<b>2017</b>	<b>2016</b>
Cash flows used in operating activities:		
Net loss	\$(1,602)	\$(7,824)
Adjustments to reconcile net loss to net cash used in operating activities:		
Loss on disposal of property and equipment	94	67
Amortization of intangible assets	285	480
Depreciation	256	707
Other amortization	100	530
Capitalized interest expense	-	204
Loss on inducement of convertible notes	-	3,414
Stock-based compensation	559	320
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable and unbilled receivables	(477 )	(86 )
Prepaid expenses and other assets	77	356
Accounts payable and accrued liabilities	(163 )	(425 )
Deferred revenue	106	(182 )
Other liabilities	(175 )	(243 )
Total adjustments	662	5,142
Net cash used in operating activities	(940 )	(2,682)
Cash flows used in investing activities:		
Purchase of equipment and improvements	(47 )	(23 )
Software development capitalization costs	(46 )	(142 )
Net cash used in investing activities	(93 )	(165 )
Cash flows provided by financing activities:		
Proceeds from issuance of common stock, net of issuance costs	852	3,715
Proceeds from bank term loan	-	500
Proceeds from term notes from stockholder	-	1,000
Borrowings on bank line of credit	2,177	383
Payments on bank term loan	-	(750 )
Payments on bank line of credit	(1,792)	(963 )
Contingent acquisition payments	(75 )	(393 )
Principal payments on capital leases	(45 )	(324 )
Net cash provided by financing activities	1,117	3,168
Effect of exchange rate changes on cash and cash equivalents	3	3
Net increase in cash and cash equivalents	87	324
Cash and cash equivalents at beginning of year	661	337
Cash and cash equivalents at end of year	\$748	\$661
Supplemental disclosures of cash flow information:		



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Cash paid for:

Interest	\$ 128	\$ 469
Income taxes	\$ 18	\$ 17
Non cash investing and financing activities:		
Conversion of 10% secured subordinated convertible notes (principal)	\$ -	\$ 3,000
Conversion of term notes to shareholders (principal)	\$ -	\$ 3,000
Stock dividends on convertible preferred stock	\$ 281	\$ 131

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

**BRIDGELINE DIGITAL, INC.**

**NOTES TO 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 with their digital experience from websites and intranets to online stores. Bridgeline's iAPPS® platform integrates Web Content Management, eCommerce, eMarketing, Social Media management, and Web Analytics to deliver digital experiences to its customers. iAPPSds is a platform for large franchise and multi-unit organizations and also integrates Web Content Management, eCommerce, eMarketing, Social Media management, and Web Analytics.

The iAPPS platform is delivered through a cloud-based SaaS (“Software as a Service”) multi-tenant business model, 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.

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; 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 was 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 reduced 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 were 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 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 operations, 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.

**BRIDGELINE DIGITAL, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

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 September 30, 2017, the Company had an outstanding balance under the Heritage Agreement of \$2.5 million.

On October 10, 2017, the Company entered into a Loan and Security Agreement (the “Loan Agreement”) with Montage Capital II, L.P. (“Montage”). The Loan Agreement has a thirty-six (36) month term which expires on October 10, 2020. The Loan Agreement provides for up to \$1.5 million of borrowing in the form of a non-revolving term loan which may be used by the Company for working capital purposes (the “Loan”). \$1 million of borrowing was advanced on the date of closing (the “First Tranche”). An additional \$500 thousand of borrowing will be available at the Company’s option in the event that the Company achieves certain financial milestones and is otherwise in compliance with its loan covenants (the “Second Tranche”).

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. There have been no securities sold as of September 30, 2017.

The Company has made significant cost reductions over the past two years and the current fiscal year revenues have increased in comparison to the previous fiscal years. While there can be no assurances that the anticipated sales will be achieved for future periods, 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 it is probable that we will meet our working capital, capital expenditure and debt repayment needs for the next twelve months from the financial statement date of issuance. In addition, the ability to raise funds through its credit line with Heritage Bank, the funds received from Montage, 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.

## 2. Summary of Significant Accounting Policies

### *Basis of Presentation and Principles of Consolidation*

The Company's fiscal year end is September 30. The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary. All significant inter-company accounts and transactions have been eliminated in consolidation.

### *Use of Estimates*

The preparation of financial statements in conformity with US GAAP requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reported periods. The most significant estimates included in these 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. Actual results could differ from these estimates under different assumptions or conditions.

**BRIDGELINE DIGITAL, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

The complexity of the estimation process and factors relating to assumptions, risks and uncertainties inherent with the use of the proportional performance model affect the amount of revenue and related expenses reported in the Company's financial statements. Internal and external factors can affect the Company's estimates.

