

Bridgeline Digital, Inc.
Form 10-K
December 19, 2016
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, 2016

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 or a smaller reporting company. See definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

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

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 \$4,128,871 based on the closing price of \$0.84 of the issuer’s common stock, par value \$.001 per share, as reported by the NASDAQ Stock Market on March 31, 2016.

On December 12, 2016, there were 20,783,747 shares of the registrant’s common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE: Portions of the definitive proxy statement for our 2016 annual meeting of stockholders, which is to be filed within 120 days after the end of the fiscal year ended September 30, 2016, 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, the security of our software, our dependence on our management team and key personnel, our ability to hire and retain future key personnel, or our ability to maintain an effective system of internal controls. Although we have sought to identify the most significant risks to our business, we cannot predict whether, or to what extent, any of such risks may be realized, nor is there any assurance that we have identified all possible issues which we might face. We assume no obligation to update our forward-looking statements to reflect new information or developments. We urge readers to review carefully the risk factors described herein and in the other documents that we file with the Securities and Exchange Commission. You can read these documents at www.sec.gov.

Where we say “we,” “us,” “our,” “Company” or “Bridgeline” 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 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 Bridgeline's Tier 1 co-managed hosting facility.

The iAPPS Platform is an award-winning application recognized around the globe. Our teams of Microsoft Gold® certified developers have won over 100 industry related awards. 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 in Burlington, Massachusetts. The Company maintains regional field offices serving the following geographical locations: Boston, MA; Chicago, IL; Denver, CO; San Luis Obispo, CA; and Tampa, FL. The Company has one wholly-owned subsidiary, Bridgeline Digital Pvt. Ltd. located in Bangalore, India.

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 Analyzer, 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 Analyzer 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 Analyzer, 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 Analyzer 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 Analytics 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 Analyzer'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 Analyzer. iAPPS Analyzer 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 Analyzer 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 a Tier 1 secured data center, we offer co-location services in state-of-the-art facilities. 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, 2016 and 2015.

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 2016 and 2015, research and development expenses were \$1.6 million, or 10% of revenues, and \$1.9 million, or 10% of revenues, respectively.

Employees

We have 79 employees worldwide as of September 30, 2016. Substantially all of those 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, 2016, one customer generated 10.2% of our revenue. For the year ended September 30, 2015, no customer generated more than 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 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 under the caption “Governance” 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, Analyzer, 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, Demandware, Episerver, Hubspot and Sitecore. 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 2016 was approximately 188,400 shares per day compared to approximately 15,000 for fiscal 2015 and 20,000 for fiscal 2014. 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 2016, the closing price of our common stock as reported by NASDAQ fluctuated between \$.62 and \$1.55.

We will not be able to maintain our listing on the NASDAQ Capital Market if we are unable to satisfy NASDAQ's minimum bid price requirements of \$1.00 per share.

We are currently not in compliance with the requirements for listing on the NASDAQ Capital Market. 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. Because our stock traded below \$1.00 per share for 30 consecutive business days, on August 19, 2016, The Nasdaq Stock Market ("Nasdaq") notified us that we were not in compliance with Marketplace Rule 5550(a)(2). We were provided 180 calendar days, or until February 15, 2017, to regain compliance with the minimum closing bid price requirement.

If we are unable to demonstrate compliance by February 15, 2017 then our shares of common stock will be subject to delisting. At that point, the Nasdaq staff will determine whether we meet the NASDAQ Capital Market initial listing criteria, except for the minimum bid price requirement. If NASDAQ determines that we meet the initial listing criteria, the NASDAQ staff will grant us an additional 180 calendar day compliance period. If we are not eligible for an additional compliance period, the NASDAQ staff will provide written notice that our securities will be delisted from the NASDAQ Capital Market.

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.

If the security of our software, in particular the hosted Internet solutions products we have developed, is breached, our business and reputation could suffer.

Fundamental to the use of our products is the secure collection, storage and transmission of confidential information. Third parties may attempt to breach our security or that of our customers and their databases. We might be liable to our customers for any breach in such security, and any breach could harm our customers, our business and reputation. 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. Computers, including those that utilize our software, are vulnerable to computer viruses, physical or electronic break-ins and similar disruptions, which could lead to interruptions, delays or loss of data. 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.

If our co-managed network operations center that houses our iAPPS SaaS environment and managed service hosting were to experience a disruption in service, our business and reputation could suffer.

We host our SaaS and managed hosting customers from our co-managed Network Operation Center (“NOC”), which is operated by a third-party. While we have ownership control and have access to our servers and all of the components of our network operation center, we do not control the operation of the Tier 1 data facility. Our data facility lease automatically renews each year. If upon renewal date our third-party provider does not provide commercially reasonable terms, we may be required to transfer our servers to a new data center facility, and we may incur significant costs and possible service interruption in connection with doing so.

