

TSS, Inc.
Form 10-Q
November 14, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2018

or

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

Commission file number: 001-33627

TSS, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

20-2027651

(I.R.S. Employer Identification No.)

110 E. Old Settlers Blvd

Austin, Texas

(Address of principal executive offices) (Zip Code)

78664

(512) 310-1000

(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 past 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 each 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 the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

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

Accelerated filer

Smaller reporting company

Emerging growth company

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

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Indicated by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Number of shares of common stock outstanding as of November 14, 2018	16,304,107
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TSS, INC.

QUARTERLY REPORT ON FORM 10Q

For the Quarterly Period Ended September 30, 2018

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“SAFE HARBOR” STATEMENT

UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

From time to time, we make oral and written statements that may constitute “forward-looking statements” (rather than historical facts) as defined in the Private Securities Litigation Reform Act of 1995 or by the Securities and Exchange Commission (the “SEC”) in its rules, regulations and releases, including Section 27A of the Securities Act of 1933, as amended (the “Securities Act”) and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). We desire to take advantage of the “safe harbor” provisions in the Private Securities Litigation Reform Act of 1995 for forward looking statements made from time to time, including, but not limited to, the forward- looking statements made in this Quarterly Report on Form 10-Q (the “Form 10-Q”), as well as those made in other filings with the SEC.

Forward looking statements can be identified by our use of forward looking terminology such as “may,” “will,” “expect,” “anticipate,” “estimate,” “believe,” “continue,” “forecast,” “foresee” or other similar words. Such forward looking statements are based on management’s current plans and expectations and are subject to risks, uncertainties and changes in plans that could cause actual results to differ materially from those described in the forward-looking statements. Important factors that could cause actual results to differ materially from those anticipated in our forward-looking statements include, but are not limited to, those described under *Risk Factors* set forth in Part I, Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2017.

We expressly disclaim any obligation to release publicly any updates or any changes in our expectations or any changes in events, conditions or circumstances on which any forward-looking statement is based.

As used herein, except as otherwise indicated by the context, the terms “TSS,” “Company,” “we”, “our” and “us” are used to refer to TSS, Inc. and its subsidiaries.

PART I - FINANCIAL INFORMATION**Item 1. Financial Statements****TSS, Inc.****Consolidated Balance Sheets****(in thousands except par values)**

	September 30, 2018 (unaudited)	December 31, 2017
Current Assets:		
Cash and cash equivalents	\$ 3,186	\$2,268
Contract and other receivables, net	2,620	990
Costs and estimated earnings in excess of billings on uncompleted contracts	311	223
Inventories, net	83	134
Prepaid expenses and other current assets	217	114
Total current assets	6,417	3,729
Property and equipment, net	408	418
Goodwill	1,907	1,907
Intangible assets, net	470	561
Other assets	109	112
Total assets	\$ 9,311	\$6,727
Current Liabilities:		
Accounts payable and accrued expenses	\$ 3,088	\$2,841
Deferred revenues	3,330	2,494
Total current liabilities	6,418	5,335
Long-term borrowings	1,795	1,656
Deferred revenue – noncurrent portion	126	-
Other liabilities	49	41
Total liabilities	8,388	7,032
Commitments and Contingencies	-	-
Stockholders' Equity (Deficit):		

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Preferred stock, \$.0001 par value; 1,000 shares authorized at September 30, 2018 and December 31, 2017; none issued	-	-
Common stock, \$.0001 par value; 49,000 shares authorized at September 30, 2018 and December 31, 2017; 16,316 and 16,316 issued; 15,544 and 15,547 outstanding at September 30, 2018 and December 31, 2017, respectively	2	2
Additional paid-in capital	69,066	68,886
Treasury stock 772 and 769 shares at cost at September 30, 2018 and December 31, 2017, respectively	(1,538) (1,536)
Accumulated deficit	(66,607) (67,657)
Total stockholders' equity (deficit)	923	(305)
Total liabilities and stockholders' equity (deficit)	\$ 9,311	\$6,727

See accompanying notes to the consolidated financial statements.

