Bridgeline Digital, Inc.
Form 10-Q
February 17, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended December 31, 2014

OR

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

For the transition period from ______________ to ______________

Commission File Number 333-139298

Bridgeline Digital, Inc.

(Exact name of registrant as specified in its charter)

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

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

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

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

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

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

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

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

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

The number of shares of Common Stock par value $0.001 per share, outstanding as of February 11, 2015 was 21,974,529.

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Bridgeline Digital, Inc.

Quarterly Report on Form 10-Q

For the Quarterly Period ended December 31, 2014

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Bridgeline Digital, Inc.

Quarterly Report on Form 10-Q

For the Quarterly Period ended December 31, 2014

Statements contained in this Report on Form 10-Q that are not based on historical facts are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements may be identified by the use of forward-looking terminology such as "should," "could," "may," "will," "expect," "believe," "estimate," "anticipate," "intends," "continue," or similar terms or variations of those terms or the negative of those terms. These statements appear in a number of places in this Form 10-Q and include statements regarding the intent, belief or current expectations of Bridgeline Digital, Inc. Forward-looking statements are merely our current predictions of future events. Investors are cautioned that any such forward-looking statements are inherently uncertain, are not guaranties of future performance and involve risks and uncertainties. Actual results may differ materially from our predictions. Important factors that could cause actual results to differ from our predictions include the impact of the weakness in the U.S. and international economies on our business, our inability to manage our future growth effectively or profitably, fluctuations in our revenue and quarterly results, our license renewal rate, the impact of competition and our ability to maintain margins or market share, the limited market for our common stock, the volatility of the market price of our common stock, the ability to maintain our listing on the NASDAQ Capital market, the ability to raise capital, the performance of our products, our ability to respond to rapidly evolving technology and customer requirements, our ability to protect our proprietary technology, the security of our software, our dependence on our management team and key personnel, our ability to hire and retain future key personnel, or our ability to maintain an effective system of internal controls. Although we have sought to identify the most significant risks to our business, we cannot predict whether, or to what extent, any of such risks may be realized, nor is there any assurance that we have identified all possible issues which we might face. We assume no obligation to update our forward-looking statements to reflect new information or developments. We urge readers to review carefully the risk factors described in our Annual Report on Form 10-K for the fiscal year ended September 30, 2014 as well as in the other documents that we file with the Securities and Exchange Commission. You can read these documents at www.sec.gov.

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

PART I—FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements.

BRIDGELINE DIGITAL, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

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

(Unaudited)

	December 31, 2014	September 30, 2014
ASSETS		
Current assets:		
Cash and cash equivalents	$ 1,044	$ 1,256
Accounts receivable and unbilled receivables, net	3,177	3,342
Prepaid expenses and other current assets	610	747
Total current assets	4,831	5,345
Equipment and improvements, net	2,282	2,175
Intangible assets, net	1,430	1,582
Goodwill	23,141	23,141
Other assets	1,263	1,317
Total assets	$ 32,947	$ 33,560
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 1,225	$ 1,126
Accrued liabilities	870	957
Accrued earnouts, current	383	487
Debt, current	594	985
Capital lease obligations, current	442	364
Deferred revenue	2,024	1,990
Total current liabilities	5,538	5,909
Accrued earnouts, net of current portion	306	381
Debt, net of current portion	5,977	5,935
Capital lease obligations, net of current portion	216	247
Other long term liabilities	1,271	1,155
Total liabilities	13,308	13,627

Commitments and contingencies		
Stockholders’ equity:		
Preferred stock - $0.001 par value; 1,000,000 shares authorized; 200,000 at December 31, 2014 and 0 at September 30, 2014 issued and outstanding (liquidation preference $2,021)	-	-
Common stock - $0.001 par value; 50,000,000 shares authorized; 21,974,529 at December 31, 2014 and 21,942,912 at September 30, 2014 shares issued and outstanding	22	22
Additional paid-in capital	49,615	47,773
Accumulated deficit	(29,660)	(27,529)
Accumulated other comprehensive loss	(338)	(333)
Total stockholders’ equity	19,639	19,933
Total liabilities and stockholders’ equity	$ 32,947	$ 33,560

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

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BRIDGELINE DIGITAL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

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

(Unaudited)

	Three Months Ended December 31, 2014	2013
Net revenue:		
Digital engagement services	$3,231	$4,549
Subscription and perpetual licenses	1,380	1,577
Managed service hosting	401	387
Total net revenue	5,012	6,513
Cost of revenue:		
Digital engagement services	2,564	2,503
Subscription and perpetual licenses	430	397
Managed service hosting	74	84
Total cost of revenue	3,068	2,984
Gross profit	1,944	3,529
Operating expenses:		
Sales and marketing	1,810	2,110
General and administrative	993	1,031
Research and development	602	523
Depreciation and amortization	452	454
Total operating expenses	3,857	4,118
Loss from operations	(1,913)	(589)
Interest and other expense, net	(162)	(167)
Loss before income taxes	(2,075)	(756)
Provision for income taxes	35	21
Net loss	$(2,110)	$(777)
Accrued dividends on convertible preferred stock	(21)	-
Net loss applicable to common shareholders	$(2,131)	$(777)
Net loss per share attributable to common shareholders - Basic and diluted	$(0.10)	$(0.04)
Number of weighted average shares outstanding:		
Basic and diluted	21,715,115	17,760,248

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

BRIDGELINE DIGITAL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(Dollars in thousands)

(Unaudited)

	Three Months Ended December 31,	
	2014	**2013**
Net Loss	$(2,110)	$(777)
Net change in foreign currency translation adjustment	(5)	(32)
Comprehensive loss	$(2,115)	$(809)

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

BRIDGELINE DIGITAL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

(Unaudited)

	Three Months Ended December 31,	
	2014	**2013**
Cash flows from operating activities:		
Net loss	$(2,110)	$(777)
Adjustments to reconcile net loss to net cash used in operating activities:		
Amortization of intangible assets	152	125
Depreciation	279	322
Other amortization	146	120
Stock-based compensation	89	42
Change in deferred taxes	15	-
Changes in operating assets and liabilities		
Accounts receivable and unbilled receivables	165	(847)
Prepaid expenses and other assets	255	169
Accounts payable and accrued liabilities	(245)	(700)
Deferred revenue	34	52
Other liabilities	(27)	64
Total adjustments	863	(653)
Net cash used in operating activities	(1,247)	(1,430)
Cash flows used in investing activities:		
Purchase of equipment and improvements	(54)	(147)
Software development capitalization costs	(21)	(90)
Contingent acquisition payments	(180)	(104)
Net cash used in investing activities	(255)	(341)
Cash flows provided by (used in) financing activities:		
Proceeds from exercise of employee stock options	-	129
Proceeds from employee stock purchase plan	2	13
Proceeds from issuance of 200,000 shares of preferred stock, net of issuance costs	1,776	-
Proceeds from issuance of convertible debt, net of issuance costs	-	913
Proceeeds from bank term loan	610	-
Proceeds from term note from stockholder	500	-
Payments on bank term loan	(1,000)	(273)
Payments on bank line of credit	(461)	(1,000)
Payments on subordinated promissory notes	(7)	(56)
Principal payments on capital leases	(125)	(132)
Net cash provided by (used in) financing activities	1,295	(406)
Effect of exchange rate changes on cash and cash equivalents	(5)	(32)

Net decrease in cash and cash equivalents	(212)	(2,209)
Cash and cash equivalents at beginning of period	1,256	2,830
Cash and cash equivalents at end of period	$1,044	$621
Supplemental disclosures of cash flow information:		
Cash paid for:		
Interest	$55	$70
Income taxes	$14	$24
Non cash investing and financing activities:		
Equipment purchased under capital leases	$172	$-
Other assets included in accounts payable	$19	$19
Accrued dividends on convertible preferred stock	$21	$-

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

BRIDGELINE DIGITAL, INC.

NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

1. Description of Business

Overview

Bridgeline Digital, The Digital Engagement Company™, enables its customers to maximize the performance of their mission critical websites, intranets, and online stores. Bridgeline's iAPPS® platform deeply integrates Web Content Management, eCommerce, eMarketing, Social Media management, and Web Analytics to help marketers deliver online experiences that attract, engage and convert their customers across all digital channels. Bridgeline's iAPPS platform combined with its digital services assists customers in maximizing on-line revenue, improving customer service and loyalty, enhancing employee knowledge, and reducing operational costs.

