

Bridgeline Digital, Inc.
Form 10-K
December 20, 2013

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, 2013

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)

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 \$17,336,517 based on the closing price of \$1.27 of the issuer’s common stock, par value \$.001 per share, as reported by the NASDAQ Stock Market on March 28, 2013

On December 02, 2013, there were 18,328,987 shares of the registrant’s common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE: Portions of the definitive proxy statement for our 2013 annual meeting of stockholders, which is to be filed within 120 days after the end of the fiscal year ended September 30, 2013, 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 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 enables its customers to maximize the performance of their mission critical websites, intranets, and online stores. Bridgeline is the developer of the award-winning iAPPS® Web Engagement Management (WEM) product platform and related digital solutions. The iAPPS platform deeply integrates web content management, eCommerce, eMarketing, social media management and web analytics capabilities within the heart of websites or online to help marketers deliver web 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.

In fiscal 2012 Bridgeline Digital announced the release of iAPPSds (“distributed subscription”), a platform that empowers franchise and large dealer networks with state-of-the-art web engagement management platform that provides superior oversight of corporate branding while allowing franchises to modify local content and execute local digital marketing initiatives. iAPPSds deeply integrates content management, eCommerce, eMarketing, social media management and web analytics and is a self-service web platform that is offered to each authorized franchise or dealer for a monthly subscription fee. On August 1, 2013, we acquired franchise web platform developer ElementsLocal, expanding Bridgeline Digital’s presence in the franchise market place. Please see *Acquisitions* section for more detail on the ElementsLocal acquisition.

The iAPPS platform is delivered either 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.

In 2013, 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 2012. iAPPS Content Manager and iAPPS Commerce were selected as finalists for the 2013 CODiE Awards for Best Content Management Solution and Best Electronic Commerce Solution, globally. In 2013 the Internet Advertising Competition honored Bridgeline Digital with three awards for iAPPS customer websites. In addition, in 2013 Bridgeline Digital won fifteen Horizon Interactive Awards for outstanding development of web applications and websites and B2B Magazine has selected Bridgeline Digital as one of the Top Interactive Technology companies in the United States.

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: Atlanta, GA; Baltimore, MD; Boston, MA; Chicago, IL; Dallas, TX; Denver, CO; New York, NY; San Diego, CA; San Luis Obispo, CA; and Tampa, FL. The Company has one wholly-owned subsidiary, Bridgeline Digital Pvt. Ltd. located in Bangalore, India.

Highlights of Fiscal 2013

Financial

Total iAPPS related revenue increased 13% to \$18.8 million in fiscal 2013 from \$16.6 million in fiscal 2012

Total subscription and perpetual license revenue increased \$1.5 million, or 59%, compared to fiscal 2012

Recurring revenue, which reflects amounts that are contractually due to Bridgeline, increased 23% to \$5.1 million in fiscal 2013 from \$4.2 million in fiscal 2012

Non-iAPPS revenue decreased 44%, or \$4.3 million in fiscal 2013 compared to fiscal 2012.

Acquisitions, and Product Enhancements

In the third quarter of fiscal 2012 Bridgeline released iAPPS version 5.0 which offered cross-channel interface, personalized to the user and their tasks, mobile & tablet friendly editing for publishing content, video publishing, built-in translation services and other enhancements that allow users to add or change content without needing a developer

In the fourth quarter of fiscal 2013, we acquired ElementsLocal, a franchise web platform developer, expanding our presence in the franchise marketplace

Products and Services

Products

Subscription and Perpetual Licenses

Revenue from sales of both on-demand SaaS web tools and perpetual licenses is reported as subscription and perpetual licenses in the accompanying consolidated financial statements.

iAPPS Platform

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 web content management, web Analytics, eCommerce, social media management and eMarketing 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 iAPPS platform includes:

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 marketing lifecycle management solution that includes customer transaction analysis, email management, surveys and polls, event registration and issue tracking to measure campaign return on investment and client satisfaction. Website content and user profiling is leveraged to deliver targeted campaigns and stronger customer relationships. The email management features provide comprehensive reporting capabilities including success rate, and recipient activity such as click-thrus and opt-outs. iAPPS Marketier integrates with leading Customer Relationship Management (CRM's) systems such as Salesforce.com and leading ad banner engines such as Google. iAPPS Marketier is uniquely integrated and unified with iAPPS Analyzer, iAPPS Content Manager, and iAPPS Commerce; providing customers with precise information, accurate results, expansion options, and stronger user adoption.

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, and 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.

iAPPSds is a web content management and eCommerce platform for franchises and large dealer networks. 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. 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

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 without ever exiting the iAPPS dashboard and leverage the power of publishing content to department, dealer, franchise or other social media accounts.

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 partnerships with Internap, we offer co-location services in state-of-the-art, Tier 1 secured data centers. We provide 24/7 application monitoring, emergency response, version control, load balancing, managed firewall security, and virus protection services. 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 180 days 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, high technology (software and hardware), and associations and foundations.

Bridgeline employs a direct sales force to sell iAPPSds engagements to franchises and large dealer networks. Each sale in this vertical market takes on average 365 days to complete.

We have ten geographic locations in the United States with full-time professional direct sales personnel. Our geographic locations are in the metropolitan Atlanta, Baltimore, Boston, Chicago, Dallas, Denver, New York, San Diego, San Luis Obispo, and Tampa areas.

Strategic Alliances

We have dedicated business development professionals whose mission is to identify and establish strategic alliances for iAPPS and iAPPSds. In June 2012, Bridgeline announced a strategic alliance with UPS Logistics. 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.

In July of 2012 Bridgeline signed a multi-year agreement with The UPS Stores, a national franchise network of over 4,300 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, and associations and foundations). Our business development professionals create an annual territory plan identifying various strategies to engage our target customers. These territory plans are evaluated and updated every 60 days.

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

Bridgeline will continue to evaluate expanding its distribution of iAPPS and its interactive development capabilities through acquisitions.

We completed one acquisition during the fiscal year ended September 30, 2013 and two acquisitions during the fiscal year ended September 30, 2012 as described below.

ElementsLocal

On August 1, 2013, we completed the acquisition of ElementsLocal, a California based developer of a SaaS website platform for the franchise marketplace. ElementsLocal has over 3,200 franchises on its web platform. We acquired all of the outstanding capital stock of ElementsLocal for consideration consisting of (i) \$463 thousand in cash, (ii) \$604 thousand in shares of Bridgeline Digital common stock (valued at \$1.15 per share), (iii) assumption of \$188 thousand of indebtedness and (iv) contingent consideration of up to \$904 thousand in cash and \$396 thousand in shares of Bridgeline Digital common stock. The contingent consideration is payable quarterly over the 12 consecutive calendar quarters following the acquisition, contingent upon the acquired business achieving a certain quarterly revenue target during the period. The contingent common stock payable each earnout period is determined by dividing \$33 thousand by the greater of: (i) the average closing price for Bridgeline Digital common stock for the 30 day trading period preceding the end of the earnout period, or (ii) \$1.17. To the extent that a quarterly revenue target is not met in a particular quarter, the earn-out period will be extended for up to four additional quarters.

Magnetic Corporation

On October 3, 2011, we completed the acquisition of Magnetic Corporation (“Magnetic”), an interactive technology company based in Tampa, Florida. We acquired all of the outstanding capital stock of Magnetic for consideration consisting of (i) \$150 thousand in cash (ii) assumption of \$130 thousand of indebtedness and (iii) contingent consideration of up to \$600 thousand in cash and 166,666 shares of Bridgeline Digital common stock. The contingent consideration is payable quarterly over the 12 consecutive calendar quarters following the acquisition, contingent upon the acquired business achieving certain quarterly revenue and quarterly operating income targets during the period. The contingent common stock has been issued and is being held in escrow pending satisfaction of the applicable targets. To the extent that either the quarterly revenue targets or the quarterly operating income targets are not met in a particular quarter, the earn-out period will be extended for up to four additional quarters.

MarketNet, Inc.

On May 31, 2012, we completed the acquisition of MarketNet, Inc. (“MarketNet”), an interactive technology company based in Dallas, Texas. Bridgeline acquired all of the outstanding capital stock of MarketNet for consideration consisting of (i) \$20 thousand in cash and (ii) assumption of debt of \$244 thousand and (iii) contingent consideration of up to \$650 thousand in cash and 204,331 shares of Bridgeline Digital common stock. This contingent consideration is payable quarterly over the 12 consecutive calendar quarters following the acquisition, contingent upon the acquired business achieving certain quarterly revenue and quarterly operating income targets during the period. To the extent that either the quarterly revenue target or the quarterly operating income target is not met in a particular quarter, the earn-out period will be extended for up to four additional quarters. MarketNet is also eligible to earn additional bonus equity consideration of 200,000 shares, if annual net revenues of the acquired business exceed a certain threshold in any fiscal year through September 30, 2015. The contingent common stock has been issued and is being held in escrow pending satisfaction of the applicable targets.