Problems faced by our third-party data center location, with the telecommunications network providers with whom we or they contract, or with the systems by which our telecommunications providers allocate capacity among their customers, including us, could adversely affect the experience of our customers. Our third-party data center operator could decide to close their facilities without adequate notice. In addition, any financial difficulties, such as bankruptcy, faced by our third-party data center operators or any of the service providers with whom we or they contract may have negative effects on our business, the nature and extent of which are difficult to predict. Additionally, if our data center is unable to keep up with our growing needs for capacity, this could have an adverse effect on our business. Any changes in third-party service levels at our data centers or any errors, defects, disruptions, or other performance problems with our services could harm our reputation. 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.

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 do not maintain a key man insurance policy covering any of our employees.

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. A key element of our growth and market share expansion strategy has been the pursuit of additional acquisitions in the fragmented digital engagement industry in the future. These future acquisitions may create risks such as: (i) the need to integrate and manage the businesses and products acquired with our own business and products; (ii) additional demands on our resources, systems, procedures and controls; (iii) disruption of our ongoing business; (iv) unknown liabilities associated with the acquired businesses; and (v) diversion of management's attention from other business concerns. In addition, 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. Although there are currently few such laws and regulations, state, federal 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:

Geographic Location	Address	Size
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,
San Luis Obispo, California	Denver, CO 80202 3450 Broad Street	professional office space 1,089 square feet
Tampa, Florida	San Luis Obispo, CA 93401 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.

Year Ended September 30, 2016	High	Low
Fourth Quarter	\$1.09	\$0.76
Third Quarter	\$1.55	\$0.73
Second Quarter	\$1.06	\$0.62
First Quarter	\$1.33	\$1.06

Year Ended September 30, 2015	High	Low
Fourth Quarter	\$1.81	\$1.15
Third Quarter	\$2.35	\$1.61
Second Quarter	\$2.65	\$2.25
First Quarter	\$3.80	\$2.23

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 2016 and 2015, we did issue stock dividends to holders of our Series A preferred stock. As of December 12, 2016, our common stock was held of record by approximately 700 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, 2016 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.

In October 2015, the Company sold 680,000 shares of common stock at \$1.00 per share for gross proceeds of (1) \$680,000 in a private placement. Net proceeds to the Company after offering expenses were approximately \$669,000.

(2) In February 2016, the Company issued 107,692 shares of restricted common stock at \$0.91 to four members of its Board of Directors in lieu of cash payments for their services as board members.

In May 2016, the Company issued 1,806,680 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 (3) shareholders on April 29, 2016. In June 2016, the Company issued an additional 860,005 shares of common stock for net proceeds of \$400,000 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 (4) shares of Common Stock of the Company at a conversion price of \$0.75 per share. In connection with the conversion, a total of 4,338,822 shares of common stock were issued.

In July 2016, the Company sold 2,200,000 shares of common stock at \$0.75 per share for gross proceeds of \$1.7 (5) million in a private placement. Net proceeds to the Company after offering expenses were approximately \$1.5 million.

During the year ended September 30, 2016, the Company granted 1,688,789 stock options at a weighted average (6) exercise price of \$0.84 per share under its two plans: the Amended and Restated Stock Incentive Plan and The 2016 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 (7) 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, our dependence on our management team and key personnel, our ability to hire and retain future key personnel, or our ability to maintain an effective system of internal controls. These and other risks are more fully described herein and in our other filings with the Securities and Exchange Commission.

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

Overview

Bridgeline Digital, The Digital Engagement Company™, enables its customers to maximize the performance of their mission critical websites, intranets, and online stores. Bridgeline’s 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. Our iAPPSdsr platform, released in 2015, targets the growing multi-unit organizations with 10-500 locations providing them with powerful web engagement tools while maintaining corporate brand control and consistency.

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 Bridgeline’s co-managed hosting facility.

The iAPPS Platform is an award-winning application recognized around the globe. Our teams of Microsoft Gold© certified developers have won over 100 industry related awards. 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; San Luis Obispo, CA; and Tampa, FL. The Company has one wholly-owned subsidiary, Bridgeline Digital Pvt. Ltd. located in Bangalore, India.

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, 2016, one customer represented 10.2% of the Company's total revenue. For the year ended September 30, 2015, there were no customers representing 10% or more of the Company's total revenue.

Summary of Results of Operations

Total revenue for the fiscal year ended September 30, 2016 (“fiscal 2016”) decreased to \$15.9 million from \$19.2 million for the fiscal year ended September 30, 2015 (“fiscal 2015”). Loss from operations for fiscal 2016 was (\$3.5) million compared with loss from operations of (\$16.1) million for fiscal 2015. We had a net loss for fiscal 2016 of (\$7.8) million compared with a net loss of (\$16.8) million for fiscal 2015. 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. In fiscal 2015, we recorded a goodwill impairment charge of \$10.5 million, which comprised the majority of the loss in fiscal 2015. This was also a non-cash charge to operations. Loss per share attributable to common shareholders for fiscal 2016 was (\$0.84) compared with loss per share attributable to common shareholders of (\$3.88) for fiscal 2015.

Highlights of Fiscal 2016

Subscription and perpetual license revenue increased 5% to \$6.1 million for fiscal 2016.