*Cash and Cash Equivalents*

The Company considers all highly liquid instruments with original maturity of three months or less from the date of purchase to be cash equivalents.

*Concentration of Credit Risk, Significant Customers, and Off-Balance Sheet Risk*

Financial instruments, which potentially expose the Company to concentrations of credit risk consist primarily of cash, cash equivalents, and accounts receivable. The Company's cash is maintained with what management believes to be a high-credit quality financial institution. At times, deposits held at this bank may exceed the federally insured limits. Management believes that the financial institutions that hold the Company's deposits are financially sound and have minimal credit risk. Risks associated with cash and cash equivalents are mitigated by the Company's investment policy, which limits the Company's investing of excess cash into only money market mutual funds.

The Company extends credit to customers on an unsecured basis in the normal course of business. Management performs ongoing credit evaluations of its customers' financial condition and limits the amount of credit when deemed necessary. Accounts receivable are carried at original invoice less an estimate for doubtful accounts based on a review of all outstanding amounts. The Company had two customers that contributed approximately 12% of revenue for fiscal 2017 and one customer that contributed approximately 10% of revenue in fiscal 2016. The Company had two customers that had an accounts receivable balance of greater than 10% of total accounts receivable at September 30, 2017 and 2016.

The Company has no significant off-balance sheets risks such as foreign exchange contracts, interest rate swaps, option contracts or other foreign hedging agreements.

*Allowance for Doubtful Accounts*

The Company maintains allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. For all customers, the Company recognizes allowances for doubtful accounts based on the length of time that the receivables are past due, current business environment and its historical experience. If the financial condition of the Company's customers were to deteriorate, resulting in impairment of their ability to make payments, additional allowances may be required.

*Revenue Recognition*

*Overview*

The Company enters 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.

The Company recognizes 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.

**BRIDGELINE DIGITAL, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

The Company maintains a reseller channel to supplement our direct sales force for our iAPPS platform. Resellers are generally located in territories where the Company does not have a direct sales force. Customers generally sign a license agreement directly with the Company. 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 on either a fixed price or time and materials basis. For its 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. For time and materials contracts, revenues are recognized as the services are provided.

Digital engagement services also include retained professional services contracted for on an "on call" 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 the Company recognizes 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.



*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 the Company's applications independently. Hosting agreements are either annual or month-to-month 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 life of the hosting period.

*Subscriptions and Perpetual Licenses*

The Company licenses its software on either a perpetual or subscription basis. 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.

**BRIDGELINE DIGITAL, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

Customers may also 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 either annual or month-to-month arrangements that provide for termination for convenience by either party upon 90 days’ notice. 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. The Company continues to evaluate the length of the amortization period of the set up fees as the Company gains 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 accordance with *Revenue Recognition: Multiple Deliverable Revenue Arrangement.*, 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 the Company’s 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 the Company's allocations of arrangement consideration are analyzed at minimum on an annual basis and more frequently if our business necessitates a more timely review. The Company has determined that the Company has 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. 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 method. 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.

**BRIDGELINE DIGITAL, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

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. The Company continues 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 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 concerns over delivered services, the Company has endeavored to remedy the concern and all costs related to such matters have been insignificant in all periods presented. 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.

**BRIDGELINE DIGITAL, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

*Warranty*

Certain arrangements include a warranty period, which is generally 30 days from the completion of work. In hosting arrangements, the Company provides warranties of up-time reliability. The Company continues to monitor the conditions that are subject to the warranties to identify if a warranty claim may arise. If it is determined 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.

*Property and Equipment*

The components of property and equipment are stated at cost, net of accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the related assets (three to five years). Leasehold improvements are amortized using the straight-line method over the lesser of the estimated useful life of the asset or the lease term. Repairs and maintenance costs are expensed as incurred.

*Internal Use Software*

Costs incurred in the preliminary stages of development are expensed as incurred. Once an application has reached the development stage, internal and external costs, if direct and incremental, are capitalized until the software is substantially complete and ready for its intended use. Capitalization ceases upon completion of all substantial testing. The Company also capitalizes costs related to specific upgrades and enhancements when it is probable that

the expenditures will result in additional functionality. Capitalized costs are recorded as part of equipment and improvements. Training costs are expensed as incurred. Internal use software is amortized on a straight-line basis over its estimated useful life, generally three years.

*Research and Development and Software Development Costs*

Costs for research and development of a software product to sell, lease or otherwise market are charged to operations as incurred until technological feasibility has been established. Once technological feasibility has been established, certain software development costs incurred during the application development stage are eligible for capitalization. Based on the Company's software product development process, technological feasibility is established upon completion of a working model.

Software development costs that are capitalized are amortized to cost of sales over the estimated useful life of the software, typically three years. Capitalization ceases when a product is available for general release to customers. Capitalization costs are included in other assets in the consolidated financial statements. The Company capitalized \$46 and \$142 of costs in fiscal 2017 and fiscal 2016, respectively.

