BOTTOMLINE TECHNOLOGIES INC /DE/
Form 10-Q
February 08, 2018
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended December 31, 2017

OR

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

For the transition period from _____ to _____

Commission file number: 0-25259

Bottomline Technologies (de), Inc.

(Exact name of registrant as specified in its charter)

Delaware	**02-0433294**
(State or other jurisdiction of	**(I.R.S. Employer**
incorporation or organization)	**Identification No.)**
325 Corporate Drive	
Portsmouth, New Hampshire	**03801-6808**
(Address of principal executive offices)	**(Zip Code)**

(603) 436-0700

(Registrant s telephone number, including area code)

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 website, 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 outstanding of the registrant s common stock as of January 31, 2018 was 40,680,451.

Table of Contents

BOTTOMLINE TECHNOLOGIES (de), INC.

FORM 10-Q

FOR THE FISCAL QUARTER ENDED DECEMBER 31, 2017

TABLE OF CONTENTS

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Bottomline Technologies (de), Inc.

Unaudited Condensed Consolidated Balance Sheets

(in thousands)

	December 31, 2017	June 30, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	$ 64,051	$ 124,569
Cash and cash equivalents, held for customers	3,481	
Marketable securities	10,004	1,973
Accounts receivable net of allowances for doubtful accounts of $973 at December 31, 2017 and $923 at June 30, 2017	78,073	64,244
Prepaid expenses and other current assets	18,556	16,807
Total current assets	174,165	207,593
Property and equipment, net	27,199	26,195
Goodwill	202,083	194,700
Intangible assets, net	173,266	171,280
Other assets	18,058	17,671
Total assets	$ 594,771	$ 617,439
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 10,268	$ 9,013
Accrued expenses and other current liabilities	28,411	29,179
Customer account liabilities	3,481	
Deferred revenue	59,835	74,113
Convertible senior notes		183,682
Total current liabilities	101,995	295,987
Borrowings under credit facility	150,000	
Deferred revenue, non-current	25,172	22,047
Deferred income taxes	13,452	15,433
Other liabilities	22,202	22,016
Total liabilities	312,821	355,483
Stockholders equity		

Preferred Stock, $.001 par value:		
Authorized shares-4,000; issued and outstanding shares-none		
Common Stock, $.001 par value:		
Authorized shares-100,000; issued shares-44,075 at December 31, 2017 and 42,797 at June 30, 2017; outstanding shares-38,197 at December 31, 2017 and 37,443 at June 30, 2017	44	43
Additional paid-in-capital	660,701	624,001
Accumulated other comprehensive loss	(29,671)	(32,325)
Treasury stock: 5,878 shares at December 31, 2017 and 5,354 shares at June 30, 2017, at cost	(131,528)	(113,071)
Accumulated deficit	(217,596)	(216,692)
Total stockholders equity	281,950	261,956
Total liabilities and stockholders equity	$ 594,771	$ 617,439

See accompanying notes.

Table of Contents

Bottomline Technologies (de), Inc.

Unaudited Condensed Consolidated Statements of Comprehensive Income (Loss)

(in thousands, except per share amounts)

	Three Months Ended December 31,		Six Months Ended December 31,	
	2017	2016	2017	2016
Revenues:				
Subscriptions and transactions	$ 63,187	$ 55,644	$ 123,901	$ 107,776
Software licenses	2,620	3,492	4,985	5,613
Service and maintenance	28,433	25,920	55,775	53,593
Other	955	1,672	1,830	2,830
Total revenues	95,195	86,728	186,491	169,812
Cost of revenues:				
Subscriptions and transactions	27,201	24,782	54,612	48,668
Software licenses	229	196	399	324
Service and maintenance	12,968	13,416	25,200	26,701
Other	701	1,178	1,368	2,056
Total cost of revenues	41,099	39,572	81,579	77,749
Gross profit	54,096	47,156	104,912	92,063
Operating expenses:				
Sales and marketing	21,396	19,325	40,701	38,200
Product development and engineering	13,892	13,082	27,707	26,017
General and administrative	10,981	11,772	22,810	24,476
Amortization of acquisition-related intangible assets	5,702	6,090	10,890	12,375
Goodwill impairment charge		7,529		7,529
Total operating expenses	51,971	57,798	102,108	108,597
Income (loss) from operations	2,125	(10,642)	2,804	(16,534)
Other expense, net	(3,532)	(4,182)	(7,995)	(8,117)
Loss before income taxes	(1,407)	(14,824)	(5,191)	(24,651)
Income tax benefit	4,495	4,478	4,038	3,797
Net income (loss)	$ 3,088	$ (10,346)	$ (1,153)	$ (20,854)
Net income (loss) per share:				
Basic	$ 0.08	$ (0.27)	$ (0.03)	$ (0.55)

Diluted	$ 0.08	$ (0.27)	$ (0.03)	$ (0.55)
Shares used in computing net income (loss) per share:				
Basic	38,087	37,769	37,908	37,854
Diluted	39,344	37,769	37,908	37,854
Other comprehensive income (loss), net of tax:				
Unrealized loss on available for sale securities	(3)	(49)	(3)	(106)
Unrealized gain on interest rate hedging transactions (net of income tax provision of $248 for the three and six months ended December 31, 2017)	604		369	
Minimum pension liability adjustments	38	610	142	625
Foreign currency translation adjustments	773	(8,402)	2,146	(9,459)
Other comprehensive income (loss), net of tax:	1,412	(7,841)	2,654	(8,940)
Comprehensive income (loss)	$ 4,500	$ (18,187)	$ 1,501	$ (29,794)

See accompanying notes.

Table of Contents

Bottomline Technologies (de), Inc.

Unaudited Condensed Consolidated Statements of Cash Flows

(in thousands)

	Six Months Ended December 31,	
	2017	2016
Operating activities:		
Net loss	$ (1,153)	$ (20,854)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Amortization of acquisition-related intangible assets	10,890	12,375
Stock compensation expense	16,540	16,855
Depreciation and other amortization	9,543	8,241
Goodwill impairment charge		7,529
Deferred income tax benefit	(4,745)	(5,200)
Provision for allowances on accounts receivable	75	14
Amortization of debt issuance costs	711	618
Amortization of debt discount	5,574	6,208
Amortization of premium (discount) on investments	(5)	148
Gain (loss) on disposal of equipment	(10)	36
Gain on foreign exchange	(26)	(122)
Changes in operating assets and liabilities:		
Accounts receivable	(12,326)	2,519
Prepaid expenses and other current assets	(1,089)	(956)
Other assets	926	520
Accounts payable	(145)	(209)
Accrued expenses	(1,932)	305
Deferred revenue	(12,443)	(11,155)
Other liabilities	(697)	706
Net cash provided by operating activities	9,688	17,578
Investing activities:		
Acquisition of businesses, net of cash acquired	(13,747)	
Purchase of available-for-sale securities	(9,935)	(8,833)
Proceeds from sales of available-for-sale securities	1,903	28,178
Capital expenditures, including capitalization of software costs	(9,137)	(15,345)
Proceeds from disposal of property and equipment	10	
Net cash provided by (used in) investing activities	(30,906)	4,000
Financing activities:		
Repurchase of common stock		(14,971)
Repayment of convertible senior notes	(189,750)	
Amounts borrowed under revolving credit facility	150,000	
Repayment of notes payable	(2,204)	

Debt issuance costs related to credit facility		(2,137)
Proceeds from exercise of stock options and employee stock purchase plan	1,705	1,412
Net cash used in financing activities	(40,249)	(15,696)
Effect of exchange rate changes on cash	949	(3,444)
Increase (decrease) in cash and cash equivalents	(60,518)	2,438
Cash and cash equivalents at beginning of period	124,569	97,174
Cash and cash equivalents at end of period	$ 64,051	$ 99,612
Supplemental disclosures of non-cash financing activities:		
Issuance of note payable to seller in connection with acquisition	$ 1,836	$
Issuance of common stock upon conversion of convertible senior notes	$ 19,736	$
Receipt of common stock upon settlement of Note Hedges	$ 19,964	$

See accompanying notes.

Table of Contents

Bottomline Technologies (de), Inc.

Notes to Unaudited Condensed Consolidated Financial Statements

December 31, 2017

Note 1 Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of Bottomline Technologies (de), Inc. (referred to below as we, us, our or Bottomline) have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States (U.S. GAAP) for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals and adjustments) considered necessary for a fair presentation of the interim financial information have been included. Operating results for the three and six months ended December 31, 2017 are not necessarily indicative of the results that may be expected for any other interim period or for the fiscal year ending June 30, 2018 (fiscal year 2018). For further information, refer to the financial statements and footnotes included in the Annual Report on Form 10-K as filed with the Securities and Exchange Commission (SEC) on August 28, 2017.

Note 2 Recent Accounting Pronouncements

Recently Adopted Pronouncements

Cloud Computing Arrangements: In April 2015, the Financial Accounting Standards Board (FASB) issued an accounting standard update which provides guidance as to whether a cloud computing arrangement (e.g., software as a service, platform as a service, infrastructure as a service, and other similar arrangements) includes a software license and, based on that determination, how to account for such arrangements. We adopted this standard effective July 1, 2016 on a prospective basis. The adoption of this standard did not have a material impact on our financial statements. In December 2016, the FASB issued a technical update to this standard, clarifying that any software license within the scope of this accounting standard shall be accounted for as an intangible asset by the licensee. We adopted the technical update on July 1, 2017, and reclassified software licenses from property and equipment, net to intangible assets, net in our consolidated balance sheets for all periods presented. The total amount reclassified in our June 30, 2017 consolidated balance sheet was $29.1 million.

Share-Based Compensation: In March 2016, the FASB issued an accounting standard update intended to simplify several areas of accounting for share-based compensation arrangements, including the income tax impact of excess tax benefits and tax deficiencies, accounting for forfeitures, statutory tax withholding requirements and the presentation of excess tax benefits in the statement of cash flows. We adopted this standard on July 1, 2017 (the first quarter of our fiscal year 2018). Upon adoption of this standard, excess tax benefits of $0.2 million were recognized as a component of our net deferred tax assets, with an offsetting cumulative effect adjustment recorded as a reduction to our accumulated deficit in our consolidated balance sheet. Please refer to *Note 7 Income Taxes* for additional discussion of the recognition of excess tax benefits.

We adopted the cash flow presentation of excess tax benefits retrospectively, which resulted in the reclassification of excess tax benefits associated with stock compensation of $0.06 million from financing activities to operating activities for the six months ended December 31, 2016 in our consolidated statement of cash flows.

The new standard also allows companies to make an accounting policy election to either estimate expected forfeitures or account for them as they occur, and we have elected to continue to estimate forfeitures.

Consolidation: In October 2016, the FASB issued an accounting standard update to remove the requirement that a single decision maker consider, in its assessment of primary beneficiary, its indirect interest held through related parties under common control to be the equivalent of a direct interest in a variable interest entity (VIE). Instead, indirect interest held through related parties under common control will be included in the primary beneficiary assessment based on proportionate basis, consistent with the indirect interest held through other parties. We adopted this standard effective July 1, 2017. The adoption of this standard did not have an impact on our financial statements.

Accounting Pronouncements to be Adopted

Revenue Recognition: In May 2014, the FASB issued an accounting standard update which provides for new revenue recognition guidance, superseding nearly all existing revenue recognition guidance. The core principle of the new guidance is to recognize revenue when promised goods or services are transferred to customers, in an amount that reflects the consideration which the vendor expects to receive for those goods or services. The new standard is expected to require significantly more judgment and estimation 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 separate performance obligations. The new standard is also expected to significantly increase the financial statement disclosure related to revenue recognition. This standard is currently effective for us on July 1, 2018 (the first quarter of our fiscal year ending June 30, 2019) using one of two methods of adoption, subject to the election of certain practical expedients: (i) retrospective to each prior reporting period presented, with the option to elect certain practical expedients as defined within the standard; or (ii) modified retrospective with the cumulative effect of initially applying the standard recognized at the date of initial application inclusive of certain additional disclosures.

Table of Contents

We are continuing to evaluate the expected impact of this standard on our consolidated financial statements and currently plan to adopt the standard using the modified retrospective method. While our assessment of the impact of this standard is not complete, we currently believe that the most significant impacts will be in certain areas:

Under the new standard, vendor specific objective evidence (VSOE) will no longer be required to determine the fair value of elements in a software arrangement. As a result, the absence of VSOE in certain software arrangements will no longer result in strict revenue deferral. Absent a change in how we license our products, we believe that this will result in greater up-front recognition of software revenue for certain of our license arrangements.

Under the new standard, certain expenses we incur will require deferral and recognition over the period in which revenue is recognized, subject to certain exceptions. We believe that this will result in the deferral of certain fulfillment costs associated with our SaaS offerings which would then be recognized as expense over a multi-year period; such costs are expensed directly as incurred today.

Under the new standard, costs to obtain a contract, including sales commissions, will be capitalized and amortized on a basis that is consistent with the transfer of goods and services to its customer. We anticipate that this will result in the deferral of certain commission related costs that, today, are expensed as incurred.

Significantly enhanced financial statement disclosures related to revenue, including information related to the allocation of transaction price across undelivered performance obligations, will be required.

However, we are unable to quantify the impact of these outcomes at this time, nor can we ensure that our continuing analysis and interpretation of the standard will result in these financial reporting outcomes or additional material impacts could be identified.

Financial Instruments Classification and Measurement: In January 2016, the FASB issued an accounting standard update which requires, among other things, that entities measure equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) at fair value, with changes in fair value recognized in earnings. Under the standard, entities will no longer be able to recognize unrealized holding gains and losses on equity securities classified as available for sale as a component of other comprehensive income (OCI). Subject to certain exceptions, entities will be able to elect to record equity investments without readily determinable fair values at cost, less impairment, plus or minus adjustments for observable price changes, with all such changes recognized in earnings. This new standard does not change the guidance for classifying and measuring investments in debt securities and loans. The standard is effective for us on July 1, 2018 (the first quarter of our fiscal year 2019) on a prospective basis. We are currently evaluating the anticipated impact of this standard on our financial statements. We have certain cost method investments of $7.7 million at December 31, 2017, and to the extent that there are observable price changes following the date of adoption, the accounting for these investments could be affected.

Leases: In February 2016, the FASB issued an accounting standard update which requires balance sheet recognition of a lease liability and a corresponding right-of-use asset for all leases with terms longer than twelve months. The pattern of recognition of lease related revenue and expenses will be dependent on its classification. The updated standard requires additional disclosures to enable users of the financial statements to assess the amount, timing and uncertainty of cash flows arising from leases. This standard is effective for us on July 1, 2019 (the first quarter of our fiscal year

ending June 30, 2020) with early adoption permitted; adoption is on a modified retrospective basis. We anticipate that the adoption of this standard will have a material impact to our consolidated balance sheet due to the recognition of right of use assets and lease liabilities; however, we are still evaluating the anticipated impact of this standard on our financial statements.