Licenses and Managed Hosting comprised 46% of revenue in fiscal 2016 compared to 38% in fiscal 2015

Cost of revenue decreased \$3.8 million reflecting our commitment to align costs to revenue expectations.

Gross Margin improved to 54% in fiscal 2016 compared to 43% in fiscal 2015.

Excluding the goodwill impairment charge in fiscal 2015, operating expenses decreased \$1.6 million also reflecting our cost control initiatives.

We significantly reduced our debt. We reduced our convertible debt and term notes from \$6 million to zero by converting all debt to equity.

In 2016, *CIO Review* selected iAPPS as one of the 20 Most Promising Digital Marketing Solution Providers.

RESULTS OF OPERATIONS (dollars in thousands)	Year Ended September 30,			
	2016	2015	\$ Change	% Change
Revenue				
Digital engagement services				
iAPPS digital engagement services	\$8,520	\$11,903	\$(3,383)	(28%)
% of total revenue	54%	62%		
Subscription and perpetual licenses	6,084	5,792	292	5%
% of total revenue	38%	30%		
Managed service hosting	1,291	1,529	(238)	(16%)
% of total revenue	8%	8%		
Total revenue	15,895	19,224	(3,329)	(17%)
Cost of revenue				
Digital engagement services				
iAPPS digital engagement cost	5,143	8,738	(3,595)	(41%)
% of iAPPS digital engagement revenue	60%	73%		
Subscription and perpetual licenses	1,835	1,994	(159)	(8%)
% of subscription and perpetual licenses revenue	30%	34%		
Managed service hosting	304	307	(3)	(1%)
% of managed service hosting	24%	20%		
Total cost of revenue	7,282	11,039	(3,757)	(34%)
Gross profit	8,613	8,185	428	5%
Gross profit margin	54%	43%		
Operating expenses				
Sales and marketing	4,934	5,760	(826)	(14%)
% of total revenue	31%	30%		
General and administrative	3,456	3,935	(479)	(12%)
% of total revenue	22%	20%		
Research and development	1,578	1,901	(323)	(17%)
% of total revenue	10%	10%		
Depreciation and amortization	1,309	1,695	(386)	(23%)
% of total revenue	8%	9%		
Goodwill impairment	-	10,500	(10,500)	(100%)
% of total revenue	0%	55%		
Restructuring expenses	879	496	383	77%
% of total revenue	6%	3%		
Total operating expenses	12,156	24,287	(12,131)	(50%)
% of total revenue	76%	126%		
Loss from operations	(3,543)	(16,102)	12,559	(78%)
Interest expense, net	(914)	(892)	(22)	2%
Loss on inducement of debt (convertible notes)	(3,414)	-	(3,414)	100%
Loss before income taxes	(7,871)	(16,994)	9,123	(54%)
Benefit for income taxes	(47)	(226)	179	(79%)

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Net loss	\$(7,824)	\$(16,768)	\$8,944	(53%)
Non-GAAP Measure Adjusted EBITDA	\$(785)	\$(2,624)	\$1,839	(70%)

Revenue

Total revenue for the fiscal year ended September 30, 2016 decreased \$3.3 million, or 17%, to \$15.9 million from \$19.2 million in fiscal 2015. 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 decreased \$3.4 million, or 28% to \$8.5 million in fiscal 2016 from \$11.9 million in fiscal 2015. The decrease in digital engagement services revenue for fiscal 2016 compared to the prior period is due primarily to a decrease in larger value iAPPS engagements.

Digital engagement services revenue as a percentage of total revenue decreased to 54% in fiscal 2016 from 62% in fiscal 2015. The decrease is attributable to the decrease in the number of iAPPS license related engagements and lower margin iAPPS engagements. The Company has also been focused on selling iAPPS engagements that have a smaller services component which results in a shorter sales cycle and a shorter implementation cycle. This has strategically decreased the percentage of service revenue compared to total revenue and increased the percentage of license revenue to total revenue.

Subscription and Perpetual Licenses

Revenue from subscription (SaaS) and perpetual licenses increased \$292 thousand, or 5% to \$6.1 million in fiscal 2016 from \$5.8 million in fiscal 2015. Subscription and perpetual license revenue as a percentage of total revenue increased to 38% in fiscal 2016 from 30% in fiscal 2015. The increases are due primarily to a higher concentration of iAPPS subscription license revenues and a decrease in perpetual licenses.

Managed Service Hosting

Revenue from managed service hosting decreased \$238 thousand, or 16%, to \$1.3 million in fiscal 2016 from \$1.5 million in fiscal 2015. The decreases are due to the non-renewal of engagements with smaller hosting customers

obtained through previous acquisitions combined with a majority of our new engagements that are SaaS engagements and do not have a separate managed hosting component. Managed services revenue as a percentage of total revenue remained constant at 8% for both fiscal 2016 and fiscal 2015.

The decreases are due to most of our new engagements being subscription licenses (SaaS) rather than perpetual licenses, which typically require hosting.

Cost of Revenue

Total cost of revenue for the fiscal year ended September 30, 2016 decreased \$3.8 million, or 34%, to \$7.3 million from \$11.0 million in fiscal 2015.

