Bridgeline Digital, Inc.
Form 10-Q
February 14, 2018

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended December 31, 2017

OR

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

For the transition period from ______________ to ______________

Commission File Number 333-139298

Bridgeline Digital, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**52-2263942**
State or other jurisdiction of incorporation or organization	IRS Employer Identification No.

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

(781) 376-5555
(Registrant's telephone number, including area code)

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files) Yes No

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

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

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

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

The number of shares of Common Stock par value $0.001 per share, outstanding as of February 10, 2018 was 4,200,219.

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For the Quarterly Period ended December 31, 2017

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Bridgeline Digital, Inc.

Quarterly Report on Form 10-Q

For the Quarterly Period ended December 31, 2017

Statements contained in this Report on Form 10-Q that are not based on historical facts are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements may be identified by the use of forward-looking terminology such as "should," "could," "may," "will," "expect," "believe," "estimate," "anticipate," "intends," "continue," or similar terms or variations of those terms or the negative of those terms. These statements appear in a number of places in this Form 10-Q and include statements regarding the intent, belief or current expectations of Bridgeline Digital, Inc. Forward-looking statements are merely our current predictions of future events. Investors are cautioned that any such forward-looking statements are inherently uncertain, are not guaranties of future performance and involve risks and uncertainties. Actual results may differ materially from our predictions. Important factors that could cause actual results to differ from our predictions include the impact of the weakness in the U.S. and international economies on our business, our inability to manage our future growth effectively or profitably, fluctuations in our revenue and quarterly results, our license renewal rate, the impact of competition and our ability to maintain margins or market share, the limited market for our common stock, the volatility of the market price of our common stock, the ability to maintain our listing on the NASDAQ Capital market, the ability to raise capital, the performance of our products, our ability to respond to rapidly evolving technology and customer requirements, our ability to protect our proprietary technology, the security of our software, our dependence on our management team and key personnel, our ability to hire and retain future key personnel, or our ability to maintain an effective system of internal controls. Although we have sought to identify the most significant risks to our business, we cannot predict whether, or to what extent, any of such risks may be realized, nor is there any assurance that we have identified all possible issues which we might face. We assume no obligation to update our forward-looking statements to reflect new information or developments. We urge readers to review carefully the risk factors described in our Annual Report on Form 10-K for the fiscal year ended September 30, 2017 as well as in the other documents that we file with the Securities and Exchange Commission. You can read these documents at www.sec.gov.

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

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PART I—FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements.

BRIDGELINE DIGITAL, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share data)

(Unaudited)

	December 31, 2017	September 30, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	$ *1,117*	$ *748*
Accounts receivable and unbilled receivables, net	*3,208*	*3,026*
Prepaid expenses and other current assets	*464*	*352*
Total current assets	*4,789*	*4,126*
Property and equipment, net	*181*	*209*
Intangible assets, net	*191*	*263*
Goodwill	*12,641*	*12,641*
Other assets	*303*	*334*
Total assets	$ *18,105*	$ *17,573*
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ *1,175*	$ *1,241*
Accrued liabilities	*980*	*920*
Debt, current	*42*	-
Deferred revenue	*1,380*	*1,466*
Total current liabilities	*3,577*	*3,627*
Debt, net of current portion	*3,142*	*2,500*
Other long term liabilities	*444*	*172*
Total liabilities	*7,163*	*6,299*
Commitments and contingencies		
Stockholders' equity:		

Preferred stock - $0.001 par value; 1,000,000 shares authorized; 250,927 at December 31, 2017 and 243,536 at September 30, 2017, issued and outstanding (liquidation preference $2,585)	-	-
Common stock - $0.001 par value; 50,000,000 shares authorized; 4,200,219 at December 31, 2017 and at September 30, 2017, issued and outstanding	*4*	*4*
Additional paid-in capital	*66,043*	*65,869*
Accumulated deficit	*(54,754*)	*(54,249*)
Accumulated other comprehensive loss	*(351*)	*(350*)
Total stockholders' equity	*10,942*	*11,274*
Total liabilities and stockholders' equity	$ *18,105*	$ *17,573*

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

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BRIDGELINE DIGITAL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except share and per share data)

(Unaudited)

	Three Months Ended December 31, 2017	2016
Net revenue:		
Digital engagement services	$2,060	$2,026
Subscription and perpetual licenses	1,606	1,725
Managed service hosting	303	240
Total net revenue	3,969	3,991
Cost of revenue:		
Digital engagement services	1,397	1,128
Subscription and perpetual licenses	480	496
Managed service hosting	80	71
Total cost of revenue	1,957	1,695
Gross profit	2,012	2,296
Operating expenses:		
Sales and marketing	1,104	1,294
General and administrative	736	791
Research and development	407	360
Depreciation and amortization	108	185
Restructuring charges	-	31
Total operating expenses	2,355	2,661
Loss from operations	(343)	(365)
Interest and other expense, net	(86)	(31)
Loss before income taxes	(429)	(396)
Provision for income taxes	1	12
Net loss	(430)	(408)
Dividends on convertible preferred stock	(75)	(68)
Net loss applicable to common shareholders	$(505)	$(476)
Net loss per share attributable to common shareholders:		
Basic and diluted	$(0.12)	$(0.12)
Number of weighted average shares outstanding:		
Basic and diluted	4,200,219	4,011,724

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

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BRIDGELINE DIGITAL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(in thousands)

(Unaudited)

	Three Months Ended December 31,	
	2017	**2016**
Net Loss	$*(430)*	$*(408)*
Other Comprehensive income: Net change in foreign currency translation adjustment	*1*	*2*
Comprehensive loss	$*(429)*	$*(406)*

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

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BRIDGELINE DIGITAL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(Unaudited)

	Three Months Ended December 31, 2017	2016
Cash flows from operating activities:		
Net loss	$(430)	$(408)
Adjustments to reconcile net loss to net cash used in operating activities:		
Amortization of intangible assets	72	71
Depreciation	36	89
Other amortization	16	39
Debt discount amortization	22	-
Stock-based compensation	125	122
Changes in operating assets and liabilities		
Accounts receivable and unbilled receivables	(182)	(81)
Prepaid expenses and other assets	(50)	39
Accounts payable and accrued liabilities	(37)	(390)
Deferred revenue	(86)	187
Other liabilities	(61)	39
Total adjustments	(145)	115
Net cash used in operating activities	(575)	(293)
Cash flows used in investing activities:		
Software development capitalization costs	-	(21)
Purchase of property and equipment	(8)	-
Net cash used in investing activities	(8)	(21)
Cash flows provided by financing activities:		
Proceeds from issuance of common stock, net of issuance costs	-	891
Proceeds from term notes	953	-
Borrowing on bank line of credit	300	355
Payments on bank line of credit	(300)	(80)
Contingent acquisition payments	-	(75)
Principal payments on capital leases	-	(12)
Net cash provided by financing activities	953	1,079
Effect of exchange rate changes on cash and cash equivalents	(1)	2
Net increase in cash and cash equivalents	369	767
Cash and cash equivalents at beginning of period	748	661
Cash and cash equivalents at end of period	$1,117	$1,428

Supplemental disclosures of cash flow information:		
Cash paid for:		
Interest	$*64*	$*33*
Income taxes	$*9*	$*17*
Non cash investing and financing activities:		
Accrued dividends on convertible preferred stock	$*76*	$*68*

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

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BRIDGELINE DIGITAL, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(in thousands, except share and per share data)

1. **Description of Business**

Overview

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

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

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

Locations

The Company's corporate office is located in Burlington, Massachusetts. The Company has *one* wholly-owned subsidiary, Bridgeline Digital Pvt. Ltd. located in Bangalore, India.