ElementsLocal, Magnetic and MarketNet’s operating results are reflected in the condensed consolidated financial statements as of the acquisition date.

Research and Development

We invested approximately \$2.0 million in research and development activities for the year ended September 30, 2013, which included approximately \$640 thousand in capitalized software costs.

We invested approximately \$1.9 million in research and development for the year ended September 30, 2012, which included approximately \$480 thousand of capitalized software costs.

Employees

We have 165 employees worldwide as of September 30, 2013. 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/Large Dealer Networks
- Retail Brand Names
- Health Services and Life Sciences
- High Technology (software and hardware)
- Associations and Foundations

For the years ended September 30, 2013 and 2012, no customer generated more than 10% of our revenue. We will focus our efforts to engage with customers that are aligned with the Company's core competencies and will continue to proactively end engagements with a number of smaller hosting customers obtained through previous acquisitions.

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 providing 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.bridgelinedigital.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:

oNominating and Corporate Governance Committee

oAudit Committee

oCompensation 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, 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, 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.

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.

Because most of our licenses are renewable on an annual basis, a reduction in our license renewal rate could reduce our revenue.

Our customers have no obligation to renew their annual 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) 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 Open Text, Demandware, Digital River, GSI Commerce, and Adobe. 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 2013 was approximately 50,000 shares per day. In fiscal 2012 our average shares traded per day was less than 50,000. If our average trading volume of our common stock were to decrease it 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. The 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. In fiscal 2013, the closing price of our common stock as reported by NASDAQ was between \$0.99 and \$2.40.

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 hosting experiences a disruption in service, our business and reputation could suffer.

We host our SaaS and managed hosting customers and from our co-managed network operation center (“NOC”), which is operated by a third-party. While we own, control and have access to our servers and all of the components of our network operation center, we do not control the operation of this facility. Our data center lease expires in 2014 with an automatic renewal of one 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. In addition, in the event that Thomas Massie, our founder, Chairman and Chief Executive Officer, is terminated by us without cause, he is entitled to receive severance payments equal to three years' total compensation, including bonus amounts. In the event we are required to pay the severance payments to Mr. Massie, it could have a material adverse effect on our results of operations for the fiscal quarter and year in which such payments are made.

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
Atlanta, Georgia	5555 Triangle Parkway	8,547 square feet,
Baltimore, Maryland	Norcross, Georgia 30092	professional office space
	6711 Columbia Gateway Dr.	4,925 square feet,
Bangalore, India	Baltimore, Maryland 21046	Professional office space
	65 Bagmane Tech Park, C.V Raman	6,000 square feet
Boston, Massachusetts	Nagar Byrasandra, Corp Ward 83,	professional office space
	Bangalore 560 052	21,136 square feet,
Chicago, Illinois	80 Blanchard Road	professional office space
	Burlington, Massachusetts 01803	4,880 square feet,
Dallas, Texas	30 N. LaSalle Street, 20 th Floor	professional office space
	Chicago, IL 60602	5,641 square feet,
Denver, Colorado	4975 Preston Park Boulevard, Suite 550	professional office space
	Plano, TX 75093	5,993 square feet,

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New York, New York	Denver, CO 80202 450 7 th Avenue	professional office space 5,582 square feet,
San Diego, California	New York, NY 10123 6240 Cornerstone Suite 110	professional office space 2,560 square feet
San Luis Obispo, California	San Diego, CA 92121 1150 Laurel Lane, Suite 115	Professional office space 1,800 square feet
Tampa, Florida	San Luis Obispo, CA 93401 5325 Primrose Lake Circle	Professional office space 4,264 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 beyond those described below.

Bridgeline Digital, Inc vs. e.Magination Network, LLC and its principal owner, Daniel Roche.

In August 2010, Bridgeline initiated a lawsuit against e.Magination network, LLC and its principal owner, Daniel Roche, in the Federal District Court of Massachusetts. On August 6, 2013 the parties entered into a settlement agreement pursuant to which Bridgeline will pay Mr. Roche a total of \$300 thousand, \$163 thousand, which was accrued as of June 30, 2013 in accrued liabilities and general and administrative expenses on the Condensed and Consolidated Balance Sheets and Condensed and Consolidated Statements of Operations, respectively, and the payment of previously earned contingent consideration which was accrued at the date of acquisition. These amounts are being paid over 18 months and began in August 2013.

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, 2013	High	Low
Fourth Quarter	\$1.33	\$1.00
Third Quarter	\$1.30	\$0.99
Second Quarter	\$1.80	\$1.25
First Quarter	\$2.40	\$1.20

Year Ended September 30, 2012	High	Low
Fourth Quarter	\$1.63	\$1.05
Third Quarter	\$3.24	\$1.10
Second Quarter	\$1.18	\$0.53
First Quarter	\$0.78	\$0.47

We have not declared or paid cash dividends on our common stock and do not plan to pay cash dividends to our shareholders in the near future. As of December 2, 2013, our common stock was held of record by approximately 1,526 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, 2013, other than sales of unregistered securities during the quarter ended June 30, 2013 that were previously disclosed on Form 8-K. 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.

During the year ended September 30, 2013, the Company granted 441,500 stock options under its Amended and Restated Stock Incentive Plan at a weighted average exercise price of \$1.63 per share.

The securities were issued exclusively to our directors, executive officers and employees. The issuance of options and the shares of common stock issuable upon the exercise of such options as described above were issued pursuant to written compensatory plans or arrangements with our employees, directors and consultants, in reliance on the exemptions from the registration provisions of the Securities Act set forth in Section 4(2) thereof relative to sales by an issuer not involving any public offering, to the extent an exemption from such registration was required.

Item 6. 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 volatility of the market price of our common stock, 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 enables its customers to maximize the performance of their mission critical websites, intranets, and online stores. Bridgeline is the developer of the award-winning iAPPS® Web Engagement Management (WEM) product platform and related digital solutions. The iAPPS platform deeply integrates web content management, eCommerce, eMarketing, social media management and web analytics capabilities within the heart of websites or online stores to help marketers deliver web 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.

In fiscal 2012 Bridgeline Digital announced the release of iAPPSds (“distributed subscription”), a platform that empowers franchise and large dealer networks with state-of-the-art web engagement management platform that provides superior oversight of corporate branding while allowing franchises to modify local content and execute local digital marketing initiatives. iAPPSds deeply integrates content management, eCommerce, eMarketing, social media management and web analytics and is a self-service web platform that is offered to each authorized franchise or dealer for a monthly subscription fee. On August 1, 2013, we acquired franchise web platform developer ElementsLocal, expanding Bridgeline Digital’s presence in the franchise market place. Please see *Acquisitions* section for more detail on the ElementsLocal acquisition.

The iAPPS platform is delivered either 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.

In 2013, 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 2012. iAPPS Content Manager and iAPPS Commerce were selected as finalists for the 2013 CODiE Awards for Best Content Management Solution and Best Electronic Commerce Solution, globally. In 2013 the Internet Advertising Competition honored Bridgeline Digital with three awards for iAPPS customer websites. In addition, in 2013 Bridgeline Digital won fifteen Horizon Interactive Awards for outstanding development of web applications and websites and B2B Magazine has selected Bridgeline Digital as one of the Top Interactive Technology companies in the United States.

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: Atlanta, Baltimore, Boston, Chicago, Dallas, Denver, New York, San Diego, San Luis Obispo and Tampa. 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 180 days to complete. Each franchise/large dealer network sale takes on average 365 days 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/large dealer networks; (iii) retail brand names; (iv) health services and life sciences; (v) technology (software and hardware); and (vi) associations and foundations. We have ten geographic locations in the United States with full-time professional direct sales personnel.

We have business development professionals dedicated to identifying and establishing strategic alliances for iAPPS and iAPPSds. In June 2012, Bridgeline announced a strategic alliance with UPS Logistics. 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.

In July of fiscal 2012 Bridgeline signed a multi-year agreement with The UPS Stores, a national franchise network of over 4,300 locations who license the iAPPSds platform. In July of 2013 we signed a multi-year agreement with a national provider of outsourced sales services with over 300 locations. In August of 2013 we added national brand names such as Sport Clips®, Glass Doctor® and Maaco® to our list of franchise customers via the ElementsLocal acquisition.

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.

During the fiscal year ended September 30, 2013 we completed one acquisition. On August 1, 2013, we completed the acquisition of ElementsLocal, a California based developer of an online SaaS platform for the franchise marketplace. ElementsLocal had over 3,200 franchises on its platform. We acquired all of the outstanding capital stock of ElementsLocal for consideration consisting of (i) \$463 thousand in cash; (ii) \$604 thousand in shares of Bridgeline Digital common stock (valued at \$1.15 per share);(iii) assumption of \$188 thousand of indebtedness; and (iv) contingent consideration of up to \$904 thousand in cash and \$396 thousand in shares of Bridgeline Digital common stock. The contingent consideration is payable quarterly over the 12 consecutive calendar quarters following the acquisition, contingent upon the acquired business achieving a certain quarterly revenue target during the period. The contingent common stock payable each earnout period is determined by dividing \$33 thousand by the greater of: (i) the average closing price for Bridgeline Digital common stock for the 30 day trading period preceding the end of the earnout period, or (ii) \$1.17. To the extent that a quarterly revenue target is not met in a particular quarter, the earn-out period will be extended for up to four additional quarters.