In fiscal 2012, Bridgeline Digital announced the release of a new product, iAPPSds ("distributed subscription"), a platform that empowers franchise and large dealer networks with state-of-the-art web engagement management while providing superior oversight of corporate branding. iAPPSds deeply integrates content management, eCommerce, eMarketing and web analytics and is a self-service web platform that is offered to each authorized franchise or dealer for a monthly subscription fee. On August 1, 2013, we acquired franchise web developer ElementsLocal, expanding Bridgeline Digital's presence in the franchise market place.

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

The iAPPS Platform is an award-winning application recognized around the globe. Our teams of Microsoft Gold© certified developers have won over 100 industry related awards. In recent years, our iAPPS Content Manager and iAPPS Commerce products were selected as finalists for the 2014, 2013, and 2012 CODiE Awards for Best Content Management Solution and Best Electronic Commerce Solution, globally. In 2014 and 2013, Bridgeline Digital won twenty-five Horizon Interactive Awards for outstanding development of web applications and websites. Also in 2013, the Web Marketing Association sponsored Internet Advertising Competition honored Bridgeline Digital with three awards for iAPPS customer websites and B2B Magazine selected Bridgeline Digital as one of the Top Interactive

Technology companies in the United States. KMWorld Magazine Editors selected Bridgeline Digital as one of the 100 Companies That Matter in Knowledge Management and also selected iAPPS as a Trend Setting Product in 2013.

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

Locations

The Company's corporate office is in Burlington, Massachusetts. The Company maintains regional field offices serving the following geographical locations: Atlanta, GA; Baltimore, MD; Boston, MA; Chicago, IL; Dallas, TX; Denver, CO; New York, NY; San Diego, CA; San Luis Obispo, CA; and Tampa, FL. The Company has one wholly-owned subsidiary, Bridgeline Digital Pvt. Ltd. located in Bangalore, India.

Liquidity

The Company has incurred operating losses and used cash in its operating activities for the past several years. Cash was used to fund acquisitions to broaden our geographic footprint, develop new products, and build infrastructure, while also ramping down a lower margin services model. The Company is currently working on reducing operating expenses. The Company's management believes it will have an appropriate cost structure for its anticipated sales in the second half of fiscal 2015. Management believes that operating expenses will be reduced to the point where the Company can drive positive Adjusted EBITDA (earnings before interest, taxes, depreciation and amortization and stock-based compensation charges). As such, management believes that the Company will provide sufficient cash flows to fund its operations in the ordinary course of business through at least the next twelve months. However, there can be no assurance that the anticipated sales level will be achieved. The Company also maintains a bank financing agreement which provides for up to $5 million of revolving credit advances. Borrowing is limited to the lesser of the $5 million or 80% of eligible receivables. Additionally, the Company can borrow up to $1 million in out of formula borrowings, which are further guaranteed by a director/shareholder of the Company. Subsequent to the quarter end, the Company received $500 in a long-term note from a stockholder of the Company.

BRIDGELINE DIGITAL, INC.

NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

2. Summary of Significant Accounting Policies

Basis of Presentation and Principles of Consolidation

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

Unaudited Interim Financial Information

The accompanying interim Condensed Consolidated Balance Sheets as of December 31, 2014 and September 30, 2014, and the interim Condensed Consolidated Statements of Operations, Comprehensive Loss, and Cash Flows for the three months ended December 31, 2014 and 2013 are unaudited. The unaudited interim condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("US GAAP") and in the opinion of the Company's management have been prepared on the same basis as the audited consolidated financial statements as of and for the year ended September 30, 2014. These interim condensed consolidated financial statements include all adjustments, consisting of normal recurring adjustments and accruals, necessary for the fair presentation of the Company's financial position at December 31, 2014 and September 30, 2014 and its results of operations and cash flows for the three months ended December 31, 2014 and 2013. The results for the three months ended December 31, 2014 are not necessarily indicative of the results to be expected for the year ending September 30, 2015. The accompanying September 30, 2014 Condensed Consolidated Balance Sheet has been derived from the audited financial statements at that date, but does not include all of the information and footnotes required by US GAAP for complete financial statements.

Recent Accounting Pronouncements

In June 2014, the Financial Accounting Standards Board ("FASB") issued a standards update on accounting for share-based payments when the terms of the award provide that a performance target could be achieved after a requisite service period. The standard is effective beginning January 1, 2016, with early adoption permitted. Management does not expect it to have a material impact on our consolidated financial position, results of operations or cash flows.

In May 2014, the FASB issued a standard on revenue recognition providing a single, comprehensive revenue recognition model for all contracts with customers. The revenue standard is based on the principle that revenue should be recognized to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The standard is effective beginning January 1, 2017, with no early adoption permitted. The amendments may be applied retrospectively to each prior period presented or retrospectively with the cumulative effect recognized as of the date of initial application. Management is currently evaluating the adoption method options and the impact of this new guidance on our condensed consolidated financial statements.

In April 2014, the FASB issued new accounting guidance on reporting discontinued operations and disclosures of disposals of components of an entity which clarifies the scope of what should be reported as discontinued operations and expands required disclosures. This new guidance is effective beginning October 1, 2015, with early adoption permitted. The impact of this guidance will be dependent on the nature and significance of any transactions within the scope of this new guidance.

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

BRIDGELINE DIGITAL, INC.

NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

3. Accounts Receivable and Unbilled Receivables

Accounts receivable and unbilled receivables consists of the following:

	As of December 31, 2014	As of September 30, 2014
Accounts receivable	$ 2,752	$ 3,303
Unbilled receivables	625	229
Subtotal	3,377	3,532
Allowance for doubtful accounts	(200)	(190)
Accounts receivable and unbilled receivables, net	$ 3,177	$ 3,342

4. Fair Value Measurement and Fair Value of Financial Instruments

The Company's other financial instruments consist principally of accounts receivable, accounts payable, and debt. The Company believes the recorded values for accounts receivable and accounts payable approximate current fair values as of December 31, 2014 and September 30, 2014 because of their nature and durations. The carrying value of debt instruments also approximates fair value as of December 31, 2014 and September 30, 2014 based on acceptable valuation methodologies which use market data of similar size and situated debt issues.

Assets and liabilities of the Company measured at fair value on a recurring basis as of December 31, 2014 and September 30, 2014 are as follows:

	December 31, 2014			
	Level 1	**Level 2**	**Level 3**	**Total**
Liabilities:				
Contingent acquisition consideration			$ 689	$ 689
Warrant liability			30	30
Total Liabilities	$ -	$ -	$ 719	$ 719

	September 30, 2014			
	Level 1	**Level 2**	**Level 3**	**Total**
Liabilities:				
Contingent acquisition consideration			$ 868	$ 868
Warrant liability			39	39
Total Liabilities	$ -	$ -	$ 907	$ 907

BRIDGELINE DIGITAL, INC.

NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

The Company determines the fair value of acquisition-related contingent consideration based on assessment of the probability that the Company would be required to make such future payments. Changes to the fair value of contingent consideration are recorded in general and administrative expenses. The following table provides a rollforward of the fair value, as determined by Level 3 inputs, of the contingent consideration.

The following table summarizes the changes in contingent consideration for the three months ended December 31, 2014 and 2013:

	Three Months Ended December 31,	
	2014	**2013**
Beginning balance	$868	$1,511
Additions	-	-
Payments	(179)	(643)
Ending balance	$689	$868

The following table summarizes the changes in warrant liability for the three months ended December 31, 2014 and 2013:

	Three Months Ended December 31,	
	2014	**2013**
Beginning balance	$39	$-
Warrant liability	-	72
Fair market value adjustment	(9)	(33)
Ending balance	$30	$39

5. Intangible Assets

The components of intangible assets are as follows:

	As of December 31, 2014	As of September 30, 2014
Domain and trade names	$ 10	$ 10
Customer related	1,150	1,284
Non-compete agreements	270	288
Balance at end of period	$ 1,430	$ 1,582

BRIDGELINE DIGITAL, INC.

NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

Total amortization expense related to intangible assets for the three months ended December 31, 2014 and 2013 was $152 and $125, respectively, and are reflected in operating expenses on the Condensed Consolidated Statements of Operations. The estimated amortization expense for fiscal years 2015 (remaining), 2016, 2017, and 2018 is: $418, $428, $369 and $215, respectively.