Reverse Stock Split

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

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

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

Liquidity and Management's Plans

The Company has a Loan and Security Agreement ("Heritage Agreement") with Heritage Bank of Commerce ("Heritage Bank") which has a maturity date of *June 15, 2019.* The Heritage Agreement currently provides for *$2.5* million of revolving credit advances and *may* be used for acquisitions and working capital purposes. The credit advances *may not* exceed the monthly borrowing base capacity, which will fluctuate based on monthly accounts receivable balances. The Company *may* request credit advances if the borrowing capacity is more than the current outstanding loan advance, and must pay down the outstanding loan advance if it exceeds the borrowing capacity. As of *December 31, 2017,* the Company had an outstanding balance under the Heritage Agreement of *$2.5* million.

BRIDGELINE DIGITAL, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(in thousands, except share and per share data)

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

On *May 19, 2017,* the Company filed a Registration Statement on Form S-*3* with the Securities and Exchange Commission in relation to the registration of securities of the Company having an aggregate public offering price of up to *$10* million. The determinate number of shares of common stock, preferred stock, warrants, and units of any combination thereof (collectively, the "Securities") *may* be offered and sold from time to time, but shall *not* exceed *$10* million in total. There have been *no* securities sold as of *December 31, 2017.*

Historically, the Company has had operating losses and working capital deficiencies, but has undertaken a long term cost reduction plan that includes staff reductions and office lease consolidations to compensate for the shortfalls. The Company will continue to follow through with its plan and closely monitor and adjust such expenditures throughout the next *twelve* months. While there can be *no* assurance that anticipated sales will be achieved for future periods, the Company's management believes it has an appropriate cost structure in place to support the revenues that will be achieved under the Company's operating plan. Management believes that it is probable that working capital, capital expenditure and debt repayment needs for the next *twelve* months from the financial statement date of issuance will be met. The cash balance as of *December 31, 2017* of *$1.1* million as well as collections from accounts receivable will be sufficient to meet the Company's obligations for a minimum of *twelve* months from the financial statement issuance date. While *not* currently included in the Company's operating plan and forecast, it *may* raise additional capital or borrow on its credit facility with Heritage Bank and/or advance the *second* tranche of funds from Montage Capital, if the respective financial milestones are met, in order to fund future operations. The ability to raise funds through these means *may* be helpful to the Company if the anticipated sales levels are *not* achieved or it cannot reduce operating expenses to account for any shortfalls.

2. Summary of Significant Accounting Policies

Basis of Presentation and Principles of Consolidation

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

Unaudited Interim Financial Information

The unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("US GAAP"), and with the instructions to Form *10*-Q and Regulation S-*X,* and in the opinion of the Company's management. These condensed consolidated financial statements include all adjustments, consisting of normal recurring adjustments and accruals, necessary for the fair presentation. The operating results for the *three* months ended *December 31, 2017* are *not* necessarily indicative of the results to be expected for the year ending *September 30, 2018.* The accompanying *September 30, 2017* Condensed Consolidated Balance Sheet has been derived from the audited financial statements at that date, but does *not* include all of the information and footnotes required by US GAAP for complete financial statements. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's annual report on Form *10*-K for the year ended *September 30, 2017.*

Subsequent Events

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

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BRIDGELINE DIGITAL, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(in thousands, except share and per share data)

Recent Accounting Pronouncements

Revenue Recognition

In *May 2014,* the Financial Accounting Standards Board (FASB) issued Accounting Standards Update ("ASU") *No. 2014-09,* Revenue from Contracts with Customers: Topic *606* (ASU *2014-09*), to supersede nearly all existing revenue recognition guidance under U.S. GAAP. ASU *2014-09* is effective for annual reporting periods beginning after *December 15, 2017,* including interim reporting periods within that reporting period. The core principle of ASU *2014-09* is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration that is expected to be received for those goods or services. ASU *2014-09* defines a *five* step process to achieve this core principle and, in doing so, it is possible more judgment and estimates *may* be required within the revenue recognition process than required under existing U.S. GAAP including identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. ASU *2014-09* is effective for the Company in the *first* quarter of fiscal *2019.* Companies *may* adopt ASU *2014-09* using either the retrospective method, under which each prior reporting period is presented under ASU *2014-09,* with the option to elect certain permitted practical expedients, or the modified retrospective method, under which a company adopts ASU *2014-09* from the beginning of the year of initial application with *no* restatement of comparative periods, with the cumulative effect of initially applying ASU *2014-09* recognized at the date of initial application, with certain additional required disclosures. The Company plans to adopt the standard using the full retrospective method to restate each prior reporting period presented. Additionally, as the Company continues to assess the new standard along with industry trends and additional interpretive guidance, the Company *may* adjust its implementation plan accordingly.

As the Company is continuing to assess all potential impacts of the new standard, it currently believes that the impact will *not* be significant. A large portion of the Company's business is for the licensing of Software-as-a-Service (SaaS) term-based software licenses bundled with maintenance and support. Under current GAAP, the revenue attributable to these software licenses is recognized ratably over the term of the arrangement because VSOE does *not* exist for the undelivered maintenance and support element as it is *not* sold separately. To apply the revenue standard, a company must *first* determine whether a contract includes a promise of a license of intellectual property. A separate promise of a license exists when (*1*) the customer has the contractual right to take possession of the software at any time without significant penalty and (*2*) the customer can run the software on its own hardware or contract with another party unrelated to the vendor to hoist of the software. Neither of these criteria are met with our current SaaS licensing arrangements, therefore, revenue recognition will continue to be recognized over the period of service. Revenue recognition related to our professional services is expected to remain substantially unchanged.

Another significant provision under ASU *2014-09* includes the capitalization and amortization of costs associated with obtaining a contract, such as sales commissions. Currently, the Company expenses sales commissions in the period incurred. Under ASU *2014-09,* direct and incremental costs to acquire a contract are capitalized and amortized using a systematic basis over the pattern of transfer of the goods and services to which the asset relates. While we are continuing to assess the impact of this provision of ASU *2014-09,* we likely will be required to capitalize incremental costs such as commissions and amortize those costs over the period the capitalized assets are expected to contribute to future cash flows. Due to the complexity of certain of our contracts, the actual accounting treatment required under the new standard for these arrangements *may* be dependent on contract-specific terms and therefore *may* vary in some instances.