Financial Instruments Credit Losses: In June 2016, the FASB issued an accounting standard update that introduces a new forward-looking approach, based on expected losses, to estimate credit losses on certain types of financial instruments including trade receivables. The estimate of expected credit losses will require entities to incorporate historical information, current information and reasonable and supportable forecasts. This standard also expands the disclosure requirements to enable users of financial statements to understand the entity s assumptions, models and methods for estimating expected credit losses. This standard is effective for us on July 1, 2020 (the first quarter of our fiscal year 2021) with early application permitted. We are currently evaluating the anticipated impact of this standard on our financial statements.

Statement of Cash Flows: In August and November of 2016, the FASB issued updates to the accounting standard which addresses the classification and presentation of certain cash receipts, cash payments and restricted cash in the statement of cash flows. The standard is effective for us on July 1, 2018 (the first quarter of our fiscal year 2019) and requires a retrospective approach. Early adoption is permitted, including adoption in an interim period. We are currently evaluating the anticipated impact of this standard on our financial statements.

Goodwill Impairment: In January 2017, the FASB issued an accounting standard update to simplify the test for goodwill impairment which removes step 2 from the goodwill impairment test. Under the revised standard, an entity will perform its annual or interim goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount and recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit s fair value. The loss should not exceed the total amount of goodwill allocated to the reporting unit. The standard is effective for us on July 1, 2020 (the first quarter of our fiscal year 2021) on a prospective basis, with early adoption permitted for periods beginning on or after January 1, 2017. We are currently evaluating the impact of this standard on our financial statements and the timing of adoption.

Table of Contents

Defined Benefit Plan Expenses: In March 2017, the FASB issued an accounting standard update that changes the income statement presentation of defined benefit plan expense by requiring separation between operating expense (service cost component) and non-operating expense (all other components of net periodic defined benefit cost). Under the revised standard, the operating expense component will be reported with similar compensation costs, while the non-operating components will be reported in Other Income and Expense. In addition, only the service cost component is eligible for capitalization as part of an asset such as property, plant and equipment. This standard is effective for us on July 1, 2018 (the first quarter of our fiscal year 2019). We do not currently believe that the adoption of this standard will have a material impact on our financial statements.

Note 3 Fair Value

Fair Values of Assets and Liabilities

We measure fair value at the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In determining fair value, the assumptions that market participants would use in pricing an asset or liability (the inputs) are based on a tiered fair value hierarchy consisting of three levels, as follows:

Level 1: Observable inputs such as quoted prices for identical assets or liabilities in active markets.

Level 2: Other inputs that are observable directly or indirectly, such as quoted prices for similar instruments in active markets or for similar markets that are not active.

Level 3: Unobservable inputs for which there is little or no market data and which require us to develop our own assumptions about how market participants would price the asset or liability.

Valuation techniques for assets and liabilities include methodologies such as the market approach, the income approach or the cost approach, and may use unobservable inputs such as projections, estimates and management s interpretation of current market data. These unobservable inputs are only utilized to the extent that observable inputs are not available or cost-effective to obtain.

At December 31, 2017 and June 30, 2017, our assets and liabilities measured at fair value on a recurring basis were as follows:

	December 31, 2017 Fair Value Measurements Using Input Types				June 30, 2017 Fair Value Measurements Using Input Types			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
	(in thousands)							
Assets								
Money market funds (cash and cash equivalents)	$ 89	$	$	$ 89	$ 593	$	$	$ 593
Available for sale securities Debt								
U.S. Corporate	$	$ 3,475	$	$ 3,475	$	$ 1,906	$	$ 1,906
Government U.S.		6,461		6,461				

Total available for sale securities	$	$ 9,936	$	$ 9,936	$	$ 1,906	$	$ 1,906
Derivative interest rate swap	$	$ 782	$	$ 782	$	$	$	$
Liabilities								
Derivative interest rate swap	$	$ 165	$	$ 165	$	$	$	$

Fair Value of Financial Instruments

We have certain financial instruments which consist of cash and cash equivalents, cash and cash equivalents held for customers, marketable securities, accounts receivable, accounts payable, customer account liabilities, a derivative interest rate swap as more fully described in *Note 11 Derivative Instruments* and debt drawn on our Credit Facility as more fully described in *Note 10 Indebtedness*. Fair value information for each of these instruments is as follows:

Cash and cash equivalents, cash and cash equivalents held for customers, accounts receivable, accounts payable and customer account liabilities fair value approximates their carrying values, due to the short-term nature of these instruments.

Marketable securities classified as held to maturity, all of which mature within one year, are recorded at amortized cost, which at December 31, 2017 and June 30, 2017, approximated fair value.

Table of Contents

Marketable securities classified as available for sale are recorded at fair value. Unrealized gains and losses are included as a component of accumulated other comprehensive loss in stockholders equity, net of tax. We use the specific identification method to determine any realized gains or losses from the sale of our marketable securities classified as available for sale.

The fair value of our derivative interest rate swap is based on the present value of projected cash flows that will occur over the life of the instrument, after considering certain contractual terms of the arrangement.

The carrying value of assets related to deposits we have made to fund future requirements associated with Israeli severance arrangements was $1.5 million at both December 31, 2017 and June 30, 2017, which approximated their fair value.

We have certain other investments accounted for at cost. The carrying value of these investments was $7.7 million at both December 31, 2017 and June 30, 2017 and are reported as a component of our other assets. These investments are recorded at cost, less any write-downs for other-than-temporary impairment charges. To determine the fair value of these investments, we use all available financial information including information based on recent or pending third-party equity investments in these entities. In certain instances, a cost method investment s fair value may not be estimated if there are no identified events or changes in circumstances that would indicate a significant adverse effect on the fair value of the investment and to do so would be impractical, and as a result, we have not estimated the fair value of these investments.

We have borrowings of $150 million against our Credit Facility (refer to *Note 10 Indebtedness* for a discussion of this credit agreement). The fair value of these borrowings, which are classified as Level 2, approximates their carrying value at December 31, 2017, as the instrument carries a variable rate of interest and reflects current market rates.

Marketable Securities

The table below presents information regarding our marketable securities by major security type as of December 31, 2017 and June 30, 2017.

	December 31, 2017			June 30, 2017		
	Held to Maturity	Available for Sale	Total	Held to Maturity	Available for Sale	Total
	(in thousands)					
Marketable securities:						
Corporate and other debt securities	$ 68	$ 9,936	$ 10,004	$ 67	$ 1,906	$ 1,973
Total marketable securities	$ 68	$ 9,936	$ 10,004	$ 67	$ 1,906	$ 1,973

The following table summarizes the estimated fair value of our investments in available for sale marketable securities classified by the contractual maturity date of the securities:

	December 31, 2017 (in thousands)
Due within 1 year	$ 9,936
Due in 1 year through 5 years	
Total	$ 9,936

All of our available for sale marketable securities are included in current assets as we do not have the positive intent to hold these investments until maturity and view these investments as available to fund current operations. At December 31, 2017, the difference between the fair value of our available for sale securities and their amortized cost was not significant.

Table of Contents

The following table presents the aggregate fair values and gross unrealized losses for those available for sale investments that were in an unrealized loss position as of December 31, 2017 and June 30, 2017, aggregated by investment category and the length of time that individual securities have been in a continuous loss position:

	At December 31, 2017		At June 30, 2017	
	Less than 12 Months			
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
	(in thousands)			
U.S. Corporate	$ 3,475	$ (2)	$ 1,628	$ (1)
Government U.S.	6,461	(4)		
Total	$ 9,936	$ (6)	$ 1,628	$ (1)

Note 4 Acquisitions and Other Investments

First Capital Cashflow Ltd.

On October 4, 2017, we acquired First Capital Cashflow Ltd. (FCC) for 10.5 million British Pound Sterling (approximately $13.9 million based on the exchange rate in effect at the acquisition date) in cash and 42,080 shares of our common stock. The shares, which were issued to the selling stockholders of FCC who became employees of Bottomline, have vesting conditions tied to continued employment; as such the shares are compensatory and we will record share-based payment expense over the underlying stock vesting period of five years. FCC is headquartered and operates in the United Kingdom and is a provider of transaction settlement solutions. The acquisition is expected to strengthen our payment solution capabilities and further enhance our ability to provide secure, scalable technology solutions that enable customers to adapt to and leverage changes in the business payments environment.

For the period ended December 31, 2017, our consolidated balance sheet reflects $3.5 million of cash and cash equivalents held for customers and a corresponding $3.5 million of customer account liabilities. Cash and cash equivalents held for customers and customer account liabilities arise as a by-product of FCC s operations as it is customary to collect client funds and hold them for a short transient period before ultimately disbursing the amounts and settling the corresponding liability. Cash we hold on behalf of clients is segregated from our other corporate cash accounts and is not available for use by us other than to settle the corresponding client liability.

In the allocation of the purchase price, which is preliminary at December 31, 2017, we recorded $4.7 million of goodwill. The goodwill is not deductible for income tax purposes and arose principally due to anticipated future benefits arising from the acquisition. Identifiable intangible assets of $10.5 million, consisting of customer related and other intangible assets, are being amortized over a weighted average estimated useful life of eleven years. FCC s operating results are included in the Payments and Transactional Documents segment from the date of the acquisition forward and did not have a material impact on our revenue or earnings.

Decillion

On August 14, 2017, we acquired Singapore-based Decillion Group (Decillion) for total consideration of 6.2 million Singapore Dollars (approximately $4.6 million based on the exchange rate in effect at the acquisition date), consisting of cash of $2.8 million and a note payable of $1.8 million. The note is payable in equal installments over ten quarters starting during the three months ended September 30, 2017. Decillion is a financial messaging solution provider in the

Asia Pacific region. Headquartered in Singapore, Decillion has offices in Australia, China, Indonesia, Malaysia and Thailand and they operate a SWIFT service bureau which connects more than 130 financial institutions and corporations to the SWIFT community. This acquisition expands the depth and breadth of our financial messaging solutions, particularly in the Asia Pacific region.

In the allocation of the purchase price, which is preliminary at December 31, 2017, we recorded $1.4 million of goodwill. The goodwill is not deductible for income tax purposes and arose principally due to anticipated future benefits arising from the acquisition. Identifiable intangible assets of $2.4 million, consisting of customer related intangible assets, are being amortized over their estimated useful life of twelve years. Decillion s operating results have been included in our Cloud Solutions segment from the date of the acquisition forward and did not have a material impact on our revenue or earnings.

Acquisition expenses of approximately $0.8 million were expensed during the six months ended December 31, 2017 related to the Decillion and FCC acquisitions, principally as a component of general and administrative expense.

Other Investments

In December 2015, we made a $3.5 million investment in preferred stock of a privately held, early-stage technology company. We have the ability to exercise significant influence over this company; however, we have no ability to exercise control. Investments in common stock or in-substance common stock, through which an investor has the ability to exercise significant influence over the operating or financial policies of the investee, are accounted for under the equity method of accounting. In-substance common stock is an investment that has risk and reward characteristics that are substantially similar to an entity s common stock. The preferred stock underlying our investment is not in-substance common stock as its terms include a substantive liquidation preference not available to common stockholders. Accordingly, we account for this investment under the cost method of accounting, subject to periodic review for impairment. Impairment losses, to the extent occurring, would be recorded as an operating expense in the period incurred. Our maximum investment exposure, which is determined based on the cost of our investment, was $3.5 million as of December 31, 2017 and is located within other assets on our consolidated balance sheet. There were no indicators of impairment identified as of December 31, 2017.

Table of Contents

We concluded that this company is a VIE as it lacks sufficient equity to finance its activities. However, we also concluded that we are not the primary beneficiary of the VIE as we do not have the power to exert control or direct the activities that most significantly impact the VIE s economic performance. As we have determined we are not the primary beneficiary, consolidation of the VIE is not required.

Note 5 Net Income (Loss) Per Share

The following table sets forth the computation of basic and diluted net income (loss) per share:

	Three Months Ended December 31,		Six Months Ended December 31,	
	2017	2016	2017	2016
	(in thousands, except per share amounts)			
Numerator basic and diluted:				
Net income (loss)	$ 3,088	$ (10,346)	$ (1,153)	$ (20,854)
Denominator:				
Shares used in computing basic net income (loss) per share attributable to common stockholders	38,087	37,769	37,908	37,854
Impact of dilutive securities	1,257			
Shares used in computing diluted net income (loss) per share attributable to common stockholders	39,344	37,769	37,908	37,854
Basic net income (loss) per share attributable to common stockholders	$ 0.08	$ (0.27)	$ (0.03)	$ (0.55)
Diluted net income (loss) per share attributable to common stockholders	$ 0.08	$ (0.27)	$ (0.03)	$ (0.55)

For the six months ended December 31, 2017, approximately 2.8 million shares of unvested restricted stock and stock options were excluded from the calculation of diluted earnings per share as their effect on the calculation would have been anti-dilutive.

For the three and six months ended December 31, 2016, approximately 3.0 million and 3.1 million shares, respectively, of unvested restricted stock and stock options were excluded from the calculation of diluted earnings per share as their effect on the calculation would have been anti-dilutive.

Note 6 Operations by Segments and Geographic Areas

Segment Information

Operating segments are the components of our business for which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing

performance. Our chief operating decision maker is our chief executive officer. Our operating segments are organized principally by the type of product or service offered and by geography. During the quarter ended December 31, 2017 we changed the name of one of our reportable segments to Banking Solutions from Digital Banking, and that name change is reflected in the discussion that follows.

Similar operating segments have been aggregated into four reportable segments as follows:

Cloud Solutions. Our Cloud Solutions segment provides customers predominately with SaaS technology offerings that facilitate electronic payment, electronic invoicing, and spend management. Our legal spend management solutions, which enable customers to create more efficient processes for managing invoices generated by outside law firms while offering insight into important legal spend factors such as expense monitoring and outside counsel performance, are included within this segment. This segment also incorporates our settlement network solutions (financial messaging and Paymode-X). Our settlement network solutions are highly scalable, secure and cost effective and facilitate cash payment and transaction settlement between businesses, their vendors and banks. Revenue within this segment is generally recognized on a subscription or transaction basis or ratably over the estimated life of the customer relationship.

Banking Solutions. Our Banking Solutions segment provides solutions that are specifically designed for banking and financial institution customers. Our Banking Solution products are now sold predominantly on a subscription basis, which has the effect of contributing to recurring subscription and transaction revenue and the revenue predictability of future periods, but which also delays revenue recognition over a longer period.

Payments and Transactional Documents. Our Payments and Transactional Documents segment is a supplier of software products that provide a range of financial business process management solutions, including making and collecting payments, sending

Table of Contents

and receiving invoices, and generating and storing business documents. This segment also provides a range of standard professional services and equipment and supplies that complement and enhance our core software products. Revenue associated with the aforementioned products and services is typically recorded upon delivery. However, if we license products on a subscription basis, revenue is typically recorded ratably over the subscription period or the expected life of the customer relationship.

Other. Our Other segment consists of our healthcare and cyber fraud and risk management operating segments. Our cyber fraud and risk management solutions non-invasively monitor, replay and analyze user behavior to flag and even stop suspicious activity in real time. Our healthcare solutions for patient registration, electronic signature, mobile document and payments allow healthcare organizations to improve business efficiencies, reduce costs and improve care quality. When licensed on a perpetual license basis, revenue for our cyber fraud and risk management and healthcare products is typically recorded upon delivery, with the exception of software maintenance which is normally recorded ratably over a twelve-month period. When products are licensed on a subscription basis, revenue is normally recorded ratably over the subscription period.