6. Goodwill

Changes in the carrying amount of goodwill follows:

	As of December 31, 2014	**As of September 30, 2014**
Balance at beginning of period	$ 23,141	$ 23,777
Purchase price allocation adjustments	-	(636)
Balance at end of period	$ 23,141	$ 23,141

7. Debt

Debt consists of the following:

	As of December 31, 2014	As of September 30, 2014
Line of credit borrowings	$ 2,477	$ 2,938
Bank term loan	610	1,000
Subordinated convertible debt	3,000	3,000
Term note from shareholder	500	-
Subordinated promissory notes	14	21
Subtotal debt	$ 6,601	$ 6,959
Other (debt warrants)	$ (30)	$ (39)
Total debt	$ 6,571	$ 6,920
Less current portion	$ 594	$ 985
Long term debt, net of current portion	$ 5,977	$ 5,935

Line of Credit and Bank Term Loan

In December 2013, the Company entered into a Loan and Security Agreement with BridgeBank (the “BridgeBank Loan Agreement”). The BridgeBank Loan Agreement replaced the Company’s prior credit facility with Silicon Valley Bank (“SVB”), which expired on December 31, 2013. The Loan Agreement has a 27 month term which expires on March 31, 2016. The Loan Agreement provides for up to $5 million of revolving credit advances which may be used for acquisitions and working capital purposes. Borrowings are limited to the lesser of (i) $5 million and (ii) 80% of eligible receivables as defined. The Company can borrow up to $1.0 million in out of formula borrowings for specified periods of time. Borrowings bear interest at BridgeBank’s prime plus 1.00% (4.25%). The Company pays an annual commitment fee of 0.25%. Borrowings are secured by all of the Company’s assets and all of the Company’s intellectual property. The Company is also required to comply with certain financial and reporting covenants including an Asset Coverage Ratio. As of December 31, 2014, the Company had an outstanding balance under the BridgeBank Loan Agreement of $2.5 million. The Company was in compliance with all reporting covenants for the period ended December 31, 2014. At December 31, 2014, the Company also had an outstanding short term loan with BridgeBank of $610 which was repaid in January 2015.

BRIDGELINE DIGITAL, INC.

NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

In December 2014, the Company signed an Amendment to its Loan and Security Agreement with Bridge Bank (the “Amendment”). As part of the Amendment Mr. Michael Taglich, a member of the Board of Directors, signed an unconditional quaranty (the “Guaranty”) and promise to pay the Company’s lender, Bridge Bank, N.A all indebtedness in an amount not to exceed $1 million in connection with the out of formula borrowings. The Amendment also modified certain monthly financial reporting requirements and financial covenants on a prospective basis commencing as of the effective date of the Amendment.

Under the terms of the Guaranty, the Guarantor authorizes Lender, without notice or demand and without affecting its liability hereunder, from time to time to: (a) renew, compromise, extend, accelerate, or otherwise change the time for payment, or otherwise change the terms, of the Indebtedness or any part thereof, including increase or decrease of the rate of interest thereon, or otherwise change the terms of the Indebtedness; (b) receive and hold security for the payment of this Guaranty or any Indebtedness and exchange, enforce, waive, release, fail to perfect, sell, or otherwise dispose of any such security; (c) apply such security and direct the order or manner of sale thereof as Lender in its discretion may determine; and (d) release or substitute any Guarantor or any one or more of any endorsers or other guarantors of any of the Indebtedness.

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

Subordinated Convertible Debt

On September 30, 2013, the Company entered into a Note Purchase Agreement (the "Purchase Agreement") with accredited investors pursuant to which Bridgeline Digital sold an aggregate of $2.0 million of 10% secured subordinated convertible notes (the "Notes"). The gross proceeds to Bridgeline Digital at the closing of this private placement were $2.0 million. The Notes accrue interest at a rate of ten percent (10%) per annum and mature on September 30, 2016. Interest on the Notes is payable quarterly in cash. The Notes are convertible at the election of the holder into shares of common stock of Bridgeline Digital at a conversion price equal to $1.30 per share at any time prior to the maturity date, provided that no holder may convert the Notes if such conversion would result in the holder beneficially owning more than 4.99% of the number of shares of Bridgeline Digital common stock outstanding at the time of conversion.

On November 6, 2013, the Company entered into an amendment (the "Amendment") to the Purchase Agreement by and among Bridgeline Digital and the accredited investors' party thereto. The Amendment increased the aggregate amount of 10% secured subordinated convertible notes (the "New Notes") able to be sold by Bridgeline Digital to $3.0 million. On November 6, 2013, Bridgeline Digital sold an additional $1.0 million of New Notes (the "Second Closing"). The gross proceeds to Bridgeline Digital at the Second Closing of this private placement were $1.0 million. The Notes accrue interest at a rate of ten percent (10%) per annum and mature on November 6, 2016. Interest on the Notes is payable quarterly in cash. The Notes are convertible at the election of the holder into shares of common stock of Bridgeline Digital at a conversion price equal to $1.30 per share at any time prior to the maturity date, provided that no holder may convert the Notes if such conversion would result in the holder beneficially owning more than 4.99% of the number of shares of Bridgeline Digital common stock outstanding at the time of conversion.

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

The Notes contain customary events of default. Upon the occurrence of any event of default the interest rate under the Notes will increase. In addition, upon the occurrence of a payment default under the Notes, Bridgeline Digital must pay a premium equal to 20% of the outstanding principal amount of the Notes. In the event of a change in control of Bridgeline Digital while the Notes are outstanding, Bridgeline Digital will provide the holders of the Notes with the opportunity to convert the Notes immediately prior to the change in control. In the event the holders of the Notes do not elect to convert the Notes, Bridgeline Digital may prepay all outstanding principal and accrued interest under the Notes.

The placement agent for both transactions was Taglich Brothers, Inc. As compensation for the initial transaction on September 30, 2013, Bridgeline Digital paid a fee of $160 and issued to Taglich Brothers, Inc., or its designees, five-year warrants to purchase an aggregate of 153,846 shares of common stock at an exercise price equal to $1.30 per share. The warrants are first exercisable on March 30, 2014, and provide the holders piggyback registration rights with respect to the shares of common stock underlying the warrants and contain a cashless exercise provision. As compensation for the Second Closing, Bridgeline Digital paid Taglich Brothers, Inc. a fee of $80 and issued to Taglich Brothers, Inc., or its designees, five-year warrants to purchase an aggregate of 76,923 shares of common stock at an exercise price equal to $1.30 per share. The warrants are first exercisable on May 6, 2014, provide the holders piggyback registration rights with respect to the shares of common stock underlying the warrants and contain a cashless exercise provision. Fair market value of the warrants are $49 and is included in current liabilities and non-current debt with the offsetting amount recorded to additional paid in capital in the Condensed Consolidated Balance Sheet. The fair market value of the warrants will be amortized on a straight-line basis over the estimated life of two years.

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BRIDGELINE DIGITAL, INC.

NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

The shares of common stock issuable upon conversion of the Notes and upon exercise of the warrants are restricted securities and may be sold only pursuant to Rule 144 or in another transaction exempt from the registration requirements under the Securities Act of 1933. Pursuant to the terms of the Purchase Agreement, Bridgeline Digital has agreed to provide piggyback registration rights with respect to the shares of common stock issuable upon conversion of the Notes in the event Bridgeline Digital files a registration statement, with certain limited exceptions.

Term Note from Shareholder

On January 7, 2015, Bridgeline issued a Term Note to Michael Taglich to document a loan by Michael Taglich to Bridgeline of $500. The funds were received in December 2014 and are reflected in Long Term Debt on the Balance Sheet. The terms of the Note provide that Bridgeline will pay interest at a rate of 7% per annum and the note will mature on June 30, 2016. Subsequent to the end of the quarter, the Company entered into a second Term Note ("Second Note") for $500 with Mr. Taglich. The terms of the Second Note provide that Bridgeline will pay interest at a rate of 7% per annum and the note will mature on September 1, 2016.

In consideration of the loan by Michael Taglich and a personal guaranty delivered by Michael Taglich to Bridge Bank, N.A. for the benefit of Bridgeline on December 19, 2014 (the "Guaranty"), on January 7, 2015 the Company issued Michael Taglich a warrant to purchase 300,000 shares of Common Stock of the Company at a price equal to $0.80 per share. The warrant has a term of five years and is exercisable six months after the date of issuance. Bridgeline agreed to provide piggyback registration rights with respect to the shares of common stock underlying the warrant. On January 7, 2015, Bridgeline also entered into a side letter with Michael Taglich pursuant to which Bridgeline agreed in the event the Guaranty remains outstanding for a period of more than 12 months, on each anniversary of the date of issuance of the Guaranty while the Guaranty remains outstanding Bridgeline will issue Michael Taglich a warrant to purchase 150,000 shares of common stock, which warrant shall contain the same terms as the warrant issued to Michael Taglich on January 7, 2015.

Subordinated Promissory Notes

In May 2010, in connection with the acquisition of TMX, the Company issued a $500 subordinated promissory note payable to TMX. The Promissory note is subordinated to the Company's primary lender and is payable in twelve quarterly installments of $42, plus interest at 1%, with the first payment due on January 15, 2011. The Promissory note may be paid in whole or in part at any time without discount, premium, or penalty.

In May 2012, the Company assumed two Promissory Notes in connection with the acquisition of MarketNet, Inc. The first Promissory Note in the amount of $63 is payable in eight equal installments of $8, including interest accrued at 5%, and matured in May 2014. This note was paid in full as of September 30, 2014. The second Promissory Note in the amount of $80 is payable in twelve equal installments of $7, including interest accrued at 5%, and matures in May 2015.

8. Other Long Term Liabilities

Deferred Rent

In connection with the leases in Massachusetts, New York, and San Luis Obispo the Company made investments in leasehold improvements at these locations of approximately $1.6 million, of which the respective landlords funded approximately $857. The capitalized leasehold improvements are being amortized over the initial lives of each lease. The improvements funded by the landlords are treated as lease incentives. Accordingly, the funding received from the landlords was recorded as fixed asset additions and a deferred rent liability on the Condensed Consolidated Balance Sheet. As of December 31, 2014, $199 was reflected in Accrued Liabilities and $800 is reflected in Other Long Term Liabilities. The deferred rent liability is being amortized as a reduction of rent expense over the lives of the leases.

9. Shareholders' Equity

Preferred Stock

On October 27, 2014, the Company sold 200,000 shares of Series A convertible preferred stock (the "Preferred Stock") at a purchase price of $10.00 per share for gross proceeds of $2.0 million in a private placement. Net proceeds to the Company after offering expenses were approximately $1.8 million. The shares of Preferred Stock may be converted, at the option of the holder at any time, into such number of shares of common stock ("Conversion Shares") equal (i) to the number of shares of Preferred Stock to be converted, multiplies by the stated value of $10.00 (the "Stated Value") and (ii) divided by the conversion price in effect at the time of conversion. The initial conversion price is $0.65, and is subject to adjustment in the event of stock splits or stock dividends. Any accrued but unpaid dividends on the shares of Preferred Stock to be converted shall also be converted in common stock at the conversion price. A mandatory provision also may provide that the Company will have the right to require the holders to convert shares of Preferred Stock into Conversion Shares if (i) the Company's common stock has closed at or above $1.30 per share for ten consecutive trading days and (ii) the Conversion Shares are (A) registered for resale on an effective registration statement or (B) may be resold pursuant to Rule 144.

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

Cumulative dividends are payable at a rate of 6% per year. If the Company does not pay the dividends in cash, then the Company may pay dividends in any quarter by delivery of additional shares of Preferred Stock ("PIK Election"). If the Company shall make the PIK Election with respect to the dividend payable, it shall deliver a number of shares of Preferred Stock equal to (A) the aggregate dividend payable to such holder as of the end of the quarter divided by (B) the lesser of (x) the then effective Conversion Price or (y) the average VWAP for the five (5) consecutive Trading Days prior to such dividend payment date. If, after two years, any Preferred Stock are outstanding the cash dividend rate will increase to 12.0% per year. The Company shall have the right to force conversion of the Preferred Stock into shares of Common Stock at any time after the Common Stock trades in excess of $1.30 per share. The Preferred Shares shall vote with the Common or an as converted basis.

In December 2014, the Company elected to declare a stock dividend (PIK election) for the first dividend payment date of January 2, 2015. The Company issued 2,132 preferred convertible shares in January 2015 to the preferred shareholders.

Common Stock

In June 2013, the Company sold 2,300,000 shares of common stock at $1.00 per share for gross proceeds of $2.3 million in a private placement. Net proceeds to the Company after offering expenses were approximately $2.1 million. In addition, the Company issued the investors and placement agent and its affiliates five year warrants to purchase an aggregate of 460,000 and 230,000 shares, respectively, of Bridgeline's common stock at a price equal to $1.25 per share. There are no plans to register the common stock issued in this offering, however in the event the Company does register other Common stock, the Company agreed to provide piggyback registration rights with respect to the shares of common stock sold in the offering and underlying the warrants.

In January 2014, the Company issued 56,897 shares of common stock at $1.16 per share to four members of its Board of Directors in lieu of cash payments for their services as board members. The shares vested in equal installments on a monthly basis through the end of the service period of September 30, 2014. The aggregate fair value of the shares is $66 and was expensed over the service period.

In March 2014, the Company sold 3,200,000 shares of common stock at $0.95 per share for gross proceeds of $3 million in a private placement. Net proceeds to the Company after offering expenses were approximately $2.7 million. In addition, the Company issued the placement agent five year warrants to purchase an aggregate of 320,000 shares of Bridgeline's common stock at a price equal to $1.05 per share. There are no plans to register the common stock issued in this offering, however in the event the Company does register other common stock, the Company agreed to provide piggyback registration rights with respect to the shares of common stock sold in the offering and underlying the warrants.

Contingent Consideration

In connection with the acquisition of ElementsLocal on August 1, 2013, the Company issued 526,438 common shares to the sellers of ElementsLocal. In addition, contingent consideration not to exceed 338,461 shares of Bridgeline Digital common stock is contingently issuable to the sellers of ElementsLocal. The contingent consideration is payable quarterly over the 12 consecutive calendar quarters following the acquisition, contingent upon the acquired business achieving certain revenue targets. Through December 31, 2014, the stockholders of ElementsLocal earned 141,025 shares of common stock.

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In connection with the acquisition of MarketNet on May 31, 2012, contingent consideration of 204,331 shares of Bridgeline Digital common stock is contingently issuable to the sole stockholder of MarketNet. The contingent consideration is payable quarterly over the 12 consecutive calendar quarters following the acquisition, contingent upon the acquired business achieving certain operating and revenue targets. The common stock has been issued and is being held in escrow pending satisfaction of the applicable earnout targets. Through December 31, 2014, the sole stockholder of MarketNet earned 144,738 shares of common stock. In addition, MarketNet is also eligible to earn additional equity consideration of 200,000 shares of Bridgeline Digital common stock if a certain annual revenue threshold is met in any fiscal year during the next three years.

In connection with the acquisition of Magnetic Corporation on October 3, 2011, contingent consideration of 166,666 shares of Bridgeline Digital common stock is contingently issuable to the sole stockholder of Magnetic. The contingent consideration is payable quarterly over the 12 consecutive calendar quarters following the acquisition, contingent upon the acquired business achieving certain operating and revenue targets. The common stock has been issued and is being held in escrow pending satisfaction of the applicable earnout targets. Through December 31, 2014, the sole stockholder of Magnetic earned the full value or 166,666 shares of common stock.

Amended and Restated Stock Incentive Plan

Effective August 2014, the Company’s Amended and Restated Stock Incentive Plan (the “Plan”) provides for the issuance of up 4,500,000 million shares of common stock. The Plan authorizes the award of incentive stock options, non-statutory stock options, restricted stock, unrestricted stock, performance shares, stock appreciation rights and any combination thereof to employees, officers, directors, consultants, independent contractors and advisors of the Company.   Options granted under the Plan may be granted with contractual lives of up to ten years. There were 3,497,139 options outstanding reserved under the Plan as of December 31, 2014 and 1,002,861 shares available for future issuance.

Employee Stock Purchase Plan

On April 12, 2012, the Company’s stockholders approved and adopted the Bridgeline Digital, Inc. 2012 Employee Stock Purchase Plan (the “ESPP”). Under the terms of the ESPP, the Company will grant eligible employees the right to purchase shares of Bridgeline common stock through payroll deductions at a price equal to 85% of the fair market value of Bridgeline common stock on the purchase termination date of defined offering or purchase periods. Each offering period is six months in duration. The ESPP permits the Company to offer up to 300,000 shares of common stock. The maximum number of shares of common stock that may be purchased by all participants in any purchase period may not exceed 150,000 shares. During the quarter ended December 31, 2014, employees purchased 2,421 shares for the most recent offering period.

Common Stock Warrants

On October 21, 2010, the Company issued 50,000 common stock warrants to purchase shares of the Company's common stock to a non-employee consultant as compensation for services rendered. The warrants vested over a one year period and expire on October 15, 2015. Of the warrants issued, 25,000 are exercisable at an exercise price of $1.00 per share and 25,000 are exercisable at an exercise price of $2.00 per share.

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On May 31, 2012, the Company issued five year warrants to the placement agent in the Company's private placement. The warrants are exercisable to purchase 217,931 shares of the Company's common stock at a price equal to $1.40 per share.

On June 19, 2013, the Company issued five year warrants to the investors and placement agent in the Company's private placement. The warrants are exercisable to purchase 460,000 and 230,000 shares, respectively, of the Company's common stock at a price equal to $1.25 per share.

On September 30, 2013, the Company issued five year warrants to the placement agent in the Company's placement of subordinated convertible debt. The warrants are exercisable to purchase 153,846 of the Company's common stock at a price equal to $1.30 per share. The warrants are first exercisable on March 30, 2014, provide the holders piggyback registration rights with respect to the shares of common stock underlying the warrants and contain a cashless exercise provision.

On November 1, 2013, the Company issued five year warrants to the placement agent in the Company's placement of subordinated convertible debt. The warrants are exercisable to purchase 76,923 shares of the Company's common stock at a price equal to $1.30 per share. The warrants are first exercisable on May 6, 2014, provide the holders piggyback registration rights with respect to the shares of common stock underlying the warrants and contain a cashless exercise provision.

In March 2014, the Company issued five year warrants to the investors and placement agent in the Company's private placement. The warrants are exercisable to purchase 320,000 shares of the Company's common stock at a price equal to $1.05 per share.

On October 28, 2014, the Company issued five year warrants to the placement agent in the Company's private placement of series A convertible preferred stock. The warrants are exercisable to purchase 307,692 shares of the Company's common stock at a price equal to $0.65 per share.

As of December 31, 2014: (i) placement agent warrants to purchase 217,931, 230,000, 230,769, 142,300 and 307,692 shares at an exercise price of $1.40, $1.25, $1.30, $1.05 and $0.65, respectively are outstanding; (ii) investor warrants to purchase 460,000 and 177,700 shares at an exercise price of $1.25 and $1.05 and (iii) warrants issued to a non-employee consultant to purchase 25,000 shares at an exercise price of $1.00 and 25,000 shares at an exercise price of $2.00 are outstanding.

Summary of Option and Warrant Activity and Outstanding Shares

	Stock Options		**Stock Warrants**	
	Options	**Weighted Average Exercise Price**	**Warrants**	**Weighted Average Exercise Price**
Outstanding, September 30, 2014	3,535,640	$ 0.98	1,508,700	$ 1.25
Granted	150,000	$ 0.65	307,692	$ 0.65
Exercised	-	$ -	-	-
Forfeited or expired	(188,501)	$ 1.36	-	-
Outstanding, December 31, 2014	3,497,139	$ 0.94	1,816,392	$ 1.14

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10. Accumulated Other Comprehensive Loss

The following table presents changes in accumulated other comprehensive loss for three months ended December 31, 2014 and 2013:

	Three Months Ended December 31,	
	2014	**2013**
Balance at beginning of period	$(333)	$(162)
Foreign currency translation adjustment	(5)	(32)
Balance at end of period	$(338)	$(194)

11. Net Loss Per Share

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

(in thousands, except per share data)	Three Months Ended December 31,	
	2014	**2013**
Net loss	$(2,110)	$(777)
Accrued dividends on convertible preferred stock	(21)	-
Net loss applicable to common shareholders	$(2,131)	$(777)

Weighted average common shares outstanding - basic	21,715	17,760
Effect of dilutive securities	-	-
Weighted average common shares outstanding - diluted	21,715	17,760
Net loss per share attributable to common shareholders:		
Basic and diluted	$(0.10)	$(0.04)

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

For the three months ended December 31, 2014, options to purchase shares of the Company's common stock of 12,169 were excluded from the computation of diluted net loss per share as the effect was anti-dilutive to the Company's net loss. Warrants to purchase 1,816,392 shares of common stock and contingent shares to be issued in connection with prior acquisitions of Marketnet, Magnetic and ElementsLocal have also been excluded as they are anti-dilutive to the Company's net loss. Also, excluded in the computation of diluted loss per share are the Series A convertible preferred stock shares as they are anti-dilutive to the Company's net loss.

12. Income Taxes

Income tax expense was $35 and $21 for the three months ended December 31, 2014 and 2013. Income tax expense consists of the estimated liability for federal and state income taxes owed by the Company, including the alternative minimum tax. Net operating loss carry forwards are estimated to be sufficient to offset additional taxable income for all periods presented.

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

13. Related Party Transactions

In October 2013, Mr. Michael Taglich joined the Board of Directors. Mr. Taglich is the Chairman and President of Taglich Brothers, Inc. a New York based securities firm. Taglich Brothers, Inc. was the agent for the past two private placements of Bridgeline Digital common stock in 2012 and 2013 and the private placement of convertible preferred stock in 2014. Taglich Brothers, Inc was also the agent for Bridgeline's convertible debt offerings of $2 million and $1 million in September and November 2013, respectively. The fees paid to Taglich Brothers, Inc. in connection with the 2012 and 2013 private placements of common stock were $200 and $180, respectively. Fees paid to Taglich Brothers, Inc. in connection with the October 2014 convertible preferred stock were $160. Fees paid to Taglich Brothers, Inc. in connection with the 2013 convertible debt offerings were $240. Mr. Taglich personally owns more than 5% of Bridgeline stock. Other employees, affiliates and clients of Taglich Brothers, Inc. own approximately 3,000,000 shares of Bridgeline common stock and 200,000 shares of convertible preferred stock.

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14. Legal Proceedings

The Company is subject to ordinary routine litigation and claims incidental to its business. As of December 31, 2014 the Company was not engaged with any material legal proceedings.

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15. Subsequent Events

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

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

This section contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in the forward-looking statements as a result of a variety of factors and risks including risks described in our Annual Report on Form 10-K for the fiscal year ended September 30, 2014 as well as in the other documents that we file with the Securities and Exchange Commission. You can read these documents at www.sec.gov.

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

Overview

Bridgeline Digital, The Digital Engagement Company™, enables its customers to maximize the performance of their mission critical websites, intranets, and online stores. Bridgeline's iAPPS® platform deeply integrates Web Content Management, eCommerce, eMarketing, Social Media management, and Web Analytics to help marketers deliver online experiences that attract, engage and convert their customers across all digital channels. Bridgeline's iAPPS platform combined with its digital services assists customers in maximizing on-line revenue, improving customer service and loyalty, enhancing employee knowledge, and reducing operational costs.

In fiscal 2012, Bridgeline Digital announced the release of a new product, iAPPSds ("distributed subscription"), a platform that empowers franchise and large dealer networks with state-of-the-art web engagement management while providing superior oversight of corporate branding. iAPPSds deeply integrates content management, eCommerce, eMarketing and web analytics and is a self-service web platform that is offered to each authorized franchise or dealer for a monthly or annual subscription fee. On August 1, 2013, we acquired franchise web developer ElementsLocal, expanding Bridgeline Digital's presence in the franchise market place.

In November 2014, we released iAPPS version 5.2 which includes enhancements to iAPPS Marketier, the platform's native email solution. Among the upgrades to the integrated email solution is a new Communication Dashboard with intuitive features that empower corporate marketing teams to develop, manage and execute effective email campaigns. Now, with the latest release customers can build campaigns with custom email designs or use new email templates available to them out-of-the-box. Additionally, new dynamic list segmentation capabilities allow customers to easily nurture specific audiences with targeted communications. Other lead-generation and CRM upgrades to iAPPS 5.2 include a brand new Form Builder.

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

The iAPPS Platform is an award-winning application recognized around the globe. Our teams of Microsoft Gold© certified developers have won over 100 industry related awards. In recent years, our iAPPS Content Manager and iAPPS Commerce products were selected as finalists for the 2014, 2013, and 2012 CODiE Awards for Best Content Management Solution and Best Electronic Commerce Solution, globally. In 2014 and 2013, Bridgeline Digital won twenty-five Horizon Interactive Awards for outstanding development of web applications and websites. Also in 2013, the Web Marketing Association sponsored Internet Advertising Competition honored Bridgeline Digital with three awards for iAPPS customer websites and B2B Magazine selected Bridgeline Digital as one of the Top Interactive Technology companies in the United States. KMWorld Magazine Editors selected Bridgeline Digital as one of the 100 Companies That Matter in Knowledge Management and also selected iAPPS as a Trend Setting Product in 2013.

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

Customer Information

We currently have over 2,500 customers, the majority of which are iAPPSds customers who pay a monthly subscription fee. For the three months ended December 31, 2014 and 2013 no customer represented 10% or more of total revenue.

Results of Operations for the Three Months Ended December 31, 2014 compared to the Three Months Ended December 31, 2013

Total revenue for the three months ended December 31, 2014 was $5.0 million compared with $6.5 million for the three months ended December 31, 2013. We had a net loss of ($2.1) million for the three months ended December 31, 2014 compared with net loss of ($777) thousand for the three months ended December 31, 2013. Net loss per share was ($0.10) for the three months ended December 31, 2014 and ($0.04) for the three months ended December 31, 2013.

Revenue

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

Net revenue:	**Three Months Ended December 31, 2014**	**Three Months Ended December 31, 2013**	**$ Change**	**% Change**
Digital engagement services				
iAPPS digital enagement services	$ 2,856	$ 3,912	(1,056)	(27%)
% of total net revenue	*57%*	*60%*		
Other digital engagement services	375	637	(262)	(41%)
% of total net revenue	*7%*	*10%*		
Subtotal digital engagement services	**3,231**	**4,549**	**(1,318)**	**(29%)**
% of total net revenue	*64%*	*70%*		
Subscription and perpetual licenses	**1,380**	**1,577**	**(197)**	**(12%)**
% of total net revenue	*28%*	*24%*		
Managed service hosting	**401**	**387**	**14**	**4%**
% of total net revenue	*8%*	*6%*		
Total net revenue	**$ 5,012**	**$ 6,513**	**$ (1,501)**	**(23%)**

Digital Engagement Services

Digital engagement services revenue is comprised of iAPPS digital engagement related services and other digital engagement related services generated from non-iAPPS related engagements. Revenue from iAPPS digital engagement services decreased $1.1 million, or 27% to $2.9 million compared to $3.9 million for the three months ended December 31, 2013. The decrease in iAPPS digital engagements services is related to the timing in ramping up new engagements combined with project delays on existing engagements. Revenue from non-iAPPS digital engagement services decreased $262 thousand, or 41%, to $375 thousand for the three months ended December 31, 2014 compared to $637 thousand for the three months ended December 31, 2013. The decrease compared to the prior period is due to a decrease in non-iAPPS engagement services as we continue to concentrate on selling higher-margin iAPPS digital engagements to both new and existing customers. In total, revenue from digital engagement services decreased $1.3 million, or 29%, to $3.2 million for the three months ended December 31, 2014 compared to $4.5 million for the three months ended December 31, 2013.

Digital engagement services revenue as a percentage of total revenue decreased to 64% from 70% for the three months ended December 31, 2014 compared to the prior period. The decrease is attributable to the decreases in both iAPPS and non iAPPS digital engagement services revenue.

Subscription and Perpetual Licenses

Revenue from subscription and perpetual licenses decreased $197 thousand, or 12%, to $1.4 million for the three months ended December 31, 2014 compared to $1.6 million for the three months ended December 31, 2013. The decrease is due to a decrease in perpetual licenses sold and recognized in the current quarter as a larger percentage of our engagements sold have been SaaS rather than perpetual.

Subscription and perpetual license revenue as a percentage of total revenue increased to 28% for the three months ended December 31, 2014 from 24% compared to the three months ended December 31, 2013. The increase as a percentage of revenues is attributable to the decreases in iAPPS digital engagement services revenues.

Managed Service Hosting

Revenue from managed service hosting increased $14 thousand, or 4%, to $401 thousand for the three months ended December 31, 2014 compared to $387 thousand for the three months ended December 31, 2013. The increase is due to new customers who host their perpetual licenses in our environment.

Managed services revenue as a percentage of total revenue increased to 8% for the three months ended December 31, 2014 from 6% for three months ended December 31, 2013. The increase as a percentage of revenues is attributable to the decreases in iAPPS digital engagement services revenues.

Costs of Revenue

Total cost of revenue increased $84 thousand to $3.1 million for the three months ended December 31, 2014 compared to $3.0 million for the three months ended December 31, 2013. This increase is attributable to fixed labor costs to deliver iAPPS digital engagement services.

Cost of revenue:	**Three Months Ended December 31, 2014**		**Three Months Ended December 31, 2013**		**$ Change**		**% Change**	
Digital engagement services								
iAPPS digital engagement costs	2,339		2,115		224		11	%
% of iAPPS digital engagement services revenue	*82*	*%*	*54*	*%*				
Other digital engagement costs	225		388		(163	)	(42%	)
% of other digital engagement services revenue	*60*	*%*	*61*	*%*				
Subtotal digital engagement costs	**2,564**		**2,503**		**61**		**2**	**%**

% of digital engagement services revenue	*79%*	*55%*		
Subscription and perpetual licenses	**430**	**397**	**33**	**8%**
% of subscription and perpetual revenue	*31%*	*25%*		
Managed service hosting	**74**	**84**	**(10)**	**(12%)**
% of managed service hosting revenue	*18%*	*22%*		
Total cost of revenue	3,068	2,984	84	3%
Gross profit	**$ 1,944**	**$ 3,529**	**$(1,585)**	(45%)
Gross profit margin	***39%***	***54%***		

Cost of Digital Engagement Services

Cost of digital engagement services increased $61 thousand, or 2%, to $2.6 million for the three months ended December 31, 2014 compared to $2.5 million for the three months ended December 31, 2013. Costs associated with non-iAPPS related engagements decreased in line with non-iAPPS digital engagement services. The increase in iAPPS digital related costs is attributable to fixed labor costs to deliver iAPPS digital engagement services combined with some iAPPS ds projects sold at lower margins.

Cost of Subscription and Perpetual License

Cost of subscription and perpetual licenses increased $33 thousand, or 8%, to $430 thousand for the three months ended December 31, 2014 compared to $397 thousand for the three months ended December 31, 2013. This slight increase is due to fixed costs to support our network operations center.

The cost of subscription and perpetual licenses as a percentage of subscription and perpetual license revenue increased to 31% from 25% compared to the three months ended December 31, 2013. This is due to a decrease in perpetual revenue recognized in the current quarter compared to the previous.

Cost of Managed Service Hosting

Cost of managed service hosting decreased $10 thousand, or 12%, for the three months ended December 31, 2014 compared to the three months ended December 31, 2013. The cost of managed services as a percentage of managed services revenue decreased to 18% from 22% compared to the three months ended December 31, 2013. The percentage decreases are attributable to fixed costs to support the network operations center.

Operating Expenses

Operating expenses:	**Three Months Ended December 31, 2014**		**Three Months Ended December 31, 2013**		**$ Change**		**% Change**	
Sales and marketing	1,810		2,110		(300	)	(14%	)
% of total revenue	*36*	%	*32*	%				
General and administrative	993		1,031		(38	)	(4%	)

% of total revenue	*20*	*%*	*16*	*%*				
Research and development	602		523		79		15	%
% of total revenue	*12*	*%*	*8*	*%*				
Depreciation and amortization	452		454		(2	)	-	
% of total revenue	*9*	*%*	*7*	*%*				
Total operating expenses	**3,857**		**4,118**		**(261**	**)**	**(6%**	**)**

Sales and Marketing Expenses

Sales and marketing expenses decreased $300 thousand to $1.8 million, or 14%, for the three months ended December 31, 2014 compared to $2.1 for the three months ended December 31, 2013. Sales and marketing expenses represented 36% and 32% of total revenue for the three months ended December 31, 2014 and 2013, respectively.

The decreases for the three months ended December 31, 2014 compared to the prior period is primarily attributable to decreases in sales commissions and marketing expenses.

General and Administrative Expenses

General and administrative expenses decreased $38 thousand, or 4%, to $993 thousand for the three months ended December 31, 2014 compared to $1.0 million for the three months ended December 31, 2013. General and administrative expenses represented 20% of total revenue compared to 16% in the prior period. The decrease in expense was due to decreases in headcount and the decrease in general legal expenses.

Research and Development

Research and development expense increased by $79 thousand, or 15%, to $602 thousand for the three months ended December 31, 2014 compared to $523 thousand for the three months ended December 31, 2013. The increase in research and development expense is due to an increase in headcount and personnel expenses.

Depreciation and Amortization

Depreciation and amortization expense remained relatively flat for the three months ended December 31, 2014 compared to the three months ended December 31, 2013. Equipment related depreciation and amortization related to leasehold improvements declined slightly due to retirements, but was offset almost entirely by amortization related to intangibles acquired in the Elements/Local acquisition. Depreciation and amortization represented 9% and 7% of revenue for the three months ended December 31, 2014 and 2013.

Net Loss

	Three Months Ended December 31, 2014	**Three Months Ended December 31, 2013**	**$ Change**	**% Change**
Loss from operations	(1,913)	(589)	(1,324)	225%
Interest income (expense) net	(162)	(167)	5	(3%)
Loss before income taxes	(2,075)	(756)	(1,319)	174%
Provision for income taxes	35	21	14	67%
Net loss	**$ (2,110)**	**$ (777)**	**$ (1,333)**	172%

Loss from operations

The loss from operations was ($1.9) million for three months ended December 31, 2014, compared to a loss of ($589) thousand in the prior period. Contributing to the overall loss was a decrease in gross profit margin by 15% as we maintained fixed costs to support our revenue base. The decline in the gross profit margin was partially offset by a decrease in overall operating expenses, as we streamlined costs in line with the expected revenue shortfall.

Income Taxes

The provision for income tax expense was $35 thousand and $21 thousand for the three months ended December 31, 2014 and 2013, respectively. Income tax expense represents the estimated liability for federal and state income taxes owed, including the alternative minimum tax. We have net operating loss carryforwards and other deferred tax benefits that are available to offset future taxable income.

Adjusted EBITDA

We also measure our performance based on a non-GAAP (“Generally Accepted Accounting Principles”) measurement of earnings before interest, taxes, depreciation, and amortization and before stock-based compensation expense and impairment of goodwill and intangible assets (“Adjusted EBITDA”).

We believe this non-GAAP financial measure of Adjusted EBITDA is useful to management and investors in evaluating our operating performance for the periods presented and provide a tool for evaluating our ongoing operations.

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

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

	Three Months Ended December 31,	
	2014	**2013**
Net loss	$(2,110)	$(777)
Provision for income tax	35	21
Interest expense (income), net	162	167
Amortization of intangible assets	152	125
Depreciation	279	322
EBITDA	(1,482)	(142)
Other amortization	146	120
Stock based compensation	89	42
Adjusted EBITDA	$(1,247)	$20

The decrease in Adjusted EBITDA is primarily due to the decrease in revenues and gross profit margin.

Liquidity and Capital Resources

Cash Flows

Operating Activities

Cash used in operating activities was $1.2 million for the three months ended December 31, 2014 compared to cash used in operating activities of $1.4 million for the three months ended December 31, 2013. This decrease compared to the prior period was due a decrease in accounts receivable due to collection activities, payments made to vendors in the comparable period, and the adjustments for non-cash items such as amortization and depreciation for the period, offset by the higher net loss for the period.

Investing Activities

Cash used in investing activities was $255 thousand for the three months ended December 31, 2014 compared to $341 thousand for the three months ended December 31, 2013.   In the three months ended December 31, 2014, we purchased additional equipment to support our network operations center and made contingent acquisition payments.

Financing Activities

Cash provided by financing activities was $1.3 million for the three months ended December 31, 2014 compared to cash used in financing activities of $406 thousand for the three months ended December 31, 2013. The increase in cash provided by financing activities is primarily attributable to a private placement of 200,000 shares of Series A convertible preferred stock in October 2014, which raised a net $1.8 million in funds, as well as $500 thousand received from Mr. Taglich for a term note with a maturity date of June 2016, and a short term loan from BridgeBank of $610 thousand. Offsetting these proceeds, were payments of $461 thousand on the Bridge Bank line of credit and $1.0 million on a short term loan from BridgeBank.

Capital Resources and Liquidity Outlook

In January 2015 and February 2015, we issued $1 million of term notes to Michael Taglich. The January 2015 term note of $500,000 has a maturity date of June 30, 2016 and the February 2015 term note of $500,000 has a maturity date of September 1, 2016. Both notes accrue interest at 7% per annum.

We believe that cash generated from operations, proceeds from the bank line of credit, the sale of common stock and sale of preferred stock, and term loans from shareholders will be sufficient to fund the Company's working capital and capital expenditure needs in the foreseeable future. However, we currently have a borrowing facility with Bridge Bank from which we can borrow, and this line is subject to financial covenants that must be met. It is not certain that all or part of this line will be available to us in the future; and other sources of financing may not be available to us in a timely basis if at all, or on terms acceptable to us. If we fail to obtain acceptable funding when needed, we may not have sufficient resources to fund our normal operations, and this would have a material adverse effect on our business.

Off-Balance Sheet Arrangements

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

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

Commitments and Contingencies

As of December 31, 2014, we had an accrued contingent earnout liability of $689 thousand from acquisitions completed in prior fiscal years, which are scheduled to be paid out through fiscal 2016. Contingent earnout payments related to acquisitions are paid when and if certain revenue and earnings targets are achieved.

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Critical Accounting Policies

Critical Accounting Policies

These critical accounting policies and estimates by our management should be read in conjunction with Note 2 *Summary of Significant Accounting Policies* to the Consolidated Financial Statements that were prepared in accordance with accounting principles generally accepted in the United States of America ("US GAAP").

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

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

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

Accounting for stock-based compensation.

Revenue Recognition

Overview

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

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

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

Digital Engagement Services

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

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

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

Subscriptions and Perpetual Licenses

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

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

Managed Service Hosting

Managed service hosting includes hosting arrangements that provide for the use of certain hardware and infrastructure for those customers who do not wish to host our applications independently. Hosting agreements are either annual or month-to-month arrangements that provide for termination for convenience by either party generally upon 30-days’ notice. Revenue is recognized monthly as the hosting services are delivered. Set up fees paid by customers in connection with managed hosting services are deferred and recognized ratably over the longer of the life of the hosting period or the expected lives of customer relationships. We continue to evaluate the length of the amortization period of the set up fees as we gain more experience with customer contract renewals.

Multiple Element Arrangements

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

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

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

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

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

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

Customer Payment Terms

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

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

Warranty

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

Reimbursable Expenses

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

Allowance for Doubtful Accounts

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

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

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

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

Accounting for Goodwill and Intangible Assets

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

For fiscal 2014, we performed the annual assessment of our goodwill during the fourth quarter of 2014, using the qualitative approach described above. Based on our qualitative assessment, we concluded that it was not more likely than not that the fair values of any of our reporting units were less than their carrying amounts, and therefore it was not necessary to perform the quantitative two-step impairment test. The key qualitative factors that led to our conclusion included the following: (i) Positive access to capital with two recent stock offerings totaling $5 million in capital; (ii) Positive market acceptance of our multi-unit products; and (iii) Fair market value of Company is in excess of book value.

Accounting for Stock-Based Compensation

At December 31, 2014, we maintained one stock-based compensation plan and one employee stock purchase plan which are more fully described in Note 12 to the Consolidated Financial Statements of our Annual Report on Form 10-K filed with the Securities and Exchange Commission on December 29, 2014.

The Company accounts for stock compensation awards in accordance with the *Compensation-Stock Compensation* Topic of the Codification. Share-based payments (to the extent they are compensatory) are recognized in our consolidated statements of operations based on their fair values.

We recognize stock-based compensation expense for share-based payments issued or assumed after October 1, 2006 that are expected to vest on a graded, accelerated basis over the service period of the award, which is generally three years. We recognize the fair value of the unvested portion of share-based payments granted prior to October 1, 2006 over the remaining service period, net of estimated forfeitures. In determining whether an award is expected to vest, we use an estimated, forward-looking forfeiture rate based upon our historical forfeiture rate and reduce the expense over the recognition period. Estimated forfeiture rates are updated for actual forfeitures quarterly. We also consider, each quarter, whether there have been any significant changes in facts and circumstances that would affect our forfeiture rate. Although we estimate forfeitures based on historical experience, actual forfeitures in the future may differ. In addition, to the extent our actual forfeitures are different than our estimates, we record a true-up for the difference in the period that the awards vest, and such true-ups could materially affect our operating results.

We estimate the fair value of employee stock options using the Black-Scholes-Merton option valuation model. The fair value of an award is affected by our stock price on the date of grant as well as other assumptions including the estimated volatility of our stock price over the term of the awards and the estimated period of time that we expect employees to hold their stock options. The risk-free interest rate assumption we use is based upon United States treasury interest rates appropriate for the expected life of the awards. We use the historical volatility of our publicly traded options in order to estimate future stock price trends. In order to determine the estimated period of time that we expect employees to hold their stock options, we use historical trends of employee turnovers. Our expected dividend rate is zero since we do not currently pay cash dividends on our common stock and do not anticipate doing so in the foreseeable future. The aforementioned inputs entered into the option valuation model we use to fair value our stock awards are subjective estimates and changes to these estimates will cause the fair value of our stock awards and related stock-based compensation expense we record to vary.

We record deferred tax assets for stock-based awards that result in deductions on our income tax returns, based on the amount of stock-based compensation recognized and the statutory tax rate in the jurisdiction in which we will receive a tax deduction.

Item 3. Qualitative and Quantitative Disclosures About Market Risk.

Not required.

Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

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

As of December 31, 2014 we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective in enabling us to record, process, summarize and report information required to be included in our periodic filings with the Securities and Exchange Commission within the required time period.

Changes in Internal Control over Financial Reporting

There have been no changes in our internal controls over financial reporting that occurred during the quarter ended December 31, 2014 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings.

From time to time we are subject to ordinary routine litigation and claims incidental to our business. We are not currently involved in any legal proceedings that we believe are material beyond those previously disclosed in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on December 29, 2014.

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

The following summarizes all sales of our unregistered securities during the quarter ended December 31, 2014. The securities in the below-referenced transactions were (i) issued without registration and (ii) were subject to restrictions under the Securities Act and the securities laws of certain states, in reliance on the private offering exemptions contained in Sections 4(2), 4(6) and/or 3(b) of the Securities Act and on Regulation D promulgated there under, and in reliance on similar exemptions under applicable state laws as transactions not involving a public offering. Unless stated otherwise, no placement or underwriting fees were paid in connection with these transactions.

Preferred Stock

On October 27, 2014, the Company sold 200,000 shares of Series A convertible preferred stock (the “Preferred Stock”) at purchase price of $10.00 per share for gross proceeds of $2.0 million in a private placement. Net proceeds to the Company after offering expenses were approximately $1.8 million. The shares of Preferred Stock may be converted, at the option of the holder at any time, into such number of shares of common stock (“Conversion Shares”) equal (i) to the number of shares of Preferred Stock to be converted, multiplied by the stated value of $10.00 (the “Stated Value”) and (ii) divided by the conversion price in effect at the time of conversion. The initial conversion price is $0.65, and is subject to adjustment in the event of stock splits or stock dividends. Any accrued but unpaid dividends on the shares of Preferred Stock to be converted shall also be converted in common stock at the conversion price. A mandatory provision also may provide that the Company will have the right to require the holders to convert shares of Preferred Stock into Conversion Shares if (i) the Company’s common stock has closed at or above $1.30 per share for ten consecutive trading days and (ii) the Conversion Shares are (A) registered for resale on an effective registration statement or (B) may be resold pursuant to Rule 144.

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

Stock Options

During the fiscal quarter ended December 31, 2014, the Company granted 150,000 stock options under its Amended and Restated Stock Incentive Plan at a weighted average exercise price of $0.65 per share.

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

Item 5. Other Information.

Entry into a Material Definitive Agreement; Creation of a Direct Financial Obligation

On February 12, 2015, the Company issued a Term Note (the “Note”) to Michael Taglich to document a loan by Mr. Taglich to the Company of $500,000. The terms of the Note provide that the Company will pay interest at a rate of 7% per annum and the note will mature on September 1, 2016.

In consideration of the loan by Mr. Taglich, on February 12, 2015 the Company issued Mr. Taglich a warrant to purchase 300,000 shares of Common Stock of the Company at a price equal to $0.80 per share. The warrant has a term of five years and is first exercisable six months after the date of issuance. The Company agreed to provide piggyback registration rights with respect to the shares of common stock underlying the warrant.

Mr. Taglich is a member of the Board of Directors of the Company.

Amended and Restated Bylaws

On February 10, 2015, the Company's Board of Directors amended and restated its by-laws (the "Amended Bylaws").

Article VIII of the Amended Bylaws were amended to: (i) provide that, unless the Company consents in writing to the selection of an alternative forum, the Court of Chancery of the State of Delaware shall be the sole and exclusive forum for certain legal actions, including (a) any derivative action or proceeding brought on behalf of the Company, (b) any action asserting a claim of breach of a fiduciary duty owed by any director or officer or other employee of the Company to the Company or the Company's stockholders, (c) any action asserting a claim arising pursuant to any provision of the Delaware General Corporation Law, or (d) any action asserting a claim governed by the internal affairs doctrine; (ii) provide for fee-shifting with respect to certain types of litigation brought against the Company and/or any director, officer, employee or affiliate where the claiming parties do not obtain a judgment on the merits that substantially achieves, in substance and amount, the full remedy sought; and (iii) include a severability provision.

The foregoing description of the Amended Bylaws, Note and warrant does not purport to be complete and is qualified in its entirety by reference to the full text of such documents, copies of which are filed as exhibits to this Report on Form 10-Q.

Item 6. Exhibits.

Exhibit No.	Description of Document
3.1	Certificate of Designations of the Series A Convertible Preferred Stock (incorporated by reference to Exhibit 3.1 to our Current Report on Form 8-K filed on November 4, 2014).
3.2	Amended and Restated By-Laws
10.1	Term Note In principal amount of $500,000 dated February 12, 2015
10.2	Common Stock Purchase Warrant Issued by Company to Michael Taglich dated February 12, 2015
10.3	Securities Purchase Agreement between Bridgeline Digital, Inc and the investors therein, dated October 28, 2014 (incorporated by reference to Exhibit 10.1 to our Current Report on Form 8-K filed on November 4, 2014).
10.4	Form of Common Stock Purchase Warrant issued to Placement Agent (incorporated by reference to Exhibit 10.2 to our Current Report on Form 8-K filed on November 4, 2014).
31.1	Certification required by Rule 13a-14(a) or Rule 15d-14(a).
31.2	Certification required by Rule 13a-14(a) or Rule 15d-14(a).
32.1	Certification required by Rule 13a-14(b) or Rule 15d-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. §1350).
32.2	Certification required by Rule 13a-14(b) or Rule 15d-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. §1350).
101.INS*	XBRL Instance
101.SCH*	XBRL Taxonomy Extension Schema
101.CAL*	XBRL Taxonomy Extension Calculation
101.DEF*	XBRL Taxonomy Extension Definition
101.LAB*	XBRL Taxonomy Extension Labels
101.PRE*	XBRL Taxonomy Extension Presentation

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

SIGNATURES

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

	Bridgeline Digital, Inc. (Registrant)
February 17, 2015 Date	/s/ Thomas L. Massie **Thomas L. Massie** **President and Chief Executive Officer** (Principal Executive Officer)
February 17, 2015 Date	/s/ Michael D. Prinn **Michael D. Prinn** **Executive Vice President and Chief Financial Officer** (Principal Financial and Accounting Officer)

INDEX OF EXHIBITS

Exhibit No.	**Description of Document**
3.2	Amended and Restated By-Laws
10.1	Term Note In principal amount of $500,000 dated February 12, 2015
10.2	Common Stock Purchase Warrant Issued by Company to Michael Taglich dated February 12, 2015
31.1	Certification required by Rule 13a-14(a) or Rule 15d-14(a).
31.2	Certification required by Rule 13a-14(a) or Rule 15d-14(a).
32.1	Certification required by Rule 13a-14(b) or Rule 15d-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. §1350).
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