Leases

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

Income Taxes

On *December 22, 2017,* the U.S. government enacted comprehensive tax legislation commonly referred to as the Tax Cuts and Jobs Act (the "Tax Act"). The Tax Act makes broad and complex changes to the U.S. tax code that will affect the Company's fiscal year ending *September 30, 2018,* including, but *not* limited to, reducing the U.S. federal corporate tax rate. The Tax Act reduces the federal corporate tax rate to *21* percent in the fiscal year ending *September 30, 2018.* The reduction of the corporate tax rate will cause the Company to reduce its deferred tax asset to the lower federal base rate and adjust the allowance against the deferred tax asset by the same amount. The Company has *not* yet determined the impact the rate reduction will have on its gross deferred tax asset and liabilities and offsetting valuation allowance. The Company has a full allowance against the deferred tax asset and as a result there was *no* impact to income tax expense for the quarter ended *December 31, 2017.*

The changes included in the Tax Act are broad and complex. The final transition impacts of the Tax Act *may* differ from the above estimate, possibly materially, due to, among other things, changes in interpretations of the Tax Act, any legislative action to address questions that arise because of the Tax Act, any changes in accounting standards for income taxes or related interpretations in response to the Tax Act, or any updates or changes to estimates the company has utilized to calculate the transition impact. The Securities Exchange Commission has issued rules that would allow for a measurement period of up to *one* year after the enactment date of the Tax Act to finalize the recording of the related tax impacts. We currently anticipate finalizing and recording any resulting adjustments by the end of our current fiscal year ending *September 30, 2018*.

BRIDGELINE DIGITAL, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(in thousands, except share and per share data)

Cash Flows

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

In *November 2016,* the FASB issued ASU *No. 2016-18* which requires entities to include in their cash and cash-equivalent balances in the statement of cash flows those amounts that are deemed to be restricted cash and restricted cash equivalents. As a result, companies will *no* longer present transfers between cash and cash equivalents, and restricted cash and restricted cash equivalents in the statement of cash flows. The guidance is effective for annual and interim periods beginning after *December 15, 2017.* Early adoption of ASU *2016-18* is permitted, including adoption in an interim period. Management is currently evaluating the adoption of ASU *2016-18* on its consolidated financial statements.

Goodwill

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

Business Combinations

In *January 2017,* the FASB issued ASU *No. 2017-01,* which amended the existing FASB Accounting Standards Codification Topic *805* Business Combinations. The standard provides additional guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The definition of a business affects many areas of accounting, including acquisitions, disposals, goodwill, and consolidation. ASU *2017-01* is effective for annual periods beginning after *December 15, 2017,* including interim periods within those annual periods, with early adoption permitted. Management is currently evaluating the impact of the new guidance on its consolidated financial statements.

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

3. Accounts Receivable and Unbilled Receivables

Accounts receivable and unbilled receivables consists of the following:

	As of December 31, 2017	As of September 30, 2017
Accounts receivable	$ *3,090*	$ *3,174*
Unbilled receivables	*204*	*41*
Subtotal	*3,294*	*3,215*
Allowance for doubtful accounts	*(86*)	*(189*)
Accounts receivable and unbilled receivables, net	$ *3,208*	$ *3,026*

For the *three* months ended *December 31, 2017* and *December 31, 2016, one* customer represented more than *10%* of accounts receivable. For the *three* months ended *December 31, 2017, two* customers represented *11%* and *12%* of the Company's total revenue. For the *three* months ended *December 31, 2016, one* customer represented *12%* of the Company's total revenue.

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BRIDGELINE DIGITAL, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(in thousands, except share and per share data)

***4.* Fair Value Measurement and Fair Value of Financial Instruments**

The Company's other financial instruments consist principally of accounts receivable, accounts payable, and debt. The Company measures its financial assets and liabilities at fair value. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (i.e., exit price) in an orderly transaction between market participants at the measurement date. Additionally, companies are required to provide disclosure and categorize assets and liabilities measured at fair value into *one* of *three* different levels depending on the assumptions (i.e., inputs) used in the valuation. Level *1* provides the most reliable measure of fair value while Level *3* generally requires significant management judgment. Financial assets and liabilities are classified in their entirety based on the lowest level of input significant to the fair value measurement. The fair value hierarchy is defined as follows:

Level *1—Valuations* are based on unadjusted quoted prices in active markets for identical assets or liabilities.

Level *2—Valuations* are based on quoted prices for similar assets or liabilities in active markets, or quoted prices in markets that are *not* active for which significant inputs are observable, either directly or indirectly.

Level *3—Valuations* are based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement. Inputs reflect management's best estimate of what market participants would use in valuing the asset or liability at the measurement date.

The Company believes the recorded values for accounts receivable and accounts payable and short term debt approximate current fair values as of *December 31, 2017* and *September 30, 2017* because of their short-term nature and durations. The carrying value of long term debt also approximates fair value as of *December 31, 2017* and *September 30, 2017 based upon the Company's ability to acquire similar debt at similar maturities.* In the *three* months ended *December 31, 2017,* the Company recorded a liability associated with a conversion feature embedded in a warrant to purchase common stock issued to Montage Capital. The fair value of the warrant liability will utilize a Level *3* input. To determine the value of the warrant liability, the Company used a Monte Carlo option-pricing model, which takes into consideration the market values of comparable public companies, considering among other factors, the use of multiples of earnings, and adjusted to reflect the restrictions on the ability of our shares to trade in an active market. The Monte Carlo option-valuation model also uses certain assumptions to determine the fair value, including expected life and annual volatility. Such inputs used to value the warrant liability include an expected life of *eight* (*8*) years, annual volatility of *80%,* and a risk-free interest rate of *2.24%.*

The fair value of the warrant liability was valued at the loan execution date in the amount of *$341* and will be revalued at the end of each reporting period to fair value. The fair value at *December 31, 2017* was *$338* and is included in other long term liabilities in the Condensed Consolidated Balance Sheet. Changes in fair value are included in interest expense in the Condensed Statement of Operations in the period the change occurs.

Assets and liabilities of the Company measured at fair value on a recurring basis as of *December 31, 2017* are as follows:

	As of December 31, 2017			
	Level 1	**Level 2**	**Level 3**	**Total**
Liabilities:				
Warrant liability	$ -	$ -	$ *338*	$ *338*
Total Liabilities	$ -	$ -	$ *338*	$ *338*

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BRIDGELINE DIGITAL, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(in thousands, except share and per share data)

The following table provides a rollforward of the fair value, as determined by Level *3* inputs, of the warrant liability.

	Three Months Ended December 31, 2017
Balance at beginning of period, October 1, 2017	$ -
Additions	*341*
Adjustment to fair value	*(3*)
Balance at end of period, December 31, 2017	$ *338*

5. Intangible Assets

The components of intangible assets are as follows:

	As of December 31, 2017	**As of September 30, 2017**
Domain and trade names	$ *10*	$ *10*
Customer related	*125*	*179*
Non-compete agreements	*56*	*74*
Balance at end of period	$ *191*	$ *263*

Total amortization expense related to intangible assets for the *three* months ended *December 31, 2017* and *2016* was *$72* and *$71,* respectively, and is reflected in operating expenses on the Condensed Consolidated Statements of Operations. The estimated amortization expense for fiscal years *2018* (remaining) and *2019* is *$175* and *$16,* respectively.