*Intangible Assets*

All intangible assets have finite lives and are stated at cost, net of amortization. Amortization is computed over the estimated useful life of the related assets on a straight-line method as follows:

<b>Description</b>	<b>Estimated Useful Life</b>
	<b>(in years)</b>
Developed and core technology	3
Non-compete agreements	3 - 6
Customer relationships	5 - 6
Trademarks and trade names	1 - 10

**BRIDGELINE DIGITAL, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

*Goodwill*

Goodwill represents the excess of the purchase price over the fair value of identifiable net assets of the business acquired. 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. Goodwill is assessed at the consolidated level as one reporting unit. 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. 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, the relevant events and circumstances that may impact the fair value and the carrying amount of a reporting unit are assessed. 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 the company, 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 2017 and 2016, the Company performed the annual assessment of goodwill during the fourth quarter of each year 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 fiscal 2016, the Company performed a quantitative step 1 analysis since a significant impairment was recorded in the prior fiscal year 2015. In estimating fair value, the Company performed a discounted cash flow analysis on the reporting unit to determine fair value. While there are inherent limitations in any valuation, the Company believes that using a Discounted Cash Flow Method is the most indicative of the fair value, or the price, that the Company would be sold at in an orderly transaction between market participants. The Company believes the most significant change in circumstances that could affect the key assumptions in its valuation are a significant reduction in the observed revenue multiples implied by future mergers and acquisitions and/or a significant deterioration of the Company's projected financial performance. 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 analysis performed, the Company assessed that goodwill was not impaired.

For fiscal 2017, the Company used 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. The Company concluded that it was not more likely than not that the fair value of our reporting unit was less



than the corresponding carrying amount, and therefore it was not necessary to perform the two-step impairment test. The key qualitative factors that led to the conclusion included the following: (i) access to capital (ii) market acceptance of products (iii) improvements in financial metrics and (iv) market value of the Company.

**BRIDGELINE DIGITAL, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

*Valuation of Long-Lived Assets*

The Company periodically reviews its long-lived assets, which consist primarily of property and equipment and intangible assets with finite lives, for impairment whenever events or changes in circumstances indicate the carrying amount of such assets may exceed their fair value. Recoverability of these assets is assessed using a number of factors including operating results, business plans, budgets, economic projections and undiscounted cash flows.

In addition, the Company's evaluation considers non-financial data such as market trends, product development cycles and changes in management's market emphasis. For the definite-lived intangible asset impairment review, the carrying value of the intangible assets is compared against the estimated undiscounted cash flows to be generated over the remaining life of the intangible assets. To the extent that the undiscounted future cash flows are less than the carrying value, the fair value of the asset is determined and impairment is recognized. If such fair value is less than the current carrying value, the asset is written down to the estimated fair value. There were no impairments in fiscal 2017 or 2016.

*Deferred Revenue*

Deferred revenue includes PCS and services billed in advance. PCS revenue, whether sold separately or as part of a multiple element arrangement, is deferred and recognized ratably over the term of the maintenance contract, generally 12 months. Payments made for PCS fees are generally made in advance and are nonrefundable. Revenue from consulting and training services is recognized as the related services are performed, using a proportional performance model.

*Fair Value of Financial Instruments*

The Company's financial instruments consist principally of cash and cash equivalents, accounts receivable, accounts payable, and debt. Estimated fair values of amounts reported in the consolidated financial statements have been determined using available market information and valuation methodologies, as applicable. Fair value is defined as the

exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The Company believes the recorded values for accounts receivable and accounts payable approximate current fair values as of September 30, 2017 and September 30, 2016 because of their nature and durations. The carrying value of debt instruments also approximates fair value as of September 30, 2017 and September 30, 2016 based on acceptable valuation methodologies which use market data of similar size and situated debt issues.

#### *Fair Value Measurements*

For fair value measurements, the Company defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The use of market-based information over entity specific information is also prioritized and establishes a three-level hierarchy for fair value measurements based on the nature of inputs used in the valuation of an asset or liability as of the measurement date.

The hierarchy established under the Codification gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3).

Level 1 – Quoted prices in active markets for identical assets or liabilities;

Level 2 – Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities; and

Level 3 – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

**BRIDGELINE DIGITAL, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

*Foreign Currency*

The Company determines the appropriate method of measuring assets and liabilities as to whether the method should be based on the functional currency of the entity in the environment it operates or the reporting currency of the Company, the U.S. dollar. The Company has determined that the functional currency of its Indian subsidiary is the Rupee. Assets and liabilities are translated into U.S. dollars at exchange rates in effect at the balance sheet date. Equity accounts are translated at historical rates, except for the change in retained earnings during the results of the income statement translation process. Revenue and expense items are translated into U.S. dollars at average exchange rates for the period. The adjustments are recorded as a separate component of stockholders' equity and are included in accumulated other comprehensive income (loss). The Company's foreign currency translation net gains for fiscal 2017 and 2016 were \$3 for both periods. Translation gains and losses related to monetary assets and liabilities denominated in a currency different from a subsidiary's functional currency are included in the consolidated statements of operations.