TSS, Inc.**Consolidated Statements of Operations****(in thousands, except per-share amounts; unaudited)**

	Three Months Ended		Nine Months Ended	
	September 30 2018	2017	September 30 2018	2017
Results of Operations:				
Revenue	\$6,371	\$4,898	\$16,587	\$13,485
Cost of revenue	3,855	2,818	10,140	7,792
Gross profit	2,516	2,080	6,447	5,693
Selling, general and administrative expenses	1,654	1,578	4,747	4,876
Depreciation and amortization	91	109	297	372
Gain on sale of business component	-	-	-	(321)
Total operating costs	1,745	1,687	5,044	4,927
Income from operations	771	393	1,403	766
Other income (expense):				
Interest expense, net	(102)	(82)	(306)	(233)
Other income (expense), net	-	-	-	(3)
Income from operations before income taxes	669	311	1,097	530
Income tax expense	17	13	47	3
Net income	\$652	\$298	\$1,050	\$527
Basic income per common share	\$0.04	\$0.02	\$0.06	\$0.03
Diluted income per common share	\$0.03	\$0.02	\$0.05	\$0.03

See accompanying notes to the consolidated financial statements.

TSS, Inc.

Consolidated Statements of Changes in Stockholders' Equity (Deficit)

(in thousands, except share amounts, unaudited)

	Common Stock		Additional	Treasury		Accumulated	Total
	Shares	Amount	Paid-in Capital	Shares	Amount	Deficit	Stockholders' Equity (Deficit)
Balance January 1, 2017	16,370	\$ 2	\$ 68,522	748	\$(1,532)	\$(68,422)	\$(1,430)
Treasury stock repurchased	-	-	-	11	(1)	-	(1)
Restricted stock cancelled	(54)	-	-	-	-	-	-
Stock-based compensation	-	-	37	-	-	-	37
Net income	-	-	-	-	-	229	229
Balance at June 30, 2017	16,316	\$ 2	\$ 68,559	759	\$(1,533)	\$(68,193)	\$(1,165)
Warrants issued with new debt	-	-	104	-	-	-	104
Stock-based compensation	-	-	24	-	-	-	24
Net income	-	-	-	-	-	298	298
Balance at September 30, 2017	16,316	\$ 2	\$ 68,687	759	\$(1,533)	\$(67,896)	\$(740)
Warrants issued with new debt	-	-	191	-	-	-	191
Treasury stock repurchased	-	-	-	10	(3)	-	(3)
Stock-based compensation	-	-	8	-	-	-	8
Net income	-	-	-	-	-	239	239
Balance at December 31, 2017	16,316	\$ 2	\$ 68,886	769	\$(1,536)	\$(67,657)	\$(305)
Restricted stock canceled	(30)	-	-	-	-	-	-
Stock-based compensation	-	-	115	-	-	-	115
Net income	-	-	-	-	-	398	398
Balance at June 30, 2018	16,286	\$ 2	\$ 69,001	769	\$(1,536)	\$(67,259)	\$208
Stock options exercised	30	-	3	-	-	-	3
Treasury stock repurchased	-	-	-	3	(2)	-	(2)
Stock-based compensation	-	-	62	-	-	-	62
Net income	-	-	-	-	-	652	652
Balance at September 30, 2018	16,316	\$ 2	\$ 69,066	772	\$(1,538)	\$(66,607)	\$923

See accompanying notes to the consolidated financial statements.

TSS, Inc.**Consolidated Statements of Cash Flows****(in thousands; unaudited)**

	Nine Months Ended September 30, 2018	2017
Cash Flows from Operating Activities:		
Net income	\$ 1,050	\$ 527
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	297	372
Non-cash interest	75	22
Amortization of debt discount	64	22
Stock-based compensation	177	61
Gain on sale of business component	-	(321)
Changes in operating assets and liabilities:		
Contract and other receivables	(1,630)	401
Costs and estimated earnings in excess of billings on uncompleted contracts	(88)	434
Inventories, net	51	(187)
Prepaid expenses and other assets	(100)	(96)
Accounts payable and accrued expenses	247	(2,557)
Deferred revenues	962	331
Other liabilities	8	(26)
Net cash provided by (used in) operating activities	1,113	(1,017)

Cash Flows from Investing Activities:				
Capital expenditures	(196)	(141)
Proceeds from sale of business component	-		314	
Net cash provided by (used in) investing activities	(196)	173	
Cash Flows from Financing Activities:				
Payment on long-term borrowings	-		(250)
Repayment under receivables factoring agreement	-		(737)
Proceeds from issuance of new long-term debt	-		650	
Issuance of shares from option exercise	3		-	
Repurchase of treasury stock	(2)	(1)
Net cash provided by (used in) financing activities	1		(338)
Net increase (decrease) in cash and cash equivalents	918		(1,182)
Cash and cash equivalents at beginning of period	2,268		2,152	
Cash and cash equivalents at end of period	\$	3,186	\$	970
Supplemental disclosure of cash flow information:				
Cash paid for interest	\$	173	\$	181
Cash paid for taxes	\$	49	\$	42
Supplemental non-cash financing information:				
Issuance of warrants in connection with debt	\$	-	\$	39

See accompanying notes to the consolidated financial statements.