Periodically a sales person in one operating segment will sell products and services that are typically sold within a different operating segment. In such cases, the transaction is generally recorded by the operating segment to which the sales person is assigned. Accordingly, segment results can include the results of transactions that have been allocated to a specific segment based on the contributing sales resources, rather than the nature of the product or service. Conversely, a transaction can be recorded by the operating segment primarily responsible for delivery to the customer, even if the sales person is assigned to a different operating segment.

Our chief operating decision maker assesses segment performance based on a variety of factors that normally include segment revenue and a segment measure of profit or loss. Each segment s measure of profit or loss is on a pre-tax basis and excludes certain items as presented in our reconciliation of the measure of total segment profit to GAAP loss before income taxes that follows. There are no inter-segment sales; accordingly, the measure of segment revenue and profit or loss reflects only revenues from external customers. The costs of certain corporate level expenses, primarily general and administrative expenses, are allocated to our operating segments based on a percentage of the segment s revenues.

We do not track or assign our assets by operating segment.

Segment information for the three and six months ended December 31, 2017 and 2016 according to the segment descriptions above, is as follows:

	Three Months Ended December 31,		Six Months Ended December 31,	
	2017	2016	2017	2016
	(in thousands)			
Segment revenue:				
Cloud Solutions [1]	$ 44,518	$ 38,032	$ 86,962	$ 73,589
Banking Solutions	20,954	19,464	42,275	37,650
Payments and Transactional Documents	25,343	24,815	48,392	49,661
Other	4,380	4,417	8,862	8,912

Total segment revenue	$ 95,195	$ 86,728	$ 186,491	$ 169,812
Segment measure of profit (loss):				
Cloud Solutions	$ 9,650	$ 6,778	$ 19,034	$ 12,231
Banking Solutions	1,148	1,043	3,309	1,068
Payments and Transactional Documents	7,734	7,617	14,094	15,193
Other	(903)	(913)	(1,387)	(1,358)
Total measure of segment profit	$ 17,629	$ 14,525	$ 35,050	$ 27,134

(1) Revenues from our legal spend management solutions were $16.1 million and $14.7 million for the three months ended December 31, 2017 and 2016, respectively. Revenues from our settlement network solutions were $28.4 million and $23.3 million for the three months ended December 31, 2017 and 2016, respectively. Revenues from our legal spend management solutions were $31.6 million and $27.7 million for the six months ended December 31, 2017 and 2016, respectively. Revenues from our settlement network solutions were $55.4 million and $45.9 million for the six months ended December 31, 2017 and 2016, respectively.

Table of Contents

A reconciliation of the measure of total segment profit to GAAP loss before income taxes is as follows:

	Three Months Ended December 31,		Six Months Ended December 31,	
	2017	2016	2017	2016
	(in thousands)			
Total measure of segment profit	$ 17,629	$ 14,525	$ 35,050	$ 27,134
Less:				
Amortization of acquisition-related intangible assets	(5,702)	(6,090)	(10,890)	(12,375)
Goodwill impairment charge		(7,529)		(7,529)
Stock-based compensation expense	(8,080)	(8,656)	(16,540)	(16,855)
Acquisition and integration-related expenses	(380)	(522)	(1,372)	(1,771)
Restructuring benefit			9	
Minimum pension liability adjustments	(3)	(264)	(38)	(541)
Global ERP system implementation and other costs	(1,339)	(2,106)	(3,415)	(4,597)
Other expense, net	(3,532)	(4,182)	(7,995)	(8,117)
Loss before income taxes	$ (1,407)	$ (14,824)	$ (5,191)	$ (24,651)

The following depreciation and other amortization expense amounts are included in the measure of segment profit (loss):

	Three Months Ended December 31,		Six Months Ended December 31,	
	2017	2016	2017	2016
	(in thousands)			
Depreciation and other amortization expense:				
Cloud Solutions	$ 2,535	$ 1,860	$ 4,978	$ 3,700
Banking Solutions	1,537	1,436	3,029	2,806
Payments and Transactional Documents	705	749	1,344	1,554
Other	98	109	192	181
Total depreciation and other amortization expense	$ 4,875	$ 4,154	$ 9,543	$ 8,241

Geographic Information

We have presented geographic information about our revenues below. This presentation allocates revenue based on the point of sale, not the location of the customer. Accordingly, we derive revenues from geographic locations based on the location of the customer that would vary from the geographic areas listed here; particularly in respect of financial institution customers located in Australia for which the point of sale was North America and customers located in Africa for which the point of sale was the Middle East.

	Three Months Ended December 31,		Six Months Ended December 31,	
	2017	2016	2017	2016
	(in thousands)			
North America	$ 59,036	$ 56,190	$ 116,606	$ 106,712
United Kingdom	22,468	19,313	42,539	40,144
Continental Europe	10,120	9,182	20,531	18,534
Asia-Pacific and Middle East	3,571	2,043	6,815	4,422
Total revenues from unaffiliated customers	$ 95,195	$ 86,728	$ 186,491	$ 169,812

Table of Contents

Long-lived assets based on geographical location, excluding deferred tax assets and intangible assets, were as follows:

	At December 31, 2017	At June 30, 2017
	(in thousands)	
Long-lived assets:		
North America	$ 36,211	$ 35,569
United Kingdom	5,767	5,188
Continental Europe	921	1,208
Asia-Pacific and Middle East	2,357	1,901
Total long-lived assets	$ 45,256	$ 43,866

Note 7 Income Taxes

The income tax expense we record in any interim period is based on our estimated effective tax rate for the fiscal year for those tax jurisdictions in which we can reliably estimate our effective tax rate. The calculation of our estimated effective tax rate requires an estimate of pre-tax income by tax jurisdiction, as well as total tax expense for the fiscal year. Accordingly, this tax rate is subject to adjustment if, in subsequent interim periods, there are changes to our initial estimates of total tax expense or pre-tax income, including the mix of income by jurisdiction. For those tax jurisdictions for which we are unable to reliably estimate an overall effective tax rate, we calculate income tax expense based upon the actual effective tax rate for the year-to-date period.

The Tax Cuts and Jobs Act (the Tax Act) was signed into U.S. law on December 22, 2017 and makes broad and complex changes to the U.S. tax code. This legislation contains a variety of income tax changes, including a reduction to the federal corporate income tax rate from 35% to 21%, a repeal of the corporate alternative minimum tax, a one-time transition tax on accumulated foreign earnings (if any), a move to a territorial tax system, a limitation on the tax deductibility of interest expense and an acceleration of tax deductions for qualifying capital expenditures. As discussed in more detail below, at December 31, 2017, we have not completed our accounting for the tax effects of enactment of the Tax Act.

The Tax Act resulted in three immediate consequences to us, as follows:

Assessing whether we would incur any tax liability under the one-time transition tax. Under the Tax Act, un-repatriated foreign earnings post-1986 are subject to a one-time transition tax, at rates that vary depending on the composition of foreign assets. Based on our calculations and estimates to date, we do not expect to incur any transition tax liability as we believe we are in an accumulated deficit position with respect to our foreign subsidiaries. Accordingly, we have not provided for any such tax liability as of December 31, 2017.

Re-valuing our U.S. deferred tax balances to reflect lower income tax rates. Deferred tax assets and deferred tax liabilities are recorded based on the income tax rates expected to be in effect when book and tax basis differences reverse. We are in a net U.S. deferred tax liability position. As such, upon re-valuation to lower

projected future income tax rates, we wrote down the carrying value of our net deferred tax liabilities and recognized a non-recurring income tax benefit of $3.7 million in the quarter ended December 31, 2017.

Recognizing the ability to recover amounts paid for alternative minimum tax. The Tax Act eliminated the alternative minimum tax calculation and provided for the ability to recover certain amounts previously paid for such tax. Based on our preliminary calculations, we expect to receive a tax refund of $0.7 million and we recognized a non-recurring income tax benefit for this amount in the quarter ended December 31, 2017.

All of our accounting calculations, estimates and financial reporting positions for consequences arising from the Tax Act are incomplete and preliminary as of December 31, 2017. In particular, we are completing our assessment of un-repatriated foreign earnings, our calculation of refundable alternative minimum tax, our permanent reinvestment assertions and our assessment of the required valuation allowance against our U.S. deferred tax assets in light of the changes under the Tax Act and the indefinite nature of net operating losses arising after January 1, 2018. Our on-going analysis could result in subsequent period adjustments to the preliminary amounts recorded to-date. In addition, our financial reporting conclusions may also be affected as we gain a more thorough understanding of the tax law. Any required future adjustment would be recorded in the subsequent period in which we determine that an adjustment is required.

We have not changed our permanent reinvestment assertions as of the period ended December 31, 2017.

We recorded an income tax benefit of $4.5 million for each of the three months ended December 31, 2017 and 2016. The income tax benefit for the three months ended December 31, 2017 includes the discrete tax benefit of $4.4 million relating to the consequences of the Tax Act as discussed above. Additionally, we recorded an income tax benefit associated with our Swiss and Israeli operations, offset in part by income tax expense principally associated with our U.S. and UK operations. Tax expense associated with our U.S. operations arose primarily as a result of deferred tax expense for goodwill that is deductible for tax purposes but not amortized for financial reporting purposes. The income tax benefit for the three months ended December 31, 2016 was due to a discrete tax benefit in Switzerland of $4.5 million related to the impairment of its investment in Intellinx Ltd. (a wholly owned subsidiary). We also recorded tax expense associated with our U.S. and UK operations, offset by a tax benefit associated with our Swiss and Israeli operations.

Table of Contents

We recorded an income tax benefit of $4.0 million and $3.8 million for the six months ended December 31, 2017 and 2016, respectively. The income tax benefit for the six months ended December 31, 2017 includes the discrete tax benefit of $4.4 million relating to the consequences of the Tax Act as discussed above. Additionally, we recorded income tax expense principally associated with our U.S. and UK operations, offset in part by a tax benefit associated with our Swiss and Israeli operations. Tax expense associated with our U.S. operations arose primarily as a result of deferred tax expense for goodwill that is deductible for tax purposes but not amortized for financial reporting purposes. The income tax benefit for the six months ended December 31, 2016 was due to a discrete tax benefit in Switzerland of $4.5 million related to the impairment of its investment in Intellinx Ltd. We also recorded tax expense associated with our U.S. and UK operations, offset by a tax benefit associated with our Swiss and Israeli operations.

We currently anticipate that our unrecognized tax benefits will decrease within the next twelve months by approximately $0.4 million as a result of the expiration of certain statutes of limitations associated with intercompany transactions subject to tax in multiple jurisdictions.

We record a deferred tax asset if we believe that it is more likely than not that we will realize a future tax benefit. Ultimate realization of any deferred tax asset is dependent on our ability to generate sufficient future taxable income in the appropriate tax jurisdiction before the expiration of carryforward periods, if any. Our assessment of deferred tax asset recoverability considers many different factors including historical and projected operating results, the reversal of existing deferred tax liabilities that provide a source of future taxable income, the impact of current tax planning strategies and the availability of future tax planning strategies. We establish a valuation allowance against any deferred tax asset for which we are unable to conclude that recoverability is more likely than not.

Effective July 1, 2017, we adopted a new accounting standard intended to simplify certain aspects of accounting for share-based compensation arrangements, including the associated income tax consequences. Upon adoption, excess tax benefits associated with share-based compensation arrangements that previously were only recognized for financial reporting purposes when they actually reduced currently payable income taxes were recognized as deferred tax assets, net of any required valuation allowance. Accordingly, after adoption, we recognized the following:

		(in thousands)
Increase to deferred tax assets for excess tax benefits	$	17,393
Increase to deferred tax asset valuation allowance		(17,144)
Net increase to deferred tax assets	$	249

This net increase to our deferred tax assets was recorded as a cumulative effect adjustment, reducing the accumulated deficit in our consolidated balance sheet.

During the quarter ended December 31, 2017 we reduced the carrying value of our U.S. deferred tax assets (including the corresponding impact to the valuation allowance) and our U.S. deferred tax liabilities to reflect the impact of lower income tax rates under the Tax Act.

At December 31, 2017, we had a total valuation allowance of $39.8 million against our deferred tax assets given the uncertainty of recoverability of these amounts. The change in our valuation allowance during the six months ended December 31, 2017 includes the valuation allowance provided against excess tax benefits associated with share-based payment arrangements and the preliminary reduction to valuation allowance due the change in the U.S. federal corporate income tax rate, as discussed above.

15

Table of Contents

In November 2016, the Internal Revenue Service commenced an audit on our U.S. federal tax return for the fiscal year ended June 30, 2015. We do not expect this audit to have a material impact on our financial statements.

Note 8 Goodwill and Other Intangible Assets

Goodwill and acquired intangible assets are initially recorded at fair value and tested periodically for impairment. We perform an impairment test of goodwill during the fourth quarter of each fiscal year or sooner, if indicators of potential impairment arise.

At December 31, 2017, the carrying value of goodwill for all of our reporting units was $202.1 million, and the carrying value of goodwill in our Intellinx reporting unit was $4.4 million, which we believe to be at a heightened risk of impairment. Please refer to *Note 7. Goodwill and Other Intangible Assets* to our consolidated financial statements included in Item 8 of our Annual Report in Form 10-K for the fiscal year ended June 30, 2017 for more information regarding our accumulated impairment losses and goodwill balances.

Effective July 1, 2017, we adopted an accounting standard update requiring that software be classified as an intangible asset rather than an element of property and equipment. Intangible asset information as of June 30, 2017 has been recast in the table that follows, to reflect this change.

The following tables set forth the information for intangible assets subject to amortization and for intangible assets not subject to amortization.

	As of December 31, 2017			
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Value	Weighted Average Remaining Life (in years)
		(in thousands)		
Amortized intangible assets:				
Customer related	$ 203,379	$ (129,527)	$ 73,852	8.8
Core technology	130,777	(78,954)	51,823	8.5
Other intangible assets	22,098	(16,442)	5,656	5.5
Capitalized software development costs	17,693	(4,765)	12,928	4.5
Software [1]	58,501	(29,494)	29,007	4.6
Total	$ 432,448	$ (259,182)	$ 173,266	
Unamortized intangible assets:				
Goodwill			202,083	
Total intangible assets			$ 375,349	

	As of June 30, 2017

	Gross Carrying Amount	Accumulated Amortization	Net Carrying Value	Weighted Average Remaining Life (in years)
		(in thousands)		
Amortized intangible assets:				
Customer related	$ 190,965	$ (122,698)	$ 68,267	8.7
Core technology	130,572	(74,452)	56,120	8.8
Other intangible assets	20,591	(15,691)	4,900	6.6
Capitalized software development costs	16,304	(3,423)	12,881	5.0
Software [1]	54,489	(25,377)	29,112	3.5
Total	$ 412,921	$ (241,641)	$ 171,280	
Unamortized intangible assets:				
Goodwill			194,700	
Total intangible assets			$ 365,980	

(1) Software includes purchased software and software developed for internal use.