*Segment Information*

The Company has sales offices in the United States that operate internally as one reportable operating segment because all of these locations have similar economic characteristics.

*Stock-Based Compensation*

The Company accounts for stock-based compensation in the consolidated statements of operations based on their fair values of the awards on the date of grant on a straight-line basis over their vesting term. Compensation expense is recognized only for share-based payments expected to vest. The Company estimates forfeitures at the date of grant based on the Company's historical experience and future expectations.

*Valuation of Stock Options and Warrants Issued to Non-Employees*

The Company measures expense for non-employee stock-based compensation and the estimated fair value of options exchanged in business combinations and warrants issued for services using the fair value method for services received or the equity instruments issued, whichever is more readily measured. The Company estimated the fair value of stock options issued to non-employees using the Black-Scholes Merton option valuation model.

The Company estimated the fair value of common stock warrants issued to non-employees using the binomial options pricing model. The Company evaluates common stock warrants as they are issued to determine whether they should be classified as an equity instrument or a liability. Those warrants that are classified as a liability are carried at fair value at each reporting date, with changes in their fair value recorded in other income (expense) in the consolidated statements of operation.

#### *Advertising Costs*

Advertising costs are expensed when incurred. Such costs were \$528 and \$621 for fiscal 2017 and 2016, respectively.

#### *Employee Benefits*

The Company sponsors a contributory 401(k) plan allowing all full-time employees who meet prescribed service requirements to participate. The Company is not required to make matching contributions, although the plan provides for discretionary contributions by the Company. The Company made no contributions in either fiscal 2017 or fiscal 2016.

**BRIDGELINE DIGITAL, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

*Income Taxes*

The Company recognizes deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the Company's financial statements and tax returns. Deferred income taxes are recognized based on temporary differences between the financial statement and tax basis of assets and liabilities using enacted tax rates in effect for the year in which the temporary differences are expected to reverse. Valuation allowances are provided if based upon the weight of available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized.

The Company provides for reserves for potential payments of taxes to various tax authorities related to uncertain tax positions. Reserves are based on a determination of whether and how much of a tax benefit taken by the Company in its tax filings or positions is "more likely than not" to be realized following resolution of any uncertainty related to the tax benefit, assuming that the matter in question will be raised by the tax authorities. Interest and penalties associated with uncertain tax positions are included in the provision for income taxes.

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

*Net Loss Per Share*

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 using the "treasury stock" method and convertible preferred stock using the as-if-converted method. The computation of diluted earnings per share does not include the effect of outstanding stock options, warrants and convertible preferred stock that are considered anti-dilutive.

For fiscal 2017 and 2016, all outstanding options to purchase shares of the Company's common stock totaling 450,646 and 448,586 respectively, were considered as anti-dilutive, as the options were all valued more than the current market price. Common stock warrants of 539,593 and 328,752 for fiscal 2017 and fiscal 2016 were also excluded due to their anti-dilutive nature. Also, excluded were contingent shares issuable related to an acquisition earnout in fiscal 2016.

#### *Recent Accounting Pronouncements*

#### *Revenue Recognition*

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 CONSOLIDATED FINANCIAL STATEMENTS**

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

*Income Taxes*

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.

*Leases*

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.

*Stock Compensation*

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.

*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.

**BRIDGELINE DIGITAL, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

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.

*Goodwill*

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.

*Business Combinations*

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.

**3. Accounts Receivable and Unbilled Receivables**

Accounts receivable and unbilled receivables consists of the following:

	<b>As of</b>	
	<b>September 30,</b>	
	<b>2017</b>	<b>2016</b>
Accounts receivable	\$3,174	\$2,627
Unbilled receivables	41	60
Subtotal	3,215	2,687
Allowance for doubtful accounts	(189 )	(138 )
Accounts receivable and unbilled receivables, net	\$3,026	\$2,549

**BRIDGELINE DIGITAL, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**4. Property and equipment**

Property and equipment consists of the following:

	<b>As of</b>	
	<b>September 30,</b>	
	<b>2017</b>	<b>2016</b>
Furniture and fixtures	\$212	\$713
Purchased software	14	1,043
Computers and equipment	46	4,080
Leasehold improvements	872	1,223
Total cost	1,144	7,059
Less accumulated depreciation	(935 )	(6,547)
Property and equipment, net	\$209	\$512

Depreciation and amortization on the above assets was \$256 and \$707 in fiscal 2017 and 2016, respectively. During fiscal 2017, the Company disposed of property and equipment totaling \$5.9 million related to the downsizing of offices, the majority of which was fully depreciated. During fiscal 2016, the Company disposed of property and equipment totaling \$1.1 million in fiscal 2016, also mostly fully depreciated and of which \$67 was included in Restructuring Expenses in the Statement of Operations.