Cost of Digital Engagement Services

Cost of digital engagement services decreased \$3.6 million, or 41%, compared to fiscal 2015. The cost of total digital engagement services as a percentage of total digital engagement services revenue decreased to 60% in fiscal 2016 from 73% in fiscal 2015. 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 decreased \$159 thousand or 8% to \$1.8 million in fiscal 2016 compared to \$2.0 million in fiscal 2015. The cost of subscription and perpetual licenses as a percentage of subscription and perpetual license revenue decreased to 30% in fiscal 2016 from 34% in fiscal 2015. The decreases are due to the cessation of amortization costs related to the capitalization of software partially offset by fixed costs to support our network operations center.

Cost of Managed Service Hosting

Cost of managed service hosting decreased \$3 thousand or 1% in fiscal 2016 to \$304 thousand compared to \$307 thousand in fiscal 2015. The cost of managed services as a percentage of managed services revenue increased to 24% in fiscal 2016 from 20% in fiscal 2015. The percentage increase is attributable to maintaining a certain level of fixed costs to support the network operations center.

Gross Profit

Gross profit increased \$428 thousand, or 5% in fiscal 2016 to \$8.6 million compared to \$8.2 million in fiscal 2015. The increase is primarily attributable to the increase in iAPPS SaaS licenses revenue. The increase is related to a higher percentage of our revenue coming from license and managed service hosting, 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 \$826 thousand, or 14% to \$4.9 million in fiscal 2016 from \$5.8 million in fiscal 2015. 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 increased to 31% in fiscal 2016 compared to 30% in fiscal 2015. The increase as a percentage of total revenue is attributable to the decrease in overall revenue.

General and Administrative Expenses

General and administrative expenses decreased \$479 thousand, or 12% to \$3.5 million in fiscal 2016 from \$3.9 million in fiscal 2015. The decrease is attributable to decreases in compensation related expenses and legal expenses. General and administrative expense as a percentage of revenue increased to 22% in fiscal 2016 compared to 20% in fiscal 2015. The increase as a percentage of revenue is attributable to the decrease in revenues.

Research and Development

Research and development expense decreased by \$323 thousand, or 17% to \$1.6 million in fiscal 2016 from \$1.9 million in fiscal 2015. The decrease in fiscal 2016 compared to fiscal 2015 is attributable to a decrease in compensation related costs. In order to compensate for headcount reduction in services, employees from our development group assisted the delivery team to maintain certain production schedules and their costs were charged to cost of digital engagement services. Research and development expense as a percentage of total revenue was 10% for both periods.

Depreciation and Amortization

Depreciation and amortization expense decreased by \$386 thousand, or 23% to \$1.3 million in fiscal 2016 from \$1.7 million in fiscal 2015. This decrease is primarily attributable to retirement of fixed assets in relation to a reduction of office space during fiscal 2016 and a reduction in capital expenditure purchases in fiscal 2016. Depreciation and amortization as a percentage of total revenue decreased to 8% in fiscal 2016 from 9% in fiscal 2015.

Goodwill Impairment

We performed our annual assessment of goodwill for both fiscal 2016 and fiscal 2015. We concluded that there was no impairment loss for 2016. In 2015, we concluded that it was more likely than not that the fair values of our reporting unit were less than their carrying amounts and that there should be an impairment loss. We determined that the most appropriate approach to use to determine the fair value of the reporting unit was the discounted cash flow method. A comparison to the implied fair value of goodwill to its carrying value resulted in an impairment charge of \$10.5 million for fiscal 2015.

Restructuring Expenses

During the second half of fiscal 2015 and through fiscal 2016, the Company's management approved, committed to and initiated plans to restructure and further improve efficiencies by implementing cost reductions in line with the expected decrease in revenues. The Company renegotiated several office leases. We entered into sub-leases for the original space and moved to new less expensive leases or vacated the office space entirely. In addition, the Company executed a general work-force reduction in fiscal 2015 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. 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 \$879 and \$496 was recorded to restructuring expenses for fiscal 2016 and fiscal 2015 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.

Loss from Operations

The loss from operations was (\$3.5) million for fiscal 2016 compared to a loss from operations of (\$16.1) million for fiscal 2015. The decrease in iAPPS related digital engagement services revenue in fiscal 2016 was partially offset by the reduction in cost of revenue and operating expenses.

Provision for Income Taxes

We recorded a net benefit for income tax expense of \$47 thousand for fiscal 2016 compared to a net benefit for income tax of \$226 thousand for fiscal 2015. The benefit in 2015 was primarily attributable to the elimination of a naked tax credit related to deductible goodwill from previous acquisitions that was eliminated upon recording a \$10.5 million goodwill impairment charge. 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, 2016 and 2015.