TSS, Inc.

Notes to Consolidated Statements

(unaudited)

Note 1 – Significant Accounting Policies

Description of Business

TSS, Inc. (“TSS”, the “Company”, “we”, “us” or “our”) provides a comprehensive suite of services for the planning, design, deployment, maintenance, refresh and take-back of end-user and enterprise systems, including the mission-critical facilities they are housed in. We provide a single source solution for enabling technologies in data centers, operations centers, network facilities, server rooms, security operations centers, communications facilities and the infrastructure systems that are critical to their function. Our services consist of technology consulting, design and engineering, project management, systems integration, systems installation and facilities management. Our corporate offices are in Round Rock, Texas, and we also have an office in Dulles, Virginia.

The accompanying consolidated balance sheet as of December 31, 2017, which has been derived from audited consolidated financial statements, and the unaudited interim consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (“US GAAP”) for interim financial statements and pursuant to the rules and regulations of the SEC for interim reporting and include the accounts of the Company and its consolidated subsidiaries. In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments (consisting only of normal recurring items) necessary to present fairly the consolidated financial position of the Company and its consolidated results of operations, changes in stockholders’ equity (deficit) and cash flows. These interim financial statements should be read in conjunction with the consolidated financial statements and accompanying notes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017.

The accompanying consolidated financial statements have also been prepared on the basis that the Company will continue to operate as a going concern. Accordingly, assets and liabilities are recorded on the basis that the Company will be able to realize its assets and discharge its liabilities in the normal course of business. Our history of operating losses, negative working capital, and our stockholders’ deficiency cause doubt about our ability to continue to operate our business as a going concern. We have reviewed our current and prospective sources of liquidity, significant conditions and events as well as our forecasted financial results and, while we believe that we have adequate plans to address these issues, there is still doubt about our ability continue as a going concern. Our operating results have improved since 2016 and we achieved operating and net income in 2017 and during the first three quarters of 2018.

During 2016 and 2017 we sold certain parts of our business and discontinued several other services. These actions, along with cost reductions made at that time, provided additional capital for our business, lowered our total operating costs, improved our operating profits, and allowed us to focus our business activities on systems integration and modular data center build and maintenance activities. We also obtained additional debt financing during 2017 and restructured our existing long-term debt to help us improve our liquidity and manage our working capital. We have now eliminated our stockholder's deficit and, with our improved operating results, anticipate removing the uncertainty regarding our ability to continue to operate our business as a going concern if our results continue improving.

Our business plans and our assumptions around the adequacy of our liquidity are based on estimates regarding expected revenues and future costs and our ability to secure additional sources of funding if needed. However, our revenue may not meet our expectations, or our costs may exceed our estimates. Further, our estimates may change, and future events or developments may also affect our estimates. Any of these factors may change our expectation of cash usage in 2018 or significantly affect our level of liquidity, which may require us to take measures to reduce our operating costs or obtain funding to continue operating. Any action to reduce operating costs may negatively affect our range of products and services that we offer or our ability to deliver such products and services, which could materially impact our financial results depending on the level of cost reductions taken. These consolidated financial statements do not include any adjustments that might result from the Company not being able to continue as a going concern.

Revenue Recognition

On January 1, 2018, we adopted Accounting Standards Update 2014-09, *Revenue from Contracts with Customers* (ASU 2014-09), using the modified retrospective method. Adoption of ASU 2014-09 did not have a material impact on our consolidated financial position or results of operations.

We recognize revenues when control of the promised goods or services is transferred to our customers in an amount that reflects the consideration we expect to be entitled to in exchange for those goods or services.

Maintenance services

We generate maintenance services revenues from fees that provide our customers with as-needed maintenance and repair services on modular data centers during the contract term. Our contracts are typically one year in duration, are billed annually in advance, and are non-cancellable. As a result, we record deferred revenue (a contract liability) and recognize revenue from these services on a ratable basis over the contract term. We can mitigate our exposure to credit losses by discontinuing services in the event of non-payment, however our history of non-payments and bad debt expense has been insignificant.