**5. 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 September 30, 2017 and 2016 because of their short-term nature and durations. The carrying value of debt instruments also approximates fair value as of September 30, 2017 and 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 September 30, 2017.

Assets and liabilities of the Company measured at fair value on a recurring basis as of September 30, 2016 are as follows:

	<b>As of September 30, 2016</b>			
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
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. The following table provides a roll forward of the fair value, as determined by Level 3 inputs, of the contingent consideration.

**BRIDGELINE DIGITAL, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

The following table summarizes the changes in contingent consideration for the fiscal year ended September 30, 2017 and 2016.

	<b>Years Ended September 30, 2017 2016</b>	
Balance at beginning of period	\$75	\$468
Payments	(75)	(393)
Balance at end of period	\$-	\$75

**6. Intangible Assets**

Intangible assets are comprised as follows:

	<b>As of September 30, 2017 2016</b>	
Domain and trade names	\$10	\$10
Customer related	179	392
Non-compete agreements	74	146
Balance at end of period	\$263	\$548

Total amortization expense of \$285 and \$480 related to intangible assets for the years ended September 30, 2017 and 2016, respectively, is reflected in the consolidated statements of operations in depreciation and amortization. The estimated amortization expense for fiscal years 2018, 2019, and 2020 is: \$242, \$11, and \$10, respectively.

**7. Accrued Liabilities**

Accrued liabilities consist of the following:

	<b>As of</b>	
	<b>September</b>	
	<b>30,</b>	
	<b>2017</b>	<b>2016</b>
Accrued taxes	41	44
Compensation and benefits	244	194
Deferred rent (1)	154	141
Professional fees	161	133
Restructuring expenses	119	331
Other	201	103
Total	\$920	\$946

(1) The deferred rent liability is being amortized as a reduction of rent expense over the lives of the leases. As of September 30, 2017, \$154 is reflected in Accrued Liabilities and \$43 is reflected in Other Long Term Liabilities on the Consolidated Balance Sheet as deferred rent liabilities. As of September 30, 2016, \$141 is reflected in Accrued Liabilities and \$197 is reflected in Other Long Term Liabilities on the Consolidated Balance Sheet as deferred rent liabilities.

**BRIDGELINE DIGITAL, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**8. Debt**

The Company's debt as of September 30, 2017 and 2016 consisted of the Line of Credit from Heritage Bank of Commerce. All other debt instruments and bank lines of credit were satisfied in full.

*Heritage 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 ("Heritage Agreement" or "Loan Agreement") with Heritage Bank of Commerce ("Heritage"). The Heritage Agreement had an original term of 24 months but was amended in 2017 to a maturity date of June 9, 2019. The Company paid an annual commitment fee of 0.4% of the commitment amount in the first year and 0.2% in the second year. The facility fee will be \$6 on each anniversary thereafter. Borrowings are secured by all of the Company's assets and all of the Company's intellectual property. The Company is required to comply with certain financial and reporting covenants including an Asset Coverage Ratio and an Adjusted EBITDA metric. The Company was in compliance with all financial covenants as of September 30, 2017.

The Heritage Agreement 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 6%). As of September 30, 2017 and 2016, the Company had an outstanding balance under the Loan Agreement of \$2.5 million and \$2.1 million, respectively.



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 \$1.5 million in connection with the out of formula borrowings. 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.

**BRIDGELINE DIGITAL, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

*Amendments – Heritage Bank*

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, the Adjusted EBITDA metric for the quarter ended September 30, 2016, and 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 its accounts at Heritage and the Adjusted EBITDA metrics for the first half of fiscal 2017.

On August 10, 2017, the third Amendment was executed (“Third Amendment”). The Third Amendment extended the maturity date of the loan to June 9, 2019.

On October 6, 2017, a fourth amendment to the Heritage Agreement (“Fourth Amendment”) was executed. The Fourth Amendment included a consent to the Company’s incurrence of additional indebtedness from Montage Capital (“Montage”) and the grant of a second position lien to Montage (See Subsequent Events). In addition, Heritage and Montage entered into an Intercreditor Agreement dated October 10, 2017, and acknowledged by the Company.