The Federal net operating loss (NOL) carryforward of approximately \$26.0 million as of September 30, 2016 expires on various dates through 2036. 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, goodwill impairment, 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:

	Year Ended	
	September 30,	
	2016	2015
Net loss	\$(7,824)	\$(16,768)
Benefit for income taxes	(47)	(226)
Interest expense, net	914	892
Amortization of intangible assets	480	554
Depreciation	707	1,065
EBITDA	(5,770)	(14,483)
Loss on inducement of debt (convertible notes)	3,414	-
Goodwill impairment	-	10,500
Restructuring expenses	879	496
Other amortization	372	549
Stock-based compensation	320	314
Adjusted EBITDA	\$(785)	\$(2,624)

Adjusted EBITDA was (\$785) thousand for fiscal 2016 compared with (\$2.6) million for fiscal 2015. This was primarily due to the improvement in gross margin along with our focus on reducing our expenses.

Liquidity and Capital Resources

Cash Flows

Operating Activities

Cash used in operating activities was \$2.7 million for fiscal 2016, compared to cash used in operating activities of \$2.8 million for fiscal 2015. Although the net loss was reduced in fiscal 2016, we used funds to pay down accounts payable.

Investing Activities

Cash used in investing activities was \$165 thousand for fiscal 2016 compared with \$187 thousand for fiscal 2015. The decrease was primarily due to less purchases of capital equipment and software in fiscal 2016 than fiscal 2015.

Financing Activities

Cash provided by financing activities was \$3.2 million for fiscal 2016 compared with \$2.1 million for fiscal 2015. The increase was due to proceeds from the sale of common stock of \$3.7 million and \$1 million in term notes from a shareholder offset by payments made on bank term loans, our bank line of credit and contingent acquisition payments. At September 30, 2016, we had an outstanding balance under our credit line with Heritage Bank of \$2.1 million.

Capital Resources and Liquidity Outlook

In June 2016, the Company entered into a new Loan and Security Agreement with Heritage Bank of Commerce (“Loan Agreement”). The Loan Agreement has a term of 24 months and will expire on June 9, 2018. The Loan 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, 2016, the Company had an outstanding balance under the Loan Agreement of \$2.1 million.

In November 2016, we entered into Securities Purchase Agreements with certain institutional and accredited investors to sell an aggregate total of 2,135,362 shares of our common stock for \$0.48 per share (“*November Private Placement*”). In total, we received net proceeds of \$987 thousand. The proceeds will be used to fund current and future operations.

We believe that the proceeds from the November Private Placement, cash generated from operations, and borrowing capacity from the Heritage Bank line of credit will be sufficient to fund our working capital and capital expenditure needs in the foreseeable future. However, 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; 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. Other contractual obligations include: (i) certain equipment acquired under capitalized lease agreements and (ii) contingent earnouts in the amount of \$75 thousand payable in cash on the achievement of revenue and earnings targets. We have no future commitments that extend past fiscal 2020.

The following summarizes our contractual obligations:

(in thousands)	For the Year Ended September 30,				
	FY17	FY18	FY19	FY20	Total
Payment obligations by year					
Line of credit	\$-	\$2,115	\$-	\$ -	\$2,115
Capital Leases	45	-	-	-	45
Operating Leases (a)	564	474	178	64	1,280
Contingent acquisition payments (b)	75	-	-	-	75
	\$684	\$2,589	\$178	\$ 64	\$3,515

(a) Net of sublease income

(b) The contingent acquisition payments are maximum potential earn-out consideration payable to former owners of acquired companies.

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 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.

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.

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 longer of the life of the hosting 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.

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.

Reimbursable Expenses

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

Allowance for Doubtful Accounts

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

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

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

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

Accounting for Goodwill and Intangible Assets

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

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

For fiscal 2015, the Company performed the annual assessment of goodwill during the fourth quarter of 2015, using the qualitative approach described above. Based on the qualitative assessment, the Company concluded that it was more likely than not that the fair values of the reporting units were less than their carrying amounts. While there were numerous positive qualitative factors discovered during the qualitative analysis, the instability of the market price of the Company's common stock and the decline in revenues were significant adverse factors that directed a full assessment. (See Note 7) In estimating fair value, the Company performed a discounted cash flow analysis on the reporting unit to determine fair value. The inputs to the discounted cash flow model are considered level 3 in the fair value hierarchy. The impairment test performed by the Company indicated that the estimated fair value of the reporting unit was less than its corresponding carrying amount. As a result of the analyses performed, the Company recorded goodwill impairment charges of \$10.5 million in 2015.

Accounting for Stock-Based Compensation

At September 30, 2016, 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 12 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, 2016 and 2015, 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, 2016 and 2015, 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 16, 2016

Boston, Massachusetts

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

(Dollars in thousands, except share data)