_6._ Restructuring

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

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The following table summarizes the restructuring activity for the *three* months ended *December 31, 2017:*

	Facility Closures and Other Costs
Balance at beginning of period, October 1, 2017	$ *176*
Charges to operations	-
Cash disbursements	*(67*)
Changes in estimates	-
Balance at end of period, December 31, 2017	$ *109*

The components of the accrued restructuring liabilities is as follows:

	As of December 31, 2017	As of September 30, 2017
Facilities and related	$ *103*	$ *133*
Other	*6*	*43*
Total	$ *109*	$ *176*

As of *December 31, 2017, $57* was reflected in Accrued Liabilities and *$52* in Other Long Term Liabilities in the Condensed Consolidated Balance Sheet. As of *September 30, 2017, $119* is reflected in Accrued Liabilities and *$57* is reflected in Other Long Term liabilities in the Condensed Consolidated Balance Sheet.

7. Debt

Debt at *December 31, 2017* and *September 30, 2017* consists of the following:

	As of December 31, 2017	As of September 30, 2017
Line of credit borrowings	$ *2,500*	$ *2,500*
Term loan - Montage Capital	*1,000*	-
Subtotal debt	$ *3,500*	$ *2,500*
Other (debt discount)	$ *(316*)	-
Total debt	$ *3,184*	$ *2,500*
Less current portion	$ *42*	$ -
Long term debt, net of current portion	$ *3,142*	$ *2,500*

Heritage Line of Credit

In *June 2016,* the Company entered into a new Loan and Security Agreement with Heritage Bank of Commerce ("Heritage Agreement" or "Loan Agreement"). The Heritage Agreement had and original a term of *24* months but was amended in *2017* to a maturity date of *June 9, 2019.* The Company paid an annual commitment fee of *0.4%* of the commitment amount in the *first* year and *0.2%* in the *second* year. The facility fee is *$6* on each anniversary thereafter. Borrowings are secured by all of the Company's assets and all of the Company's intellectual property. The Company is required to comply with certain financial and reporting covenants including an Asset Coverage Ratio and an Adjusted EBITDA metric. The Company was in compliance with all financial covenants as of *December 31, 2017.*

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The Heritage Agreement provides for up to $*2.5* million of revolving credit advances which *may* be used for acquisitions and working capital purposes. Borrowings are limited to the lesser of (i) *$2.5* million and (ii) *75%* of eligible receivables as defined. The Company can borrow up to *$1.0* million in out of formula borrowings for specified periods of time. The borrowings or credit advances *may not* exceed the monthly borrowing base capacity, which will fluctuate based on monthly accounts receivable balances. The Company *may* request credit advances if the borrowing capacity is more than the current outstanding loan advance, and must pay down the outstanding loan advance if it exceeds the borrowing capacity. Borrowings accrue interest at Wall Street Journal Prime Rate plus *1.75%,* (currently *6%*). As of *December 31, 2017,* the Company had an outstanding balance under the Loan Agreement of *$2.5* million.

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

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

Amendments – Heritage Bank

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

Heritage, which was waived for the period ended *September 30, 2016.*

On *December 14, 2016,* a *second* amendment to the Heritage Agreement ("Second Amendment") was executed. The Second Amendment included a minimum cash requirement of *$250* in its accounts at Heritage and the Adjusted EBITDA metrics for the *first* half of fiscal *2017.*

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

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

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

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Montage Capital II, L.P. Loan Agreement

On *October 10, 2017,* the Company entered into a Loan and Security Agreement (the "Loan Agreement") with Montage Capital II, L.P. ("Montage"). The Loan Agreement has a *thirty-six* (*36*) month term which expires on *October 10, 2020.* The Loan Agreement provides for up to *$1.5* million of borrowing in the form of a non-revolving term loan which *may* be used by the Company for working capital purposes. *$1* million of borrowing was advanced on the date of closing (the "First Tranche"). An additional *$500* thousand of borrowing will be available at the Company's option in the event that the Company achieves certain financial milestones and is otherwise in compliance with its loan covenants (the "Second Tranche"). Borrowings bear interest at the rate of *12.75%* per annum. The Company paid a fee of *$47* to Montage at closing. Interest only payments are due and payable during the *first nine* months of the Loan. Commencing on *July 1, 2018,* the Company shall be obligated to make principal payments of *$26* per month if only the First Tranche has been received and *$39* if the Company has received both the First Tranche and the Second Tranche. All remaining principal and interest shall be due and payable at maturity. Borrowings are secured by a *second* position lien on all of the Company's assets including intellectual property and general intangibles. Pursuant to the Loan Agreement, the Company is also required to comply with certain financial covenants. The Loan is subordinate to the Company's senior debt facility with Heritage Bank of Commerce ("Heritage"). Heritage consented to the Company's incurrence of additional indebtedness from Montage and the grant of a *second* position lien to Montage. In addition, Heritage and Montage entered into an intercreditor agreement dated *October 10, 2017,* and acknowledged by the Company.

As additional consideration for the Loan, the Company issued to Montage an *eight*-year warrant (the "Warrant") to purchase *66,315* shares of the Company's common stock at a price equal to *$2.65* per share which *may* increase to an aggregate of *100,082* shares of the Company's common stock in the event that Montage advances the Second Tranche. The Warrant contains an equity buy-out provision upon the earlier of (*1*) dissolution or liquidation of the Company, (*2*) any sale or distribution of all or substantially all of the assets of the Company or (*3*) a "Change in Control" as defined within the meaning of Section *13*(d) and *14*(d)(*2*) of the Securities Exchange Act of *1934.* Montage shall have the right to receive an equity buy-out of either *$250* if only the First Tranche has been advanced or *$375* if both the First Tranche and the Second Tranche have been advanced. If the equity buy-out is exercised, the Warrant will be surrendered to the Company for cancellation. The fair value of the Warrant was initially valued at *$341* at the loan execution. The Warrant is classified as a liability with an offsetting entry to debt discounts, which will be amortized over the life of the Loan Agreement. Total amortization of the debt discount for the *three* months ended *December 31, 2017* was *$25.*

8. Other Long Term Liabilities

Deferred Rent

In connection with the lease in Massachusetts, the Company made an investment in leasehold improvements at this location of approximately *$1.4* million, of which approximately *$657* was funded by the landlord. The capitalized leasehold improvements are being amortized over the initial life of the lease. The improvements funded by the landlord are treated as lease incentives. Accordingly, the funding received from the landlord was recorded as a fixed asset addition and a deferred rent liability on the Condensed Consolidated Balance Sheets. As of *December 31, 2017*, *$150* was reflected in Accrued Liabilities and *$11* is reflected in Other long term liabilities on the Condensed Consolidated Balance Sheet. As of *September 30, 2017, $154* was reflected in Accrued Liabilities and *$43* is reflected in Other long term liabilities on the Condensed Consolidated Balance Sheet. The deferred rent liability is being amortized as a reduction of rent expense over the life of the lease.

Warrant Liability

The warrant issued to Montage Capital is included in Other Long Term Liabilities in the Condensed Consolidated Balance Sheet. The fair value of the warrant was valued at the loan execution date in the amount of *$341* and will be revalued at the end of each reporting period to fair value. The fair value at *December 31, 2017* was *$338.* Changes in fair value are recorded as expense in the period the change occurs.