On November 27, 2017, a fifth amendment to the Heritage Agreement (“Fifth Amendment”) was executed. The Fifth Amendment included the Adjusted EBITDA metrics for the second half of fiscal 2017 and the first six months of fiscal 2018. Thereafter, the Company and Heritage shall mutually agree upon minimum quarterly Adjusted EBITDA amounts for each fiscal year within thirty days following the beginning of each fiscal year.

*Western Alliance (formerly Bridgebank, N.A)*

Prior to entering into the Heritage Agreement in June 2016, the Company had a loan agreement with Bridgebank, N.A (“Bridgebank Agreement”). The Bridgebank Agreement provided for up to \$5 million of revolving credit advances which could be used for acquisitions and working capital purposes. Borrowings were limited to the lesser of (i) \$5 million and (ii) 80% of eligible receivables as defined. The Company could borrow up to \$1.0 million in out of formula borrowings for specified periods of time. Borrowings accrued interest at BridgeBank’s prime plus 1.00% plus 5.00% (8.25%). The Company paid an annual commitment fee of 0.25%. Borrowings were secured by all of the Company’s assets and all of the Company’s intellectual property. The Company was also required to comply with certain financial and reporting covenants including an Asset Coverage Ratio. The Bridgebank Agreement also included an unconditional guarantee from one of the Company’s Directors, Michael Taglich (the “Guaranty”) and promise to pay the BridgeBank all indebtedness in an amount not to exceed \$2 million in connection with the out of formula borrowings.

*Term Notes from Shareholders*

The Company issued term notes to certain officers and directors of the Company. Term notes totaling \$2.45 million were issued to Michael Taglich from the period of January 7, 2015 through February 2016. Term notes totaling \$450 were issued to Robert Taglich on December 3, 2015 and February 2016. Michael Taglich is both a shareholders and director of the Company. Robert Taglich is a shareholder and was a director of the Company from May 2016 to June 29, 2017. In February 2016, Bridgeline issued a term note to Roger Kahn in the amount of \$100. Roger Kahn is the Company’s President and Chief Executive Officer.

In April 2016, the shareholders of the Company approved the proposal for the issuance of up to 940,000 shares of the Company’s common stock upon conversion of the above outstanding term notes totaling \$3 million. In May 2016, each of the holders of the outstanding term notes converted all outstanding principal and accrued but unpaid interest due under such outstanding term notes into shares of common stock of the Company at a conversion price of \$3.75 per share. In connection with the conversion, a total of 867,765 shares of common stock was issued. Michael Taglich received 715,209 shares of common stock, Robert Taglich received 125,320 shares of common stock and Roger Kahn received 27,236 shares of common stock. The Taglich Brothers, Inc acted as the Placement Agent for the conversion of these notes and were granted warrants to purchase 86,778 shares of common stock at a price of \$3.75 per share.

**BRIDGELINE DIGITAL, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

*Subordinated Convertible Debt*

In April 2016, the shareholders of the Company approved a proposal for issuance of up to 800,000 shares of the Company's Common Stock upon conversion of the outstanding \$3.0 million of secured subordinated convertible notes (the "Convertible Notes"). The conversion price to \$3.75 per share was provided as an incentive to the holders of such Convertible Notes to convert the outstanding principal into shares of Common Stock. As of September 30, 2016, all of the shares converted and a total of 800,000 shares of common stock was issued. Due to the reduction in the conversion price from \$32.50 per share to \$3.75 per share, the Company recorded an inducement charge of \$3.4 million in fiscal 2016. The charge was recorded as a non-operating expense in the Consolidated Income Statement with a corresponding credit to additional paid in capital.

*Minimum Debt Obligations*

As of September 30, 2017, the Company had minimum debt obligations of \$2.5 million related to the Heritage Bank line of credit, which has a maturity date of June 9, 2019.

**9. Restructuring Charges**

Commencing in fiscal 2015 and through fiscal 2017, 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.

In total, a charge of \$286 and \$879 was recorded to restructuring expenses for fiscal 2017 and fiscal 2016 in the consolidated statement of operations for the total lease expenses less sub-lease rental income, other miscellaneous lease termination costs, loss on disposal of fixed assets, and costs for severance and termination benefits.

**BRIDGELINE DIGITAL, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

The following table summarizes the restructuring charges reserve activity:

	<b>Employee Severance and Benefits</b>	<b>Facility and Other Costs</b>	<b>Total</b>
Balance at end of period, September 30, 2015	\$ -	\$ 307	\$307
Charges to operations	505	158	663
Cash disbursements	(311 )	(223 )	(534)
Changes in estimates	(1 )	5	4
Balance at end of period, September 30, 2016	\$ 193	\$ 247	\$440
Charges to operations	-	241	241
Cash disbursements	(203 )	(347 )	(550)
Changes in estimates	-	33	33
Accretion Expense	10	2	12
Balance at end of period, September 30, 2017	\$ -	\$ 176	\$176

As of September 30, 2017, \$119 is reflected in Accrued Liabilities and \$57 is reflected in Other long term liabilities.  
As of September 30, 2016, \$331 is reflected in Accrued Liabilities and \$109 is reflected in Other long term liabilities.