Table of Contents

Estimated amortization expense for the remainder of fiscal year 2018 and subsequent fiscal years for acquired intangible assets, capitalized software development costs and software is as follows:

	Acquired Intangible Assets	Capitalized Software Development Costs	Software
		(in thousands)	
Remaining 2018	$ 11,481	$ 1,434	4,329
2019	20,439	2,868	7,687
2020	18,100	2,868	5,990
2021	16,358	2,869	3,740
2022	14,187	2,869	2,476
2023 and thereafter	50,766		3,400

Each period, for capitalized software development costs, we evaluate whether amortization expense using a ratio of revenue in the period to total expected revenue over the product s expected useful life would result in greater amortization than as calculated under a straight-line methodology and, if that were to occur, amortization in that period would be accelerated accordingly.

The following table represents a rollforward of our goodwill balances, by reportable segment, as follows:

	Cloud Solutions	Banking Solutions	Payments and Transactional Documents	Other	Total
			(in thousands)		
Balance at June 30, 2017 [1]	$ 90,069	$ 35,880	$ 60,557	$ 8,194	$ 194,700
Goodwill acquired during the period	1,377		4,739		6,116
Impact of foreign currency translation	447		820		1,267
Balance at December 31, 2017 [1]	$ 91,893	$ 35,880	$ 66,116	$ 8,194	$ 202,083

[1] Other goodwill balance is net of $7.5 million accumulated impairment losses.

There can be no assurance that there will not be impairment charges in future periods as a result of future impairment reviews. To the extent that future impairment charges occur it would likely have a material impact on our financial results.

Note 9 Commitments and Contingencies

Legal Matters

In May 2017, we received notification from a customer alleging a warranty claim associated with software we licensed to them in September 2013. Their claim seeks recovery of $1.269 million in software, professional services and support fees, inclusive of related sales tax. On September 22, 2017, the customer commenced arbitration proceedings in connection with the claim and an arbitration date has been set for May 2018. We believe the claim is

without merit and intend to vigorously defend ourselves. At December 31, 2017 we had not accrued for any losses associated with this matter as we do not believe a loss is probable.

We are, from time to time, a party to legal proceedings and claims that arise out of the ordinary course of our business. We are not currently a party to any material legal proceedings.

Note 10 Indebtedness

Credit Agreement

On December 9, 2016, we (as borrower) and certain of our existing and future domestic material restricted subsidiaries (the Guarantors) entered into a credit agreement (the Credit Agreement) with Bank of America, N.A. and certain other lenders (the Lenders) that provides for a five-year revolving credit facility in the amount of up to $300 million (the Credit Facility).

Under the Credit Agreement, we also have the right to request an increase of the aggregate commitments under the Credit Facility by up to $150 million without the consent of any Lenders not participating in such increase, subject to specified conditions.

The proceeds of the Credit Facility may be used for lawful corporate purposes of Bottomline and its subsidiaries, including acquisitions, share buybacks, capital expenditures, the repayment or refinancing of indebtedness, redemption of our 1.5% Convertible Senior Notes that matured on December 1, 2017 (the Notes) and general corporate purposes. The Credit Facility is available for the issuance of up to $20 million of letters of credit and up to $20 million of swing line loans. The Credit Facility will terminate on December 8, 2021.

Table of Contents

Loans outstanding under the Credit Facility will bear interest, at our option, at either (i) a Eurodollar rate plus a margin of between 1.50% and 2.25% (which is initially 1.75%) based on the Consolidated Net Leverage Ratio (as defined in the Credit Agreement), or (ii) a base rate plus a margin of between 0.50% and 1.25% (which is initially 0.75%) based on the Consolidated Net Leverage Ratio. Loans under the Credit Agreement may be prepaid at par and commitments under the Credit Agreement may be reduced at any time, in whole or in part, without premium or penalty (except for LIBOR breakage costs).

The Credit Facility is guaranteed by the Guarantors and is secured by substantially all of our domestic assets and those of the Guarantors, including a pledge of all of the shares of capital stock of the Guarantors and 65% of the shares of the capital stock of our first-tier foreign subsidiaries or those of any Guarantor, in each case subject to certain exceptions as set forth in the Credit Agreement. The collateral does not include, among other things, any real property or the capital stock or any assets of any unrestricted subsidiary.

The Credit Agreement contains customary representations, warranties and covenants, including, but not limited to, material adverse events, specified restrictions on indebtedness, liens, investments, acquisitions, sales of assets, dividends and other restricted payments, and transactions with affiliates. We are required to comply with (a) a maximum consolidated net leverage ratio of 3.75 to 1.00, stepping down to 3.50 to 1.00 for the quarter ending June 30, 2018; (b) a minimum consolidated interest coverage ratio of 3.00 to 1.00; and (c) a minimum liquidity requirement at all times that the Notes are outstanding, where the outstanding principal amount of the Notes must not exceed the sum of the unutilized availability under the Credit Agreement plus our domestic cash and marketable securities.

The Credit Agreement also contains customary events of default and related cure provisions. In the case of a continuing event of default, the administrative agent would be entitled to exercise various remedies on behalf of the Lenders, including the acceleration of any outstanding loans.

During the three months ended December 31, 2017, we borrowed $150 million against the Credit Facility to finance the repayment of a portion of the principal balance of the Notes.

As of December 31, 2017, we were in compliance with the covenants associated with the Credit Facility.

Convertible Senior Notes

On December 1, 2017, we repaid the aggregate principal balance of $189.8 million of our convertible senior notes which were issued on December 12, 2012. We borrowed $150 million under our Credit Facility and used $39.8 million of cash on hand to fund the settlement of the Notes.

The principal balance of the Notes was required to be settled in cash. However, we were permitted at our election to settle any conversion obligation in excess of the principal portion in cash, shares of our common stock, or a combination of cash and shares of our common stock. Upon the maturity of the Notes, we elected to settle the conversion premium with shares of our common stock and, accordingly, issued approximately 0.6 million shares with a fair value of $33.54 per share. The impact of the share issuance was recorded entirely within stockholder s equity in our consolidated balance sheet and we recorded no gain or loss on the settlement of the Notes.

The following table sets forth total interest expense related to the Notes:

	Three Months Ended December 31,		Six Months Ended December 31,	
	2017	2016	2017	2016
	(in thousands)			
Contractual interest expense (cash)	$ 482	$ 712	$ 1,194	$ 1,424
Amortization of debt discount (non-cash)	2,271	3,132	5,574	6,208
Amortization of debt issue costs (non-cash)	198	296	494	592
	$ 2,951	$ 4,140	$ 7,262	$ 8,224
Effective interest rate of the liability component	8.54%	8.10%	8.45%	8.04%

Table of Contents

Note Hedges

In December 2012, we entered into privately negotiated transactions to purchase hedge instruments (the Note Hedges), covering approximately 6.3 million shares of our common stock. The Note Hedges, subject to anti-dilution provisions substantially similar to those of the Notes, had a strike price that corresponds to the conversion price of the Notes, were exercisable by us upon any conversion under the Notes and expired on December 1, 2017. On December 1, 2017, in connection with the maturity of the Notes, we redeemed a portion of the Note Hedges and received from the Note Hedge counterparties approximately 0.6 million shares of our common stock with a fair value $33.54 per share. The impact of the share redemption was recorded as treasury stock in our consolidated balance sheet and we recorded no gain or loss on the redemption of these shares. The redemption of these shares offset the dilution that otherwise would have occurred as a result of the common stock we issued upon the settlement of the Notes.

Warrants

In December 2012, we received aggregate proceeds of $25.8 million, net of issue costs, from the sale of warrants (the Warrants), for the purchase of up to 6.3 million shares of our common stock, subject to antidilution adjustments, at a strike price of $40.04 per share. The Warrants are exercisable in equal tranches over a period of 150 days beginning on March 1, 2018, and ending on October 18, 2018.

The Warrants are transactions that are separate from the terms of the Notes and the Note Hedges, and holders of the Notes and Note Hedges have no rights with respect to the Warrants.

Note Payable

We financed a portion of the Decillion purchase price by entering into a note payable for 2.5 million Singapore Dollars (approximately $1.8 million based on the exchange rate in effect at the acquisition date). The note is payable in equal installments over ten quarters starting during the three months ended September 30, 2017. Please refer to *Note 4 Acquisitions and Other Investments* for additional discussion of our Decillion acquisition.

Note 11 Derivative Instruments

Note Hedges, Conversion Feature and Warrants

During the three months ended December 31, 2017, in connection with the maturity of the Notes, we settled the Note Hedges and Conversion Feature as discussed in *Note 10 Indebtedness*. The remaining derivative instruments related to the Notes at December 31, 2017 consist of the Warrants, also discussed in *Note 10 Indebtedness*. The Warrants continue to meet the classification requirements for inclusion within stockholders equity and as such they were not subject to fair value re-measurement. We are required to assess whether we continue to meet the stockholders equity classification requirements. If in any future period we failed to satisfy those requirements, we would be required to reclassify the derivative instruments out of stockholders equity, to either assets or liabilities depending on their nature, and record those instruments at fair value with changes in fair value reflected in earnings.

Cash Flow Hedges

Interest Rate Swap

On July 10, 2017, we entered into an interest rate swap to hedge our exposure to interest rate risk. The agreement has a notional value of $100.0 million, was effective as of December 1, 2017 and expires on December 1, 2021. The notional amount of the swap matches the corresponding principal amount of a portion of our borrowings under the Credit Agreement with the Lenders. During the term of the agreement, we have a fixed interest rate of 1.9275 percent on the notional amount and Citizens Bank, National Association, as counterparty to the agreement, will pay us interest at a floating rate based on the 1 month USD-LIBOR-BBA swap rate on the notional amount. Interest payments are made quarterly on a net settlement basis.

We designated the interest rate swap as a hedging instrument and it qualified for hedge accounting upon inception and at December 31, 2017. To continue to qualify for hedge accounting, the instrument must retain a highly effective ability to hedge interest rate risk for borrowings under the Credit Agreement. We are required to test hedge effectiveness at the end of each financial reporting period. If a derivative qualifies for hedge accounting, changes in fair value of the hedge instrument will be recognized in accumulated other comprehensive income (loss) (AOCI) and subsequently reclassified into earnings in the period that the hedged transaction affects earnings. The reclassification into earnings will be recorded as a component of our interest expense within other expense, net. If the instrument were to lose some or all of its hedge effectiveness, changes in fair value for the ineffective portion of the instrument would be recorded immediately in earnings.

Table of Contents

The fair values of the gross asset and gross liability of our interest rate swap and their respective locations in our consolidated balance sheet at December 31, 2017 were as follows:

Description	Balance Sheet Location	December 31, 2017 (in thousands)
Derivative interest rate swap		
Derivative asset	Other assets	$ 782
Derivative liability	Accrued expenses and other current liabilities	$ 165

The following tables presents the effect of the derivative interest rate swap in our consolidated statement of comprehensive income (loss) for the three and six months ended December 31, 2017.

	Amount of Gain (Loss) Recognized in OCI on Derivative Instruments (Effective Portion) Three Months Ended December 31,		Amount of Gain (Loss) Reclassified from AOCI into Net Income (Loss) (Effective Portion) Three Months Ended December 31,	
	2017	2016	2017	2016
	(in thousands)			
Derivative interest rate swap	$ 804	$	$ (48)	$

	Amount of Gain (Loss) Recognized in OCI on Derivative Instruments (Effective Portion) Six Months Ended December 31,		Amount of Gain (Loss) Reclassified from AOCI into Net Income (Loss) (Effective Portion) Six Months Ended December 31,	
	2017	2016	2017	2016
	(in thousands)			
Derivative interest rate swap	$ 569	$	$ (48)	$

During the three and six months ended December 31, 2017, we concluded that no portion of the hedge was ineffective.

As of December 31, 2017, there was $0.6 million of unrealized gain in accumulated other comprehensive loss. We do not expect to reclassify any of this unrealized gain from accumulated other comprehensive loss to earnings over the next twelve months.

Note 12 Postretirement and Other Employee Benefits

Defined Benefit Pension Plan

We sponsor a retirement plan for our Swiss-based employees that is governed by local regulatory requirements. This plan includes certain minimum benefit guarantees that, under U.S. GAAP, require defined benefit plan accounting.

Net periodic pension costs for the Swiss pension plan included the following components:

	Three Months Ended December 31,		Six Months Ended December 31,	
	2017	2016	2017	2016
	(in thousands)			
Components of net periodic cost				
Service cost	$ 624	$ 732	$ 1,264	$ 1,482
Interest cost	87	31	176	63
Prior service credit	(22)	(22)	(45)	(45)
Net actuarial loss	54	161	109	326
Expected return on plan assets	(294)	(219)	(595)	(443)
Net periodic cost	$ 449	$ 683	$ 909	$ 1,383

Table of Contents

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

This Quarterly Report on Form 10-Q contains forward-looking statements that involve risks and uncertainties. The statements contained in this report that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). Without limiting the foregoing, the words may, will, should, could, expects, plans, intends, anticipates, believes, estimates, predicts, potential and similar expressions are intended to identify forward-looking statements. All forward-looking statements included in this Quarterly Report on Form 10-Q are based on information available to us up to and including the date of this report, and we assume no obligation to update any such forward-looking statements. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors, including those set forth below under Management s Discussion and Analysis of Financial Condition and Results of Operations and Item 1A. Risk Factors and elsewhere in this Quarterly Report on Form 10-Q. You should carefully review those factors and also carefully review the risks outlined in other documents that we file from time to time with the Securities and Exchange Commission, including Item 1A. Risk Factors in our Annual Report on Form 10-K for the fiscal year ended June 30, 2017.

In the management discussion that follows, we have highlighted those changes and operating factors that were the primary factors affecting period to period fluctuations. The remainder of the change in period to period fluctuations from that which is specifically disclosed arises from various individually insignificant items.

Overview

We help make complex business payments simple, smart, and secure. Corporations and banks rely on us for domestic and international payments, efficient cash management, automated workflows for payment processing and bill review, and state of the art fraud detection, behavioral analytics and regulatory compliance solutions. The majority of our revenues are derived from offerings sold as SaaS-based solutions and paid for on a subscription and transaction basis.

We operate cloud-based settlement networks that facilitate electronic payments and transaction settlement between businesses, their vendors and banks. We offer cloud and on-premise solutions that banks use to provide payment, cash management and treasury capabilities to their business customers, as well as solutions that banks and credit unions use to facilitate customer acquisition and growth. We offer legal spend management solutions that help manage and determine the right amount to pay for legal services and claims vendor expenditures for insurance companies and other large corporate consumers of outside legal services. Our corporate customers rely on our solutions to automate their payment and accounts payable processes and to streamline and manage the production and retention of electronic documents. Our healthcare customers use our solutions to streamline financial processes, particularly the patient enrollment process. We also offer comprehensive cyber fraud and risk management solutions that are designed to non-invasively monitor and analyze user behavior and payment transactions to flag behavioral and data anomalies and other suspicious activity.