	As of September 30,	
	2016	2015
ASSETS		
Current assets:		
Cash and cash equivalents	\$661	\$337
Accounts receivable and unbilled receivables, net	2,549	2,463
Prepaid expenses and other current assets	381	680
Total current assets	3,591	3,480
Equipment and improvements, net	512	1,315
Intangible assets, net	548	1,028
Goodwill	12,641	12,641
Other assets	436	723
Total assets	\$17,728	\$19,187
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$1,285	\$1,626
Accrued liabilities	946	1,046
Accrued earnouts, current	75	468
Debt, current	-	92
Capital lease obligations	45	320
Deferred revenue	1,360	1,542
Total current liabilities	3,711	5,094
Debt, net of current portion	2,115	7,695
Other long term liabilities	400	726
Total liabilities	6,226	13,515
Commitments and contingencies		
Stockholders' equity:		
Preferred stock - \$0.001 par value; 1,000,000 shares authorized; 221,092 at September 30, 2016 and 208,222 at September 30, 2015, issued and outstanding (liquidation preference \$2,245)	-	-
Common stock - \$0.001 par value; 50,000,000 shares authorized; 18,637,709 at September 30, 2016 and 4,637,684 at September 30, 2015, issued and outstanding	19	5
Additional paid-in capital	64,202	50,434

Accumulated deficit	(52,366)	(44,411)
Accumulated other comprehensive loss	(353)	(356)
Total stockholders' equity	11,502	5,672
Total liabilities and stockholders' equity	\$17,728	\$19,187

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

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

(Dollars in thousands, except per share data)

	Year Ended September	
	30,	
	2016	2015
Net revenue:		
Digital engagement services	\$8,520	\$11,903
Subscription and perpetual licenses	6,084	5,792
Managed service hosting	1,291	1,529
Total net revenue	15,895	19,224
Cost of revenue:		
Digital engagement services	5,143	8,738
Subscription and perpetual licenses	1,835	1,994
Managed service hosting	304	307
Total cost of revenue	7,282	11,039
Gross profit	8,613	8,185
Operating expenses:		
Sales and marketing	4,934	5,760
General and administrative	3,456	3,935
Research and development	1,578	1,901
Depreciation and amortization	1,309	1,695
Goodwill impairment charge	-	10,500
Restructuring expenses	879	496
Total operating expenses	12,156	24,287
Loss from operations	(3,543)	(16,102)
Interest expense, net	(914)	(892)
Loss on inducement of debt (convertible notes)	(3,414)	-
Loss before income taxes	(7,871)	(16,994)
Benefit for income taxes	(47)	(226)
Net loss	(7,824)	(16,768)
Dividends on convertible preferred stock	(131)	(114)
Net loss applicable to common shareholders	\$(7,955)	\$(16,882)
Net loss per share attributable to common shareholders:		
Basic and diluted	\$(0.84)	\$(3.88)
Number of weighted average shares outstanding:		
Basic and diluted	9,465,012	4,350,627

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

BRIDGELINE DIGITAL, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(Dollars in thousands)

	Year Ended	
	September 30,	
	2016	2015
Net Loss	\$(7,824)	\$(16,768)
Other Comprehensive Loss: Net change in foreign currency translation adjustment	3	(23)
Comprehensive loss	\$(7,821)	\$(16,791)

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	Accumulated Other Comprehensive Loss		Total
	Shares	Par Value	Shares	Par Value	Paid in Capital	Accumulated Deficit	Loss	Stockholders' Equity
Balance at September 30, 2014	-	\$ -	4,389	\$ 5	\$ 47,790	\$ (27,529)	\$ (333)	\$ 19,933
Issuance of common stock	-	-	185	-	197	-	-	197
Stock-based compensation expense	-	-	-	-	216	-	-	216
Issuance of common stock - ESPP	-	-	3	-	6	-	-	6
Issuance of common stock - contingent shares	-	-	19	-	-	-	-	-
Issuance of common stock - restricted shares	-	-	41	-	97	-	-	97
Issuance of preferred stock - less issuance costs	200	-	-	-	1,776	-	-	1,776
Stock dividends - issued	8	-	-	-	82	(82)	-	-
Stock dividends - declared	-	-	-	-	-	(32)	-	(32)
Valuation of debt warrants	-	-	-	-	270	-	-	270
Net loss	-	-	-	-	-	(16,768)	-	(16,768)
Foreign currency translation	-	-	-	-	-	-	(23)	(23)
Balance at September 30, 2015	208	\$ -	4,637	\$ 5	\$ 50,434	\$ (44,411)	\$ (356)	\$ 5,672
Issuance of common stock	-	-	5,546	6	3,709	-	-	3,715
Conversion of term notes from shareholders, including accrued interest of \$204	-	-	4,339	4	3,200	-	-	3,204
Conversion of 10% secured subordinated notes	-	-	4,000	4	2,996	-	-	3,000
Inducement of debt (convertible notes)	-	-	-	-	3,414	-	-	3,414
Stock-based compensation expense	-	-	-	-	214	-	-	214
Issuance of common stock - contingent shares	-	-	26	-	-	-	-	-
Issuance of common stock - restricted shares	-	-	119	-	106	-	-	106
Stock dividends - issued	13	-	-	-	129	(98)	-	31
Stock dividends - declared	-	-	-	-	-	(33)	-	(33)
Net loss	-	-	-	-	-	(7,824)	-	(7,824)
Foreign currency translation adj	-	-	-	-	-	-	3	3

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Balance at September 30, 2016 221 \$ - 18,667 \$ 19 \$ 64,202 \$ (52,366) \$ (353) \$ 11,502

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

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

(Dollars in thousands)