Accrued restructuring liabilities is comprised of the following:

**As of  
September  
30,  
2017 2016**

Facilities and related	\$ 133	\$ 195
Employee related	-	193
Other	43	52
Total	\$ 176	\$ 440

## 10. Commitments and Contingencies

### *Operating Lease Commitments*

The Company leases facilities in the United States and India. Future minimum rental commitments under non-cancelable operating leases with initial or remaining terms in excess of one year at September 30, 2017 were as follows:

<b><u>Years Ending September 30,</u></b>	<b>Gross Amount</b>	<b>Sublease</b>	
		<b>Income</b>	<b>Net</b>
		<b>Amount</b>	
2018	\$ 611	\$ (159 )	\$ 452
2019	242	(126 )	116
2020	97	(73 )	24
Total	\$ 950	\$ (358 )	\$ 592

The Company has no lease commitments that extend past fiscal 2020. Rent expense for fiscal 2017 and 2016 was \$686 and \$976, respectively, inclusive of sublease income \$45 for fiscal 2017.

**BRIDGELINE DIGITAL, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

*Capital Lease Obligations*

	<b>As of</b>	
	<b>September</b>	
	<b>30,</b>	
	<b>2017</b>	<b>2016</b>
Capital Lease Obligations	\$ -	\$ 45
Less: Current portion	-	(45 )
Capital Lease obligations	\$ -	\$ -

As of September 30, 2017, the Company has no further lease payments due under capitalized leases.

*Other Commitments, Guarantees, and Indemnification Obligations*

The Company frequently warrants that the technology solutions it develops for its clients will operate in accordance with the project specifications without defects for a specified warranty period, subject to certain limitations that the Company believes are standard in the industry. In the event that defects are discovered during the warranty period, and none of the limitations apply, the Company is obligated to remedy the defects until the solution that the Company provided operates within the project specifications. The Company is not typically obligated by contract to provide its clients with any refunds of the fees they have paid, although a small number of its contracts provide for the payment of liquidated damages upon default. The Company has purchased insurance policies covering professional errors and omissions, property damage and general liability that reduce its monetary exposure for warranty-related claims and enable it to recover a portion of any future amounts paid.

The Company's contracts typically provide for testing and client acceptance procedures that are designed to mitigate the likelihood of warranty-related claims, although there can be no assurance that such procedures will be effective for each project. The Company has not paid any material amounts related to warranties for its solutions. The Company sometimes commits unanticipated levels of effort to projects to remedy defects covered by its warranties. The Company's estimate of its exposure to warranties on contracts is immaterial as of September 30, 2017.



The Company's agreements with customers generally require the Company to indemnify the customer against claims in which the Company's products infringe third-party patents, copyrights, or trademarks and indemnify against product liability matters. As of September 30, 2017 and 2016, respectively, the Company has not experienced any losses related to the indemnification obligations and no significant claims with respect thereto were outstanding. The Company does not expect significant claims related to the indemnification obligations and, consequently, concluded that the fair value of these obligations is negligible, and no related reserves were established.

*Litigation*

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

**BRIDGELINE DIGITAL, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**11. Stockholders' Equity**

*Preferred Stock*

In October 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. 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 September 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% 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") up to 64,000 shares cumulatively. 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 September 30, 2017, the Company has issued 45,172 preferred convertible shares (PIK shares) to the preferred shareholders of which 24,080 shares were issued in fiscal 2017. The Company elected to declare a PIK dividend for the next quarterly payment due October 1, 2017. The total PIK dividend declared for October 1, 2017 is 7,391 preferred stock shares at a dividend rate of 12%.

### *Common Stock*

In October 2015, the Company sold 136,000 shares of common stock at \$5.00 per share for gross proceeds of \$680 in a private placement. Net proceeds to the Company after offering expenses were approximately \$669.

In February 2016, the Company issued 21,539 shares of restricted common stock at \$4.55 to four members of its Board of Directors in lieu of cash payments for their services as board members. The shares vested in equal installments on a monthly basis through the end of the service period of September 30, 2016. The aggregate fair value of the shares of \$98 was expensed over the service period. In May 2016, additional restricted common shares were issued to a new board member totaling 2,192 shares with a fair market value of \$8, and fully expensed in fiscal 2016.