During the fiscal year ended September 30, 2012 we completed two acquisitions. On October 3, 2011, we completed the acquisition of Magnetic Corporation (“Magnetic”), an interactive technology company based in Tampa, Florida. We acquired all of the outstanding capital stock of Magnetic for consideration consisting of (i) \$150 thousand in cash (ii) assumption of \$130 thousand of indebtedness; and (iii) contingent consideration of up to \$600 thousand in cash and 166,666 shares of Bridgeline Digital common stock. The contingent consideration is payable quarterly over the 12 consecutive calendar quarters following the acquisition, contingent upon the acquired business achieving certain quarterly revenue and quarterly operating income targets during the period. The contingent common stock has been issued and is being held in escrow pending satisfaction of the applicable targets. To the extent that either the quarterly revenue targets or the quarterly operating income targets are not met in a particular quarter, the earn-out period will be extended for up to four additional quarters.

On May 31, 2012, we completed the acquisition of MarketNet, Inc. (“MarketNet”), an interactive technology company based in Dallas, Texas. Bridgeline acquired all of the outstanding capital stock of MarketNet for consideration consisting of (i) \$20 thousand in cash; (ii) assumption of debt of \$244 thousand; and (iii) contingent consideration of up to \$650 thousand in cash and 204,331 shares of Bridgeline Digital common stock. This contingent consideration is payable quarterly over the 12 consecutive calendar quarters following the acquisition, contingent upon the acquired business achieving certain quarterly revenue and quarterly operating income targets during the period. To the extent that either the quarterly revenue target or the quarterly operating income target is not met in a particular quarter, the earn-out period will be extended for up to four additional quarters. MarketNet is also eligible to earn additional bonus equity consideration of 200,000 shares, if annual net revenues of the acquired business exceed a certain threshold in any fiscal year through September 30, 2015. The contingent common stock has been issued and is being held in escrow pending satisfaction of the applicable targets.

Each of ElementsLocal, Magnetic and MarketNet’s operating results are reflected in the condensed consolidated financial statements as of the acquisition date.

We may make additional acquisitions in the foreseeable future. These potential acquisitions are 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 2,500 active customers. For the years ended September 30, 2013 and 2012 no one customer represented 10% or more of the Company’s total revenue.

Summary of Results of Operations

Total revenue for the fiscal year ended September 30, 2013 (“fiscal 2013”) decreased to \$24.5 million from \$26.3 million for the fiscal year ended September 30, 2012 (“fiscal 2012”). Loss from operations for fiscal 2013 was (\$3.2) million compared with loss from operations of (\$602) thousand for fiscal 2012. We had a net loss for fiscal 2013 of (\$3.6) million compared with a net loss of (\$946) thousand for fiscal 2012. Loss per share for fiscal 2013 was (\$0.23) compared with loss per share of (\$0.07) for fiscal 2012.

Highlights of Fiscal 2013

Financial

Total iAPPS related revenue increased 13% to \$18.8 million in fiscal 2013 from \$16.6 million in fiscal 2012

Total subscription and perpetual license revenue increased \$1.5 million, or 59%, compared to fiscal 2012

Recurring revenue, which reflects amounts that are contractually due to Bridgeline, increased 23% to \$5.1 million in fiscal 2013 from \$4.2 million in fiscal 2012

Non-iAPPS related revenue decreased 44%, or \$4.3 million, in fiscal 2013 compared to fiscal 2012

Acquisitions, and Product Enhancements

In the fourth quarter of fiscal 2013, we acquired ElementsLocal, a franchise web platform developer, expanding our presence in the franchise marketplace

In the third quarter of fiscal 2012 Bridgeline released iAPPS version 5.0 which offered cross-channel interface, personalized to the user and their tasks, mobile & tablet friendly editing for publishing content, video publishing, built-in translation services and other enhancements that allow users to add or change content without needing a developer

RESULTS OF OPERATIONS (dollars in thousands)	Year Ended September 30,				
	2013	2012	\$	%	
			Change	Change	
Revenue					
Digital engagement services					
iAPPS digital engagement services	\$14,733	\$13,493	\$1,240	9	%
% of total revenue	60 %	51 %			
Other digital engagement services	3,853	7,775	(3,922)	(50)	%
% of total revenue	16 %	30 %			
Subtotal digital engagement services	18,586	21,268	(2,682)	(13)	%
% of total revenue	76 %	81 %			
Managed service hosting	1,921	2,517	(596)	(24)	%
% of total revenue	8 %	10 %			
Subscription and perpetual licenses	4,000	2,511	1,489	59	%
% of total revenue	16 %	9 %			
Total revenue	24,507	26,296	(1,789)	(7)	%
Cost of revenue					
Digital engagement services					
iAPPS digital engagement cost	7,808	6,342	1,467	23	%
% of iAPPS digital engagement revenue	53 %	47 %			
Other digital engagement cost	2,306	4,607	(2,301)	(50)	%
% of other digital engagement revenue	60 %	59 %			
Subtotal digital engagement services	10,114	10,949	(834)	(8)	%
% of digital engagement revenue	54 %	51 %			
Managed service hosting	317	372	(55)	(15)	%
% of managed service hosting	17 %	15 %			
Subscription and perpetual licenses	1,108	450	658	146	%
% of subscription and perpetual licenses revenue	28 %	18 %			
Total cost of revenue	11,539	11,771	(231)	(2)	%
Gross profit	12,968	14,525	(1,558)	(11)	%
Gross profit margin	52.9 %	55.2 %			
Operating expenses					
Sales and marketing	8,593	7,730	863	11	%
% of total revenue	35 %	29 %			
General and administrative	4,474	3,931	543	14	%
% of total revenue	18 %	15 %			
Research and development	1,365	1,456	(91)	(6)	%

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% of total revenue	6	%	6	%		
Depreciation and amortization	1,690		1,729	(39)	(2 %)
% of total revenue	7	%	7	%		
Impairment of intangible asset	-		281	(281	)	NA
% of total revenue	0	%	1	%		
Total operating expenses	16,122		15,127	995	7	%
% of total revenue	66	%	58	%		
Loss from operations	(3,154	)	(602	)	(2,553)	424 %
Interest expense, net	(273	)	(276	)	3	(1 %)
Loss before income taxes	(3,427	)	(878	)	(2,550)	291 %
Provision for income taxes	171		68		103	151 %
Net loss	\$(3,598)		\$(946)		\$(2,653)	281 %
Adjusted EBITDA	\$(712)		\$1,964		\$(2,677)	(136 %)

Revenue

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

Digital Engagement Services

Digital engagement services revenue is comprised of iAPPS digital engagement services and other services generated from non iAPPS related engagements. Total revenue from digital engagement services decreased \$2.7 million, or 13% to \$18.6 million for the year ended September 30, 2013 (“fiscal 2013”). The decrease in digital engagement services revenue compared to the prior period is due to a decrease in non-iAPPS digital engagement services revenues of \$3.9 million, or 50%, when compared to the year ended September 30, 2012 (“fiscal 2012”). However, revenue from iAPPS related digital engagement services increased \$1.2 million, or 9% to \$14.7 million compared to fiscal 2012 as we continue to concentrate on selling higher-margin iAPPS engagements to both new and existing customers.

Digital engagement services revenue as a percentage of total revenue decreased to 76% from 81% in the prior period. The decrease is attributable to a larger mix of iAPPS license related revenue compared to sales of digital engagement services.

Managed Service Hosting

Revenue from managed service hosting decreased \$596 thousand from \$2.5 million in fiscal 2012. The decrease is due to our efforts to engage with customers that are aligned with our core competencies and proactively end engagements with a number of smaller hosting customers obtained through previous acquisitions.

Managed services revenue as a percentage of total revenue decreased to 8% from 10% in fiscal 2013 due to the ending of engagements with smaller hosting customers obtained through previous acquisitions.

Subscription and Perpetual Licenses

Revenue from subscription and perpetual licenses increased \$1.5 million, or 59%, to \$4.0 million from \$2.5 million in fiscal 2012. The increase is due primarily to a higher amount of subscription license revenues from our new product, iAPPSds, and annual maintenance renewals.

Subscription and perpetual license revenue as a percentage of total revenue increased to 16% from 10% in fiscal 2012 due to the increase in subscription license revenues from our new product, iAPPSds, and annual maintenance renewals.

Costs of Revenue

Total cost of revenue for the fiscal year ended September 30, 2013 decreased \$231 thousand, or 2%, to \$11.5 million from \$11.8 million in fiscal 2012.

Cost of Digital Engagement Services

Cost of digital engagement services decreased \$0.8 million, or 8%, compared to fiscal 2012. The cost of total digital engagement services as a percentage of total digital engagement services revenue increased to 54% from 51% in fiscal 2012. This increase is a result of the decrease in non-iAPPS related revenue compared to fiscal 2012.