Our solutions are designed to complement, leverage and extend our customers existing information systems, accounting applications and banking relationships so that they can be deployed quickly and efficiently. To help our customers realize the maximum value from our products and meet their specific business requirements, we also provide professional services for installation, training, consulting and product enhancement.

Financial Highlights

For the six months ended December 31, 2017, our revenue increased to $186.5 million from $169.8 million in the same period of the prior fiscal year. This revenue increase was attributable to revenue increases in our Cloud Solutions segment of $13.4 million and Banking Solutions segment of $4.6 million, offset in part by decreased revenue in our

Payments and Transactional Documents segment of $1.3 million. Increased revenue from our legal spend management and settlement network solutions accounted for the revenue increase in our Cloud Solutions segment. The Banking Solutions segment s revenue increase was primarily due to increased services revenue and increased subscription and transaction revenue from our cloud based solutions. The revenue decrease in our Payments and Transactional Documents segment was related to lower European software license revenue and service and maintenance revenue in our payment and document automation products. Our revenue for the six months ended December 31, 2017 was favorably impacted by $1.8 million due to the impact of foreign currency exchange rates primarily related to the British Pound Sterling which appreciated against the U.S. Dollar as compared to the same period of the prior fiscal year.

We incurred a net loss of $1.2 million in the six months ended December 31, 2017 compared to a net loss of $20.9 million in the same period of the prior fiscal year. Our net loss for the six months ended December 31, 2017 was reduced by the impact of increased gross margins of $12.8 million and decreased operating expenses of $6.5 million. The increase in gross margins was primarily driven by increases in revenue in our Cloud Solutions and Banking Solutions segments. The decrease in our operating expenses was due primarily to the absence of a goodwill impairment charge of $7.5 million we incurred during the three months ended December 31, 2016, a decrease in amortization of acquisition-related intangible assets of $1.5 million and decreased global enterprise resource planning (ERP) implementation and other costs of $1.2 million, partially offset by an increase in sales and

Table of Contents

marketing costs of $2.5 million and product development and engineering costs of $1.7 million. Our operating expenses for the six months ended December 31, 2017 were unfavorably impacted by $0.6 million due to the impact of foreign currency exchange rates primarily related to the British Pound Sterling which appreciated against the U.S. Dollar as compared to the same period of the prior fiscal year.

In the six months ended December 31, 2017, we derived approximately 38% of our revenue from customers located outside of North America, principally in the United Kingdom, continental Europe and the Asia-Pacific region.

We expect future revenue growth to be driven primarily by our banking, legal spend management and settlement network solutions.

Over the past several years we have made strategic investments in innovative new technology offerings that we believe will enhance our competitive position, help us win new business, drive subscription revenue growth and expand our operating margins. We believe that these initiatives have positioned us effectively for revenue growth in future years.

Critical Accounting Policies and Significant Judgments and Estimates

We believe that several accounting policies are important to understanding our historical and future performance. We refer to these policies as critical because these specific areas generally require us to make judgments and estimates about matters that are uncertain at the time we make the estimate, and different estimates which also would have been reasonable could have been used.

The critical accounting policies we identified in our most recent Annual Report on Form 10-K for the fiscal year ended June 30, 2017 related to revenue recognition, the valuation of goodwill and intangible assets, the valuation of acquired deferred revenue and income taxes. There have been no material changes to the critical accounting policies disclosed in our Annual Report on Form 10-K for the fiscal year ended June 30, 2017. It is important that the discussion of our operating results that follows be read in conjunction with the critical accounting policies disclosed in our Annual Report on Form 10-K, as filed with the SEC on August 28, 2017.

Recent Accounting Pronouncements

For information with respect to recent accounting pronouncements and the impact of these pronouncements on our consolidated financial statements, please refer to *Note 2 Recent Accounting Pronouncements* to our unaudited consolidated financial statements included in Item 1 of this Quarterly Report on Form 10-Q.

Results of Operations

Three and Six Months Ended December 31, 2017 Compared to the Three and Six Months Ended December 31, 2016

Segment Information

Operating segments are components of an enterprise for which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. Our chief operating decision maker is our chief executive officer.

Our operating segments are organized principally by the type of product or service offered and by geography. Similar operating segments have been aggregated into four reportable segments: Cloud Solutions, Banking Solutions, Payments and Transactional Documents and Other.

Table of Contents

The following tables represent our segment revenues and our segment measure of profit (loss):

	Three Months Ended December 31,		Increase (Decrease) Between Periods		Six Months Ended December 31,		Increase (Decrease) Between Periods	
	2017	2016	$ Change Inc (Dec)	% Change Inc (Dec)	2017	2016	$ Change Inc (Dec)	% Change Inc (Dec)
	(Dollars in thousands)							
Segment revenue:								
Cloud Solutions	$ 44,518	$ 38,032	$ 6,486	17.1%	$ 86,962	$ 73,589	$ 13,373	18.2%
Banking Solutions	20,954	19,464	1,490	7.7%	42,275	37,650	4,625	12.3%
Payments and Transactional Documents	25,343	24,815	528	2.1%	48,392	49,661	(1,269)	(2.6)%
Other	4,380	4,417	(37)	(0.8)%	8,862	8,912	(50)	(0.6)%
Total revenues	$ 95,195	$ 86,728	$ 8,467	9.8%	$ 186,491	$ 169,812	$ 16,679	9.8%
Segment measure of profit (loss):								
Cloud Solutions	$ 9,650	$ 6,778	$ 2,872	42.4%	$ 19,034	$ 12,231	$ 6,803	55.6%
Banking Solutions	1,148	1,043	105	10.1%	3,309	1,068	2,241	209.8%
Payments and Transactional Documents	7,734	7,617	117	1.5%	14,094	15,193	(1,099)	(7.2)%
Other	(903)	(913)	10	1.1%	(1,387)	(1,358)	(29)	(2.1)%
Total measure of segment profit	$ 17,629	$ 14,525	$ 3,104	21.4%	$ 35,050	$ 27,134	$ 7,916	29.2%

A reconciliation of the measure of total segment profit to GAAP loss before income taxes is as follows:

	Three Months Ended December 31,		Six Months Ended December 31,	
	2017	2016	2017	2016
	(in thousands)			
Total measure of segment profit	$ 17,629	$ 14,525	$ 35,050	$ 27,134
Less:				
Amortization of acquisition-related intangible assets	(5,702)	(6,090)	(10,890)	(12,375)
Goodwill impairment charge		(7,529)		(7,529)
Stock-based compensation expense	(8,080)	(8,656)	(16,540)	(16,855)

Acquisition and integration-related expenses	(380)	(522)	(1,372)	(1,771)
Restructuring benefit			9	
Minimum pension liability adjustments	(3)	(264)	(38)	(541)
Global ERP system implementation and other costs	(1,339)	(2,106)	(3,415)	(4,597)
Other expense, net	(3,532)	(4,182)	(7,995)	(8,117)
Loss before income taxes	$ (1,407)	$ (14,824)	$ (5,191)	$ (24,651)

Cloud Solutions

Revenues from our Cloud Solutions segment increased $6.5 million for the three months ended December 31, 2017 as compared to the same period in the prior fiscal year, inclusive of a favorable impact of foreign currency exchange rates of $0.5 million, due primarily to increased revenue of $5.1 million from our settlement network solutions and $1.4 million from our legal spend management solutions. Segment profit increased $2.9 million for the three months ended December 31, 2017 as compared to the same period in the prior fiscal year, due primarily to the revenue increase described above, partially offset by increased cost of revenues of $2.4 million and increased operating expenses of $1.2 million primarily related to increased sales and marketing costs.

Revenues from our Cloud Solutions segment increased $13.4 million for the six months ended December 31, 2017 as compared to the same period in the prior fiscal year, inclusive of a favorable impact of foreign currency exchange rates of $0.7 million, due primarily to increased revenue of $9.5 million from our settlement network solutions and $3.9 million from our legal spend management solutions. Segment profit increased $6.8 million for the six months ended December 31, 2017 as compared to

Table of Contents

the same period in the prior fiscal year, due primarily to the revenue increase described above, partially offset by increased cost of revenues of $4.4 million and increased operating expenses of $2.2 million. We expect revenue and profit for the Cloud Solutions segment to increase in fiscal year 2018 as compared to the prior fiscal year, as a result of increased revenue from our legal spend management solutions and settlement network solutions.

Banking Solutions

Revenues from our Banking Solutions segment increased $1.5 million for the three months ended December 31, 2017 as compared to the same period in the prior fiscal year, due primarily to increased services revenue of $2.2 million, partially offset by decreased subscriptions and transactions revenue of $0.7 million. Segment profit increased $0.1 million for the three months ended December 31, 2017 as compared to the same period in the prior fiscal year, due primarily to the revenue increase described above, partially offset by increased cost of revenues of $0.7 million and increased sales and marketing expenses of $0.7 million.

Revenues from our Banking Solutions segment increased $4.6 million for the six months ended December 31, 2017 as compared to the same period in the prior fiscal year, due primarily to increased services revenue of $3.6 million, software license revenue of $0.7 million and subscriptions and transactions revenue of $0.4 million. Segment profit increased $2.2 million for the six months ended December 31, 2017 as compared to the same period in the prior fiscal year, due primarily to the revenue increase described above, partially offset by increased cost of revenues of $2.0 million and increased sales and marketing expenses of $0.5 million. We expect revenue for the Banking Solutions segment to increase, and profit for the Banking Solutions segment to remain relatively consistent, in fiscal year 2018 as compared to the prior fiscal year, as a result of our continued deployment of our newer banking solutions.

Payments and Transactional Documents

Revenues from our Payments and Transactional Documents segment increased $0.5 million for the three months ended December 31, 2017 as compared to the same period in the prior fiscal year, inclusive of a favorable impact of foreign currency exchange rates of $1.1 million, due primarily to increased subscription and transactions revenue of $2.4 million from our European payments and transactional documents solutions, partially offset by decreased software licenses revenue of $1.0 million, decreased service and maintenance revenue of $0.4 million and decreased other revenue of $0.4 million. The segment profit increase of $0.1 million for the three months ended December 31, 2017, as compared to the same period in the prior fiscal year, inclusive of a favorable impact of foreign currency exchange rates of $0.4 million, was primarily attributable to the revenue increase described above, as well as decreased cost of revenues of $0.7 million, partially offset by increased sales and marketing expenses of $0.8 million and increased product development and engineering expenses of $0.3 million.

Revenues from our Payments and Transactional Documents segment decreased $1.3 million for the six months ended December 31, 2017 as compared to the same period in the prior fiscal year, inclusive of a favorable impact of foreign currency exchange rates of $1.1 million, due primarily to decreased service and maintenance revenue of $2.0 million, decreased software license revenue of $1.6 million and decreased other revenue of $0.7 million, partially offset by increased subscriptions and transactions revenue of $3.1 million. The segment profit decrease of $1.1 million for the six months ended December 31, 2017, as compared to the same period in the prior fiscal year, inclusive of a favorable impact of foreign currency exchange rates of $0.5 million, was primarily attributable to the revenue decrease described above, as well as increased sales and marketing expenses of $1.2 million, partially offset by decreased cost of revenues of $1.6 million. We expect revenue for the Payments and Transactional Documents segment to increase and profit to increase slightly in fiscal year 2018 as compared to the prior fiscal year, as a result of increased sales of our payment and document automation solutions.

Other

Revenues and profit from our Other segment remained relatively consistent for the three and six months ended December 31, 2017 as compared to the same period in the prior fiscal year. We expect Other segment revenue and profit to increase slightly, in fiscal year 2018 as compared to the prior fiscal year, principally as the result of increased sales of our cyber fraud and risk management products.

Table of Contents

Revenues by category

	Three Months Ended December 31,		Increase (Decrease) Between Periods		Six Months Ended December 31,		Increase (Decrease) Between Periods	
	2017	2016	$ Change Inc (Dec)	% Change Inc (Dec)	2017	2016	$ Change Inc (Dec)	% Change Inc (Dec)
				(Dollars in thousands)				
Revenues:								
Subscriptions and transactions	$ 63,187	$ 55,644	$ 7,543	13.6%	$ 123,901	$ 107,776	$ 16,125	15.0%
Software licenses	2,620	3,492	(872)	(25.0)%	4,985	5,613	(628)	(11.2)%
Service and maintenance	28,433	25,920	2,513	9.7%	55,775	53,593	2,182	4.1%
Other	955	1,672	(717)	(42.9)%	1,830	2,830	(1,000)	(35.3)%
Total revenues	$ 95,195	$ 86,728	$ 8,467	9.8%	$ 186,491	$ 169,812	$ 16,679	9.8%
As % of total revenues:								
Subscriptions and transactions	66.4%	64.2%			66.4%	63.5%		
Software licenses	2.8%	4.0%			2.7%	3.3%		
Service and maintenance	29.9%	29.9%			29.9%	31.6%		
Other	0.9%	1.9%			1.0%	1.6%		
Total revenues	100.0%	100.0%			100.0%	100.0%		

Subscriptions and Transactions

Revenues from subscriptions and transactions increased $7.5 million for the three months ended December 31, 2017 as compared to the same period in the prior fiscal year, inclusive of a favorable impact of foreign currency exchange rates of $0.8 million. The overall revenue increase was due principally to increases in revenue from our Cloud Solutions segment and Payments and Transactional Documents segment of $5.9 million and $2.4 million, respectively, partially offset by a decrease in revenue from our Banking Solutions segment of $0.7 million.

Revenues from subscriptions and transactions increased $16.1 million for the six months ended December 31, 2017 as compared to the same period in the prior fiscal year, inclusive of a favorable impact of foreign currency exchange rates of $0.8 million. The overall revenue increase was due principally to increases in revenue from our Cloud Solutions segment and Payments and Transactional Documents segment of $12.6 million and $3.1 million, respectively. We expect subscriptions and transactions revenues to increase in fiscal year 2018 as compared to the prior fiscal year, primarily as a result of the revenue contribution from our legal spend management solutions and settlement network solutions and revenue increases in our Banking Solutions segment.

Software Licenses

Revenues from software licenses decreased $0.9 million for the three months ended December 31, 2017 as compared to the same period in the prior fiscal year, inclusive of a favorable impact of foreign currency exchange rates of $0.1 million, primarily as a result of decreased revenue from our Payments and Transactional Documents segment of $1.0 million.

Revenues from software licenses decreased $0.6 million for the six months ended December 31, 2017 as compared to the same period in the prior fiscal year, inclusive of a favorable impact of foreign currency exchange rates of $0.1 million, primarily as a result of decreased revenue from our European payments and transactional documents solutions of $1.5 million, partially offset by increased revenue from our Banking Solutions segment and Other segment of $0.7 million and $0.3 million, respectively. We expect software license revenues to decrease slightly in fiscal year 2018 as compared to the prior fiscal year.

Service and Maintenance

Revenues from service and maintenance increased $2.5 million for the three months ended December 31, 2017 as compared to the same period in the prior fiscal year, inclusive of a favorable impact of foreign currency exchange rates of $0.7 million. The overall revenue increase was primarily the result of increased revenue from our Banking Solutions segment of $2.2 million.