	Year Ended	
	September 30,	
	2016	2015
Cash flows from operating activities:		
Net loss	\$(7,824)	\$(16,768)
Adjustments to reconcile net loss to net cash used in operating activities:		
Provision for deferred taxes	-	(376)
Amortization of intangible assets	480	554
Depreciation	707	1,065
Other amortization	530	700
Goodwill impairment	-	10,500
Capitalized interest expense	204	-
Loss on inducement of convertible notes	3,414	-
Stock-based compensation/restricted shares	320	314
Adjustment to accrued earnouts	-	109
Net loss on disposal of fixed assets/restructuring	67	161
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable and unbilled receivables	(86)	879
Prepaid expenses and other assets	356	622
Accounts payable and accrued liabilities	(425)	195
Deferred revenue	(182)	(448)
Other liabilities	(243)	(270)
Total adjustments	5,142	14,005
Net cash used in operating activities	(2,682)	(2,763)
Cash flows used in investing activities:		
Purchase of equipment and improvements	(23)	(124)
Software development capitalization costs/other intangibles	(142)	(63)
Net cash used in investing activities	(165)	(187)
Cash flows provided by financing activities:		
Proceeds from issuance of common stock, net of issuance costs	3,715	197
Proceeds from issuance of preferred stock, net of issuance costs	-	1,776
Proceeds from employee stock purchase plan	-	6
Proceeds from bank term loan	500	1,710
Proceeds from term notes from stockholder	1,000	2,000
Borrowings on bank line of credit	383	795
Payments on bank term loan	(750)	(2,460)
Payments on bank line of credit	(963)	(1,038)
Payments on subordinated promissory notes	-	(21)
Contingent acquisition payments	(393)	(447)
Principal payments on capital leases	(324)	(463)

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Net cash provided by financing activities	3,168	2,055
Effect of exchange rate changes on cash and cash equivalents	3	(24)
Net increase(decrease) in cash and cash equivalents	324	(919)
Cash and cash equivalents at beginning of period	337	1,256
Cash and cash equivalents at end of period	\$661	\$337
Supplemental disclosures of cash flow information:		
Cash paid for:		
Interest	\$469	\$243
Income taxes	\$17	\$52
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	-
Equipment purchased under capital leases	\$-	\$172
Stock dividends on convertible preferred stock	\$131	\$114

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

BRIDGELINE DIGITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

1. Description of Business

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 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. Our iAPPSdsr platform, released in 2015, targets the growing multi-unit organizations with 10-500 locations providing them with powerful web engagement tools while maintaining corporate brand control and consistency.

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 Bridgeline's co-managed hosting facility.

The iAPPS Platform is an award-winning application recognized around the globe. Our teams of Microsoft Gold® certified developers have won over 100 industry related awards. 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 north of Boston, Massachusetts. The Company maintains regional field offices serving the following geographical locations: Boston, MA; Chicago, IL; Denver, CO; San Luis Obispo, CA; and Tampa, FL. The Company has one wholly-owned subsidiary, Bridgeline Digital Pvt. Ltd. located in Bangalore, India.

BRIDGELINE DIGITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

Reverse Stock Split

On May 4, 2015, 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 May 7, 2015 and the Company's stock began trading on a split-adjusted basis on May 8, 2015.

The reverse stock split reduced the number of shares of the Company's common stock currently outstanding at that time from approximately 22 million shares to approximately 4.4 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, convertible notes and stock options, and to the number of shares issued and issuable under the Company's Amended and Restated Stock Incentive Plan. 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 \$0.001. 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 acquisitions to broaden our geographic footprint, develop new products, and build infrastructure. In fiscal 2015, the Company initiated a restructuring plan that included a reduction of workforce and office space, which significantly reduced operating expenses. Restructuring activities continued in fiscal 2016 with more renegotiations of office space. The Company's management believes it will have an appropriate cost structure for its anticipated sales in fiscal 2017. Management believes that operating expenses will be reduced to the point where the Company can drive

positive Adjusted EBITDA (earnings before interest, taxes, depreciation and amortization, stock-based compensation charges and other onetime charges). As such, management believes that the Company will provide sufficient cash flows to fund its operations in the ordinary course of business through at least the next twelve months. However, there can be no assurance that the anticipated sales level will be achieved.

In June 2016, the Company replaced its Loan and Security Agreement with BridgeBank (the “Bridgebank Agreement”) with a new Loan and Security Agreement with Heritage Bank of Commerce (“Heritage Agreement” or “Loan Agreement”). The Heritage Agreement has a term of 24 months and will expire on June 9, 2018. The Loan 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, 2016, the Company had an outstanding balance under the Loan Agreement of \$2.1 million.

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.

BRIDGELINE DIGITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

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.

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 one customer that contributed 10.2% of revenue for fiscal 2016. No customer contributed more than 10% of total revenue in fiscal 2015.

The Company has no significant off-balance sheet 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. The Company had two customers that had an accounts receivable balance of greater than 10% of total accounts receivable at September 30, 2016. There were no customers that had an accounts receivable balance greater than 10% at September 30, 2015.