Cost of iAPPS digital engagement services increased \$1.5 million to \$7.8 million, an increase of 23% when compared to fiscal 2012. The increase is a result of iAPPS digital engagement service revenue increasing 9% when compared to fiscal 2012. Cost of iAPPS digital engagement services as a percentage of iAPPS digital engagement revenue increased to 53% from 47% due to unused capacity of digital engagement personnel in the third quarter of fiscal 2013 compared to the prior year.

Cost of other digital engagement services for fiscal 2013 decreased \$2.3 million to \$2.3 million, a decrease of 50% when compared to fiscal 2012. The decrease is due to reducing personnel costs in line with non-iAPPS revenue decrease. The cost of other digital engagement services as a percentage of other digital engagement service revenue increased to 60% in fiscal 2013 from 59% in fiscal 2012.

Cost of Managed Service Hosting

Cost of managed service hosting decreased \$55 thousand or 15% when compared to fiscal 2012. The decrease in the amount of managed service hosting costs is due to efforts to streamline costs by ending engagements with non-iAPPS related customers, and our continued investments in our co-managed network operation center to support our core iAPPS customer base. The cost of managed services as a percentage of managed services revenue increased to 17% from 15% in fiscal 2012. This increase was due to managed service hosting revenue from low margin hosting customers decreasing faster than the addition of new, iAPPS related managed service hosting agreements for perpetual licenses.

Cost of Subscription and Perpetual License

Cost of subscription and perpetual licenses increased \$658 thousand when compared to fiscal 2012. This is primarily due to the increase in subscription and perpetual license revenue as more of the direct costs associated with our co-managed network operations center are being used to support subscription license revenue, software amortization costs of \$270 thousand related to significant enhancements to our iAPPS platform that began in April 2013, investments made in our co-managed network operations center during the period and, to a lesser extent, incremental costs on lower margin, non-iAPPS SaaS licenses from the MarketNet and ElementsLocal acquisitions.

The cost of subscription and perpetual licenses as a percentage of subscription and perpetual license revenue increased to 28% from 18% in fiscal 2012. This is primarily due to a decrease in perpetual license sales when compared to the prior period as perpetual licenses sales can be lumpy and have a significantly lower direct cost than subscription licenses and an increase in software amortization. We expect the increase in costs of subscription and perpetual licenses as a percentage of license revenue to be temporary and should begin to decrease in fiscal 2014 due to the acquisition of ElementsLocal and the expansion of our iAPPS customer base by selling more iAPPS licenses, including iAPPSds.

Gross Profit

Gross profit decreased \$1.6 million, or 11%, when compared with fiscal 2012. This was due to the decrease in non-iAPPS related digital engagement revenue of 50%.

Operating Expenses

Sales and Marketing Expenses

Sales and marketing expenses increased \$0.9 million, or 11%, compared to fiscal 2012. This increase is primarily attributable to increases associated with personnel and marketing costs related to our acquisitions of MarketNet and ElementsLocal, including personnel costs and marketing costs to promote our iAPPS products. Sales and marketing expense as a percentage of total revenue increased to 35% compared to 29% in fiscal 2012. This increase was due to the decrease in non-iAPPS related digital engagement revenue.

General and Administrative Expenses

General and administrative expenses increased \$0.5 million, or 14%, compared to fiscal 2012. The increase was primarily due to costs associated with the settlement of *Bridgeline Digital, Inc. vs. e.Magination network, LLC and its principal owner, Daniel Roche*, which is described in further detail in *Legal Proceedings* and fiscal 2012 reflecting a larger reduction of expense for changes in estimate of settlement of contingent earnout payments from prior acquisitions that, in our estimation, will not be achieved.

General and administrative expense as a percentage of revenue increased to 18% compared to 15% in fiscal 2012. General and administrative expenses as a percentage of revenue increased due to the decrease in non-iAPPS related digital engagement revenue.

Research and Development

Research and development expense decreased by \$91 thousand, or 6%, compared with fiscal 2012, after capitalization of software development costs. Capitalized software development costs were \$640 thousand and \$480 thousand for fiscal 2013 and 2012, respectively. The decrease is due to the aforementioned increase in capitalized software and development costs related to enhancements to our existing iAPPS platform.

Depreciation and Amortization

Depreciation and amortization expense decreased by \$39 thousand, or 2%, compared to fiscal 2012. This decrease is primarily attributable to a decrease in amortization for intangibles acquired before fiscal 2010 that reached the end of their useful life, offset by additional depreciation expense related to investments made in our co-managed network operation center. Depreciation and amortization was 7% of total revenue for both fiscal 2013 and fiscal 2012.

Impairment of Intangible Asset

We incurred a charge to operations of \$281 thousand for impairment charges related to an intangible asset assumed from our fiscal 2010 acquisition of e.Magination and its wholly-owned subsidiary e.Magination IG, LLC. In the first quarter of fiscal 2012, the Company stopped servicing low margin non-iAPPS opportunities acquired from e.Magination IG, LLC. It was therefore determined that a portion of the customer list was impaired.

Loss from Operations

The loss from operations was (\$3.2) million for fiscal 2013 compared to a loss from operations of (\$602) thousand for fiscal 2012. This increase in loss from operations is a result of the foregoing.

Provision for Income Taxes

The provision for income tax expense was \$171 thousand for fiscal 2013 compared to \$68 thousand for fiscal 2012. Income tax expense represents the estimated liability for Federal, state and foreign income taxes owed by the Company, including the alternative minimum tax. This increase is due to deferred tax liabilities related to indefinite lived, tax deductible assets from two previous acquisitions. 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 asset at September 30, 2013 and 2012.

The Federal net operating loss (NOL) carryforward of approximately \$8.0 million as of September 30, 2013 expires on various dates through 2028. 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 stock-based compensation expense and impairment of goodwill and intangible assets (“Adjusted EBITDA”).

We believe this non-GAAP financial measure of Adjusted EBITDA is useful to management and investors in evaluating our operating performance for the periods presented and 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, amortization of intangibles, depreciation, 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,	
	2013	2012
Net loss	\$(3,598)	\$(946)
Provision for income taxes	171	68
Interest expense, net	273	276
Amortization of intangible assets	511	750
Impairment of intangible assets	-	281
Depreciation	1,179	979
EBITDA	(1,464)	1,408
Other amortization	314	170
Stock-based compensation	438	386
Adjusted EBITDA	\$(712)	\$1,964

Adjusted EBITDA was (\$0.7) million for fiscal 2013 compared with \$2.0 million for fiscal 2012. This was due to the decrease in non-iAPPS related application development revenue compared to fiscal 2012.

Liquidity and Capital Resources

Cash Flows

Operating Activities

Cash used in operating activities was \$77 thousand for fiscal 2013, compared to cash provided by operating activities of \$279 thousand for fiscal 2012. This decrease in cash from operating activities is primarily attributable to lower net income for fiscal 2013, offset by adjustments to reconcile net loss to net cash used in operating activities and an increase in deferred revenue as the majority of our iAPPSds customers elect annual subscriptions.

Investing Activities

Cash used in investing activities was \$2.3 million for fiscal 2013 compared to \$2.0 million for fiscal 2012. The increase was primarily due to the cash consideration for the acquisition of ElementsLocal in fiscal 2013 compared to MarketNet and Magnetic. The decrease in cash used for equipment and improvements was offset by increases in amounts capitalized for software development and contingent acquisition payments.

Financing Activities

Cash provided by financing activities was \$3.0 million for fiscal 2013 compared with \$1.3 million for fiscal 2012. The increase was due to the net proceeds from the sale of subordinated convertible debt. At September 30, 2013, the Company had an outstanding balance under the credit line of \$3.5 million at 9.25% (Silicon Valley Bank's prime rate was 4.00%) and \$272 thousand on its term loan at 9.75%.

Capital Resources and Liquidity Outlook

In December 2013, we entered into a Loan and Security Agreement with BridgeBank (the "BridgeBank Loan Agreement"). The Loan Agreement has a 27 month which expires on March 31, 2016. The Loan Agreement provides for up to \$5 million of revolving credit advances which may be used for acquisitions and working capital purposes. Borrowings are limited to the lesser of (i) \$5 million and (ii) 80% of eligible receivables as defined. We can borrow up to \$1.0 million in out of formula borrowings for specified periods of time. Borrowings bear interest at BridgeBank's prime plus 1.00%. We pay an annual commitment fee of 0.25%. Borrowings are secured by all of our assets and all intellectual property. We are also required to comply with certain financial covenants. The BridgeBank Loan Agreement replaced our prior credit facility with Silicon Valley Bank ("SVB"), which expires on December 31, 2013.

At September 30, 2013, the Company had an outstanding balance under the SVB credit line of \$3.5 million and \$272 thousand outstanding on the term loan, of which \$1.0 million and \$272 thousand was repaid after September 30, 2013, respectively. As of the date of the BridgeBank Loan Agreement the Company had an outstanding balance under the SVB credit line of \$2.5 million. In November 2013, we amended our loan agreement ("the November 2013 Amendment") with SVB. The November 2013 Amendment accelerated the maturity date of the line of credit to December 31, 2013.