9. Shareholders' Equity

Preferred Stock

In *October 2014,* the Company sold *200,000* shares of Series A convertible preferred stock (the "Preferred Stock") at a purchase price of *$10.00* per share for gross proceeds of *$2.0* million in a private placement. The shares of Preferred Stock *may* be converted, at the option of the holder at any time, into such number of shares of common stock ("Conversion Shares") equal (i) to the number of shares of Preferred Stock to be converted, multiplied by the stated value of *$10.00* (the "Stated Value") and (ii) divided by the conversion price in effect at the time of conversion. The current conversion price is *$16.25,* and is subject to adjustment in the event of stock splits or stock dividends. Any accrued but unpaid dividends on the shares of Preferred Stock to be converted shall also be converted in common stock at the conversion price. A mandatory provision also *may* provide that the Company will have the right to require the holders to convert shares of Preferred Stock into Conversion Shares if (i) the Company's common stock has closed at or above *$32.50* per share for *ten* consecutive trading days and (ii) the Conversion Shares are (A) registered for resale on an effective registration statement or (B) *may* be resold pursuant to Rule *144.* As of *December 31, 2017,* a total of *1,636* preferred shares have been converted to *1,007* shares of common stock.

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

The Company *may* pay dividends in cash or Preferred Stock. Effective *January 1, 2017,* cumulative dividends are payable at a rate of *12%* per year, as after *two* years, any Preferred Stock dividends increase from *6%* to *12%* per year. If the Company does *not* pay the dividends in cash, then the Company *may* pay dividends in any quarter by delivery of additional shares of Preferred Stock ("PIK Election") up to *64,000* shares cumulatively. If the Company shall make the PIK Election with respect to the dividend payable, it shall deliver a number of shares of Preferred Stock equal to (A) the aggregate dividend payable to such holder as of the end of the quarter divided by (B) the lesser of (*x*) the then effective Conversion Price or (y) the average VWAP for the *five* (*5*) consecutive Trading Days prior to such dividend payment date. The Company shall have the right to force conversion of the Preferred Stock into shares of Common Stock at any time after the Common Stock trades in excess of *$32.50* per share. The Preferred Shares shall vote with the Common on an as converted basis.

As of *December 31, 2017,* the Company has issued *52,563* preferred convertible shares (PIK shares) to the preferred shareholders. The Company elected to declare a PIK dividend for the next quarterly payment due *January 1, 2018.* The total PIK dividend declared for *January 1, 2018* is *7,567* preferred stock shares at a dividend rate of *12%.*

Stock Incentive Plans

The Company has granted common stock, common stock warrants, and common stock option awards (the "Equity Awards") to employees, consultants, advisors and debt holders of the Company and to former owners and employees of acquired companies that have become employees of the Company. On *April 29, 2016,* the stockholders approved a new stock incentive plan, The *2016* Stock Incentive Plan (the *"2016* Plan"). The *2016* Plan replaced an older plan that had expired in *August 2016.* The *2016* Plan authorizes the award of incentive stock options, non-statutory stock options, restricted stock, unrestricted stock, performance shares, stock appreciation rights and any combination thereof to employees, officers, directors, consultants, independent contractors and advisors of the Company. Initially, a total of *500,000* shares of the Company's Common Stock is reserved for issuance under this new plan. As of *December 31, 2017,* there were *224,166* options outstanding under this plan and *275,834* shares available for future issuance.

Common Stock Warrants

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

BRIDGELINE DIGITAL, INC.

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As of *December 31, 2017,* the total warrants outstanding were issued as follows: *227,655* warrants were issued to the placement agents in connection with private placements, *311,938* warrants were issued to individual investors in connection with private placements, debt issuances and bank guarantees, and *66,315* warrants were issued to Montage Capital. Certain of the Company's officers and directors have also been issued warrants. Included in the total warrants outstanding are warrants to purchase *8,600* shares of common stock issued to the Company's CEO and President, Roger Kahn, in connection with the *November 2016* Private Placement, in which he purchased shares of common stock. Also included in the total warrants outstanding are warrants to purchase *152,812* shares of common stock issued to Michael Taglich. Michael Taglich is a member of the Board of Directors and a shareholder. Michael Taglich has been issued warrants in connection with his participation as an investor in private offerings and issuance of loans to the Company. He has also guaranteed *$1.5* million in connection with the Company's out of formula borrowings on its credit facility with Heritage Bank for which he received warrants totaling *80,000.* Michael Taglich is also a principal of Taglich Brothers, Inc who have been the placement agents for many of the Company's private placements.

Total warrants outstanding as *December 31, 2017* were as follows:

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

Investors	11/9/2016	*213,538*	$*3.50*	5/22/2022
Director/Shareholder	12/31/2016	*6,000*	$*20.00*	12/31/2021
Financing	10/10/2017	*66,315*	$*2.65*	10/10/2025
Total		*605,908*		

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Summary of Option and Warrant Activity and Outstanding Shares

	Stock Options		**Stock Warrants**	
	Options	**Weighted Average Exercise Price**	**Warrants**	**Weighted Average Exercise Price**
Outstanding, September 30, 2017	*450,646*	$ *7.02*	*539,593*	$ *8.18*
Granted	*800*	$ *2.92*	*66,315*	$ *2.65*
Exercised	-	$ -	-	-
Forfeited or expired	*(1,520*)	$ *(4.82*)	-	-
Outstanding, December 31, 2017	*449,926*	$ *7.02*	*605,908*	$ *7.57*

10. **Net Loss Per Share**

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

(in thousands, except per share data)	**Three Months Ended December 31,**	
	2017	**2016**
Net loss	$*(430*)	$*(408*)
Accrued dividends on convertible preferred stock	*(75*)	*(68*)
Net loss applicable to common shareholders	$*(505*)	$*(476*)

Weighted average common shares outstanding - basic and diluted	*4,200*	*4,012*
Net loss per share attributable to common shareholders:		
Basic and diluted	$*(0.12*)	$*(0.12*)

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

For the *three* months ended *December 31, 2017,* all options to purchase shares of the Company's common stock were considered anti-dilutive, as the options were all valued at less than the current market price. Warrants to purchase *605,908* shares of common stock and the Series A convertible preferred stock shares have also been excluded as they are anti-dilutive to the Company's net loss.

For the *three* months ended *December 31, 2016,* all options to purchase shares of the Company's common stock were considered anti-dilutive, as the options were all valued at less than the current market price. Warrants to purchase *548,281* shares of common stock and the Series A convertible preferred stock shares have also been excluded as they are anti-dilutive to the Company's net loss.

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11. Income Taxes

Income tax expense was $*1* and *$12* for the *three* months ended *December 31, 2017* and *2016.* Income tax expense consists of the estimated liability for federal and state income taxes owed by the Company, including the alternative minimum tax. Net operating loss carry forwards are estimated to be sufficient to offset additional taxable income for all periods presented.

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

12. Related Party Transactions

In *October 2013,* Mr. Michael Taglich joined the Board of Directors. Michael Taglich is the Chairman and President of Taglich Brothers, Inc. a New York based securities firm. Taglich Brothers, Inc were the Placement Agents for many of the Company's private offerings in *2012, 2013, 2014,* and *2016.* They were also the Placement Agent for the Company's *$3* million subordinated debt offering in *2013* and the Series A Preferred stock sale in *2015.* Michael Taglich beneficially owns approximately *22%* of Bridgeline stock. Michael Taglich has also guaranteed *$1.5* million in connection with the Company's out of formula borrowings on its credit facility with Heritage Bank. Michael Taglich's brother, Robert Taglich is a former member of the Company's Board of Directors and beneficially owns approximately *8%* of the Company's stock.