BRIDGELINE DIGITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

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.

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 longer of the life of the hosting period or the expected lives of customer relationships. The Company will continue to evaluate the length of the amortization period of the set up fees as the Company gains more experience with customer contract renewals.

BRIDGELINE DIGITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

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.

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.

BRIDGELINE DIGITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

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.

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 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.

Equipment and Improvements

The components of 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 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 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 \$142 and \$63 of costs in fiscal 2016 and fiscal 2015, respectively.

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

(Dollars in thousands, except per share data)

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:

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

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

For fiscal 2015, the Company performed the annual assessment of goodwill during the fourth quarter of 2015. In estimating fair value, the Company performed a discounted cash flow analysis on the reporting unit to determine fair value. The inputs to the discounted cash flow model are considered level 3 in the fair value hierarchy. The impairment test performed by the Company indicated that the estimated fair value of the reporting unit was less than its corresponding carrying amount. As a result of the analyses performed, the Company recorded goodwill impairment charges of \$10.5 million in 2015.

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 our 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 Company records contingent consideration payments as additional purchase price and goodwill at the acquisition date. Any adjustments made within one year from the acquisition date are charged to goodwill. Any adjustment made after the one year refinement period will be charged to the consolidated statement of operations.

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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 2016 or 2015.

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, 2016 and September 30, 2015 because of their nature and durations. The carrying value of debt instruments also approximates fair value as of September 30, 2016 and September 30, 2015 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.

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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. 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 (losses) for fiscal 2016 and 2015 were \$3 and \$(23), respectively. 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 \$621 and \$461 for fiscal 2016 and 2015, 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 2016 or fiscal 2015.

BRIDGELINE DIGITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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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. The computation of diluted earnings per share does not include the effect of outstanding stock options and warrants that are anti-dilutive.

Recent Accounting Pronouncements

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

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.

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(Dollars in thousands, except per share data)

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

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

In April 2016, the FASB issued ASU No. 2016-10, which adds further guidance on identifying performance obligations and improves the operability and understanding of the licensing implementation guidance.

In May 2016, the FASB issued ASU 2016-12, which addresses narrow-scope improvements to the guidance on collectability, noncash consideration, and completed contracts at transition. Additionally, the amendments in this update provide a practical expedient for contract modifications at transition and an accounting policy election related to the presentation of sales taxes and other similar taxes collected from customers. Management is evaluating the new guidelines to determine if they will have a significant impact on consolidated results of operation, financial condition or cash flows.

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

3. Accounts Receivable and Unbilled Receivables

Accounts receivable and unbilled receivables consists of the following:

	As of	
	September 30,	
	2016	2015
Accounts receivable	\$2,627	\$2,228
Unbilled receivables	60	306
Subtotal	2,687	2,534
Allowance for doubtful accounts	(138)	(71)
Accounts receivable and unbilled receivables, net	\$2,549	\$2,463

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4. Equipment and Improvements

Equipment and improvements consists of the following:

	As of September 30,	
	2016	2015
Furniture and fixtures	\$713	\$1,208
Purchased software	1,043	1,119
Computers and equipment	4,080	4,254
Leasehold improvements	1,223	1,555
Total cost	7,059	8,136
Less accumulated depreciation	(6,547)	(6,821)
Equipment and improvements, net	\$512	\$1,315

Depreciation and amortization on the above assets was \$707 and \$1.1 million in fiscal 2016 and 2015, respectively. During fiscal 2016 and 2015, the Company disposed of \$1.1 million and \$598, respectively, of fixed assets related to the downsizing of offices, of which \$67 and \$161, respectively, were recorded as restructuring expenses in the consolidated 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, 2016 and 2015 because of their short-term nature and durations. The carrying value of debt instruments also approximates fair value as of September 30, 2016 and 2015 based on acceptable valuation methodologies which use market data of similar size and situated debt issues.

Assets and liabilities of the Company measured at fair value on a recurring basis as of September 30, 2016 and 2015 are as follows:

**As of September 30,
2016**

Level	Level	Level	Total
1	2	3	

Liabilities:

Contingent acquisition consideration	\$-	\$ -	\$ 75	\$ 75
Total Liabilities	\$-	\$ -	\$ 75	\$ 75

**As of September 30,
2015**

Level	Level	Level	Total
1	2	3	

Liabilities:

Contingent acquisition consideration	\$-	\$ -	\$ 468	\$ 468
Total Liabilities	\$-	\$ -	\$ 468	\$ 468

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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 rollforward of the fair value, as determined by Level 3 inputs, of the contingent consideration.

The following table summarizes the changes in contingent consideration for the fiscal year ended September 30, 2016 and 2015.

	Year Ended	
	September	
	30,	
	2016	2015
Balance at beginning of period	\$468	\$868
Additions	-	136
Payments	(393)	(509)
Other adjustments	-	(27)
Balance at end of period	\$75	\$468

6. Intangible Assets

Intangible assets are comprised as follows:

	As of	
	September	
	30,	
	2016	2015
Domain and trade names	\$ 10	\$ 10
Customer related	392	