On September 30, 2013, Bridgeline Digital entered into a Note Purchase Agreement (the "Purchase Agreement") with accredited investors pursuant to which Bridgeline Digital sold an aggregate of \$2,000,000 of 10% secured subordinated convertible notes (the "Notes"). Taglich Brothers, Inc. served as placement agent for the transaction. The gross proceeds to Bridgeline Digital at the closing of this private placement were \$2,000,000. The Notes accrue interest at a rate of ten percent (10%) per annum and mature on September 30, 2016. Interest on the Notes is payable quarterly in cash. The Notes are convertible at the election of the holder into shares of common stock of Bridgeline Digital at a conversion price equal to \$1.30 per share at any time prior to the maturity date, provided that no holder may convert the Notes if such conversion would result in the holder beneficially owning more than 4.99% of the number of shares of Bridgeline Digital common stock outstanding at the time of conversion. We amended the Purchase Agreement in November 2013 and sold another \$1,000,000 of 10% secured subordinated convertible notes with the same terms.

The Notes are secured by all of Bridgeline Digital's assets. The security interest granted to the holders of the Notes is subordinate to the security interest held by Bridgeline Digital's senior lender, BridgeBank. Bridgeline Digital may prepay any portion of the principal amount of the outstanding Notes at any time, provided that if Bridgeline Digital prepays any principal on or before September 30, 2014, Bridgeline Digital will pay a penalty equal to 10% of the principal amount being prepaid. Under certain circumstances Bridgeline Digital has the right to force conversion of the Notes into shares of Bridgeline Digital common stock in the event the Bridgeline Digital common stock trades in excess of \$2.60 per share for 20 trading days out of any 30 trading day period.

In May 2012, we assumed two promissory notes in connection with the acquisition of MarketNet, Inc. The first promissory note in the amount of \$63 thousand is payable in eight equal installments of \$8 thousand, including interest accrued at 5%, and matures in May 2014. The first installment was paid in July 2012. The second promissory note in the amount of \$80 thousand is due in twelve equal installments of \$7 thousand, including interest accrued at 5%, and matures in May 2015. The first installment was paid in July 2012.

On May 31, 2012, the Company sold 2,173,913 shares of common stock at \$1.15 per share for gross proceeds of \$2.5 million in a private placement. Net proceeds after offering expenses were approximately \$2.2 million.

On June 19, 2013, the Company sold 2,300,000 shares of common stock at \$1.00 per share for gross proceeds of \$2.3 million in a private placement. Net proceeds after offering expenses were approximately \$2.0 million.

We believe that cash generated from operations and proceeds from the bank line of credit, the sale of common stock and sale of subordinated convertible debt will be sufficient to fund the company's working capital and capital expenditure needs in the foreseeable future.

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; (ii) a subordinated promissory notes in the amount of \$500 thousand and \$143 thousand payable quarterly over three years beginning January 2011 and July 2013, respectively, with interest at 1% and 5%, respectively, per annum; (iii) contingent earnouts in the amount of \$600 thousand payable in cash beginning with the quarter ended December 31, 2012 based on the achievement of revenue and earnings targets and 166,666 shares of Bridgeline common stock in connection with the Magnetic acquisition; (iv) contingent earnouts in the amount of \$650 thousand payable in cash beginning with the quarter ended September 30, 2012 based on the achievement of revenue and earnings targets and 404,331 shares of Bridgeline common stock in connection with the MarketNet acquisition; and (v) contingent earnouts in the amount of \$904 thousand payable in cash beginning with the quarter ended September 30, 2012 based on the achievement of revenue targets and 338,461 shares of Bridgeline common stock in connection with the ElementsLocal acquisition. Our contractual obligations extend through FY 2019 and pertain to two leased facilities located in the United States.

The following summarizes our contractual obligations:

(in thousands)	For the Year Ending September 30,					Total
	2014	2015	2016	2017	2018 and thereafter	
Payment obligations by year						
Line of credit	\$800	\$-	\$2,704	\$-	\$-	\$3,504

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Term loan (a)	272	-	-	-	-	272
Subordinated convertible debt	-	-	2,000	-	-	2,000
Subordinated promissory notes	93	21	-	-	-	114
Capital leases	397	339	205	-	-	941
Operating leases (b)	1,310	1,197	1,100	912	1,230	5,749
Contingent acquisition payments (c)	561	507	443	-	-	1,511
Total	\$3,433	\$2,064	\$6,452	\$912	\$ 1,230	\$14,091

(a) Paid in full in October 2013

(b) Net of sublease income

(c) The contingent acquisition payments are maximum potential earn-out consideration payable to former owners of acquired companies. Amounts actually paid may be less. Contingent acquisition payments do not include \$0.8 million of potential common stock issuable upon achievement of certain revenue and earnings targets.

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

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

We recognize revenue as required by the *Revenue Recognition* Topic of the Codification. Revenue is generally recognized when all of the following conditions are satisfied: (1) there is persuasive evidence of an arrangement; (2) delivery has occurred or the services have been provided to the customer; (3) the amount of fees to be paid by the customer is fixed or determinable; and (4) the collection of the fees is reasonably assured. Billings made or payments received in advance of providing services are deferred until the period these services are provided.

During fiscal 2010, we began to develop a reseller channel to supplement our direct sales force for our iAPPS platform. We continue to develop this reseller channel. Resellers are generally located in territories where we do not have a direct sales force. Customers generally sign a license agreement directly with us. Revenue from perpetual licenses sold through resellers is recognized upon delivery to the end user as long as evidence of an arrangement exists, collectability is probable, and the fee is fixed and determinable. Revenue for subscription licenses is recognized monthly as the services are delivered.

Digital Engagement Services

Digital engagement services include professional services primarily related to the Company's web development solutions that address specific customer needs such as site audits, digital strategy, design, information architecture, search engine optimization, search engine marketing, directory services, project management, .NET development, and third party system integration.

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 we recognize revenue as the services are delivered or over the term of the contractual retainer period. These arrangements do not require formal customer acceptance and do not grant any future right to labor hours contracted for but not used.

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. We continue to evaluate the length of the amortization period of the set up fees as we gain more experience with customer contract renewals.

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. We continue to evaluate the length of the amortization period of the set up fees as we gain more experience with customer contract renewals.

Multiple Element Arrangements

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

In accordance with this standard, each deliverable within a multiple-deliverable revenue arrangement is accounted for as a separate unit of accounting if both of the following criteria are met (1) the delivered item has value to the customer on a standalone basis and (2) for an arrangement that includes a right of return relative to the delivered item, delivery or performance of the delivered item is considered probable and within our control. If the deliverables do not meet the criteria for being a separate unit of accounting then they are combined with a deliverable that does meet that criterion. The accounting guidance also requires that arrangement consideration be allocated at the inception of an arrangement to all deliverables using the relative selling price method. The accounting guidance also establishes a selling price hierarchy for determining the selling price of a deliverable. We determine selling price using VSOE, if it exists; otherwise, we use Third-party Evidence (“TPE”). If neither VSOE nor TPE of selling price exists for a unit of accounting, we use Estimated Selling Price (“ESP”).

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

When the Company licenses its software on a perpetual basis in a multiple element arrangement that arrangement typically includes PCS and application development services, we follow the guidance of ASC Topic 605-985. In assessing the hierarchy of relative selling price for PCS, we have determined that VSOE is established for PCS. VSOE for PCS is based on the price of PCS when sold separately, which has been established via annual renewal rates. Similarly, when the Company licenses its software on a perpetual basis in a multiple element arrangement that also includes managed service hosting (“hosting”), we have determined that VSOE is established for hosting based on the price of the hosting when sold separately, which has been established based on renewal rates of the hosting contract. Revenue recognition for perpetual licenses sold with application development services are considered on a case by case basis. The Company has not established VSOE for perpetual licenses or fixed price development services and therefore in accordance with ASC Topic 605-985, when perpetual licenses are sold in multiple element arrangements including application development services where VSOE for the services has not been established, the license revenue is deferred and recognized over the largest measured deliverable. 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 application development services element, the ability to separate the application development services from the software license and the value of the services when sold on a standalone basis are considered. The Company also considers the categorization of the services, the timing of when the services contract was signed in relation to the signing of the perpetual license contract and delivery of the software, and whether the services can be performed by others. The Company has concluded that its application development services are not required for the customer to use the product but, rather enhance the benefits that the software can bring to the customer. In addition, the services provided do not result in significant customization or modification of the software and are not essential to its functionality, and can also be performed by the customer or a third party. If an application development services arrangement does qualify for separate accounting, the Company recognizes the perpetual license on a residual basis. If an application development services arrangement does not qualify for separate accounting, the Company recognizes the perpetual license under the proportional performance model as described above.