***13*. Legal Proceedings**

The Company is subject to ordinary routine litigation and claims incidental to its business. As of *December 31, 2017,* the Company was *not* engaged with any material legal proceedings.

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

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

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

Overview

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

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

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

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

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Locations

The Company's corporate office is located in Burlington, Massachusetts. The Company has one wholly-owned subsidiary, Bridgeline Digital Pvt. Ltd. located in Bangalore, India.

Reverse Stock Split

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

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

Customer Information

We currently have over 3,000 active customers. For the three months ended December 31, 2017, two customers represented 11% and 12% of the Company's total revenue. For the three months ended December 31, 2016, one customer represented 12% of the Company's total revenue.

Results of Operations for the Three Months Ended December 31, 2017 compared to the Three Months Ended December 31, 2016

Total revenue for the three months ended December 31, 2017 and the three months ended December 31, 2016 was $4.0 million. We had a net loss of ($430) thousand for the three months ended December 31, 2017 and ($408) thousand for the three months ended December 31, 2016. Net loss per share applicable to common shareholders was ($0.12) for the three months ended December 31, 2017 and the three months ended December 31, 2016.

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(in thousands)	Three Months Ended December 31, 2017	Three Months Ended December 31, 2016	$ Change	% Change
Revenue				
Digital engagement services	$ 2,060	$ 2,026	$ 34	2 %
% of total revenue	52 %	51 %		
Subscription and perpetual licenses	1,606	1,725	(119)	(7 %)
% of total revenue	40 %	43 %		
Managed service hosting	303	240	63	26 %
% of total revenue	8 %	6 %		
Total revenue	**3,969**	**3,991**	**(22)**	**(1 %)**
Cost of revenue				
Digital engagement services	1,397	1,128	269	24 %
% of digital engagement revenue	68 %	56 %		
Subscription and perpetual licenses	480	496	(16)	(3 %)
% of subscription and perpetual licenses revenue	30 %	29 %		
Managed service hosting	80	71	9	13 %
% of managed service hosting	*26* %	*30* %		
Total cost of revenue	1,957	1,695	262	15 %
Gross profit	**2,012**	**2,296**	**(284)**	**(12 %)**
Gross profit margin	**51 %**	**58 %**		
Operating expenses				
Sales and marketing	1,104	1,294	(190)	(15 %)
% of total revenue	28 %	32 %		
General and administrative	736	791	(55)	(7 %)
% of total revenue	19 %	20 %		
Research and development	407	360	47	13 %
% of total revenue	10 %	9 %		
Depreciation and amortization	108	185	(77)	(42 %)
% of total revenue	3 %	5 %		
Restructuring expenses	-	31	(31)	(100 %)
% of total revenue	0 %	1 %		
Total operating expenses	**2,355**	**2,661**	**(306)**	**(11 %)**
% of total revenue	59 %	67 %		
Loss from operations	(343)	(365)	22	(6 %)
Interest and other expense, net	(86)	(31)	(55)	177 %
Loss before income taxes	(429)	(396)	(33)	8 %
Provision for income taxes	1	12	(11)	(92 %)
Net loss	**$ (430)**	**$ (408)**	**$ (22)**	**5 %**

Non-GAAP Measure

Adjusted EBITDA	**$ (94)**	**$ 10**	**$ (104)**	**(1,040 %)**

Revenue

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

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Digital Engagement Services

Digital engagement services revenue is comprised of iAPPS digital engagement related services and other digital engagement related services generated from non-iAPPS related engagements. In total, revenue from digital engagement services increased $34 thousand, or 2%, for the three months ended December 31, 2017 compared to three months ended December 31, 2016. Digital engagement services revenue as a percentage of total revenue increased to 52% from 51% for the three months ended December 31, 2017 compared to the prior period. The increase as a percentage of total revenue is attributable to the decreases in subscription and license revenue for the three months ended December 31, 2017 compared to the prior quarter.

Subscription and Perpetual Licenses

Revenue from subscription and perpetual licenses decreased $119 thousand, or 7%, to $1.6 million for the three months ended December 31, 2017 compared to $1.7 million for the three months ended December 31, 2016. The decrease for the three months ended December 31, 2017 compared to the prior period is a decline in perpetual licenses as demand for perpetual licenses can vary and we did not sell any perpetual licenses in the three months ended December 31, 2017. Subscription and perpetual license revenue as a percentage of total revenue decreased to 40% for the three months ended December 31, 2017 from 43% compared to the three months ended December 31, 2016. The decrease as a percentage of revenues is attributable to the decreases in iAPPS subscriptions and perpetual licenses.

Managed Service Hosting

Revenue from managed service hosting increased $63 thousand, or 26%, to $303 thousand for the three months ended December 31, 2017 compared to $240 thousand for the three months ended December 31, 2016. The increase is due to new hosting contracts for iAPPs perpetual licenses sold in fiscal 2017. Managed services revenue as a percentage of total revenue increased to 8% for the three months ended December 31, 2017 from 6% compared to the three months ended December 31, 2016. The increase as a percentage of revenue is attributable to the increase in iAPPS customer hosting contracts.

Costs of Revenue

Total cost of revenue increased $262 thousand to $2.0 million or 15% for the three months ended December 31, 2017 compared to $1.7 million for the three months ended December 31, 2016. The gross profit margin declined to 51% for the three months ended December 31, 2017 compared to 58% for the three months ended December 31, 2016. The decline in the gross profit margin for the three months ended December 31, 2017 compared to the three months ended December 31, 2016 is attributable to an increase in cost of digital engagement services.

Cost of Digital Engagement Services

Cost of digital engagement services increased $269 thousand, or 24%, to $1.4 million for the three months ended December 31, 2017 compared to $1.1 million for the three months ended December 31, 2016. The cost of digital engagement services as a percentage of digital engagement services revenue increased to 68% from 56% compared to the three months ended December 31, 2016. The increase is due to an increase in both internal costs and third party subcontractors that were incurred at a lower gross margin in order to complete a project for a strategic customer.

Cost of Subscription and Perpetual License

Cost of subscription and perpetual licenses decreased $16 thousand, or 3%, to $480 thousand for the three months ended December 31, 2017 compared to $496 thousand for the three months ended December 31, 2016. The cost of subscription and perpetual licenses as a percentage of subscription and perpetual license revenue increased to 30% from 29% compared to the three months ended December 31, 2016.

Cost of Managed Service Hosting

Cost of managed service hosting increased $9 thousand, or 13%, to $80 thousand for the three months ended December 31, 2017 compared to $71 thousand for the three months ended December 31, 2016. The cost of managed services as a percentage of managed services revenue decreased to 26% from 30% compared to the three months ended December 31, 2016. The percentage decrease is attributable to the transition of our network operations center from a co-managed facility at Internap to a cloud-based model with Amazon Web Services.