Revenues from service and maintenance increased $2.2 million for the six months ended December 31, 2017 as compared to the same period in the prior fiscal year, inclusive of a favorable impact of foreign currency exchange rates of $0.9 million. The overall revenue increase was primarily the result of increased revenue from our Banking Solutions and Cloud Solutions segment of $3.5 million and $0.7 million, respectively, partially offset by decreased revenue from our Payments and Transactional Documents segment of $2.0 million. We expect that service and maintenance revenues will increase slightly in fiscal year 2018 as compared to the prior fiscal year.

Table of Contents

Other

Our other revenues consist principally of equipment and supplies sales which remained minor components of our overall revenue. We expect that other revenues will decrease slightly in fiscal year 2018 as compared to the prior fiscal year.

Cost of revenues by category

	Three Months Ended December 31,		Increase (Decrease) Between Periods		Six Months Ended December 31,		Increase (Decrease) Between Periods	
	2017	2016	$ Change Inc (Dec)	% Change Inc (Dec)	2017	2016	$ Change Inc (Dec)	% Change Inc (Dec)
	(Dollars in thousands)							
Cost of revenues:								
Subscriptions and transactions	$ 27,201	$ 24,782	$ 2,419	9.8%	$ 54,612	$ 48,668	$ 5,944	12.2%
Software licenses	229	196	33	16.8%	399	324	75	23.1%
Service and maintenance	12,968	13,416	(448)	(3.3)%	25,200	26,701	(1,501)	(5.6)%
Other	701	1,178	(477)	(40.5)%	1,368	2,056	(688)	(33.5)%
Total cost of revenues	$ 41,099	$ 39,572						

In addition, the length of time required to complete clinical trials for pharmaceutical and medical device products varies substantially according to the degree of regulation and the type, complexity, novelty and intended use of a product, and can continue for several years and cost millions of dollars. The commencement and completion of clinical trials for our products under development may be delayed by many factors, including governmental or regulatory delays and changes in regulatory requirements, policy

and guidelines or our inability or the inability of any potential licensee to manufacture or obtain from third parties materials sufficient for use in preclinical studies and clinical trials.

Physicians may not widely adopt the MGuard™ stent unless they determine, based on experience, long-term clinical data and published peer reviewed journal articles, that the use of the MGuard™ stent provides a safe and effective alternative to other existing treatments for coronary artery disease.

We believe that physicians will not widely adopt the MGuard™ stent unless they determine, based on experience, long-term clinical data and published peer reviewed journal articles, that the use of our MGuard™ stent provides a safe and effective alternative to other existing treatments for coronary artery disease, including coronary artery bypass grafting, or CABG, balloon angioplasty, bare-metal stents and other drug-eluting stents, provided by Johnson & Johnson, Boston Scientific Corporation, Medtronic Inc., Abbott Laboratories, and others.

We cannot provide any assurance that the data collected from our current and planned clinical trials will be sufficient to demonstrate that the MGuard™ stents are an attractive alternative to other procedures. If we fail to demonstrate safety and efficacy that is at least comparable to other drug-eluting stents or bare-metal stents that have received regulatory approval and that are available on the market, our ability to successfully market

the MGuard™ stent will be significantly limited. Even if the data collected from clinical studies or clinical experience indicate positive results, each physician's actual experience with our MGuard™ stent will vary. Clinical trials conducted with the MGuard™ stent have involved procedures performed by physicians who are technically proficient and are high-volume stent users. Consequently, both short-term and long-term results reported in these clinical trials may be significantly more favorable than typical results of practicing physicians, which could negatively affect rates of adoptions of our products. We also believe that published peer-reviewed journal articles and recommendations and support by influential physicians regarding our MGuard™ stent will be important for market acceptance and adoption, and we cannot assure you that we will receive these recommendations and support, or that supportive articles will be published.

Table of Contents

Our products are based on a new technology, and we have only limited experience in regulatory affairs, which may affect our ability or the time required to obtain necessary regulatory approvals, if such approvals are received at all.

Because our products are new and long-term success measures have not been completely validated, regulatory agencies, including the FDA, may take a significant amount of time in evaluating product approval applications. For example, there are currently several methods of measuring restenosis and we do not know which of these metrics, or combination of these metrics, will be considered appropriate by the FDA for evaluating the clinical efficacy of stents. Treatments may exhibit a favorable measure using one of these metrics and an unfavorable measure using another metric. Any change in the accepted metrics may result in reconfiguration of, and delays in, our clinical trials. Additionally, we have only limited experience in filing and prosecuting the applications necessary to gain regulatory approvals, and our clinical, regulatory and quality assurance personnel are currently composed of only 30 employees. As a result, we may experience a long regulatory process in connection with obtaining regulatory approvals for our products.

Even if our products are approved by regulatory authorities, if we or our suppliers

fail to comply with ongoing regulatory requirements, or if we experience unanticipated problems with our products, these products could be subject to restrictions or withdrawal from the market.

Any product for which we obtain marketing approval, along with the manufacturing processes, post-approval clinical data and promotional activities for such product, will be subject to continual review and periodic inspections by the FDA and other regulatory bodies. In particular, we and our suppliers will be required to comply with the FDA's Quality System Regulation ("QSR") for the manufacture of our MGuard™ stent, which covers the methods and documentation of the design, testing, production, control, quality assurance, labeling, packaging, storage and shipping of any product for which we obtain marketing approval in the United States. The FDA enforces the QSR through unannounced inspections. We and our third-party manufacturers and suppliers have not yet been inspected by the FDA and will have to successfully complete such inspections before we receive U.S. regulatory approval for our products. Failure by us or one of our suppliers to comply with statutes and regulations administered by the FDA and other regulatory bodies, or failure to take adequate response to any observations, could result in, among other things, any of the following enforcement actions:

- warning letters or untitled letters;
- fines and civil penalties;

- unanticipated expenditures;
- delays in approving, or refusal to approve, our products;
- withdrawal or suspension of approval by the FDA or other regulatory bodies;
- product recall or seizure;
- orders for physician notification or device repair, replacement or refund;
- interruption of production;
- operating restrictions;
- injunctions; and
- criminal prosecution.

If any of these actions were to occur, it could harm our reputation and could cause our product sales and profitability to suffer. Furthermore, key component suppliers may not currently be or may not continue to be in compliance with applicable regulatory requirements.

Even if regulatory approval of a product is granted, the approval may be subject to limitations on the indicated uses for which the product may be marketed. If the FDA determines that our promotional materials, training or other activities constitutes promotion of an unapproved use, it could request that we cease or modify our training or promotional materials or subject us to regulatory enforcement actions. It is also possible that other federal, state or foreign enforcement authorities might take action if they consider our training or other promotional materials to constitute promotion of an unapproved use, which could result in significant fines or penalties under other statutory authorities, such as laws prohibiting false claims for reimbursement.

Moreover, any modification to a device that has received FDA approval that could significantly affect its safety or effectiveness, or that would constitute a major change in its intended use, design or manufacture, requires a new approval from the FDA. If the FDA disagrees with any determination by us that new approval is not required, we may be required to cease marketing or to recall the modified product until approval is obtained. In addition, we could also be subject to significant regulatory fines or penalties.

Additionally, we may be required to conduct costly post-market testing and surveillance to monitor the safety or efficacy of our products, and we will be required to report adverse events and malfunctions related to our products. Later discovery of previously unknown problems with our products, including unanticipated adverse events or adverse events of unanticipated severity or frequency, manufacturing problems, or failure to comply with regulatory requirements, such as QSR, may result in restrictions on such products or manufacturing processes, withdrawal of the products from the market, voluntary or mandatory recalls, fines, suspension of regulatory approvals, product seizures, injunctions or the imposition of civil or criminal penalties. For example, Boston Scientific Corporation has initiated significant recalls of its stent products due to manufacturing and other quality issues associated with the products.

19

Table of Contents

Further, healthcare laws and regulations may change significantly in the future. Any new healthcare laws or regulations may adversely affect our business. A review of our business by courts or regulatory authorities may result in a determination that could adversely affect our operations. In addition, the healthcare regulatory environment may change in a way that restricts our operations.

Failure to obtain regulatory approval in foreign jurisdictions will prevent us from marketing our products in such jurisdictions.

We intend to market our products in international markets. In order to market our products in other foreign jurisdictions, we must obtain separate regulatory approvals from those obtained in the United States. The approval procedure varies among countries and can involve additional testing, and the time required to obtain approval may differ from that required to obtain CE Mark or FDA approval. Foreign regulatory approval processes may include all of the risks associated with obtaining CE Mark or FDA approval in addition to other risks. We may not obtain foreign regulatory approvals on a timely basis, if at all. CE Mark does not ensure approval by regulatory authorities in other countries. We may not be able to file for regulatory approvals and may not receive necessary approvals to commercialize our products in certain markets.

Regulatory delays or denials may increase our costs, cause us to lose revenue and materially and adversely affect our results of operations and the value of our business.

The products we and any potential licensees license, develop, manufacture and market are subject to complex regulatory requirements, particularly in the United States, Europe and Asia. The process of obtaining regulatory approvals to market a medical device, particularly in the United States, Europe and Japan, can be costly and time-consuming. There can be no assurance that such approvals will be granted on a timely basis, if at all. Furthermore, there can be no assurance of continuing compliance with all regulatory requirements necessary for the manufacture, marketing and sale of the products we will offer in each market where such products are expected to be sold, or that products we have commercialized will continue to comply with applicable regulatory requirements. If a government regulatory agency were to conclude that we were not in compliance with applicable laws or regulations, the agency could institute proceedings to detain or seize our products, issue a recall, impose operating restrictions, enjoin future violations and assess civil and criminal penalties against us, our officers or employees and could recommend criminal prosecution. Furthermore, regulators may proceed to ban, or request the recall, repair, replacement or refund of the cost of, any device manufactured or sold by us. Furthermore, there

can be no assurance that all necessary regulatory approvals will be obtained for the manufacture, marketing and sale in any market of any new product developed or that any potential licensee will develop using our licensed technology.

We operate in an intensely competitive and rapidly changing business environment, and there is a substantial risk our products could become obsolete or uncompetitive.

The medical device market is highly competitive. We compete with many medical service companies in the United States and internationally in connection with our current product and products under development. We face competition from numerous pharmaceutical and biotechnology companies in the therapeutics area, as well as competition from academic institutions, government agencies and research institutions. When we commercialize our products, we expect to face intense competition from Cordis Corporation, a subsidiary of Johnson & Johnson; Boston Scientific Corporation; Guidant; Medtronic, Inc.; Abbott Vascular Devices; Terumo, and others. Most of our current and potential competitors, including but not limited to those listed above, have, and will continue to have, substantially greater financial, technological, research and development, regulatory and clinical, manufacturing, marketing and sales, distribution and personnel resources, than we do. There can be no assurance that we will have sufficient

resources to successfully commercialize our products, if and when they are approved for sale. The worldwide market for stent products is characterized by intensive development efforts and rapidly advancing technology. Our future success will depend largely upon our ability to anticipate and keep pace with those developments and advances. Current or future competitors could develop alternative technologies, products or materials that are more effective, easier to use or more economical than what we or any potential licensee develop. If our technologies or products become obsolete or uncompetitive, our related product sales and licensing revenue would decrease. This would have a material adverse effect on our business, financial condition and results of operations.

Table of Contents

If we fail to maintain or establish satisfactory agreements with suppliers, we may not be able to obtain materials that are necessary to develop our products.

We depend on outside suppliers for certain raw materials. These raw materials or components may not always be available at our standards or on acceptable terms, if at all, and we may be unable to locate alternative suppliers or produce necessary materials or components on our own. If we cannot obtain necessary materials or components, we may be unable to manufacture products of sufficient quality in sufficient quantities to meet customer needs. We may also be unable to develop new products and applications and conduct clinical trials. This would compromise our ability to obtain necessary regulatory approvals, thereby impairing our ability to expand into new markets or develop new products.

Our stents may be subject to certain pricing restrictions that could reduce our product revenue.

The successful commercialization of our stents will depend, in part, on the extent to which third-party reimbursement is available from government health administration authorities, private health care insurers and other health-care funding organizations. Some element of price control over medical devices exists in most major

markets and third party reimbursement is highly variable and complex. There is increasing pressure by governments worldwide to contain health care costs by limiting both the coverage and the level of reimbursement for therapeutic products and by refusing, in some cases, to provide any coverage for products that have not been approved by the relevant regulatory agency. There can be no assurance that health administration or third party coverage will allow any potential licensee or us to achieve pricing that provides an appropriate return on such licensees' or our investment. If any potential licensee fails to achieve such pricing, it may de-emphasize or cease to commercialize our products, which could have a material adverse effect on our business and results of operations.

We may be exposed to product liability claims and insurance may not be sufficient to cover these claims.

We may be exposed to product liability claims based on the use of any of our products, or products incorporating our licensed technology, in clinical trials. We may also be exposed to product liability claims based on the sale of any such products following the receipt of regulatory approval. Product liability claims could be asserted directly by consumers, health-care providers or others. We have obtained product liability insurance coverage; however such insurance may not provide full

coverage for our future clinical trials, products to be sold, and other aspects of our business. We also have liability insurance for our ongoing clinical trial in Europe. Insurance coverage is becoming increasingly expensive and we may not be able to maintain current coverages, or expand our insurance coverage to include future clinical trials or the sale of products incorporating our licensed technology if marketing approval is obtained for such products, at a reasonable cost or in sufficient amounts to protect against losses due to product liability or at all. A successful product liability claim or series of claims brought against us could result in judgments, fines, damages and liabilities that could have a material adverse effect on our business, financial condition and results of operations. We may incur significant expense investigating and defending these claims, even if they do not result in liability. Moreover, even if no judgments, fines, damages or liabilities are imposed on us, our reputation could suffer, which could have a material adverse effect on our business, financial condition and results of operations.

The successful management of operations depends on our ability to attract and retain talented personnel.

We depend on the expertise of our senior management and research personnel, including our chief executive officer, Ofir Paz, and president, Asher Holzer, each of whom would be difficult to replace. The loss of the

services of any of our senior management could compromise our ability to achieve our objectives. Furthermore, recruiting and retaining qualified personnel will be crucial to future success. There can be no assurance that we will be able to attract and retain necessary personnel on acceptable terms given the competition among medical device, biotechnology, pharmaceutical and healthcare companies, universities and non-profit research institutions for experienced management, scientists, researchers, and sales and marketing and manufacturing personnel. If we are unable to attract, retain and motivate our key personnel, our operations may be jeopardized and our results of operations may be materially and adversely affected.

We are an international business, and we are exposed to various global and local risks that could have a material adverse effect on our financial condition and results of operations.

We operate globally and develop and manufacture products in our research and manufacturing facilities in multiple countries. Consequently, we face complex legal and regulatory requirements in multiple jurisdictions, which may expose us to certain financial and other risks. International sales and operations are subject to a variety of risks, including:

Table of Contents

- foreign currency exchange rate fluctuations;
- greater difficulty in staffing and managing foreign operations;
- greater risk of uncollectible accounts;
- longer collection cycles;
- logistical and communications challenges;
- potential adverse changes in laws and regulatory practices, including export license requirements, trade barriers, tariffs and tax laws;
- changes in labor conditions;
- burdens and costs of compliance with a variety of foreign laws;
- political and economic instability;
- increases in duties and taxation;
- foreign tax laws and potential increased costs associated with overlapping tax structures;
- greater difficulty in protecting intellectual property; and
- general economic and political conditions in these foreign markets.