When subscription arrangements are sold with application development services, the Company uses its judgment as to whether the application development services qualify as a separate unit of accounting. When subscription service arrangements involve multiple elements that qualify as separate units of accounting, the Company allocates arrangement consideration in multiple-deliverable arrangements at the inception of an arrangement to all deliverables

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

Customer Payment Terms

Payment terms with customers typically require payment 30 days from invoice date. Payment terms may vary by customer but generally do not exceed 45 days from invoice date. Invoicing for digital engagement services are either monthly or upon achievement of milestones and payment terms for such billings are within the standard terms described above. Invoicing for subscriptions and hosting are typically issued monthly and are generally due in the month of service.

Our 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 2013 we performed the annual assessment of our goodwill during the fourth quarter of 2013, using the qualitative approach described above. Based on our qualitative assessment, we concluded that it was not more likely than not that the fair values of any of our reporting units were less than their carrying amounts, and therefore it was not necessary to perform the quantitative two-step impairment test. The key qualitative factors that led to our conclusion included the following: (i) our stock price of \$1.10 as of September 30, 2013 did not materially change from the stock price of \$1.20 of September 30, 2012; (ii) the successful launch of iAPPSds in 2012 with our first iAPPSds customer, a franchisor with over 4,000 locations, and our strategic acquisition of ElementsLocal in 2013, has improved predictability of our forecasts by increasing contractually recurring revenue; and (iii) inputs from recent transactions within the technology sector, such as revenue multiples used to value transactions, have either remained steady since the fiscal 2012 assessment

For fiscal 2012 we performed the annual assessment of our goodwill during the fourth quarter of fiscal 2012, using the qualitative approach described above. Based on our qualitative assessment, we concluded that it was not more likely than not that the fair values of any of our reporting units were less than their carrying amounts, and therefore it was not necessary to perform the quantitative two-step impairment test. The key qualitative factors that led to our conclusion included the following: (i) our stock price more than doubled to \$1.20 as of September 30, 2012; (ii) our strategic alliance with UPS Logistics and the successful launch of iAPPSds with our first iAPPSds customer, a franchisor with over 4,000 locations, has improved the predictability of our forecasts; and (iii) inputs from recent transactions within the technology sector, such a revenue multiples used to value transactions, have either remained steady or improved since the fiscal 2011 assessment.

Accounting for Stock-Based Compensation

At September 30, 2013, we maintained one stock-based compensation plan more fully described in Note 11.

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.

Stock Options Activity (Repricing Plan)

On October 28, 2011, the Company offered its employees the opportunity to have certain outstanding options modified by (i) reducing the grant exercise price to \$0.67, the fair market value of the common stock as of the modification date and (ii) starting a new three year vesting schedule. The aggregate fair value of the modified options of approximately \$90 thousand was calculated using the difference in value between the original terms and the new terms as of the modification date. The incremental cost of the modified option over the original option will be recognized as additional compensation expense over the new three year vesting period beginning on the date of modification. This opportunity was generally limited to options issued subsequent to October 2008.

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 Board of Directors of

Bridgeline Digital, Inc:

We have audited the consolidated balance sheets of Bridgeline Digital, Inc., and subsidiary (the “Company”) as of September 30, 2013 and 2012, and the related consolidated statements of operations, stockholders’ equity, comprehensive loss and cash flows for the years then ended. These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these 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 financial position of Bridgeline Digital, Inc. as of September 30, 2013 and 2012, and the 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.

As discussed in Note 1 to the consolidated financial statements, effective October 1, 2012, the Company adopted Financial Accounting Standards Board issued ASU No. 2011-05, *Comprehensive Income* (Topic 220).

/s/ Marcum LLP

Marcum LLP

December 20, 2013

Boston, Massachusetts

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

(Dollars in thousands, except per share data)

	September 30,	
	2013	2012
ASSETS		
Current assets:		
Cash and cash equivalents	\$2,830	\$2,126
Accounts receivable and unbilled receivables, net	3,194	3,977
Prepaid expenses and other current assets	963	648
Total current assets	6,987	6,751
Equipment and improvements, net	3,065	2,735
Intangible assets, net	1,517	1,527
Goodwill	23,777	21,545
Other assets	1,631	1,132
Total assets	\$36,977	\$33,690
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$1,746	\$1,132
Accrued liabilities	1,093	1,306
Accrued earnouts, current	561	375
Debt, current	1,165	1,424
Capital lease obligations, current	397	230
Deferred revenue	1,960	1,042
Total current liabilities	6,922	5,509
Accrued earnouts, net of current portion	950	990
Debt, net of current portion	4,725	2,988
Capital lease obligations, net of current portion	544	127
Other long term liabilities	1,088	1,106
Total liabilities	14,229	10,720
Commitments and contingencies (See note 10)		
Stockholders' equity:		
Preferred stock - \$0.001 par value; 1,000,000 shares authorized; none issued and outstanding	-	-
Common stock - \$0.001 par value; 20,000,000 shares authorized; 18,313,765 and 15,209,038 shares issued and outstanding, respectively	18	15
Additional paid-in capital	44,206	40,847
Accumulated deficit	(21,314)	(17,716)

Accumulated other comprehensive loss	(162)	(176)
Total stockholders' equity	22,748	22,970
Total liabilities and stockholders' equity	\$36,977	\$33,690

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)

	Years Ended September	
	30,	
	2013	2012
Revenue:		
Web application development services	\$18,585	\$21,268
Managed service hosting	1,921	2,517
Subscription and perpetual licenses	4,000	2,511
Total revenue	24,506	26,296
Cost of revenue:		
Web application development services	10,114	10,949
Managed service hosting	317	372
Subscription and perpetual licenses	1,107	450
Total cost of revenue	11,538	11,771
Gross profit	12,968	14,525
Operating expenses:		
Sales and marketing	8,593	7,730
General and administrative	4,474	3,931
Research and development	1,365	1,456
Depreciation and amortization	1,690	1,729
Impairment of intangible asset	-	281
Total operating expenses	16,122	15,127
Loss from operations	(3,154)	(602)
Interest expense, net	(273)	(276)
Loss before income taxes	(3,427)	(878)
Provision for income taxes	171	68
Net loss	\$(3,598)	\$(946)
Net loss per share:		
Basic and diluted	\$(0.23)	\$(0.07)
Number of weighted average shares:		
Basic and diluted	15,558,244	13,084,095

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,	
	2013	2012
Net Loss	\$(3,598)	\$(946)
Other comprehensive income (loss):		
Net change in foreign currency translation adjustment	14	(59)
Other comprehensive income (loss):	14	(59)
Comprehensive loss	\$(3,584)	\$(1,005)

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

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

(Dollars in thousands)

	Common Stock	Additional	Accumulated	Accumulated	Total	
	Par	Paid in	Deficit	Other	Stockholders'	
	Shares	Value	Capital	Loss	Equity	
Balance at September 30, 2011	12,306,207	\$ 12	\$ 38,083	\$ (16,770)	\$ (117)	\$ 21,208
Issuance of common stock	2,173,913	2	2,215	-	-	2,217
Stock-based compensation expense	-	-	386	-	-	386
Issuance of common stock - acquisitions	570,997	1	410	-	-	411
Decrease in estimate of contingent shares that will be earned from a prior acquisition	-	-	(380)	-	-	(380)
Exercise of stock options	157,921	-	133	-	-	133
Net loss	-	-	-	(946)	-	(946)
Foreign currency translation adjustment	-	-	-	-	(59)	(59)
Balance at September 30, 2012	15,209,038	15	40,847	(17,716)	(176)	22,970
Issuance of common stock	2,300,000	3	2,044	-	-	2,047
Stock-based compensation expense	-	-	438	-	-	438
Issuance of common stock - ESPP	56,112	-	74	-	-	74
Issuance of common stock - Warrants	22,599	-	-	-	-	-
Issuance of common stock - acquisitions	526,438	-	995	-	-	995
Decrease in estimate of contingent shares that will be earned from a prior acquisition	-	-	(354)	-	-	(354)
Exercise of stock options	199,578	-	162	-	-	162
Net loss	-	-	-	(3,598)	-	(3,598)
Foreign currency translation adjustment	-	-	-	-	14	14
Balance at September 30, 2013	18,313,765	\$ 18	\$ 44,206	\$ (21,314)	\$ (162)	\$ 22,748