Integration services

We generate integration services revenues from fees that provide our customers with customized system and rack-level integration services. We recognize revenue upon shipment to the customer of the completed systems as this is when we have completed our services and when the customer obtains control of the promised goods. We typically extend credit terms to our integration customers based on their credit worthiness and generally do not receive advance payments. As such, we record accounts receivable at the time of shipment, when our right to the consideration becomes unconditional. Accounts receivable from our integration customers are typically due within 30-60 days of invoicing. An allowance for doubtful accounts is provided based on a periodic analysis of individual account balances, including an evaluation of days outstanding, payment history, recent payment trends, and our assessment of our customers' credit worthiness. As of September 30, 2018 and December 31, 2017, our allowance for doubtful accounts was \$8,000.

Equipment sales

We generate revenues under fixed price contracts from the sale of data center and related ancillary equipment to customers in the United States. We recognize revenue when the product is shipped to the customer as that is when the customer obtains control of the promised goods. Typically, we do not receive advance payments for equipment sales, however if we do, we record the advance payment as deferred revenue. Normally we record accounts receivable at the time of shipment, when our right to the consideration has become unconditional. Accounts receivable from our equipment sales are typically due within 30-45 days of invoicing.

Deployment and Other services

We generate revenues from fees we charge our customers for other services, including repairs or other services not covered under maintenance contracts, installation and servicing of equipment including modular data centers that we sold, and other fixed-price services including repair, design and project management services. In some cases, we arrange for a third party to perform warranty and servicing of equipment, and in these instances, we recognize revenue as the amount of any fees or commissions that we expect to be entitled to. Other services are typically invoiced upon completion of services or completion of milestones. We record accounts receivable at the time of completion when our right to consideration becomes unconditional.

Some of our contracts with customers contain multiple performance obligations. For these contracts, we account for individual performance obligations separately if they are distinct. The transaction price is allocated to the separate performance obligations based on relative standalone selling prices.

Judgments

We consider several factors in determining that control transfers to the customer upon shipment of equipment or upon completion of our services. These factors include that legal title transfers to the customer, we have a present right to payment, and the customer has assumed the risks and rewards of ownership at the time of shipment or completion of the services.

Sales taxes

Sales (and similar) taxes that are imposed on our sales and collected from customers are excluded from revenues.

Shipping and handling costs

Costs for shipping and handling activities, including those activities that occur subsequent to transfer of control to the customer, are recorded as cost of sales and are expensed as incurred. We accrue costs for shipping and handling activities that occur after control of the promised good or service has transferred to the customer.

The following table shows our revenues disaggregated by reportable segment and by product or service type (in \$'000):

	Three-months ended Sept. 30,		Nine-months ended Sept. 30,	
	2018	2017	2018	2017
FACILITIES:				
Maintenance revenues	\$1,213	\$1,199	\$3,615	\$3,446
Equipment sales	958	816	2,085	1,608
Deployment and other services	2,079	1,234	5,096	3,411
	\$4,250	\$3,249	\$10,796	\$8,465
SYSTEMS INTEGRATION:				
Integration services	\$2,121	\$1,649	\$5,791	\$5,020
TOTAL REVENUES	\$6,371	\$4,898	\$16,587	\$13,485

Remaining Performance Obligations

As part of our adoption of ASU 2014-09, we have elected to use a practical expedient to exclude disclosure of transaction prices allocated to remaining performance obligations, and when we expect to recognize such revenue, for all periods prior to the date of initial application of the standard.

As of September 30, 2018, deferred revenue of \$3,330,000 represents our remaining performance obligations for our maintenance contracts, all of which are expected to be recognized within one year. The remaining \$126,000 of deferred revenue is our remaining performance obligations for other services, all of which is expected to be recognized between one and two years.

Concentration of Credit Risk

We are currently economically dependent upon our relationship with a large US-based IT Original Equipment Manufacturer (OEM). If this relationship is unsuccessful or discontinues, our business and revenue would materially suffer. The loss of or a significant reduction in orders from this customer or the failure to provide adequate products or services to it would significantly reduce our revenue.

The following customers accounted for a significant percentage of our revenues for the periods shown:

	Three months ended Sept. 30, 2018		Nine Months Ended Sept. 30, 2017	
US-based IT OEM	66%	65 %	69%	63 %
US-based IT services company	13%	11 %	8 %	8 %

No other customers represented more than 10% of our revenues for any periods presented. Our US-based IT OEM customer represented 20% and 26% of our accounts receivable at September 30, 2018 and December 31, 2017, respectively. A US-based IT services company represented 41% and 23% of our accounts receivable at September 30, 2018 and December 31, 2017, respectively. A US-based data center operator represented 16% of our accounts receivable at September 30, 2018. A US-based electronic equipment manufacturer represented 22% of our accounts receivable at December 31, 2017. No other customer represented more than 10% of our accounts receivable at September 30, 2018 or at December 31, 2017.