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Operating Expenses

Sales and Marketing Expenses

Sales and marketing expenses decreased $190 thousand to $1.1 million, or 15%, for the three months ended December 31, 2017 compared to $1.3 million for the three months ended December 31, 2016. Sales and marketing expenses represented 28% and 32% of total revenue for the three months ended December 31, 2017 and 2016, respectively. The decreases for the three months ended December 31, 2017 compared to the three months ended December 31, 2016 is attributable to decreases in sales personnel and marketing expenses.

Administrative Expenses

General and administrative expenses decreased $55 thousand, or 7%, to $736 thousand for the three months ended December 31, 2017 compared to $791 thousand for the three months ended December 31, 2016. General and administrative expenses represented 19% and 20% of total revenue for the three months ended December 31, 2017 and 2016, respectively. The decrease in expense was due to decreases in headcount and personnel expenses.

Research and Development

Research and development expense increased $47 thousand, or 13%, to $407 thousand for the three months ended December 31, 2017 compared to $360 thousand for the three months ended December 31, 2016. Research and development expenses represented 10% and 9% of total revenue for the three months ended December 31, 2017 and 2016, respectively. The increase in research and development expense is due to an increase in compensation expenses.

Depreciation and Amortization

Depreciation and amortization expense decreased $77 thousand, or 42% to $108 thousand for the three months ended December 31, 2017 compared to $185 thousand for the three months ended December 31, 2016. Depreciation and amortization has decreased due to asset retirements related to the termination and closing of offices, as well as reductions in capital expenditures. Depreciation and amortization represented 3% and 5% of revenue for the three months ended December 31, 2017 and 2016.

Restructuring Expenses

Commencing in fiscal 2015, the Company’s management approved, committed to and initiated plans to restructure and further improve efficiencies by implementing cost reductions. As part of these restructuring initiatives, we recorded $31 thousand for the three months ended December 31, 2016.

Net Loss

Loss from operations

The loss from operations was ($343) thousand for three months ended December 31, 2017, compared to a loss of $(365) thousand in the prior period. Operating expenses decreased $306 thousand or 11% for the three months ended December 31, 2017 compared to December 31, 2016. We have made concerted efforts to bring our operating expenses in line with projected revenues.

Income Taxes

The provision for income tax expense was $1 thousand and $12 thousand for the three months ended December 31, 2017 and 2016, respectively. Income tax expense represents the estimated liability for federal and state income taxes owed, including the alternative minimum tax. We have net operating loss carryforwards and other deferred tax benefits that are available to offset future taxable income.

Adjusted EBITDA

We also measure our performance based on a non-GAAP (“Generally Accepted Accounting Principles”) measurement of earnings before interest, taxes, depreciation, and amortization and before stock-based compensation expense 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 provide a tool for evaluating our ongoing operations.

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

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

	Three Months Ended December 31,	
	2017	**2016**
Net loss	$(430)	$(408)
Provision for income tax	1	12
Interest expense, net	86	31
Amortization of intangible assets	72	71
Depreciation	36	89
Restructuring charges	-	31
Other amortization	16	39
Stock based compensation	125	145
Adjusted EBITDA	$(94)	$10

Adjusted EBITDA decreased compared to the first quarter of fiscal 2017. However, a decrease in operating expenses of $306 thousand compensated for the decrease in the gross profit of $284 thousand.

Liquidity and Capital Resources

Cash Flows

Operating Activities

Cash used in operating activities was $575 thousand for the three months ended December 31, 2017 compared to cash used in operating activities of $293 thousand for the three months ended December 31, 2016. This increase in the use of cash compared to the prior period was primarily to an increase in accounts receivable and decrease in accounts payable.

Investing Activities

Cash used in investing activities was $8 thousand for the three months ended December 31, 2017 compared to $21 thousand for the three months ended December 31, 2016.   We do not expect to expend significant dollars for computer equipment or to capitalize any software in the next twelve months.

Financing Activities

Cash provided by financing activities was $953 thousand for the three months ended December 31, 2017 compared to $1.1 million for the three months ended December 31, 2016. Cash provided by financing activities for the three months ended December 31, 2017 is primarily attributable to a new term loan for gross proceeds of $1.0 million with Montage Capital II, L.P.

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Capital Resources and Liquidity Outlook

In the first quarter of fiscal 2018, we entered into a Loan and Security Agreement with Montage Capital II, L.P. (“Montage Loan”). The Montage Loan has a thirty-six (36) month term which expires on October 10, 2020. The Montage Loan provides for up to $1.5 million of borrowing in the form of a non-revolving term loan which may be used by the Company for working capital purposes. $1 million of borrowing was advanced on the date of closing. An additional $500 thousand of borrowing will be available at the Company’s option in the event that the Company achieves certain financial milestones and is otherwise in compliance with its loan covenants. The Loan is subordinate to the Company’s senior debt facility with Heritage Bank of Commerce (“Heritage Bank”). We also have a borrowing facility with Heritage Bank from which we can borrow, and this line is subject to financial covenants that must be met.

We believe that the cash balance as of December 31, 2017 of $1.1 million as well as collections from accounts receivable will be sufficient to meet the Company’s obligations for a minimum of twelve months from the financial statement issuance date. Our borrowing facility with Heritage Bank is subject to financial covenants that must be met. It is not certain that all or part of this line will be available to us in the future; and other sources of financing may not be available to us in a timely basis if at all, or on terms acceptable to us. If we fail to obtain acceptable funding when needed, we may not have sufficient resources to fund our normal operations, and this would have a material adverse effect on our business.

Off-Balance Sheet Arrangements

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

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

Commitments and Contingencies

As of December 31, 2017, we have no material commitments or contingencies.

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Critical Accounting Policies

Critical Accounting Policies

These critical accounting policies and estimates by our management were prepared in accordance with accounting principles generally accepted in the United States of America ("US GAAP") and should be read in conjunction with Note 2 *Summary of Significant Accounting Policies* to the Consolidated Financial Statements of our Annual Report on Form 10-K filed with the Securities and Exchange Commission on December 21, 2017.

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

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

- Revenue recognition;
- Allowance for doubtful accounts;
- Accounting for cost of computer software to be sold, leased or otherwise marketed;
- Accounting for goodwill and other intangible assets; and
- Accounting for stock-based compensation.

Revenue Recognition

Overview

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

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

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

Digital Engagement Services

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

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

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

Subscriptions and Perpetual Licenses

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

Customers may also license the software on a subscription basis, which can be described as “Software as a Service” or “SaaS”. SaaS is a model of software deployment where an application is hosted as a service provided to customers across the Internet. Subscription agreements include access to the Company’s software application via an internet connection, the related hosting of the application, and PCS. Customers receive automatic updates and upgrades, and new releases of the products as soon as they become available. Customers cannot take possession of the software. Subscription agreements are either annual or month-to-month arrangements that provide for termination for convenience by either party upon 90 days’ notice. Revenue is recognized monthly as the services are delivered. Set up fees paid by customers in connection with subscription services are deferred and recognized ratably over the longer of the life of subscription period or the expected lives of customer relationships. The Company continues to evaluate the length of the amortization period of the set up fees as it gains more experience with customer contract renewals.

Managed Service Hosting

Managed service hosting includes hosting arrangements that provide for the use of certain hardware and infrastructure for those customers who do not wish to host our applications independently. Hosting agreements are either annual or month-to-month arrangements that provide for termination for convenience by either party generally upon 30-days' notice. Revenue is recognized monthly as the hosting services are delivered. Set up fees paid by customers in connection with managed hosting services are deferred and recognized ratably over the life of the hosting period.

Multiple Element Arrangements

In accounting for multiple element arrangements, the Company follows either ASC Topic 605-985 *Revenue Recognition Software* or ASC Topic 605-25 *Revenue Recognition Multiple Element Arrangements*, as applicable. In October 2009, the FASB issued Accounting Standards Update No. 2009-13, *Revenue Recognition: Multiple-Deliverable Revenue Arrangements* ("ASU 2009-13"). ASU 2009-13 provides amendments to certain paragraphs of previously issued ASC Subtopic 605-25 – *Revenue Recognition: Multiple-Deliverable Revenue Arrangements*. In accordance with ASU 2009-13, each deliverable within a multiple-deliverable revenue arrangement is accounted for as a separate unit of accounting if both of the following criteria are met (1) the delivered item has value to the customer on a standalone basis and (2) for an arrangement that includes a right of return relative to the delivered item, delivery or performance of the delivered item is considered probable and within our control. If the deliverables do not meet the criteria for being a separate unit of accounting then they are combined with a deliverable that does meet that criterion. The accounting guidance also requires that arrangement consideration be allocated at the inception of an arrangement to all deliverables using the relative selling price method. The accounting guidance also establishes a selling price hierarchy for determining the selling price of a deliverable. The Company determines selling price using VSOE, if it exists; otherwise, it uses Third-party Evidence ("TPE"). If neither VSOE nor TPE of selling price exists for a unit of accounting, the Company uses Estimated Selling Price ("ESP").

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

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

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

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

Customer Payment Terms

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

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

Warranty

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

Reimbursable Expenses

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

Allowance for Doubtful Accounts

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

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

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

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

Accounting for Goodwill and Intangible Assets

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

For fiscal 2017, the Company performed the annual assessment of goodwill during the fourth quarter of that year and concluded that it was not more likely than not that the fair values of the reporting units were less than their carrying amounts. We used the option to assess qualitative factors to determine whether events or circumstances indicate that it is not more likely than not that the fair value of a reporting unit is less than its carrying amount. We concluded that it was not more likely than not that the fair value of our reporting unit was less than the corresponding carrying amount, and therefore it was not necessary to perform the two-step impairment test. The key qualitative factors that led to our conclusion included the following: (i) access to capital (ii) market acceptance of our products (iii) improvements in financial metrics and (iv) market value of the Company.

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

Accounting for Stock-Based Compensation

At December 31, 2017, we maintained two stock-based compensation plans, one of which has expired but still contains vested and unvested stock options and are more fully described in Note 11 to the Consolidated Financial Statements of our Annual Report on Form 10-K filed with the Securities and Exchange Commission on December 21, 2017.

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.

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Item 3. Qualitative and Quantitative Disclosures About Market Risk.

Not required.

Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

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

As of December 31, 2017 we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective in enabling us to record, process, summarize and report information required to be included in our periodic filings with the Securities and Exchange Commission within the required time period.

Changes in Internal Control over Financial Reporting

There have been no changes in our internal controls over financial reporting that occurred during the quarter ended December 31, 2017 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II – OTHER INFORMATION

Item 1. Legal Proceedings.

From time to time we are subject to ordinary routine litigation and claims incidental to our business. We are not currently involved in any legal proceedings that we believe are material beyond those previously disclosed in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on December 21, 2017.

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

The following summarizes all sales of our unregistered securities during the quarter ended December 31, 2017. The securities in the below-referenced transactions were (i) issued without registration and (ii) were subject to restrictions under the Securities Act and the securities laws of certain states, in reliance on the private offering exemptions contained in Sections 4(2), 4(6) and/or 3(b) of the Securities Act and on Regulation D promulgated there under, and in reliance on similar exemptions under applicable state laws as transactions not involving a public offering. Unless stated otherwise, no placement or underwriting fees were paid in connection with these transactions.

Stock Options

During the fiscal quarter ended December 31, 2017, the Company granted 800 stock options under The 2016 Stock Incentive Plan at a weighted average exercise price of $2.92 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.

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Item 6. Exhibits.

Exhibit No.	Description of Document
3.1(i)	Amended and Restated Certificate of Incorporation (incorporated by reference to Exhibit 3.1 to our Quarterly Report on Form 10-Q filed on May 15, 2013)
3.1(ii)	Certificate of Amendment to Amended and Restated Certificate of Incorporation, dated May 4, 2015 (incorporated by reference to Exhibit 3.1 to our Current Report on Form 8-K filed on May 5, 2015)
3.1(iii)	Certificate of Designations of the Series A Convertible Preferred Stock (incorporated by reference to Exhibit 3.1 to our Current Report on Form 8-K filed on November 4, 2014)
3.1(iv)	Amended and Restated By-laws (incorporated by reference to Exhibit 3.1 to our current Report on Form 8-K filed on July 24, 2017)
4.1(i)	Registration Rights Agreement, dated November 3, 2016, by and between Bridgeline Digital, Inc. and the Investors party thereto (incorporated by reference to Exhibit 10.3 to our Current Report on Form 8-K Filed on November 4, 2016)
4.1 (ii)	Registration Rights Agreement, as amended on June 30, 2017 filed with the Securities and Exchange Commission on May 19, 2017
10.1	Loan and Security Agreement between Bridgeline Digital, Inc and Montage Capital II, L.P. dated October 10, 2017 (incorporated by reference to Exhibit 10.1 to our Current Report on Form 8-K Filed on October 13, 2017)
10.2	Form of Warrant to Purchase Stock issued to Montage Capital II, L.P. (incorporated by reference to Exhibit 10.2 to our Current Report on Form 8-K Filed on October 13, 2017)
10.3	Intercreditor Agreement between Heritage Bank of Comerce and Montage Capital II, L.P dated October 10, 2017 (incorporated by reference to Exhibit 10.3 to our Current Report on Form 8-K Filed on October 13, 2017)
10.4	Fifth Amendment to the Loan and Security Amendment between Bridgeline Digital, Inc. and Heritage Bank of Commerce, dated November 27, 2017 (incorporated by reference to Exhibit 10.1 to our Current Report on Form 8-K Filed on November 28, 2017)
31.1	Certification required by Rule 13a-14(a) or Rule 15d-14(a).
31.2	Certification required by Rule 13a-14(a) or Rule 15d-14(a).
32.1	Certification required by Rule 13a-14(b) or Rule 15d-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. §1350).
32.2	Certification required by Rule 13a-14(b) or Rule 15d-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. §1350).

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

*Management compensatory plan

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

SIGNATURES

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

	Bridgeline Digital, Inc. (Registrant)
February 14, 2018	/s/ Roger Kahn **Roger Kahn**
Date	**President and Chief Executive Officer** (Principal Executive Officer)
February 14, 2018	/s/ Michael Prinn **Michael Prinn**
Date	**Executive Vice President and Chief Financial Officer** (Principal Financial and Accounting Officer)

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