In May 2016, the Company issued 361,336 shares of common stock for net proceeds of \$1.2 million for the first closing in connection with the conversion of term notes issued to accredited investors, as approved by the shareholders on April 29, 2016. In June 2016, the Company issued an additional 172,001 shares of common stock for net proceeds of \$400 for the second closing in connection with the conversion of these term notes.

In May 2016, each of Michael Taglich, Robert Taglich, and Roger Kahn, holders of outstanding term notes, converted all outstanding principal and accrued but unpaid interest due under such outstanding term notes into shares of Common Stock of the Company at a conversion price of \$3.75 per share. In connection with the conversion, a total of 867,765 shares of common stock were issued. (See Term Notes from Shareholders.)

**BRIDGELINE DIGITAL, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

On April 29, 2016, the shareholders of the Company approved a proposal for issuance of up to 800,000 shares of the Company's Common Stock upon conversion of outstanding Convertible Notes. From June 2016 through August 2016, all of the notes were converted to shares of common stock.

In July 2016, the Company sold 440,000 shares of common stock at \$3.75 per share for gross proceeds of \$1.7 million in a private placement. Net proceeds to the Company after offering expenses were approximately \$1.5 million.

In October 2016, the Company issued 2,000 shares of common stock to one of its vendors for payment for services. The fair market value of the shares was \$8.

In November 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").

In February 2017, the Company issued 36,826 shares of restricted common stock at \$3.15 to five members of its Board of Directors in lieu of cash payments for their annual services as board members. The shares vested 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 \$113 and was being expensed over the service period.

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.

*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 September 30, 2016, 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.

*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.

**BRIDGELINE DIGITAL, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

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 for net proceeds of \$852.

*Amended and Restated Stock Incentive Plan*

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. The Company’s Amended and Restated Stock Incentive Plan (the “Plan”) provided for the issuance of up to 250,000 shares of common stock. This Plan expired in August 2016. A total of 227,280 shares of common stock are outstanding under the Plan as of September 2017. On April 29, 2016, the stockholders approved a new plan, The 2016 Stock Incentive Plan (the “2016 Plan”). 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 are reserved for issuance under this new plan. There were 223,366 options outstanding under this plan as of September 30, 2017. As of September 30, 2017, there are 276,634 shares available for future issuance.

*Stock Option and Warrant Activity and Outstanding Shares*

A summary of combined option and warrant activity follows:

	<b>Stock Options</b>		<b>Stock Warrants</b>	
		<b>Weighted Average Exercise Price</b>		<b>Weighted Average Exercise Price</b>
	<b>Options</b>		<b>Warrants</b>	
Outstanding, September 30, 2015	175,200	\$ 18.40	140,656	\$ 21.89
Granted	337,758	\$ 4.22	190,110	\$ 4.46
Forfeited or expired	(64,372 )	\$ 19.77	(2,014 )	\$ 37.10
Outstanding, September 30, 2016	448,586	\$ 7.53	328,752	\$ 11.71
Granted	28,400	\$ 3.16	219,538	\$ 3.95
Forfeited or expired	(26,340 )	\$ 11.52	(8,697 )	\$ 35.00
Outstanding, September 30, 2017	450,646	\$ 7.02	539,593	\$ 8.18

There were no options exercised during fiscal 2017 and 2016. There were 194,977 and 69,041 options vested and exercisable as of September 30, 2017 and September 30, 2016, respectively. The shares outstanding at September 30, 2017 and 2016 had an intrinsic value of \$4 and \$1, respectively.

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A summary of the status of unvested shares is as follows:

	<b>Shares</b>	<b>Weighted Average Grant-Date Fair Value</b>
Unvested at September 30, 2016	379,545	\$ 4.94
Granted	28,400	3.16
Vested	(134,622)	5.77
Forfeited	(17,654 )	5.16
Unvested at September 30, 2017	255,669	\$ 4.29

Price ranges of outstanding and exercisable options as of September 30, 2017 are summarized below:

<b>Outstanding Options</b>			<b>Exercisable Options</b>		
<b>Exercise Price</b>	<b>Number of Options</b>	<b>Weighted Average Remaining Contractual Life (Years)</b>	<b>Weighted Average Exercise Price</b>	<b>Number of Options Exercisable</b>	<b>Weighted Average Exercise Price</b>
\$2.22 to \$3.80	29,400	9.53	\$ 3.17	334	\$ 3.65
\$3.81 to \$6.05	360,158	8.73	4.40	137,407	4.58
\$6.06 to \$18.75	22,280	5.83	14.53	18,428	14.82
\$18.76 to \$41.00	38,808	4.45	29.93	38,808	29.93
	450,646	8.27	\$ 7.02	194,977	\$ 10.59



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*Compensation Expense*

The Company estimates the fair value of stock options using the Black-Scholes-Merton option valuation model (the "Model"). The assumptions used to calculate compensation expense is as follows: