Bridgeline Digital, Inc.
Form 10-Q
August 15, 2016

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 June 30, 2016

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 August 2, 2016 was 18,662,069.

1

Bridgeline Digital, Inc.

Quarterly Report on Form 10-Q

For the Quarterly Period ended June 30, 2016

Index

		Page
Part I	**Financial Information**	
Item 1.	Condensed Consolidated Financial Statements	
	Condensed Consolidated Balance Sheets (unaudited) as of June 30, 2016 and September 30, 2015	4
	Condensed Consolidated Statements of Operations (unaudited) for the three and nine months ended June 30, 2016 and 2015	5
	Condensed Consolidated Statements of Comprehensive Loss (unaudited) for the three and nine months ended June 30, 2016 and 2015	6
	Condensed Consolidated Statements of Cash Flows (unaudited) for the nine months ended June 30, 2016 and 2015	7
	Notes to Unaudited Interim Condensed Consolidated Financial Statements	8
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	22
Item 3.	Qualitative and Quantitative Disclosures About Market Risk	35
Item 4.	Controls and Procedures	35
Part II	**Other Information**	
Item 1.	Legal Proceedings	36
Item 2	Unregistered Sales of Equity Securities and Use of Proceeds	36
Item 5.	Other Information	36

Item 6. Exhibits	37
Signatures	39

2

Bridgeline Digital, Inc.

Quarterly Report on Form 10-Q

For the Quarterly Period ended June 30, 2016

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 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, 2015 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 data)

(Unaudited)

ASSETS	**June 30, 2016**	**September 30, 2015**
Current assets:		
Cash and cash equivalents	$233	$ 337
Accounts receivable and unbilled receivables, net	1,984	2,463
Prepaid expenses and other current assets	523	680
Total current assets	2,740	3,480
Equipment and improvements, net	700	1,315
Intangible assets, net	706	1,028
Goodwill	12,641	12,641
Other assets	510	723
Total assets	$17,297	$ 19,187
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$1,392	$ 1,626
Accrued liabilities	1,184	1,046
Accrued contingent consideration	151	468
Debt, current	-	92
Capital lease obligations, current	29	320
Deferred revenue	1,415	1,542
Total current liabilities	4,171	5,094
Debt, net of current portion	4,270	7,695
Other long term liabilities	620	726
Total liabilities	9,061	13,515
Commitments and contingencies		
Stockholders' equity:		

Preferred stock - $0.001 par value; 1,000,000 shares authorized; 217,812 at June 30, 2016 and 208,222 at September 30, 2015, issued and outstanding (liquidation preference $2,221)	-	-
Common stock - $0.001 par value; 50,000,000 shares authorized; 13,171,099 at June 30, 2016 and 4,637,684 at September 30, 2015, issued and outstanding	14	5
Additional paid-in capital	57,468	50,434
Accumulated deficit	(48,893)	(44,411)
Accumulated other comprehensive loss	(353)	(356)
Total stockholders' equity	8,236	5,672
Total liabilities and stockholders' equity	$17,297	$ 19,187

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

BRIDGELINE DIGITAL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

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

(Unaudited)

	Three Months Ended		**Nine Months Ended**	
	June 30, 2016	**2015**	**June 30, 2016**	**2015**
Net revenue:				
Digital engagement services	$1,849	$2,956	$6,611	$9,227
Subscription and perpetual licenses	1,530	1,505	4,575	4,260
Managed service hosting	317	415	985	1,188
Total net revenue	3,696	4,876	12,171	14,675
Cost of revenue:				
Digital engagement services	1,221	2,114	4,111	7,190
Subscription and perpetual licenses	391	473	1,423	1,366
Managed service hosting	76	76	232	224
Total cost of revenue	1,688	2,663	5,766	8,780
Gross profit	2,008	2,213	6,405	5,895
Operating expenses:				
Sales and marketing	1,212	1,245	3,528	4,590
General and administrative	1,035	980	2,660	3,110
Research and development	428	373	1,145	1,442
Depreciation and amortization	328	422	1,023	1,315
Restructuring charges	16	-	795	-
Total operating expenses	3,019	3,020	9,151	10,457
Loss from operations	(1,011)	(807)	(2,746)	(4,562)
Interest and other expense, net	(287)	(278)	(867)	(643)
Loss on inducement of convertible notes	(726)	-	(726)	-
Loss before income taxes	(2,024)	(1,085)	(4,339)	(5,205)
Provision for income taxes	8	25	46	88
Net loss	(2,032)	(1,110)	(4,385)	(5,293)
Dividends on convertible preferred stock	(33)	(31)	(97)	(82)
Net loss applicable to common shareholders	$(2,065)	$(1,141)	$(4,482)	$(5,375)
Net loss per share attributable to common shareholders:				
Basic and diluted	$(0.21)	$(0.26)	$(0.66)	$(1.24)
Number of weighted average shares outstanding:				
Basic and diluted	10,015,030	4,348,865	6,835,103	4,321,132

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		**Nine Months Ended**	
	June 30,		**June 30,**	
	2016	**2015**	**2016**	**2015**
Net Loss	$(2,032)	$(1,110)	$(4,385)	$(5,293)
Net change in foreign currency translation adjustment	3	(2)	3	(24)
Comprehensive loss	$(2,029)	$(1,112)	$(4,382)	$(5,317)

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, except share data)

(Unaudited)

	Nine Months Ended	
	June 30,	
	2016	**2015**
Cash flows from operating activities:		
Net loss	$(4,385)	$(5,293)
Adjustments to reconcile net loss to net cash used in operating activities:		
Provision for deferred taxes	31	45
Loss on disposal of fixed assets	31	58
Amortization of intangible assets	322	447
Loss on inducement of convertible notes	726	-
Depreciation	608	814
Other amortization	459	490
Contingent earnout liability adjustment	-	131
Capitalized interest expense	204	-
Stock-based compensation	204	244
Changes in operating assets and liabilities		
Accounts receivable and unbilled receivables	479	187
Prepaid expenses and other assets	173	577
Accounts payable and accrued liabilities	(119)	(322)
Deferred revenue	(127)	201
Other liabilities	(115)	(216)
Total adjustments	2,876	2,656
Net cash used in operating activities	(1,509)	(2,637)
Cash flows used in investing activities:		
Purchase of equipment and improvements	(24)	(52)
Software development capitalization costs	(104)	(50)
Net cash used in investing activities	(128)	(102)
Cash flows provided by financing activities:		
Proceeds from issuance of 200,000 shares of preferred stock, net of issuance costs	-	1,722
Proceeds from issuance of 2,666,685 shares of common stock upon conversion of term notes, net of issuance costs	1574	-
Proceeds from issuance of 680,000 shares of common stock, net of issuance costs	669	-
Proceeds from employee stock purchase plan	-	6
Proceeeds from bank term loan	500	1,460
Proceeds from term notes from stockholders	1,000	2,000
Borrowing on bank line of credit	108	825

Payments on bank term loan	(750)	(2,460)
Payments on bank line of credit	(963)	(670)
Payments on subordinated promissory note	-	(21)
Contingent acquisition payments	(317)	(417)
Principal payments on capital leases	(291)	(355)
Net cash provided by financing activities	1,530	2,090
Effect of exchange rate changes on cash and cash equivalents	3	(24)
Net decrease in cash and cash equivalents	(104)	(673)
Cash and cash equivalents at beginning of period	337	1,256
Cash and cash equivalents at end of period	$233	$583
Supplemental disclosures of cash flow information:		
Cash paid for:		
Interest	$187	$163
Income taxes	$11	$43
Non cash investing and financing activities:		
Conversion of subordinated convertible notes (principal)	$570	-
Conversion of term notes (principal)	$3,000	-
Equipment purchased under capital leases	$-	$172
Other assets included in accounts payable	$-	$2
Accrued dividends on convertible preferred stock	$97	$81

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™, helps customers maximize the performance of their full digital experience from - websites and intranets to online stores and campaigns. Bridgeline's iAPPS® platform deeply integrates Web Content Management, eCommerce, eMarketing, Social Media management, and Web Analytics to help marketers deliver digital experiences that attract, engage and convert their customers across all channels. Bridgeline's iAPPS platform combined with its digital services assists customers in maximizing on-line revenue, improving customer service and loyalty, enhancing employee knowledge, and reducing operational costs. The iAPPSds ("distributed subscription") product is a platform that empowers franchise and large dealer networks with state-of-the-art web engagement management while providing superior oversight of corporate branding. iAPPSds deeply integrates content management, eCommerce, eMarketing and web analytics and is a self-service web platform that is offered to each authorized franchise or dealer for a monthly subscription fee. Our iAPPSdsr platform, released in 2015, targets the growing multi-unit organizations with 10-500 locations providing them with powerful web engagement tools while maintaining corporate brand control and consistency.

The iAPPS Platform is an award-winning application. Our teams of Microsoft Gold© certified developers have won over 100 industry related awards. In 2015, the SIIA (Software and Information Industry Association) awarded iAPPS Content Manager, the 2015 SIIA CODiE Award for Best Web Content Management Platform. Also in 2015, *EContent* magazine named iAPPS Digital Engagement Platform to its Trendsetting Products list. The list of 75 products and platforms was compiled by EContent's editorial staff, and selections were based on each offering's uniqueness and importance to digital publishing, media, and marketing. Bridgeline was also recognized in 2015 as a strong performer by Forrester Research, Inc in its independence report, "The Forrester Wave ™: Through-Channel Marketing Automation Platforms, Q3 2015." In recent years, 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 2015, the SIIA (Software and Information Industry Association) awarded iAPPS Content Manager the 2015 SIIA CODiE Award for Best Web Content Management Platform. 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.

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.

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

Locations

The Company’s corporate office is located north of Boston, Massachusetts. The Company maintains regional field offices serving the following geographical locations: Boston, MA; Chicago, IL; Denver, CO; San Luis Obispo, CA; and Tampa, FL. The Company has a wholly-owned subsidiary, Bridgeline Digital Pvt. Ltd. located in Bangalore, India.

Reverse Stock Split

On May 4, 2015, the Company’s Shareholders and the Board of Directors approved a reverse stock split pursuant to which all classes of our issued and outstanding shares of common stock at the close of business on such date were combined and reconstituted into a smaller number of shares of common stock in a ratio of 1 share of common stock for every 5 shares of common stock (“1-for-5 reverse stock split”). The 1-for-5 reverse stock split was effective as of close of business on May 7, 2015 and the Company’s stock began trading on a split-adjusted basis on May 8, 2015.

BRIDGELINE DIGITAL, INC.

NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

The reverse stock split reduced the number of shares of the Company's common stock currently outstanding from approximately 22 million shares to approximately 4.4 million shares. Proportional adjustments have been made to the conversion and exercise prices of the Company's outstanding convertible preferred stock, warrants, restricted stock awards, convertible notes and stock options, and to the number of shares issued and issuable under the Company's Amended and Restated Stock Incentive Plan. Upon the effectiveness of the 1-for-5 reverse stock split, each five shares of the Company's issued and outstanding common stock were automatically combined and converted into one issued and outstanding share of common stock, par value $0.001. The Company did not issue any fractional shares in connection with the reverse stock split. Instead, fractional share interests were rounded up to the next largest whole share. The reverse stock split does not modify the rights or preferences of the common stock. The number of authorized shares of the Company's common stock remains at 50 million shares and the par value remains $0.001.

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

Liquidity

The Company has incurred operating losses and used cash in its operating activities for the past several years. Cash was used to fund acquisitions, develop new products, and build infrastructure. The Company had issued debt instruments totaling $6 million and was carrying a credit line with its bank for over $2 million. In order improve financial stability, the Company instituted a strategic plan beginning in the second half of fiscal 2015 to significantly reduce debt and operating expenses.

Expense Reductions

Beginning in the second half of fiscal 2015, the Company initiated a restructuring plan that included a reduction of workforce and office space, which significantly reduced operating expenses. The total amount charged to restructuring in fiscal 2015 was $496. In the first three quarters of fiscal 2016, the Company recorded additional restructuring charges of $795 related to additional office leases and workforce reductions.

Debt Restructuring

In June 2016, the Company replaced its Loan and Security Agreement with BridgeBank (the "Bridgebank Agreement") with a new Loan and Security Agreement with Heritage Bank of Commerce ("Heritage Agreement" or "Loan Agreement"). The Heritage Agreement has a term of 24 months and will expire on June 9, 2018. The Heritage Agreement provides for up to $3 million of revolving credit advances which may be used for acquisitions and working capital purposes. Borrowings are limited to the lesser of (i) $3 million and (ii) 75% of eligible receivables as defined. The Company can borrow up to $1.0 million in out of formula borrowings for specified periods of time. Borrowings accrue interest at Wall Street Journal Prime Rate plus 1.75%, currently (5.25%). As of June 30, 2016, the Company had an outstanding balance under the Loan Agreement of $1.8 million, a significant reduction of $500 from the previous quarter and a reduction of $855 from the beginning of the fiscal year.

On April 29, 2016, the shareholders of the Company approved several proposals aimed at restructuring the debt instruments it has issued over the past few years, namely the term notes issued to stockholders and subordinated convertible notes. First, the shareholders approved a proposal for the issuance of up to 4,700,000 shares of the Company's common stock upon conversion of outstanding term notes totaling $3 million. This conversion was completed in May 2016, and the shareholders converted the principal value of their notes plus accrued interest to 4,338,822 shares of common stock.

BRIDGELINE DIGITAL, INC.

NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

Also on April 29, 2016, the stockholders approved the issuance of up to 4,000,000 shares of the Company’s common stock upon conversion of outstanding convertible notes. As an incentive to the holders of such convertible notes to convert the outstanding principal into shares of common stock, the conversion price was reduced from $6.50 per share to $0.75 per share. As of June 30, 2016, a total of $570,000 Convertible Notes were converted to 760,004 shares of common stock. In July 2016, an additional $1.2 million of Convertible Notes converted to 1,624,672 shares of common stock and the remainder of $1.2 million or 1,615,324 shares of common stock converted on August 1, 2016. As such, the Company has presented this debt as long-term in the Condensed Consolidated Balance Sheet.

On April 29, 2016, the stockholders approved the issuance of up to 2,666,667 shares of the Company’s Common Stock upon mandatory conversion of term notes to be issued in a private placement. An aggregate principal amount of up to $2 million in term notes may be offered to accredited investors in a private placement. In the quarter ended June 30, 2016, the Company issued 2,666,685 shares of common stock for net proceeds of $1.6 million in connection with the conversion of these term notes.

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

Management believes that the expense reduction measures, the debt restructuring, the debt conversion to equity, and the additional working capital will provide sufficient cash flow to fund its operations in the ordinary course of business through at least the next twelve months. Management plans to contain operating expenses and remain fiscally responsible, however, there can be no assurances that these financial measures will be sufficient enough to compensate for any shortfalls in revenues. In such case, a further reduction in operating expenses might be needed in order for the Company to generate positive cash flow to sustain the operations of the Company.

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 June 30, 2016 and September 30, 2015, and the interim Condensed Consolidated Statements of Operations, Comprehensive Loss, and Cash Flows for the three and nine months ended June 30, 2016 and 2015 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 with the same instructions to Form 10-Q and Regulation S-X, 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, 2015. 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 June 30, 2016 and September 30, 2015 and its results of operations and cash flows for the three and nine months ended June 30, 2016 and 2015. The results for the three and nine months ended June 30, 2016 are not necessarily indicative of the results to be expected for the year ending September 30, 2016. The accompanying September 30, 2015 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.

Subsequent Events

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

BRIDGELINE DIGITAL, INC.

NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

Recent Accounting Pronouncements

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

In November 2015, the FASB issued ASU 2015-17, Balance Sheet Classification of Deferred Taxes, (the "Update"), which eliminates the current requirement to present deferred tax liabilities and assets as current and noncurrent in a classified balance sheet. Instead, entities will be required to classify all deferred tax assets and liabilities as noncurrent. The Update is effective for financial statements issued for annual periods beginning after December 15, 2016 and interim periods within those annual periods. Management does not expect the adoption of this Update to have a material impact on its consolidated financial position, results of operations or cash flows.

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

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

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

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

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 June 30, 2016	**As of September 30, 2015**
Accounts receivable	$2,213	$ 2,228
Unbilled receivables	28	306
Subtotal	2,241	2,534
Allowance for doubtful accounts	(257)	(71)
Accounts receivable and unbilled receivables, net	$1,984	$ 2,463

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 June 30, 2016 and September 30, 2015 because of their nature and durations. The carrying value of debt instruments also approximates fair value as of June 30, 2016 and September 30, 2015 based on acceptable valuation methodologies which use market data of similar size and situated debt issues.

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

June 30, 2016

	Level 1	Level 2	Level 3	Total
Liabilities:				
Contingent acquisition consideration	-	-	$ 151	$ 151
Total Liabilities	-	-	$ 151	$ 151

	September 30, 2015			
	Level 1	Level 2	Level 3	Total
Liabilities:				
Contingent acquisition consideration	-	-	$ 468	$ 468
Total Liabilities	-	-	$ 468	$ 468

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.

BRIDGELINE DIGITAL, INC.

NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

Changes in the fair value of the contingent consideration liability were as follows:

	Contingent Consideration
Balance, October 1, 2015	$ 468
Payment of contingent consideration	(317)
Balance, June 30, 2016	$ 151

5. Intangible Assets

The components of intangible assets are as follows:

	As of June 30, 2016	As of September 30, 2015
Domain and trade names	$ 10	$ 10
Customer related	533	802
Non-compete agreements	163	216
Balance at end of period	$ 706	$ 1,028

Total amortization expense related to intangible assets for the three months ended June 30, 2016 and 2015 was $108 and $141, respectively, and $322 and $447 for the nine months ended June 30, 2016 and 2015, respectively. Amortization expense related to intangible assets is reflected in operating expenses on the Condensed Consolidated Statements of Operations. The estimated amortization expense for fiscal years 2016 (remaining), 2017, 2018, and 2019 is $108, $335, $242, and $21, respectively.

6. Goodwill

During the fourth quarter of fiscal 2015, the Company recorded a $10.5 million goodwill impairment loss. The Company determined that the most appropriate approach to use to determine the fair value of the reporting unit was the discounted cash flow method. The fair value of our reporting unit pursuant to the discounted cash flow approach was impacted by lower than forecasted revenues, volatility of the Company's common stock, longer sales cycles, and higher operating losses. A comparison to the implied fair value of goodwill to its carrying value resulted in the impairment charge. The Company did not have an impairment charge in the nine months ended June 30, 2016.

7. Restructuring

During the second half of fiscal 2015, the Company's management approved, committed to and initiated plans to restructure and further improve efficiencies by implementing cost reductions in line with the decreases in revenue. The Company renegotiated three office leases and relocated to smaller space, while also negotiating sub-leases for the original space. In addition, the Company executed a general work-force reduction and recognized costs for severance and termination benefits. A total of $16 and $795 was charged to restructuring expenses in the three and nine months ended June 30, 2016. The remaining restructuring liability at June 30, 2016 is $578.

These restructuring charges and accruals require estimates and assumptions, including contractual rental commitments or lease buy-outs for vacated office space and related costs, and estimated sub-lease income. The Company's sub-lease assumptions include the rates to be charged to a sub-tenant and the timing of the sub-lease arrangement. All of the vacated lease space is currently contractually occupied by a new sub-tenant for the remaining life of the lease. These estimates and assumptions will be monitored on a quarterly basis for changes in circumstances with the corresponding adjustments reflected in the consolidated statement of operations.

BRIDGELINE DIGITAL, INC.

NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

The following table summarizes the restructuring accrual activity for the nine months ended June 30, 2016:

	Employee Severence and Benefits	**Facility Related and Other Costs**	**Total**
Balance at beginning of period, October 1, 2015	$ -	$ 307	$307
Charges to operations	505	-	505
Cash disbursements	-	(68)	(68)
Changes in estimates	-	-	-
Balance at end of period, December 31, 2015	$ 505	$ 239	$744
Charges to operations	-	158	158
Cash disbursements	(110)	(54)	(164)
Changes in estimates	-	-	-
Balance at end of period, March 31, 2016	$ 395	$ 343	$738
Charges to operations	-	-	-
Cash disbursements	(101)	(59)	(160)
Changes in estimates	-	-	-
Balance at end of period, June 30, 2016	$ 294	$ 284	$578

As of June 30, 2016, $407 was reflected in Accrued Liabilities and $171 in Other Long Term Liabilities in the Condensed Consolidated Balance Sheet. As of September 30, 2015, $114 was reflected in Accrued Liabilities and $193 in Other Long Term Liabilities in the Condensed Consolidated Balance Sheet.

8. Debt

Debt consists of the following:

	As of June 30, 2016	**As of September 30, 2015**
Line of credit borrowings	$1,840	$ 2,695
Bank term loan	-	250
Subordinated convertible debt	2,430	3,000
Term note from shareholder	-	2,000
Subtotal debt	$4,270	$ 7,945
Other (debt warrants)	$-	$ (158)
Total debt	$4,270	$ 7,787
Less current portion	$-	$ 92
Long term debt, net of current portion	$4,270	$ 7,695

Line of Credit and Bank Term Loan

In June 2016, the Company replaced its Loan and Security Agreement with BridgeBank (the "Bridgebank Agreement") with a new Loan and Security Agreement with Heritage Bank of Commerce ("Heritage Agreement" or "Loan Agreement"). The Heritage Agreement has a term of 24 months and will expire on June 9, 2018. The Heritage Agreement provides for up to $3 million of revolving credit advances which may be used for acquisitions and working capital purposes. Borrowings are limited to the lesser of (i) $3 million and (ii) 75% of eligible receivables as defined. The Company can borrow up to $1.0 million in out of formula borrowings for specified periods of time. Borrowings accrue interest at Wall Street Journal Prime Rate plus 1.75%, currently (5.25%). The Company will pay an annual commitment fee of 0.4% of the commitment amount in the first year and 0.2% in the second year. Borrowings are secured by all of the Company's assets and all of the Company's intellectual property. The Company will be required to comply with certain financial and reporting covenants including an Asset Coverage Ratio and an Adjusted EBITDA metric. The Company was not in compliance with the Adjusted EBITDA financial reporting covenant for the period ended June 30, 2016, but has received a waiver from the bank. The First Amendment also includes a decrease in the revolving line of credit to $2.5 million, a minimum cash requirement of $500 in its accounts at Heritage, and a revision for the Adjusted EBITDA metric for the quarter ended September 30, 2016. As of June 30, 2016, the Company had an outstanding balance under the Loan Agreement of $1.8 million.

BRIDGELINE DIGITAL, INC.

NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

Similar to the Bridgebank Agreement, a Director and Shareholder of the Company, Michael Taglich, signed an unconditional guaranty (the "Guaranty") and promise to pay the Heritage all indebtedness in an amount not to exceed $2 million in connection with the out of formula borrowings. Under the terms of the Guaranty, the Guarantor authorizes Lender, without notice or demand and without affecting its liability hereunder, from time to time to: (a) renew, compromise, extend, accelerate, or otherwise change the time for payment, or otherwise change the terms, of the Indebtedness or any part thereof, including increase or decrease of the rate of interest thereon, or otherwise change the terms of the Indebtedness; (b) receive and hold security for the payment of this Guaranty or any Indebtedness and exchange, enforce, waive, release, fail to perfect, sell, or otherwise dispose of any such security; (c) apply such security and direct the order or manner of sale thereof as Lender in its discretion may determine; and (d) release or substitute any Guarantor or any one or more of any endorsers or other guarantors of any of the Indebtedness.

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

The Bridgebank Agreement had an original term of 27 months and was extended to a maturity date of March 31, 2017. The Bridgebank Agreement provided for up to $5 million of revolving credit advances which could be used for acquisitions and working capital purposes. Borrowings were limited to the lesser of (i) $5 million and (ii) 80% of eligible receivables as defined. The Company could borrow up to $1.0 million in out of formula borrowings for specified periods of time. Borrowings accrued interest at BridgeBank's prime plus 1.00% (4.25%) through June 1, 2015 and then increased to prime plus 5.00% (8.25%) in accordance with an amendment to the Loan and Security Agreement (see below). The prime rate increased to 3.50% on December 17, 2015. The Company paid an annual commitment fee of 0.25%. Borrowings were secured by all of the Company's assets and all of the Company's intellectual property. The Company was also required to comply with certain financial and reporting covenants including an Asset Coverage Ratio.

In December 2014, the Company signed an Amendment to its Loan and Security Agreement with BridgeBank (the "Amendment"). As part of the Amendment Mr. Michael Taglich, a member of the Board of Directors, signed an unconditional guaranty (the "Guaranty") and promise to pay the Company's lender, BridgeBank, 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. In July 2015, the Company further amended its Loan and Security Agreement with BridgeBank which further extended the Guaranty from Mr. Taglich to an amount not to exceed $2 million in connection with the out of formula borrowings.

At September 30, 2015, the Company had an outstanding short term bank term loan with BridgeBank of $250 which was repaid in October 2015.

Term Notes from Shareholders

The Company issued term notes to Michael Taglich and Robert Taglich, both of whom are shareholders and directors of the Company. Term notes totaling $2.45 million were issued to Michael Taglich from the period of January 7, 2015 through February 2016. Term notes totaling $450 were issued to Robert Taglich on December 3, 2015 and February 2016. Also, in February 2016, Bridgeline issued a Term Note to Roger Kahn to document a loan for $100. Mr. Kahn was appointed the President and Chief Executive Officer of the Company on May 10, 2016.

BRIDGELINE DIGITAL, INC.

NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

On April 29, 2016, the shareholders of the Company approved the proposal for the issuance of up to 4,700,000 shares of the Company’s common stock upon conversion of the above outstanding term notes totaling $3 million. In May 2016, each of the holders of the outstanding term notes converted all outstanding principal and accrued but unpaid interest due under such outstanding term notes into shares of common stock of the Company at a conversion price of $0.75 per share. In connection with the conversion, a total of 4,338,822 shares of common stock was issued. Michael Taglich received 3,576,045 shares of common stock, Robert Taglich received 626,599 shares of common stock and Roger Kahn received 136,178 shares of common stock. The Taglich Brothers, Inc acted as the Placement Agent for the conversion of these notes and will be granted warrants to purchase 433,883 shares of common stock at a price of $0.75 per share. These warrants were not issued as of June 30, 2016.

Subordinated Convertible Debt

On September 30, 2013 and November 6, 2013, Bridgeline Digital entered into Note Purchase Agreements with accredited investors pursuant to which Bridgeline Digital sold an aggregate of $3.0 million of secured subordinated convertible notes (the "Convertible Notes"). The Convertible Notes are convertible at the election of the holder into shares of common stock of Bridgeline Digital at a conversion price equal to $6.50 per share at any time prior to the maturity date, provided that no holder may convert the Convertible 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 Convertible Notes mature on March 1, 2017 and interest accrues at 11.5%.

On April 29, 2016, the shareholders of the Company approved a proposal for issuance of up to 4,000,000 shares of the Company’s Common Stock upon conversion of the outstanding Convertible Notes with a new conversion price of $0.75. The conversion price to $0.75 per share was provided as an incentive to the holders of such Convertible Notes to convert the outstanding principal into shares of Common Stock. As of June 30, 2016, a total of $570,000 Convertible Notes were converted to 760,004 shares of common stock. In July 2016, an additional $1.2 million of Convertible Notes converted to 1,624,672 shares of common stock. The remaining principal balance of $1.2 million Convertible Notes was converted to 1,615,324 shares of common stock on August 1, 2016. Due to the reduction in the conversion price from $6.50 per share to $0.75 per share, the Company recorded an inducement charge of $726 in the three and nine months ended June 30, 2016. The charge was recorded as a non-operating expense in the Condensed Consolidated Income Statement with a corresponding credit to additional paid in capital. The total expense to be recorded in connection with the inducement to convert will be $3.4 million.

9. Other Long Term Liabilities

Deferred Rent

In connection with the leases in Massachusetts, New York, and in 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 Sheets. As of June 30, 2016, $169 was reflected in Accrued Liabilities and $311 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.

BRIDGELINE DIGITAL, INC.

NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

10. 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 $3.25, and is subject to adjustment in the event of stock splits or stock dividends. Any accrued but unpaid dividends on the shares of Preferred Stock to be converted shall also be converted in common stock at the conversion price. A mandatory provision also may provide that the Company will have the right to require the holders to convert shares of Preferred Stock into Conversion Shares if (i) the Company's common stock has closed at or above $6.50 per share for ten consecutive trading days and (ii) the Conversion Shares are (A) registered for resale on an effective registration statement or (B) may be resold pursuant to Rule 144.

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 on an as converted basis.

As of June 30, 2016, the Company has issued 17,812 preferred convertible shares (PIK shares) to the preferred shareholders of which 9,590 have been issued in fiscal 2016. The Company elected to declare a PIK dividend for the next quarterly payment due July 1, 2016. The total PIK dividend declared for July 1, 2016 is 3,280 preferred stock shares.

Common Stock

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

On February 24, 2016, the Company issued 107,692 shares of restricted common stock at $0.91 to four members of its Board of Directors in lieu of cash payments for their services as board members. The shares vest in equal installments on a monthly basis through the end of the service period of September 30, 2016. The aggregate fair value of the shares is $98 and is being expensed over the service period. The amount of expense recognized as of June 30, 2016 is $74.

On May 11, 2016, the Company issued 1,806,680 shares of common stock for net proceeds of $1.2 million for the first closing in connection with the conversion of term notes issued to accredited investors, as approved by the shareholders on April 29, 2016. On June 10, 2016, the Company issued an additional 860,005 shares of common stock for net proceeds of $400 for the second closing in connection with the conversion of these term notes. There are no plans to register the common stock issued in these offerings, 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.

On May 17, 2016, each of Michael Taglich, Robert Taglich, and Roger Kahn, holders of outstanding term notes, converted all outstanding principal and accrued but unpaid interest due under such outstanding term notes into shares of Common Stock of the Company at a conversion price of $0.75 per share. In connection with the conversion, a total of 4,338,822 shares of common stock were issued. (See Term Notes from Shareholders.)

BRIDGELINE DIGITAL, INC.

NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

In July 2016, the Company sold 2,200,000 shares of common stock at $0.75 per share for gross proceeds of $1.7 million in a private placement. Net proceeds to the Company after offering expenses were approximately $1.5 million. 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 105,288 common shares to the sellers of ElementsLocal. In addition, contingent consideration not to exceed 67,693 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 June 30, 2016, the stockholders of ElementsLocal earned 62,051 shares of common stock, of which 16,923 were issued during the nine months ended June 30, 2016. There are 5,642 shares remaining for potential earnout distribution.

Amended and Restated Stock Incentive Plan

Effective August 2015, the Company's Amended and Restated Stock Incentive Plan (the "Plan") provides for the issuance of up 1,250,000 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 684,930 options outstanding reserved under the Plan as of June 30, 2016 and 565,070 shares available for future issuance. This Plan expires in August 2016. On April 29, 2016, the stockholders approved a new plan, The 2016 Stock Incentive Plan. Initially, a total of 2,500,000 shares of the Company's Common Stock will be reserved for issuance under this new plan. There were no issuances under this plan as it is not effective until August 2016.

Common Stock Warrants

As of June 30, 2016: (i) placement agent warrants to purchase 43,479, 138,000, 46,155, 64,000, and 61,539 shares at an exercise price of $7.00, $6.25, $6.50, $5.25 and $3.25, respectively are outstanding; and (ii) investor shareholder warrants to purchase 210,000 and 160,000 shares at an exercise price of $4.00 and $1.75 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, 2015	875,977	$ 0.98	703,281	$ 4.38
Granted	129,000	$ 1.14	30,000	$ 4.00
Exercised	-	$ -	-	-
Forfeited or expired	(320,047)	$ 3.96	(10,108)	7.50
Outstanding, June 30, 2016	684,930	$ 3.07	723,173	$ 4.50

BRIDGELINE DIGITAL, INC.

NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

11. Accumulated Other Comprehensive Loss

Changes in accumulated other comprehensive loss were as follows:

	Accumulated Other Comprehensive Loss
Balance, October 1, 2015	$ (356)
Foreign currency translation adjustment	1
Balance, December 31, 2015	$ (355)
Foreign currency translation adjustment	1
Balance, March 31, 2016	$ (354)
Foreign currency translation adjustment	1
Balance, June 30, 2016	$ (353)

12. Net Loss Per Share

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

	Three Months Ended June 30,	Nine Months Ended June 30,

(in thousands, except per share data)	**2016**	**2015**	**2016**	**2015**
Net loss	$(2,032)	$(1,110)	$(4,385)	$(5,293)
Accrued dividends on convertible preferred stock	(33)	(31)	(97)	(82)
Net loss applicable to common shareholders	$(2,065)	$(1,141)	$(4,482)	$(5,375)
Weighted average common shares outstanding - basic	10,015	4,348	6,835	4,321
Effect of dilutive securities	-	-	-	-
Weighted average common shares outstanding - diluted	10,015	4,348	6,835	4,321
Net loss per share attributable to common shareholders:				
Basic and diluted	$(0.21)	$(0.26)	$(0.66)	$(1.24)

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 and nine months ended June 30, 2016, there were no options to purchase shares of the Company’s common stock considered as dilutive, as the options were all valued at less than the current market price. Warrants to purchase 723,281 shares of common stock and contingent shares to be issued in connection with prior acquisitions of 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.

BRIDGELINE DIGITAL, INC.

NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

For the three and nine months ended June 30, 2015, 196,416 and 394,506 options 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 703,281 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.

13. Income Taxes

Income tax expense was $8 and $25 for the three months ended June 30, 2016 and 2015 and $46 and $88 for the nine months ended June 30, 2016 and 2015. 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.

14. Related Party Transactions

In October 2013, Mr. Michael Taglich joined the Board of Directors. Michael Taglich is the Chairman and President of Taglich Brothers, Inc. a New York based securities firm. Michael Taglich beneficially owns approximately 23% of Bridgeline stock. Michael Taglich has also guaranteed $2 million in connection with the Company's out of formula borrowings on its credit facility with Heritage Bank.

In consideration of previous loans by Michael Taglich and a personal guaranty delivered by Michael Taglich to BridgeBank, 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 60,000 shares of Common Stock of the Company at a price equal to $4.00 per share. 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 30,000 shares of common stock, which warrant shall contain the same terms as the warrant issued to Michael Taglich on January 7, 2015. Since the Guaranty did remain outstanding for a period of more than 12 months, a warrant to purchase 30,000 shares of common stock was issued to Michael Taglich in January 2016 at a price of $4.00.

Mr. Taglich was also issued warrants in connection with the first four term notes. He was issued 120,000 at an exercise price of $4.00 in conjunction with the second and third Notes and 160,000 at an exercise price of $1.75 in connection with the fourth Note. The warrants have a term of five years and are 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 warrants. The fair value of the warrants issued to Mr. Taglich in connection with all of the Term Notes is $270 which was reflected as a debt discount in current liabilities with the offsetting amount recorded to additional paid in capital in the Consolidated Balance Sheet. The fair market value of the warrants was being amortized on a straight-line basis over their expected life, however, the Company converted these term notes in May 2016 and thus the warrants are fully amortized. Amortization expense of $63 and $158 was recorded in the three and nine months ended June 30, 2016.

In November 2015, the Company entered into a consulting agreement with Robert Taglich, also of Taglich Brothers, Inc. Robert Taglich is a shareholder and director of the Company and beneficially owns approximately 7% of Bridgeline stock. The consulting services may include assistance with strategic planning and other matters as requested by management or the Board of Directors of the Company. The term of the Consulting Agreement is twelve months. As compensation for his services, Robert Taglich was granted 15,000 options to purchase the Company's common stock at a price of $1.21. The fair value of the options at the time of grant was $0.83 per share. On May 10, 2016, Robert Taglich was appointed to the Company's Board of Directors.

In connection with the equity conversion of the $3 million in Term Notes from Shareholders that was completed in May 2016, the Taglich Brothers, Inc will be granted Placement Agent warrants to purchase 433,883 shares of common stock at a price of $0.75 per share. These warrants were not issued as of June 30, 2016.

The Company also has an annual service contract for $18 with Taglich Brothers, Inc to perform market research.

15. Legal Proceedings

The Company is subject to ordinary routine litigation and claims incidental to its business. As of June 30, 2016 the Company was not engaged with any material legal proceedings.

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, 2015 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™, helps customers maximize the performance of their full digital experience from - websites and intranets to online stores and campaigns. Bridgeline's iAPPS® platform deeply integrates Web Content Management, eCommerce, eMarketing, Social Media management, and Web Analytics to help marketers deliver digital experiences that attract, engage and convert their customers across all channels. Bridgeline's iAPPS platform combined with its digital services assists customers in maximizing on-line revenue, improving customer service and loyalty, enhancing employee knowledge, and reducing operational costs. The iAPPSds ("distributed subscription") product is a platform that empowers franchise and large dealer networks with state-of-the-art web engagement management while providing superior oversight of corporate branding. iAPPSds deeply integrates content management, eCommerce, eMarketing and web analytics and is a self-service web platform that is offered to each authorized franchise or dealer for a monthly subscription fee. Our iAPPSdsr platform, released in 2015, targets the growing multi-unit organizations with 10-500 locations providing them with powerful web engagement tools while maintaining corporate brand control and consistency.

The iAPPS Platform is an award-winning application. Our teams of Microsoft Gold© certified developers have won over 100 industry related awards. In 2015, the SIIA (Software and Information Industry Association) awarded iAPPS Content Manager, the 2015 SIIA CODiE Award for Best Web Content Management Platform. Also in 2015, *EContent* magazine named iAPPS Digital Engagement Platform to its Trendsetting Products list. The list of 75 products and platforms was compiled by EContent's editorial staff, and selections were based on each offering's uniqueness and importance to digital publishing, media, and marketing. Bridgeline was also recognized in 2015 as a strong performer by Forrester Research, Inc in its independence report, "The Forrester Wave ™: Through-Channel Marketing Automation Platforms, Q3 2015." In recent years, 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 2015, the SIIA (Software and Information Industry Association) awarded iAPPS Content Manager the 2015 SIIA CODiE Award for Best Web Content Management Platform. 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.

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.

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

Locations

The Company’s corporate office is located north of Boston, Massachusetts. The Company maintains regional field offices serving the following geographical locations: Boston, MA; Chicago, IL; Denver, CO; San Luis Obispo, CA; and Tampa, FL. The Company has a wholly-owned subsidiary, Bridgeline Digital Pvt. Ltd. located in Bangalore, India.

Customer Information

We currently have over 3,000 customers, the majority of which are iAPPSds customers who pay a monthly subscription fee. For the three and nine months ended June 30, 2016 and 2015 no customer represented 10% or more of total revenue.

Results of Operations for the Three and Nine Months Ended June 30, 2016 compared to the Three and Nine Months Ended June 30, 2015

Total revenue for the three months ended June 30, 2016 was $3.7 million compared with $4.9 million for the three months ended June 30, 2015. We had a net loss of ($2.0) million for the three months ended June 30, 2016 compared with net loss of ($1.1) million for the three months ended June 30, 2015. Net loss per share applicable to common shareholders was ($0.21) for the three months ended June 30, 2016 and ($0.26) for the three months ended June 30, 2015.

Total revenue for the nine months ended June 30, 2016 was $12.2 million compared with $14.7 million for the nine months ended June 30, 2015. We had a net loss of ($4.4) million for the nine months ended June 30, 2016 compared with net loss of ($5.3) thousand for the nine months ended June 30, 2015. Net loss per share was ($0.66) for the nine months ended June 30, 2016 and ($1.24) for the nine months ended June 30, 2015.

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	**Three Months Ended**	**$ Change**	**% Change**	**Nine Months Ended**	**Nine Months Ended**	**$ Change**	**% Change**

	June 30, 2016	June 30, 2015			June 30, 2016	June 30, 2015		
iAPPS digital enagement services	**$ 1,849**	**$ 2,956**	**(1,107)**	**(37%)**	**$ 6,611**	**$ 9,227**	**(2,616)**	**(28%)**
% of total net revenue	*50 %*	*61 %*			*54 %*	*63 %*		
Subscription and perpetual licenses	**1,530**	**1,505**	**25**	**2 %**	**4,575**	**4,260**	**315**	**7 %**
% of total net revenue	*41 %*	*31 %*			*38 %*	*29 %*		
Managed service hosting	**317**	**415**	**(98)**	**(24%)**	**985**	**1,188**	**(203)**	**(17%)**
% of total net revenue	*9 %*	*9 %*			*8 %*	*8 %*		
Total net revenue	**$ 3,696**	**$ 4,876**	**$ (1,180)**	**(24%)**	**$ 12,171**	**$ 14,675**	**$ (2,504)**	**(17%)**

Digital Engagement Services

Digital engagement services revenue is comprised of iAPPS digital engagement related services. In total, revenue from digital engagement services decreased $1.1 million, or 37%, to $1.8 million for the three months ended June 30, 2016 compared to $3.0 million for the three months ended June 30, 2015. The decrease in iAPPS digital engagements services is a result of a decrease in new iAPPS implementations. Digital engagement services revenue as a percentage of total revenue decreased to 50% from 61% for the three months ended June 30, 2016 compared to the prior period. The decrease is attributable to the decreases in iAPPS and non-iAPPS digital engagement services revenue.

Revenue from iAPPS digital engagement services decreased $2.6 million, or 28% to $6.6 million for the nine months ended June 30, 2016 compared to $9.2 million for the nine months ended June 30, 2015. The decrease in iAPPS digital engagements services is a result of a decrease in new iAPPS implementations. Digital engagement services revenue as a percentage of total revenue decreased to 54% from 63% for the nine months ended June 30, 2016 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 increased $25 thousand, or 2%, to $1.5 million for the three months ended June 30, 2016 compared to $1.5 million for the three months ended June 30, 2015. The increase is primarily due to an increase in iAPPS SaaS subscription revenue as we launched new sites in the quarter. Subscription and perpetual license revenue as a percentage of total revenue increased to 41% for the three months ended June 30, 2016 from 31% compared to the three months ended June 30, 2015. The increase as a percentage of revenues is attributable to the decreases in iAPPS digital engagement services revenues.

Revenue from subscription and perpetual licenses increased $315 thousand, or 7%, to $4.6 million for the nine months ended June 30, 2016 compared to $4.3 million for the nine months ended June 30, 2015. Subscription and perpetual license revenue as a percentage of total revenue increased to 38% for the nine months ended June 30, 2016 from 29% compared to the nine months ended June 30, 2015. The increase is primarily due to an increase in iAPPS SaaS subscription revenue as we have launched several new websites through the year. 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 decreased $98 thousand, or 24%, to $317 thousand for the three months ended June 30, 2016 compared to $415 thousand for the three months ended June 30, 2015. The decrease is due to a decrease in revenue from non-iAPPS related customers from previous acquisitions. Managed services revenue as a percentage of total revenue remained flat at 9% for both periods.

Revenue from managed service hosting decreased $203 thousand, or 17%, to $985 thousand for the nine months ended June 30, 2016 compared to $1.2 million for the nine months ended June 30, 2015. The decrease is due to a decrease in revenue from non-iAPPS related customers from previous acquisitions. Managed services revenue as a percentage of total revenue remained flat at 8% for both periods.

Costs of Revenue

Total cost of revenue decreased $975 thousand to $1.7 million for the three months ended June 30, 2016 compared to $2.7 million for the three months ended June 30, 2015. The gross profit margin improved to 54% for the three months ended June 30, 2016 compared to 45% for the three months ended June 30, 2015. The decrease in costs and improvement in the gross profit margin for the three months ended June 30, 2016 compared to the three months ended

June 30, 2015 is attributable to aligning labor costs with expected revenues and on our focus on reducing our facility and overhead costs.

Total cost of revenue decreased $3.0 million to $5.8 million for the nine months ended June 30, 2016 compared to $8.8 million for the nine months ended June 30, 2015. The gross profit margin improved to 53% for the nine months ended June 30, 2016 compared to 40% for the nine months ended June 30, 2015. The decrease in costs and improvement in the gross profit margin for the nine months ended June 30, 2016 compared to the nine months ended June 30, 2015 is attributable to aligning labor costs with expected revenues and on our focus on reducing our facility and overhead costs.

Cost of revenue:	**Three Months Ended** June 30, 2016	**Three Months Ended** June 30, 2015	**$ Change**	**% Change**	**Nine Months Ended June 30, 2016**	**Nine Months Ended June 30, 2015**	**$ Change**	**% Change**
iAPPS digital engagement costs	**1,221**	**2,114**	**(893)**	**(42%)**	**4,111**	**7,190**	**(3,079)**	**(43%)**
% of iAPPS digital engagement services revenue	*66 %*	*72 %*			*62 %*	*78 %*		
Subscription and perpetual licenses	**391**	**473**	**(82)**	**(17%)**	**1,423**	**1,366**	**57**	**4 %**
% of subscription and perpetual revenue	*26 %*	*31 %*			*31 %*	*32 %*		
Managed service hosting	**76**	**76**	**-**	**0 %**	**232**	**224**	**8**	**4 %**
% of managed service hosting revenue	*24 %*	*18 %*			*24 %*	*19 %*		
Total cost of revenue	1,688	2,663	(975)	(37%)	5,766	8,780	(3,014)	(34%)
Gross profit	**$ 2,008**	**$ 2,213**	**$ (205)**	(9%)	**$ 6,405**	**$ 5,895**	**$ 510**	9 %
Gross profit margin	***54 %***	***45 %***			***53 %***	***40 %***		

Cost of Digital Engagement Services

Cost of digital engagement services decreased $893 thousand, or 42%, to $1.2 million for the three months ended June 30, 2016 compared to $2.1 million for the three months ended June 30, 2015. The cost of digital engagement services as a percentage of digital engagement services revenue decreased to 66% from 72% compared to the three months ended June 30, 2015. The decreases are due to a decrease in labor in line with the decreases in revenues, as well as efforts to reduce facility costs and overhead.

Cost of digital engagement services decreased $3.1 million, or 43%, to $4.1 million for the nine months ended June 30, 2016 compared to $7.2 million for the nine months ended June 30, 2015. The cost of digital engagement services as a percentage of digital engagement services revenue decreased to 62% from 78% compared to the nine months ended June 30, 2015. The decreases are due to a decrease in labor in line with the decreases in revenues, as well as efforts to reduce facility costs and overhead.

Cost of Subscription and Perpetual License

Cost of subscription and perpetual licenses decreased $82 thousand, or 17%, to $391 thousand for the three months ended June 30, 2016 compared to $473 thousand for the three months ended June 30, 2015. The cost of subscription and perpetual licenses as a percentage of subscription and perpetual license revenue decreased to 26% from 31% compared to the three months ended June 30, 2015. The decreases are due to the cessation of amortization costs related to the capitalization of software partially offset by fixed costs to support our network operations center.

Cost of subscription and perpetual licenses increased $57 thousand, or 4%, to $1.4 million for the nine months ended June 30, 2016 compared to $1.4 million for the nine months ended June 30, 2015. The cost of subscription and perpetual licenses as a percentage of subscription and perpetual license revenue decreased to 31% from 32% compared to the nine months ended June 30, 2015. The increases are due to fixed costs to support our network operations center.

Cost of Managed Service Hosting

Cost of managed service hosting remained flat for the three and nine months ended June 30, 2016 compared to the three and nine months ended June 30, 2015. The cost of managed services as a percentage of managed services revenue increased to 24% from 18% compared to the three months ended June 30, 2015 and increased to 24% from 19% for the nine months compared to the three months ended June 30, 2015. The percentage increases are attributable to maintaining a certain level of fixed costs to support the network operations center.

Operating Expenses

Operating expenses:	Three Months Ended June 30, 2016	Three Months Ended June 30, 2015	$ Change	% Change	Nine Months Ended June 30, 2016	Nine Months Ended June 30, 2015	$ Change	% Change
Sales and marketing	1,212	1,245	(33)	(3%)	3,528	4,590	(1,062)	(23%)
% of total revenue	*33%*	*34%*			*29%*	*31%*		
General and administrative	1,035	980	55	6%	2,660	3,110	(450)	(14%)
% of total revenue	*28%*	*27%*			*22%*	*21%*		
Research and development	428	373	55	15%	1,145	1,442	(297)	(21%)
% of total revenue	*12%*	*10%*			*9%*	*10%*		
Depreciation and amortization	328	422	(94)	(22%)	1,023	1,315	(292)	(22%)
% of total revenue	*9%*	*11%*			*8%*	*9%*		
Restructuring charges	16	-	16	194%	795	-	795	780%
% of total revenue	*0%*	*0%*			*7%*	*0%*		
Total operating expenses	**3,019**	**3,020**	**(1)**	**(0%)**	**9,151**	**10,457**	**(1,306)**	**(12%)**

Sales and Marketing Expenses

Sales and marketing expenses decreased $33 thousand to $1.2 million, or 3%, for the three months ended June 30, 2016 compared to $1.2 million for the three months ended June 30, 2015 and decreased 23% to $3.5 million for the three months ended June, 2016 compared to $4.6 million for the nine months ended June 30, 2015. Sales and marketing expenses represented 33% and 34% of total revenue for the three months ended June 30, 2016 and 2015, respectively, and 29% and 31% of total revenue for the nine months ended June 30, 2016 and 2015, respectively. The decreases for the three and nine months ended June 30, 2016 compared to the prior periods is primarily attributable to decreases in headcount and facility costs.

General and Administrative Expenses

General and administrative expenses increased $55 thousand, or 6%, to $1.1 million for the three months ended June 30, 2016 compared to $980 thousand for the three months ended June 30, 2015 and decreased $450 thousand, or 14%, to $2.7 million for the nine months ended June 30, 2016 compared to $3.1 million for the nine months ended June 30, 2015. The increase for the three months ended June 30, 2016 compared to the three months ended June 30, 2016 is due to provisions for reserves for bad debt allowances of $186 thousand. General and administrative expenses represented 28% and 27% of total revenue for the three months ended June 30, 2016 and 2015, respectively, and 22% and 21% of total revenue for the nine months ended June 30, 2016 and 2015, respectively. The decrease in the nine months ended June 30, 2016 compared to the nine months ended June 30, 2015 is due to decreases in headcount and facility costs and a decrease in travel related expenditures

Research and Development

Research and development expenses increased by $55 thousand, or 15%, to $428 thousand for the three months ended June 30, 2016 compared to $373 thousand for the three months ended June 30, 2015 and decreased $297 thousand, or 21% to $1.1 million for the nine months ended June 30, 2016 compared to $1.4 million for the nine months ended June 30, 2015. The increase in research and development expense for the three months ended June 30, 2016 compared to the three months ended June 30, 2015 is due to an increase in personnel costs.

Research and development expenses represented 12% and 10% of total revenue for the three months ended June 30, 2016 and 2015, respectively, and 9% and 10% of total revenue for both the nine months ended June 30, 2016 and 2015. The decrease in expense for the nine months ended June 30, 2016 compared to the nine months ended June 30, 2015 is due to overall decrease in headcount and facility costs.

Depreciation and Amortization

Depreciation and amortization expense decreased $94 thousand, or 22%, to $328 thousand for the three months ended June 30, 2016 compared to $422 thousand for the three months ended June 30, 2015. Equipment related depreciation and amortization related to leasehold improvements declined due to retirements and assets reaching their expected useful lives. Depreciation and amortization represented 9% and 11% of revenue for the three months ended June 30, 2016 and 2015.

Depreciation and amortization decreased $292 thousand, or 22%, to $1.0 million for the nine months ended June 30, 2016 compared to $1.3 million for the nine months ended June 30, 2015. Equipment related depreciation and amortization related to leasehold improvements declined due to retirements and assets reaching their expected useful lives. Depreciation and amortization represented 8% and 9% of revenue for the nine months ended June 30, 2016 and 2015, respectively.

Restructuring Expenses

During the second half of fiscal 2015, the Company's management approved, committed to and initiated plans to restructure and further improve efficiencies by implementing cost reductions in line with current revenue expectations. The Company has renegotiated several offices leases and relocated to smaller space, while also negotiating sub-leases for the original space, as well as restructured its workforce. In the three months ended June 30, 2016, one more office lease was renegotiated. The total charged to restructuring for the three and nine months ended June 30, 2016 was $16 thousand and $795 thousand, respectively. The total liability at June 30, 2016 is $578 thousand.

Net Loss

	Three Months Ended	**Three Months Ended**	**$ Change**	**% Change**	**Nine Months Ended**	**Nine Months Ended**	**$ Change**	**% Change**

	June 30, 2016	June 30, 2015			**June 30,** 2016	**June 30,** 2015		
Loss from operations	(1,011)	(807)	(204)	25%	(2,746)	(4,562)	1,816	(40%)
Interest income (expense) net	(287)	(278)	(9)	3%	(867)	(643)	(224)	35%
Loss on inducement of convertible notes	(726)	-	(726)	100%	(726)	-	(726)	100%
Loss before income taxes	(2,024)	(1,085)	(939)	87%	(4,339)	(5,205)	866	(17%)
Provision for income taxes	8	25	(17)	(68%)	46	88	(42)	(48%)
Net loss	**$(2,032)**	**$(1,110)**	**$(922)**	83%	**$(4,385)**	**$(5,293)**	**$908**	(17%)
Non-GAAP Measure:								
Adjusted EBITDA	**$(575)**	**$(190)**	**$(385)**	203%	**$(484)**	**$(2,646)**	**$2,162**	(82%)

Loss from operations

The loss from operations was ($1.0) million for three months ended June 30, 2016, compared to a loss of ($807) thousand in the prior period and a loss of ($2.7) million for the nine months ended June 30, 2016 compared to ($4.6) million for the prior year. The improvements period over period are attributable to improvements in gross margin and a decrease in overall operating expenses, as we streamlined costs in line with the expected revenues.

Loss from inducement of convertible notes

In the three and nine months ended June 30, 2016, we recognized an inducement charge of ($726) thousand on the conversion of convertible notes due to a reduction in the conversion price from $6.50 per share to $0.75 per share. We will record an additional charge of $2.7 million in the fourth quarter of fiscal 2016 related to the remainder of the conversions.

Income Taxes

The provision for income tax expense was $8 thousand and $25 thousand for the three months ended June 30, 2016 and 2015, respectively, and $46 thousand and $88 thousand for the nine months ended June 30, 2016 and 2015, respectively. Income tax expense represents the estimated liability for federal and state income taxes owed, including the alternative minimum tax, as well as income taxes for our subsidiary in India. We have net operating loss carryforwards and other deferred tax benefits that are available to offset future taxable income.

27

Adjusted EBITDA

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

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

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

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

	Three Months Ended		**Nine Months Ended**	
	June 30,		**June 30,**	
	2016	**2015**	**2016**	**2015**
Net loss	$(2,032)	$(1,110)	$(4,385)	$(5,293)
Provision for income tax	8	25	46	88
Interest expense, net	287	220	867	585
Loss on inducement of convertible notes	726	-	726	-

Amortization of intangible assets	108	141	323	447
Depreciation	169	258	608	814
Restructuring charges	16	-	795	-
Loss on disposal of fixed assets	-	58	-	58
Other amortization	68	137	328	411
Stock based compensation	75	81	208	244
Adjusted EBITDA	$(575)	$(190)	$(484)	$(2,646)

The decrease in Adjusted EBITDA for the three months ended June 30, 2016 compared to the three months ended June 30, 2015 is attributable to the decrease in gross profits. The increase in Adjusted EBITDA for the nine months ended June 30, 2016 compared to the nine months ended June 30, 2015 is primarily due to the improvement in gross profit margin and the decrease in operating expenses, as we have aligned our expenses with our expected revenues.

Liquidity and Capital Resources

Cash Flows

Operating Activities

Cash used in operating activities was $1.5 million for the nine months ended June 30, 2016 compared to cash used in operating activities of $2.6 million for the nine months ended June 30, 2015. This decrease in the use of cash compared to the prior period was primarily to the adjustments for non-cash items such as amortization and depreciation for the period and the decrease in net loss for the period.

Investing Activities

Cash used in investing activities was $128 thousand for the nine months ended June 30, 2016 compared to $102 thousand for the nine months ended June 30, 2015. In the nine months ended June 30, 2016, we capitalized $104 thousand of costs related to iAPPS software development.

Financing Activities

Cash provided by financing activities was $1.5 million for the nine months ended June 30, 2016 compared to $2.1 million for the nine months ended June 30, 2015. Cash provided by financing activities for the nine months ended June 30, 2016 is primarily attributable to a sale of 680,000 shares of common stock in October 2015, which raised a net $669 thousand in funds, and the sale and conversion of $2 million of term notes in May and June 2016, which netted proceeds of $1.6 million. Also, during the nine months ended June 30, 2016, we received $1 million in term notes from Michael Taglich, Robert Taglich and Roger Kahn for term notes with maturity dates of March 2017, and a short term loan from BridgeBank of $500 thousand. Offsetting these proceeds, were net borrowings/payments of $963 thousand on the BridgeBank line of credit, $750 thousand on a short term loan from BridgeBank, and contingent acquisition payments of $317 thousand.

Capital Resources and Liquidity Outlook

We have made several measures intended to improve the financial viability of the Company. Beginning in the second half of fiscal 2015, we initiated a restructuring plan that included a reduction of workforce and office space, which significantly reduced operating expenses. The restructuring plan has continued through June 2016, with a total of $795 charged to restructuring expense in the nine months ended June 30, 2016.

In conjunction with the cost reductions, on April 29, 2016, the shareholders of the Company approved several proposals for the issuance of shares of the Company's common stock for purposes of converting outstanding debt to equity. In the quarter ended June 30, 2016, we converted $3.8 million of term notes and convertible notes to 5 million shares of common stock. The remaining convertible note debt of $2.4 million was converted into common stock as of August 1, 2016. We were also able to raise another $1.6 million in net proceeds from the sale of $2 million in Term Notes during the months of May and June 2016, which immediately converted to common stock of 2.7 million shares. Lastly, we raised $1.5 million in a private equity offering in July 2016.

We also negotiated a new credit facility with Heritage Bank of Commerce ("Heritage Loan") in June 2016 to replace the BridgeBank facility, as the maturity date of the BridgeBank loan was March 31, 2017. The terms of the Heritage Loan has a more favorable interest rate of 5.25% compared to an interest rate of 8.25% charged by BridgeBank. The maturity date of the Heritage Loan will be twenty four months maturing in June 2018.

We believe that cash generated from operations, the sale of common stock, the debt restructuring, and expense reductions will be sufficient to fund the Company's working capital and capital expenditure needs in the foreseeable future. Management plans to contain operating expenses and remain fiscally responsible, however, there can be no assurances that these financial measures will be sufficient enough to compensate for any shortfalls in revenues. In addition, in order to sustain operations and cash flows, the Company must be successful in closing the new bank credit line, as well as, convert a significant portion of the convertible debt holders to equity. If the Company is not successful with its debt restructuring plan then it will not have sufficient cash flows to meet operations and it will have to renegotiate outstanding debt lines or negotiate new debt instruments in order to meet cash flow expectations. There are no assurances that existing debt holders will be willing or able to renegotiate new terms or that new debt instruments will be available. Such potential adverse events could create substantial doubts about our ability to fund operations and interrupt our normal course of 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 June 30, 2016, we had an accrued contingent earnout liability of $151 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.

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 2015, we performed the annual assessment of our goodwill during the fourth quarter of 2015, using the qualitative approach described above. Based on our qualitative assessment, we concluded that it was more likely than not that the fair values of our reporting units were less than their carrying amounts, and therefore we believed it was necessary to perform the quantitative two-step impairment test. There were numerous positive qualitative factors discovered during our analysis, but the instability of the market price of our common stock and the decline in our revenues were a material adverse factor that led us to believe that we should progress to the second step of the impairment testing. In estimating fair value, we performed a discounted cash flow analysis on the reporting unit to determine fair value. The inputs to the discounted cash flow model are considered level 3 in the fair value hierarchy. The impairment test indicated that the estimated fair value of the reporting unit was less than its corresponding carrying amount. As a result of the analyses performed, we recorded goodwill impairment charges of $10.5 million in 2015.

Accounting for Stock-Based Compensation

At June 30, 2016, 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 24, 2015. There are no employees enrolled in the employee stock purchase plan as of June 30, 2016 and this plan was terminated in April 2016.

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 June 30, 2016 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 June 30, 2016 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 24, 2015.

Item 1A. Risk Factors.

Please refer to our Annual Report on Form 10-K for the year ended September 30, 2015 filed with the Securities and Exchange Commission on December 24, 2015.

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

The following summarizes all sales of our unregistered securities during the quarter ended June 30, 2016. 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.

Common Stock

On May 11, 2016 and June 10, 2016, the Company issued 2,666,685 shares of common stock upon conversion of term notes totaling $2 million in a private placement. Net proceeds to the Company after offering expenses were approximately $1.6 million. The term notes automatically converted into shares of common stock at a conversion price of $0.75 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.

On May 17, 2016, each of Michael Taglich, Robert Taglich, and Roger Kahn, holders of outstanding term notes, converted all outstanding principal and accrued but unpaid interest due under such outstanding term notes into shares of Common Stock of the Company at a conversion price of $0.75 per share. In connection with the conversion, a total of 4,338,822 shares of common stock were issued. 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.

On June 24, 2016, a total of $570,000 subordinated Convertible Notes were converted to 760,004 shares of common stock.

Item 5. Other Information

Bank Loan Agreement

On June 9, 2016, the Company executed a new Loan and Security Agreement with Heritage Bank of Commerce ("Heritage Agreement" or "Loan Agreement"). The Heritage Agreement has a term of 24 months and will expire on June 9, 2018. The Heritage Agreement provides for up to $3 million of revolving credit advances which may be used for acquisitions and working capital purposes. Borrowings are limited to the lesser of (i) $3 million and (ii) 75% of eligible receivables as defined. The Company can borrow up to $1.0 million in out of formula borrowings for specified periods of time. Borrowings accrue interest at Wall Street Journal Prime Rate plus 1.75%, currently (5.25%). The Company will pay an annual commitment fee of 0.4% of the commitment amount in the first year and 0.2% in the second year. Borrowings are secured by all of the Company's assets and all of the Company's intellectual property. The Company will be required to comply with certain financial and reporting covenants including an Asset Coverage Ratio and an Adjusted EBITDA metric.

On August 15, 2016, the Company executed an amendment to the Heritage Agreement. The amendment includes a decrease in the revolving line of credit to $2.5 million, a minimum cash requirement of $500 thousand in its account at Heritage, and a revision for the Adjusted EBITDA metric for the quarter ended September 30, 2016. The amendment also included a waiver for the Adjusted EBITDA covenant that was not achieved for the quarter ended June 30, 2016.

The foregoing description of the Notes 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
10.1	First Amendment to Employment Agreement, Roger “Ari” Kahn, dated May 10, 2016 (incorporated by reference to Exhibit 10.1 to our Current Report on Form 8-K filed on May 13, 2016)
10.2	Note Purchase Agreement between Bridgeline Digital, Inc. and the investors named therein, dated May 11, 2016 (incorporated by reference to Exhibit 10.1 to our Current Report on Form 8-K filed on May 17, 2016)
10.3	Form of Promissory Note (incorporated by reference to Exhibit 10.2 to our Current Report on Form 8-K filed on May 17, 2016)
10.4	Form of Common Stock Purchase Warrant issued to placement agent (incorporated by reference to Exhibit 10.3 to our Current Report on Form 8-K filed on May 17, 2016)
10.5	Amendment #2 to Promissory Notes between Bridgeline Digital, Inc and Michael Taglich, dated May 17, 2016 (incorporated by reference to Exhibit 10.1 to our Current Report on Form 8-K filed on May 23, 2016)
10.6	Amendment #2 to Promissory Notes between Bridgeline Digital, Inc and Robert Taglich, dated May 17, 2016 (incorporated by reference to Exhibit 10.2 to our Current Report on Form 8-K filed on May 23, 2016)
10.7	Amendment #2 to Promissory Notes between Bridgeline Digital, Inc and Roger Kahn, dated May 17, 2016 (incorporated by reference to Exhibit 10.3 to our Current Report on Form 8-K filed on May 23, 2016)
10.8	Loan and Security Agreement between Bridgeline Digital Inc. and Heritage Bank of Commerce, dated June 9, 2016 (incorporated by reference to Exhibit 10.1 to our Current Report on Form 8-K filed on June 15, 2016)
10.9	Unconditional Gurantee entered into by Michael N. Taglich in favor of Heritage Bank of Commerce, dated June 9, 2016 (incorporated by reference to Exhibit 10.2 to our Current Report on Form 8-K filed on June 15, 2016)
10.10	Placement Agreement between Bridgeline Digital, Inc and Taglich Brothers, Inc dated March 31, 2016 (incorporated by reference to Exhibit 10.3 to our Current Report on Form 8-K filed on June 15, 2016)
10.11	Amendment #2 to 10% Secured Subordinated Convertible Notes between Bridgeline Digital, Inc. and the holders of the 10% Secured Subordinated Convertible Notes, dated June 17, 2016 (incorporated by reference to Exhibit 10.1 to our Current Report on Form 8-K filed on June 23, 2016)
10.12	First Amendment to the Loan and Security Agreement between Bridgeline Digital Inc. and Heritage Bank of Commerce, dated August 15, 2016

3.1(i)	Amended and Restated Certificate of Incorporation (incorporated by reference to Exhibit 3.1(ii) to our Registration Statement on Form S-B2, File No. 333-139298)
3.1(ii)	Certificate of Amendment to Amended and Restated Certificate of Incorporation, dated March 19,2010 (incorporated by reference to Exhibit 3.1 to our Current Report on Form 8-K filed on March 24, 2010)
3.1(iii)	Certificate of Amendment to Amended and Restated Certificate of Incorporation, dated May 4, 2015 (incorporated by reference to Exhibit 3.1 to our Current Report on Form 8-K filed on May 5, 2015)
3.1(iv)	Certificate of Designations of the Series A Convertible Preferred Stock (incorporated by reference to Exhibit 3.1 to our Current Report on Form 8-K filed on November 4, 2014)
3.1(v)	Amended and Restated By-laws (incorporated by reference to Exhibit 3.1 to our Quarterly Report on Form 10-Q filed on February 17, 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).
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)
August 15, 2016 Date	/s/ Roger Kahn **Roger Kahn** **President and Chief Executive Officer** (Principal Executive Officer)
August 15, 2016 Date	/s/ Michael Prinn **Michael Prinn** **Executive Vice President and Chief Financial Officer** (Principal Financial and Accounting Officer)

INDEX OF EXHIBITS

Exhibit No.	Description of Document
10.12	First Amendment to the Loan and Security Agreement between Bridgeline Digital Inc. and Heritage Bank of Commerce, dated August 15, 2016
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.