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,	
	2013	2012
Cash flows from operating activities:		
Net loss	\$(3,598)	\$(946)
Adjustments to reconcile net loss to net cash used by operating activities:		
Change in deferred taxes	102	-
Amortization of intangible assets	511	749
Impairment of intangible asset	-	281
Depreciation	1,179	980
Other amortization	314	170
Stock-based compensation	437	386
Adjustments to accrued earnouts	(507)	(1,100)
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable and unbilled receivables	886	658
Prepaid expenses and other assets	160	259
Accounts payable and accrued liabilities	(192)	(641)
Deferred revenue	729	(268)
Other liabilities	(98)	(249)
Total adjustments	3,521	1,225
Net cash (used in) provided by operating activities	(77)	279
Cash flows from investing activities:		
Equipment and improvements	(545)	(932)
Software development	(814)	(557)
Acquisitions, net of cash acquired	(364)	(35)
Contingent acquisition payments	(531)	(437)
Net cash used in investing activities	(2,254)	(1,961)
Cash flows from financing activities:		
Proceeds from sale of common stock, net of issuance costs	2,044	2,214
Proceeds from exercise of employee stock options	162	133
Proceeds from employee stock purchase plan	74	-
Proceeds from convertible debt, net of issuance costs	1,790	-
Borrowings from bank line of credit	1,092	1,702
Payments on term loan	(620)	(308)
Payments on bank line of credit	(769)	(1,713)
Payments on acquired debt	(188)	(221)
Payments on subordinated promissory notes	(225)	(179)
Principal payments on capital leases	(339)	(289)
Net cash provided by financing activities	3,021	1,339
Effect of exchange rate changes on cash and cash equivalents	14	(59)

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Net increase (decrease) in cash and cash equivalents	704	(402)
Cash and cash equivalents at beginning of period	2,126	2,528
Cash and cash equivalents at end of period	\$2,830	\$2,126
Supplemental disclosures of cash flow information:		
Cash paid for:		
Interest	\$273	\$275
Income taxes	\$53	\$49
Non cash activities:		
Equipment and other assets included in accounts payable	\$50	\$16
Equipment purchased under capital leases	\$855	\$137
Accrued contingent consideration (earnouts)	\$906	\$1,207
Common stock issued in connection with acquisition	\$604	\$412

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 enables its customers to maximize the performance of their mission critical websites, intranets, and online stores. Bridgeline is the developer of the award-winning iAPPS® Web Engagement Management (WEM) product platform and related digital solutions. The iAPPS platform deeply integrates Web Content Management, eCommerce, eMarketing, and web Analytics capabilities within the heart of websites or eCommerce web stores 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.

In fiscal 2012 Bridgeline Digital announced the release of a new product, iAPPSds (“distributed subscription”), 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. On August 1, 2013, we acquired franchise web developer ElementsLocal, expanding Bridgeline Digital's presence in the franchise market place. Please see *Acquisitions* section for more detail on the ElementsLocal acquisition.

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.

In 2012, 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 2012. iAPPS Content Manager and iAPPS Commerce were selected as finalists for the 2012 and 2013 CODiE Awards for Best Content Management Solution and Best Electronic Commerce Solution, globally. In 2013 the Web Marketing Association sponsored Internet Advertising Competition honored Bridgeline Digital with three awards for iAPPS customer websites. In

addition, in 2013 Bridgeline Digital won fifteen Horizon Interactive Awards for outstanding development of web applications and websites and B2B Magazine has selected Bridgeline Digital as one of the Top Interactive Technology companies in the United States.

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: Atlanta, GA; Baltimore, MD; Boston, MA; Chicago, IL; Denver, CO; New York, NY; Dallas, TX; San Diego, CA; San Luis Obispo, CA; and Tampa, FL. The Company has one wholly-owned subsidiary, Bridgeline Digital Pvt. Ltd. located in Bangalore, India.

2. Summary of Significant Accounting Policies

Basis of Presentation and Principles of Consolidation

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.

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 did not have any customers that contributed greater than 10% of revenue for the fiscal years ended September 30, 2013 ("fiscal 2013") and 2012 ("fiscal 2012"), respectively.

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 did not have any customers that had an accounts receivable balance of greater than 10% of total accounts receivable at September 30, 2013 and 2012.

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.

BRIDGELINE DIGITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

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.

During fiscal 2010, the Company began to develop a reseller channel to supplement our direct sales force for our iAPPS platform. The Company continued to develop this reseller channel in fiscal 2013. 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 information architecture and usability engineering, interface configuration, application development, rich media development, back end integration, search engine optimization, 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 we recognize revenue as the services are delivered or over the term of the contractual retainer period. These arrangements do not require formal customer acceptance and do not grant any future right to labor hours contracted for but not used.

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 this standard, 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, 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 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 application development services element, the ability to separate the application development 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.

BRIDGELINE DIGITAL, INC.

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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 and are reserved for in the month in which they occur.

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 \$814 and \$557 of costs in fiscal 2013 and fiscal 2012, respectively.

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

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

Business Combinations

We apply the appropriate guidance for business combination which requires goodwill to be recognized separately from the assets acquired and the liabilities assumed. Under this guidance, the assets acquired and the liabilities assumed are measured at fair value at the acquisition date. While the Company uses its best judgment to assign fair value, estimates are subject to refinement. The refinement period is one year from acquisition date. Adjustments are recorded to the assets acquired and liabilities assumed, with the corresponding offset to goodwill. Any subsequent adjustments made after the one year refinement period are charged to the consolidated statement of operations.

Goodwill

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 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 2013 we performed the annual assessment of our goodwill during the fourth quarter of 2013, using the qualitative approach described above. Based on our qualitative assessment, we concluded that it was not more likely than not that the fair values of any of our reporting units were less than their carrying amounts, and therefore it was not necessary to perform the quantitative two-step impairment test. The key qualitative factors that led to our conclusion included the following: (i) our stock price of \$1.10 as of September 30, 2013 did not materially change from the stock price of \$1.20 of September 30, 2012; (ii) the successful launch of iAPPSds in 2012 with our first iAPPSds customer, a franchisor with over 4,000 locations, and our strategic acquisition of ElementsLocal in 2013, has improved predictability of our forecasts by increasing contractually recurring revenue; and (iii) inputs from recent transactions within the technology sector, such as revenue multiples used to value transactions, have either remained steady since the fiscal 2012 assessment.

BRIDGELINE DIGITAL, INC.

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For fiscal 2012 we performed the annual assessment of our goodwill during the fourth quarter of 2012, using the qualitative approach described above. Based on our qualitative assessment, we concluded that it was not more likely than not that the fair values of any of our reporting units were less than their carrying amounts, and therefore it was not necessary to perform the quantitative two-step impairment test. The key qualitative factors that led to our conclusion included the following: (i) our stock price more than doubled to \$1.20 as of September 30, 2012; (ii) our strategic alliance with UPS Logistics and the successful launch of iAPPSds with our first iAPPSds customer, a franchisor with over 4,000 locations, has improved predictability of our forecasts; and (iii) inputs from recent transactions within the technology sector, such as revenue multiples used to value transactions, have either remained steady or improved since the fiscal 2011 assessment.

While there are inherent limitations in any valuation, the Company believes that placing a significant weighting of 75% on the Discounted Cash Flow Method, the Guideline Public Company Method, and the Guideline Transaction Method are more 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.

For all acquisitions completed before September 30, 2009, the Company records contingent consideration as additional purchase price and goodwill when earned. Such contingent consideration is unrelated to continuing employment with the Company and meets all other relevant criteria. For acquisitions completed after October 1, 2009, 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.

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. During fiscal 2012, the Company impaired \$281 thousand related to an asset assumed from our fiscal 2010 acquisition of e.Magination and its wholly-owned subsidiary eMagination IG, LLC (now Bridgeline Intelligence Group, Inc (See note 6).

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.

BRIDGELINE DIGITAL, INC.

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Fair Value of Financial Instruments

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. Entities are required to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value based on the following value hierarchy:

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.

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 losses for fiscal 2013 and 2012 were not material. 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 operates internally as one reportable operating segment because all of the Company's 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.

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Advertising Costs

Advertising costs are expensed when incurred. Such costs were \$808 and \$836 for fiscal 2013 and 2012, 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 2013 or 2012.

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.

Comprehensive Loss

The Company's comprehensive loss is comprised of net loss and foreign currency translation adjustments.

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.

BRIDGELINE DIGITAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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Recent Accounting Pronouncements

In March 2013, the FASB issued ASU No. 2013-05, "Foreign Currency Matters (Topic 830): Parent's Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity ." This ASU addresses the accounting for the cumulative translation adjustment when a parent either sells a part or all of its investment in a foreign entity or no longer holds a controlling financial interest in a subsidiary or group of assets that is a nonprofit activity or a business within a foreign entity. The guidance outlines the events when cumulative translation adjustments should be released into net income and is intended by FASB to eliminate some disparity in current accounting practice. This ASU is effective prospectively for fiscal years, and interim periods within those years, beginning after December 15, 2013 (fiscal 2015). The amendments should be applied prospectively to derecognition events occurring after the effective date. Prior periods should not be adjusted. Early adoption is permitted. If an entity elects to early adopt the amendments, it should apply them as of the beginning of the entity's fiscal year of adoption. The adoption of this standard is not expected to have a material impact on the Company's consolidated financial position and results of operations.

In July 2012, the FASB issued Accounting Standards Update No. 2012-02, *Testing Indefinite-Lived Intangible Assets for Impairment* ("ASU No. 2012-02"), which allows entities to use a qualitative approach to test indefinite-lived intangible assets for impairment. ASU No. 2012-02 permits an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of the indefinite-lived intangible asset is less than its carrying value. If it is concluded that this is the case, it is necessary to perform the currently prescribed quantitative impairment test. Otherwise, the quantitative impairment test is not required. ASU No. 2012-02 is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. The adoption of the provisions of ASU No. 2012-02 will not have a material impact on the Company's financial position or results of operations.