International markets are also affected by economic pressure to contain reimbursement levels and healthcare costs. Profitability from international operations may be limited by risks and uncertainties related to regional economic conditions, regulatory and reimbursement approvals, competing products, infrastructure development, intellectual property rights protection and our ability to implement our overall business strategy. We expect these risks will increase as we pursue our strategy to expand operations

into new geographic markets. We may not succeed in developing and implementing effective policies and strategies in each location where we conduct business. Any failure to do so may harm our business, results of operations and financial condition.

We intend to design the protocol of our planned pivotal U.S. clinical trial for our MGuard Prime™ stent based in part on prior clinical trials that used different stents. The results of these prior clinical trials may not be indicative of the clinical results we would obtain for our U.S. pivotal clinical trial.

We intend to commercialize our technology in the United States in the form of our MGuard Prime™ stent, which is a cobalt-chromium stent covered with a polymer mesh. We have only limited clinical data on our MGuard™ Coronary with bio-stable mesh stent, which we derived from the MGuard™ Coronary with bio-stable mesh study. We intend to design the protocol for our planned United States pivotal clinical trial based on the results of prior clinical trials. This trial is being designed in large part based on the results of our MGuard™ Coronary with bio-stable mesh study.

We have limited manufacturing capabilities and manufacturing personnel, and if our manufacturing facilities are unable to provide an adequate supply of products, our growth could be limited and our business could be harmed.

We currently manufacture our MGuard™ stent at our facilities in Tel Aviv, Israel, and we have contracted with QualiMed, a German manufacturer, to assist in production. If there were a disruption to our existing manufacturing facility, we would have no other means of manufacturing our MGuard™ stent until we were able to restore the manufacturing capability at our facility or develop alternative manufacturing facilities. If we were unable to produce sufficient quantities of our MGuard™ stent for use in our current and planned clinical trials, or if our manufacturing process yields substandard stents, our development and commercialization efforts would be delayed.

We currently have limited resources, facilities and experience to commercially manufacture our product candidates. In order to produce our MGuard™ stent in the quantities that we anticipate will be required to meet anticipated market demand, we will need to increase, or "scale up," the production process by a significant factor over the current level of production. There are technical challenges to scaling-up manufacturing capacity, and developing commercial-scale manufacturing facilities will require the investment of substantial additional funds and hiring and retaining additional management and technical personnel who have the necessary manufacturing experience. We may not successfully complete any required scale-up in a timely manner or at all. If unable to do

so, we may not be able to produce our MGuard™ stent in sufficient quantities to meet the requirements for the launch of the product or to meet future demand, if at all. If we develop and obtain regulatory approval for our MGuard™ stent and are unable to manufacture a sufficient supply of our MGuard™ stent, our revenues, business and financial prospects would be adversely affected. In addition, if the scaled-up production process is not efficient or produces stents that do not meet quality and other standards, our future gross margins may decline.

In addition, while we have validated our manufacturing process for consistency, we have experienced drug release kinetic variability within and between manufacturing lots, and we may experience similar issues in the future. Manufacturing lot variability may result in unfavorable clinical trial results.

Table of Contents

Additionally, any damage to or destruction of our Tel Aviv facilities or its equipment, prolonged power outage or contamination at our facility would significantly impair our ability to produce MGuard™ stents.

Our manufacturing facilities and the manufacturing facilities of our suppliers must comply with applicable regulatory requirements. If we fail to achieve regulatory approval for these manufacturing facilities, our business and results of operations would be harmed.

Completion of our clinical trials and commercialization of our product candidates requires access to, or the development of, manufacturing facilities that meet applicable regulatory standards to manufacture a sufficient supply of our products. The FDA and other regulatory bodies must approve facilities that manufacture our products for commercial purposes, as well as the manufacturing processes and specifications for the product. Suppliers of components of, and products used to manufacture our products, must also comply with FDA and foreign regulatory requirements, which often require significant time, money and record-keeping and quality assurance efforts and subject our and our suppliers to potential regulatory inspections and stoppages. Our suppliers may not satisfy these requirements. If we or our suppliers do not achieve the required regulatory approval for our manufacturing operations, our

commercialization efforts could be delayed, which would harm our business and results of operations.

Quality issues in our manufacturing processes could delay clinical development and commercialization efforts.

The production of our MGuard™ stent must occur in a highly controlled, clean environment to minimize particles and other yield and quality-limiting contaminants. In spite of stringent quality controls, weaknesses in process control or minute impurities in materials may cause a substantial percentage of defective products in a lot. If we are unable to maintain stringent quality controls, or if contamination problems arise, our clinical development and commercialization efforts could be delayed, which would harm our business and results of operations.

If we fail to obtain an adequate level of reimbursement for our products by third party payors, there may be no commercially viable markets for our product candidates or the markets may be much smaller than expected.

The availability and levels of reimbursement by governmental and other third party payors affect the market for our product candidates. The efficacy, safety, performance and cost-effectiveness of our product candidates and of any competing products will determine the availability and level of reimbursement. Reimbursement and healthcare payment systems

in international markets vary significantly by country, and include both government sponsored healthcare and private insurance. To obtain reimbursement or pricing approval in some countries, we may be required to produce clinical data, which may involve one or more clinical trials, that compares the cost-effectiveness of our products to other available therapies. We may not obtain international reimbursement or pricing approvals in a timely manner, if at all. Our failure to receive international reimbursement or pricing approvals would negatively impact market acceptance of our products in the international markets in which those approvals are sought.

We believe that future reimbursement may be subject to increased restrictions both in the United States and in international markets. Future legislation, regulation or reimbursement policies of third party payors may adversely affect the demand for our products currently under development and limit our ability to sell our product candidates on a profitable basis. In addition, third party payors continually attempt to contain or reduce the costs of healthcare by challenging the prices charged for healthcare products and services. If reimbursement for our products is unavailable or limited in scope or amount or if pricing is set at unsatisfactory levels, market acceptance of our products would be impaired and future revenues, if any, would be adversely affected.

In the United States, our business could be significantly and adversely affected by recent healthcare reform legislation and other administration and legislative proposals.

The Patient Protection and Affordable Care Act and Health Care and Educational Reconciliation Act (the "Health Care Acts") were enacted into law in March 2010. Certain provisions of the Health Care Acts will not be effective for a number of years and there are many programs and requirements for which the details have not yet been fully established or consequences not fully understood, and it is unclear what the full impacts will be from the legislation. The legislation does levy a 2.3% excise tax on all U.S. medical device sales beginning in 2013. If we commence sales of our MGuard™ stent in the United States, this new tax may materially and adversely affect our business and results of operations. The legislation also focuses on a number of Medicare provisions aimed at improving quality and decreasing costs. It is uncertain at this point what negative unintended consequences these provisions will have on patient access to new technologies. The Medicare provisions include value-based payment programs, increased funding of comparative effectiveness research, reduced hospital payments for avoidable readmissions and hospital acquired conditions, and pilot programs to evaluate alternative payment methodologies that promote care coordination (such as bundled physician and

hospital payments). Additionally, the provisions include a reduction in the annual rate of inflation for hospitals starting in 2011 and the establishment of an independent payment advisory board to recommend ways of reducing the rate of growth in Medicare spending. We cannot predict what healthcare programs and regulations will be ultimately implemented at the federal or state level in the United States, or the effect of any future legislation or regulation. However, any changes that lower reimbursements for our products or reduce medical procedure volumes could adversely affect our business and results of operations.

Table of Contents

Many of our competitors are much larger than us, with significant resources and incentives to initiate litigation against us.

Based on the prolific litigation that has occurred in the stent industry and the fact that we may pose a competitive threat to some large and well-capitalized companies that own or control patents relating to stents and their use, manufacture and delivery, we believe that it is possible that one or more third parties will assert a patent infringement claim against the manufacture, use or sale of our MGuard™ stent based on one or more of these patents. It is also possible that a lawsuit asserting patent infringement and related claims may have already been filed against us of which we are not aware. A number of these patents are owned by very large and well-capitalized companies that are active participants in the stent market. As the number of competitors in the stent market grows, the possibility of patent infringement by us, or a patent infringement claim against us, increases.

These companies have maintained their position in the market by, among other things, establishing intellectual property rights relating to their products and enforcing these rights aggressively against their competitors and new entrants into the market. All of the major companies in the stent and related markets, including Boston Scientific, Johnson & Johnson and Medtronic, have

been repeatedly involved in patent litigation relating to stents since at least 1997. The stent and related markets have experienced rapid technological change and obsolescence in the past, and our competitors have strong incentives to stop or delay the introduction of new products and technologies. We may pose a competitive threat to many of the companies in the stent and related markets. Accordingly, many of these companies will have a strong incentive to take steps, through patent litigation or otherwise, to prevent us from commercializing our products.

If we are unable to obtain and maintain intellectual property protection covering our products, others may be able to make, use or sell our products, which would adversely affect our revenue.

Our ability to protect our products from unauthorized or infringing use by third parties depends substantially on our ability to obtain and maintain valid and enforceable patents. Due to evolving legal standards relating to the patentability, validity and enforceability of patents covering medical devices and pharmaceutical inventions and the scope of claims made under these patents, our ability to enforce patents is uncertain and involves complex legal and factual questions. Accordingly, rights under any of our pending patents may not provide us with commercially meaningful protection for our products or afford a commercial advantage against our competitors or their competitive products or processes. In addition, patents

may not be issued from any pending or future patent applications owned by or licensed to us, and moreover, patents that may be issued to us in the future may not be valid or enforceable. Further, even if valid and enforceable, our patents may not be sufficiently broad to prevent others from marketing products like ours, despite our patent rights.

The validity of our patent claims depends, in part, on whether prior art references exist that describe or render obvious our inventions as of the filing date of our patent applications. We may not have identified all prior art, such as U.S. and foreign patents or published applications or published scientific literature, that could adversely affect the patentability of our pending patent applications. For example, patent applications in the United States are maintained in confidence for up to 18 months after their filing. In some cases, however, patent applications remain confidential in the United States Patent and Trademark Office, or USPTO, for the entire time prior to issuance as a U.S. patent. Patent applications filed in countries outside the United States are not typically published until at least 18 months from their first filing date. Similarly, publication of discoveries in the scientific or patent literature often lags behind actual discoveries. Therefore, we cannot be certain that we were the first to invent, or the first to file patent applications relating to, our stent technologies. In the event that a third party has also filed a U.S. patent application covering our

stents or a similar invention, we may have to participate in an adversarial proceeding, known as an interference, declared by the USPTO to determine priority of invention in the United States. It is possible that we may be unsuccessful in the interference, resulting in a loss of some portion or all of our position in the United States. The laws of some foreign jurisdictions do not protect intellectual property rights to the same degree as in the United States, and many companies have encountered significant difficulties in protecting and defending such rights in foreign jurisdictions. If we encounter such difficulties or are otherwise precluded from effectively protecting our intellectual property rights in foreign jurisdictions, our business prospects could be substantially harmed.

Table of Contents

We may initiate litigation to enforce our patent rights on any patents issued on pending patent applications, which may prompt adversaries in such litigation to challenge the validity, scope or enforceability of our patents. If a court decides that such patents are not valid, not enforceable or of a limited scope, we may not have the right to stop others from using our inventions.

We also rely on trade secret protection to protect our interests in proprietary know-how and for processes for which patents are difficult to obtain or enforce. We may not be able to protect our trade secrets adequately. In addition, we rely on non-disclosure and confidentiality agreements with employees, consultants and other parties to protect, in part, trade secrets and other proprietary technology. These agreements may be breached and we may not have adequate remedies for any breach. Moreover, others may independently develop equivalent proprietary information, and third parties may otherwise gain access to our trade secrets and proprietary knowledge. Any disclosure of confidential data into the public domain or to third parties could allow competitors to learn our trade secrets and use the information in competition against us.

We depend on single-source suppliers for some of the components in our MGuard™ stent. The loss of such suppliers could delay our clinical trials or prevent or delay

commercialization of our MGuard™ stent.

Some of the components of our products are currently provided by only one vendor, or a single-source supplier. We depend on QualiMed, which manufactures the body of the stent, as well as MeKo Laserstrahl-Materialbearbeitung, BMT and SewFine for various important elements of our products. We may have difficulty obtaining similar components from other suppliers that are acceptable to the FDA or foreign regulatory authorities if it becomes necessary.

If we have to switch to a replacement supplier, we will face additional regulatory delays and the manufacture and delivery of our MGuard™ stent would be interrupted for an extended period of time, which would delay completion of our clinical trials or commercialization of our products. In addition, we will be required to obtain prior regulatory approval from the FDA or foreign regulatory authorities to use different suppliers or components that may not be as safe or as effective. As a result, regulatory approval of our products may not be received on a timely basis or at all.

If we are unable to manage our expected growth, we may not be able to commercialize our products, including our MGuard™ stent.

We intend to continue to rapidly expand operations and grow our research and development, product development and

administrative operations and invest substantially in our manufacturing facilities. This expansion has and is expected to continue to place a significant strain on our management and operational and financial resources. In particular, the commencement of our planned pivotal clinical trial in the United States will consume a significant portion of management's time and our financial resources. To manage expected growth and to commercialize our MGuard™ stent, we will be required to improve existing, and implement new, operational and financial systems, procedures and controls and expand, train and manage our growing employee base. Our current and planned personnel, systems, procedures and controls may not be adequate to support our anticipated growth. If we are unable to manage our growth effectively, our business could be harmed.

Legislative or regulatory reform of the healthcare system may affect our ability to sell our products profitably.

In both the United States and certain foreign jurisdictions, there have been a number of legislative and regulatory proposals to change the regulatory and healthcare systems in ways that could impact our ability to sell our products profitably, if at all. In the United States in recent years, new legislation has been proposed at the federal and state levels that would effect major changes in the healthcare system. In addition, new regulations and interpretations of existing healthcare statutes and

regulations are frequently adopted. The potential for adoption of these proposals affects or will affect our ability to raise capital, obtain additional collaborators and market our products. We expect to experience pricing pressures in connection with the future sale of our products due to the trend toward managed health care, the increasing influence of health maintenance organizations and additional legislative proposals. Our results of operations could be adversely affected by future healthcare reforms.

Our strategic business plan may not produce the intended growth in revenue and operating income.

Our strategies include making significant investments in sales and marketing programs to achieve revenue growth and margin improvement targets. If we do not achieve the expected benefits from these investments or otherwise fail to execute on our strategic initiatives, we may not achieve the growth improvement we are targeting and our results of operations may be adversely affected.

Table of Contents

In addition, as part of our strategy for growth, we may make acquisitions and enter into strategic alliances such as joint ventures and joint development agreements. However, we may not be able to identify suitable acquisition candidates, complete acquisitions or integrate acquisitions successfully, and our strategic alliances may not prove to be successful. In this regard, acquisitions involve numerous risks, including difficulties in the integration of the operations, technologies, services and products of the acquired companies and the diversion of management's attention from other business concerns. Although our management will endeavor to evaluate the risks inherent in any particular transaction, there can be no assurance that we will properly ascertain all such risks. In addition, acquisitions could result in the incurrence of substantial additional indebtedness and other expenses or in potentially dilutive issuances of equity securities. There can be no assurance that difficulties encountered with acquisitions will not have a material adverse effect on our business, financial condition and results of operations.

We may have violated Israeli securities law.

We may have violated section 15 of the Israeli Security Law 1968 (the "ISL"). Section 15 to the ISL requires the filing of a prospectus with the Israel Security Authority (the "ISA") and the delivery thereof to purchasers in

connection with an offer or sale of securities to more than 35 parties during any 12 month period. We allegedly issued securities to more than 35 investors during certain 12-month periods, ending in October 2008. We filed an application for "No action" with the ISA in connection with the foregoing. To date, the ISA has not provided any response to such application. A failure to receive "No action" relief could expose us to fines and other remedies that could be detrimental to us.

We will need to raise additional capital to meet our business requirements in the future and such capital raising may be costly or difficult to obtain and could dilute current stockholders' ownership interests.

We will need to raise additional capital in the future, which may not be available on reasonable terms or at all. We raised approximately $9,681,000 million in the Private Placement in connection with the Share Exchange, and we expect that such proceeds, together with our income, will be insufficient to fully realize all of our business objectives. For instance, we will need to raise additional funds to accomplish the following:

- pursuing growth opportunities, including more rapid expansion;
- acquiring complementary businesses;
- making capital improvements to improve our

infrastructure;
hiring qualified management and key employees;
developing new services, programming or products;
responding to competitive pressures;
complying with regulatory requirements such as licensing and registration; and
maintaining compliance with applicable laws.

Any additional capital raised through the sale of equity or equity backed securities may dilute current stockholders' ownership percentages and could also result in a decrease in the market value of our equity securities.

The terms of any securities issued by us in future capital transactions may be more favorable to new investors, and may include preferences, superior voting rights and the issuance of warrants or other derivative securities, which may have a further dilutive effect on the holders of any of our securities then outstanding.

Furthermore, any additional debt or equity financing that we may need may not be available on terms favorable to us, or at all. If we are unable to obtain such additional financing on a timely basis, we may have to curtail our development activities and growth plans and/or be forced to sell assets, perhaps on unfavorable terms, which would have a material adverse effect on

our business, financial condition and results of operations, and ultimately could be forced to discontinue our operations and liquidate, in which event it is unlikely that stockholders would receive any distribution on their shares. Further, we may not be able to continue operating if we do not generate sufficient revenues from operations needed to stay in business.

In addition, we may incur substantial costs in pursuing future capital financing, including investment banking fees, legal fees, accounting fees, securities law compliance fees, printing and distribution expenses and other costs. We may also be required to recognize non-cash expenses in connection with certain securities we issue, such as convertible notes and warrants, which may adversely impact our financial condition.

Table of Contents

Risks Related to Our Organization and Our Common Stock

As a result of the Share Exchange, we became a company that is subject to the reporting requirements of federal securities laws, which can be expensive and may divert resources from other projects, thus impairing our ability to grow.

As a result of the Share Exchange, we became a public reporting company and, accordingly, subject to the information and reporting requirements of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and other federal securities laws, including compliance with the Sarbanes-Oxley Act of 2002, as amended (the "Sarbanes-Oxley Act"). The costs of preparing and filing annual and quarterly reports, proxy statements and other information with the Securities and Exchange Commission (the "SEC") and furnishing audited reports to stockholders will cause our expenses to be higher than they would have been if we remained privately held and did not consummate the Share Exchange.

If we fail to establish and maintain an effective system of internal control, we may not be able to report our financial results accurately or to prevent fraud. Any inability to report and file our financial results accurately and timely could harm our reputation and adversely impact the trading price of our common stock.

It may be time consuming, difficult and costly for us to develop and implement the internal controls and reporting procedures required by the Sarbanes-Oxley Act. We may need to hire additional financial reporting, internal controls and other finance personnel in order to develop and implement appropriate internal controls and reporting procedures. Effective internal control is necessary for us to provide reliable financial reports and prevent fraud. If we cannot provide reliable financial reports or prevent fraud, we may not be able to manage our business as effectively as we would if an effective control environment existed, and our business and reputation with investors may be harmed. In addition, if we are unable to comply with the internal controls requirements of the Sarbanes-Oxley Act, then we may not be able to obtain the independent accountant certifications required by such act, which may preclude us from keeping our filings with the SEC current and may adversely affect any market for, and the liquidity of, our common stock.

Public company compliance may make it more difficult for us to attract and retain officers and directors.

The Sarbanes-Oxley Act and new rules subsequently implemented by the SEC have required changes in corporate governance practices of public companies. As a public company, we expect these new rules and regulations to increase our compliance costs and to

make certain activities more time consuming and costly. As a public company, we also expect that these new rules and regulations may make it more difficult and expensive for us to obtain director and officer liability insurance in the future and we may be required to accept reduced policy limits and coverage or incur substantially higher costs to obtain the same or similar coverage. As a result, it may be more difficult for us to attract and retain qualified persons to serve on our board of directors or as executive officers.

Because we became public by means of a "reverse merger," we may not be able to attract the attention of major brokerage firms.

There may be risks associated with us becoming public through a "reverse merger". Securities analysts of major brokerage firms may not provide coverage of us since there is no incentive to brokerage firms to recommend the purchase of our common stock. No assurance can be given that brokerage firms will, in the future, want to conduct any secondary offerings on our behalf.

Our stock price may be volatile.

The market price of our common stock is likely to be highly volatile and could fluctuate widely in price in response to various factors, many of which are beyond our control, including the following:

- changes in our industry;
- competitive pricing pressures;

our ability to obtain working capital financing;
additions or departures of key personnel;
limited “public float” in the hands of a small number of persons whose sales or lack of sales could result in positive or negative pricing pressure on the market price for our common stock;
sales of our common stock;
our ability to execute our business plan;
operating results that fall below expectations;
loss of any strategic relationship;
regulatory developments;
economic and other external factors; and
period-to-period fluctuations in our financial results.

Table of Contents

In addition, the securities markets have from time to time experienced significant price and volume fluctuations that are unrelated to the operating performance of particular companies. These market fluctuations may also materially and adversely affect the market price of our common stock.

Our securities are restricted securities with limited transferability.

Our securities should be considered a long-term, illiquid investment. Our common stock has not been registered under the Securities Act, and cannot be sold without registration under the Securities Act or any exemption from registration. In addition, our common stock is not registered under any state securities laws that would permit its transfer. Because of these restrictions, a stockholder will likely find it difficult to liquidate an investment in our common stock.

We are subject to penny stock rules which will make the shares of our common stock more difficult to sell.

We are subject to the Securities and Exchange Commission's "penny stock" rules since our shares of common stock sell below $5.00 per share. Penny stocks generally are equity securities with a per share price of less than $5.00. The penny stock rules require broker-dealers to deliver a standardized risk disclosure document prepared by the Securities and Exchange

Commission which provides information about penny stocks and the nature and level of risks in the penny stock market. The broker-dealer must also provide the customer with current bid and offer quotations for the penny stock, the compensation of the broker-dealer and its salesperson, and monthly account statements showing the market value of each penny stock held in the customer's account. The bid and offer quotations, and the broker-dealer and salesperson compensation information must be given to the customer orally or in writing prior to completing the transaction and must be given to the customer in writing before or with the customer's confirmation.

In addition, the penny stock rules require that prior to a transaction the broker-dealer must make a special written determination that the penny stock is a suitable investment for the purchaser and receive the purchaser's written agreement to the transaction. The penny stock rules are burdensome and may reduce purchases of any offerings and reduce the trading activity for shares of our common stock. As long as our shares of common stock are subject to the penny stock rules, the holders of such shares of common stock may find it more difficult to sell their securities.

Our shares of common stock are very thinly traded, and the price may not reflect our value and there can be no assurance that there will be an active market for our shares of common stock in the future.

Our shares of common stock are thinly traded. Due to the illiquidity, the market price may not accurately reflect our relative value. There can be no assurance that there will be an active market for our shares of common stock either now or in the future. Investors may not be able to liquidate their investment or liquidate it at a price that reflects the value of the business. If a more active market should develop, the price may be highly volatile. Because there may be a low price for our shares of common stock, many brokerage firms may not be willing to effect transactions in the securities. Even if an investor finds a broker willing to effect a transaction in the shares of our common stock, the combination of brokerage commissions, transfer fees, taxes, if any, and any other selling costs may exceed the selling price. Further, many lending institutions will not permit the use of such shares of common stock as collateral for a loans.

We may apply the proceeds of the Private Placement to uses that ultimately do not improve our operating results or increase the price of our common stock.

We intend to use $1,000,000 of the net proceeds from the Private Placement to complete the Dr. Gregg Stone-Dr. Alexandre Abizaid trials, $7,600,000 for the FDA trials with Harvard Clinical Research Institute and the remainder for general corporate purposes. However, our management has broad discretion in how we actually use these proceeds. These proceeds could be applied in ways that do not

ultimately improve our operating results or otherwise increase the value of our common stock.

Table of Contents

We may need additional financing which may not be available on acceptable terms, which may in turn dilute your investment in us.

Our future capital requirements will depend on many factors including but not limited to: continued market acceptance of our services; competitive pressure on the price of our products; the extent to which we invest in new locations, develop new relationships with producers of polymers and chemicals as well as consumers of polymers and chemicals; and the response of competitors to our products. We believe that the existing cash balances, including the net proceeds from the Private Placement, and funds generated from operations will provide us with sufficient funds to finance our operations for the foreseeable future. To the extent that our current funds, together with existing resources, are insufficient to fund our activities over the long-term, we may need to raise additional funds through equity or debt financing or from other sources. The sale of additional equity or convertible debt may result in additional dilution to our stockholders and such securities may have rights, preferences or privileges senior to those of the common stock. To the extent that we rely upon debt financing, we will incur the obligation to repay the funds borrowed with interest and may become subject to covenants and restrictions that restrict operating flexibility. No assurance can be given that additional equity or debt financing will be available or

that, if available, it can be obtained on terms favorable to us or our stockholders. Failure to obtain necessary financing could have a material adverse effect on our business, financial condition and results of operations.

Our board of directors can authorize the issuance of preferred stock, which could diminish the rights of holders of our common stock, and make a change of control of us more difficult even if it might benefit our stockholders.

Our board of directors is authorized to issue shares of preferred stock in one or more series and to fix the voting powers, preferences and other rights and limitations of the preferred stock. Accordingly, we may issue shares of preferred stock with a preference over our common stock with respect to dividends or distributions on liquidation or dissolution, or that may otherwise adversely affect the voting or other rights of the holders of common stock. Issuances of preferred stock, depending upon the rights, preferences and designations of the preferred stock, may have the effect of delaying, deterring or preventing a change of control, even if that change of control might benefit our stockholders.

Item 6. Exhibits

(a) Exhibits

Exhibit No.	Description
2.1*	Share Exchange Agreement, dated as of December 29, 2010, by and among

	InspireMD Ltd., Saguaro Resources, Inc., and the Shareholders of InspireMD Ltd. that are signatory thereto
2.2***	Amendment to Share Exchange Agreement, dated February 24, 2011
2.3***	Second Amendment to Share Exchange Agreement, dated March 25, 2011
3.1**	Amended and Restated Certificate of Incorporation
3.2**	Amended and Restated Bylaws
10.1**	2011 Umbrella Option Plan
10.2***	Form of Stock Option Award Agreement
10.3***	Agreement of Conveyance, Transfer and Assignment of Assets and Assumption of Obligations, dated as of March 31, 2011
10.4***	Stock Purchase Agreement, by and between InspireMD, Inc. and Lynn Briggs, dated as of March 31, 2011
10.5***	Securities Purchase Agreement, dated as of March 31, 2011, by and among InspireMD, Inc. and certain purchasers set

	forth therein
10.6***	Form of $1.80 Warrant
10.7***	Form of $1.23 Warrant
10.8***	$1,250,000 Convertible Debenture, dated July 20, 2010, by and between InspireMD Ltd. and Genesis Asset Opportunity Fund, L.P.
10.9***	Unprotected Leasing Agreement, dated February 22, 2007, by and between Block 7093 Parcel 162 Company Ltd. Private Company 510583156 and InspireMD Ltd.

Table of Contents

10.10***	Securities Purchase Agreement, dated as of July 22, 2010, by and among InspireMD Ltd. and certain purchasers set forth therein
10.11***	Manufacturing Agreement, by and between InspireMD Ltd. and QualiMed Innovative Medizinprodukte GmbH, dated as of September 11, 2007
10.12***	Development Agreement, by and between InspireMD Ltd. and QualiMed Innovative Medizinprodukte GmbH, dated as of January 15, 2007
10.13***	License Agreement, by and between Svelte Medical Systems, Inc. and InspireMD Ltd., dated as of March 19, 2010
10.14***	Agreement, by and between InspireMD Ltd. and Ofir Paz, dated as of April 1, 2005
10.15***	Amendment to the Employment Agreement, by and between InspireMD Ltd. and Ofir Paz, dated as of October 1, 2008
10.16***	

	Second Amendment to the Employment Agreement, by and between InspireMD Ltd. and Ofir Paz, dated as of March 28, 2011
10.17***	Personal Employment Agreement, by and between InspireMD Ltd. and Asher Holzer, dated as of April 1, 2005
10.18***	Amendment to the Employment Agreement, by and between InspireMD Ltd. and Asher Holzer, dated as of March 28, 2011
10.19***	Personal Employment Agreement, by and between InspireMD Ltd. and Eli Bar, dated as of June 26, 2005
10.20***	Employment Agreement, by and between InspireMD Ltd. and Bary Oren, dated as of August 25, 2009
10.21***	Employment Agreement, by and between InspireMD Ltd. and Craig Shore, dated as of November 28, 2010
10.22***	Form of Indemnification Agreement between InspireMD, Inc. and each of the directors and executive officers thereof

10.23***	Agreement with Bank Mizrahi Tefahot LTD. for a loan to InspireMD Ltd. in the original principal amount of $750,000
31.1	Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Principal Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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* Incorporated by reference to Saguaro Resources, Inc. Current Report on Form 8-K filed with the Securities and Exchange Commission on January 5, 2011

** Incorporated by reference to InspireMD, Inc. Current Report on Form 8-K filed with the Securities and Exchange Commission on April 1, 2011

*** Incorporated by reference to InspireMD, Inc. Current Report on Form 8-K filed with the Securities and Exchange

Commission on April 6, 2011

30

Table of Contents

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.

INSPIREMD, INC.

Date: May 16, 2011

By: /s/ Ofir Paz
Name: Ofir Paz
Title: Chief Executive Officer

By: /s/ Craig Shore
Name: Craig Shore
Title: Chief Financial Officer, Secretary and Treasurer

31

Table of Contents

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