In June 2011, the Financial Accounting Standards Board issued an ASU that provides amendments on the presentation of comprehensive income. The amendments require that all nonowner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In the two-statement approach, the first statement should present total net income and its components followed consecutively by a second statement that should present total other comprehensive income, the components of other comprehensive income, and the total of comprehensive income. The amendments do not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. The amendments do not change the option for an entity to present components of other comprehensive income either net of related tax effects or before related tax effects, with one amount shown for the aggregate income tax expense or benefit related to the total of other comprehensive income items. In both cases, the tax effect for each component must

be disclosed in the notes to the financial statements or presented in the statement in which other comprehensive income is presented. The amendments do not affect how earnings per share is calculated or presented. This amendment was effective for fiscal years, and interim periods within those years, beginning after December 15, 2011 and should be applied retrospectively. This ASU was adopted in the first quarter of fiscal 2013 and the Company elected the two-statement approach.

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3. Accounts Receivable and Unbilled Receivables

Accounts receivable and unbilled receivables consists of the following:

	September 30,	
	2013	2012
Accounts receivable	\$3,188	\$3,794
Unbilled receivables	111	381
Subtotal	3,299	4,175
Allowance for doubtful accounts	(105)	(198)
Accounts receivable and unbilled receivables, net	\$3,194	\$3,977

4. Equipment and Improvements

Equipment and improvements consists of the following:

	September 30,	
	2013	2012
Furniture and fixtures	\$1,521	\$1,471
Purchased software	973	866
Computers and equipment	4,143	2,882
Leasehold improvements	1,828	1,791
Total cost	8,465	7,010
Less accumulated depreciation	(5,400)	(4,275)
Equipment and improvements, net	\$3,065	\$2,735

Included above are assets acquired under capitalized leases of \$2.1 million and \$1.2 million at September 30, 2013 and 2012, respectively, with accumulated depreciation of \$1.2 million and \$795, respectively. Depreciation and amortization on the above assets was \$1.2 million and \$1.0 million in fiscal 2013 and 2012, respectively.

5. Acquisitions

On August 1, 2013, the Company completed the acquisition of Transformational Technologies, Inc (“ElementsLocal”), a California based developer of an online SaaS platform for the franchise marketplace. The Company acquired all of the outstanding capital stock of ElementsLocal for consideration consisting of (i) \$463 in cash; (ii) \$604 in shares of Bridgeline Digital common stock (valued at \$1.15 per share); (iii) assumption of \$188 of indebtedness; and (iv) contingent consideration of up to \$904 in cash and \$396 in shares of Bridgeline Digital common stock. The contingent consideration is payable quarterly over the 12 consecutive calendar quarters following the acquisition, contingent upon the acquired business achieving a certain quarterly revenue target during the period. The contingent common stock payable each earnout period is determined by dividing \$33 by the greater of: (i) the average closing price for Bridgeline Digital common stock for the 30 day trading period preceding the end of the earnout period; or (ii) \$1.17. To the extent that a quarterly revenue target is not met in a particular quarter, the earn-out period will be extended for up to four additional quarters. The Company is required to assess the probability of the acquired business achieving the contingent cash and stock payments which requires management to make estimates and judgments based on forecasts of future performance. ElementsLocal’s operating results are reflected in the Company’s condensed consolidated financial statements as of the acquisition date.

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MarketNet, Inc.

On May 31, 2012, the Company completed the acquisition of MarketNet, Inc. (“MarketNet”), an interactive technology company that provides digital engagement based in Dallas, Texas. The Company acquired all of the outstanding capital stock of MarketNet for consideration consisting of (i) \$20 in cash; (ii) assumption of debt of \$244; and (ii) contingent consideration of up to \$650 in cash and 204,331 shares of Bridgeline Digital common stock, valued at \$250 (\$1.22 per share). The cash consideration was reduced by \$58 due to the Seller’s inability to meet an agreed upon target for working capital at the time of acquisition and was applied against MarketNet’s earnout payment for the three months ended December 31, 2012. The contingent consideration is payable quarterly over the 12 consecutive calendar quarters following the acquisition, contingent upon the acquired business achieving certain quarterly revenue and quarterly operating income targets during the period. To the extent that either the quarterly revenue target or the quarterly operating income target is not met in a particular quarter, the earn-out period will be extended for up to four additional quarters. MarketNet is also eligible to earn additional bonus equity consideration of 200,000 shares, if annual net revenues of the acquired business exceed a certain threshold in any fiscal year through September 30, 2015. The Company is required to assess the probability of the acquired business achieving the contingent cash and stock payments which requires management to make estimates and judgments based on forecasts of future performance. As a result, the Company reduced the initial estimate of \$607 for the contingent cash consideration to be achieved and \$262 for the contingent stock consideration to be achieved by \$92 and \$60, respectively. The contingent common stock has been issued and is being held in escrow pending satisfaction of the applicable targets. MarketNet’s operating results are reflected in the Company’s condensed consolidated financial statements as of the acquisition date.

Magnetic Corporation

On October 3, 2011, the Company completed the acquisition of Magnetic Corporation (“Magnetic”), a web technology company based in Tampa, Florida. Bridgeline acquired all of the outstanding capital stock of Magnetic for consideration consisting of (i) \$150 in cash; and (ii) contingent consideration of up to \$600 in cash and 166,666 shares of Bridgeline Digital common stock, valued at \$150 (\$0.90 per share). The cash consideration was reduced by \$100 due to the Seller’s inability to meet an agreed upon target for working capital at the time of acquisition. The contingent consideration is payable quarterly over the 12 consecutive calendar quarters following the acquisition, contingent upon the acquired business achieving certain quarterly revenue and quarterly operating income targets during the period. The contingent common stock has been issued and is being held in escrow pending satisfaction of the applicable targets. To the extent that either the quarterly revenue target or the quarterly operating income target is not met in a particular quarter, the earn-out period will be extended for up to four additional quarters. The Company is required to assess the probability of the acquired business achieving the contingent cash and stock payments which

requires management to make estimates and judgments based on forecasts of future performance. As a result, the Company estimated and accrued \$600 of the contingent cash consideration to be achieved and \$150 of the contingent stock consideration to be achieved. Magnetic achieved its quarterly revenue and operating income targets for all periods since the acquisition date. Magnetic's operating results are reflected in the Company's condensed consolidated financial statements as of the acquisition date, which corresponds to the Company's commencement of fiscal 2012.

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The estimated fair value of net assets acquired from the acquisitions of ElementsLocal, MarketNet and Magnetic are summarized as follows:

Net assets acquired:	Amount
Cash	\$ 135
Accounts Receivable, net	467
Other Assets	181
Fixed Assets	91
Intangible Assets	1,510
Goodwill	3,323
Total Assets	5,707
Current Liabilities	1,580
Liabilities, net of current	73
Total liabilities assumed	1,653
Net assets acquired:	\$ 4,054
 Purchase Price:	
Cash Paid	\$ 533
Common stock issued	604
Contingent earnouts - payable in cash	2,110
Contingent earnouts - payable in common stock	807
	\$ 4,054

As part of the ElementsLocal acquisition \$600 was allocated to intangible assets, \$400 of which was allocated to customer relationships, \$164 was allocated to non-compete agreement, and \$36 was allocated to tradename with an average useful life of seven, five and 2 years, respectively. These amounts are preliminary and will be adjusted when the valuations are completed.

As part of the Magnetic acquisition \$430 was allocated to intangible assets, \$350 of which was allocated to customer relationships and \$80 was allocated to non-compete agreement, with an average useful life of seven years and five years, respectively.

As part of the MarketNet acquisition \$480 was allocated to intangible assets, \$370 of which was allocated to customer relationships and \$110 was allocated to non-compete agreement, with an average useful life of seven years and five years, respectively.

The goodwill recorded as a result of the Magnetic, MarketNet and ElementsLocal acquisitions are nondeductible for tax purposes.

Contingent earnout liabilities for acquisitions completed after January 1, 2009 were recorded at fair value based on valuation models that utilize relevant factors such as estimated probabilities of the acquisitions achieving the performance targets throughout the earnout period. The following table summarizes the changes in earnout liabilities for the fiscal year ended September 30, 2013:

Balance at September 30, 2012	\$1,365
Contingent earnout liability accruals	933
Contingent earnout liability payments	(531)
Contingent earnout liability valuation adjustment	(256)
Balance at September 30, 2013	\$1,511

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The following unaudited pro forma financial information reflects the combined results of operations for Bridgeline for the fiscal years ended September 30, 2013 and 2012. This information does not necessarily reflect the results of operations that would have occurred had the acquisitions taken place at the beginning of the period, and is not necessarily indicative of the results which may be obtained in the future:

**Year
Ended
September
30,**