Recently Issued Accounting Pronouncements

In February 2016, the FASB issued ASU No. 2016-02, “*Leases (Topic 842)*”. Under ASU 2016-02, an entity will be required to recognize right-of-use assets and lease liabilities on its balance sheet and disclose key information about leasing arrangements. ASU 2016-02 offers specific accounting guidance for a lessee, a lessor and sale and leaseback transactions. Lessees and lessors are required to disclose qualitative and quantitative information about leasing arrangements to enable a user of the financial statements to assess the amount, timing and uncertainty of cash flows arising from leases. For public companies, ASU 2016-02 is effective for annual reporting periods beginning after December 15, 2018, including interim periods within that reporting period, and requires a modified retrospective adoption, with early adoption permitted. We are currently evaluating the future impact of ASU 2016-02 on our consolidated financial statements and while we do not anticipate this having a material impact on our results of operations, we anticipate recording lease-related assets and liabilities between \$2 - \$2.5 million on our consolidated balance sheet upon adoption of the pronouncement.

In May 2017, the FASB issued ASU No. 2017-09, which amends the scope of modification accounting for share-based payment arrangements. The AU provides guidance on the types of changes to the terms or conditions of share-based payment awards to which an entity would be required to apply modification accounting under ASC 718. Specifically, an entity would not apply modification accounting if the fair value, vesting conditions, and classification of the awards are the same immediately before and after the modification. ASU 2017-09 will be applied prospectively to awards modified on or after the adoption date. The guidance is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. Adoption of this new guidance did not have a material impact on our consolidated financial statements.

Note 2 – Supplemental Balance Sheet Information*Receivables*

Contract and other receivables consisted of the following (in ‘000’s):

September	December
30,	31,
2018	2017

Contract and other receivables	\$ 2,628	\$ 998
Allowance for doubtful accounts	(8)	(8)
Contracts and other receivables, net	\$ 2,620	\$ 990

Inventories

We state inventories at the lower of cost or net realizable value, using the first-in-first-out-method (in '000's) as follows:

	September 30, 2018	December 31, 2017
Raw materials	\$ 85	\$ 136
less: Reserve	(2)	(2)
Inventories, net	\$ 83	\$ 134

Goodwill and Intangible Assets

Goodwill and Intangible Assets consisted of the following (in '000's):

	September 30, 2018		December 31, 2017	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
<i>Intangible assets not subject to amortization:</i>				
Goodwill	\$1,907	-	\$1,907	-
<i>Intangible assets subject to amortization:</i>				
Customer relationships	\$906	\$ (486)	\$906	\$ (418)
Acquired software	\$234	\$ (234)	\$234	\$ (216)
Trade name	\$60	(10)	\$60	(5)

We recognized amortization expense related to intangibles of approximately \$24,000 and \$36,000 for the three-month periods ended September 30, 2018 and 2017, respectively. We recognized amortization expense related to intangibles of approximately \$91,000 and \$108,000 for the nine-month periods ended September 30, 2018 and 2017, respectively

We have elected to use December 31 as our annual date to test goodwill and intangibles for impairment. As circumstances change that could affect the recoverability of the carrying amount of the assets during an interim period, we will evaluate its indefinite lived intangible assets for impairment. We performed a quantitative analysis of our goodwill and intangibles at December 31, 2017 as part of our annual testing for impairment and concluded that there was no impairment. Although there were events and circumstances in existence at December 31, 2017 that suggest substantial doubt about our ability to continue as a going concern, the valuation results indicated that the fair value of our reporting units was greater than the carrying value, including goodwill, for each of our reporting units. Thus, we concluded that there was no impairment at December 31, 2017 for our goodwill and other long-lived intangible assets. There were no identified triggering events or circumstances that occurred during the three or nine-month periods ended September 30, 2018 that would have required an interim impairment analysis of our goodwill and other long-lived intangible assets.

Property and Equipment

Property and equipment consisted of the following (in \$'000):

	Estimated Useful Lives (years)	September 30, 2018	December 31, 2017
Vehicles	5	\$ 32	\$ 32
Trade equipment	5	210	162
Leasehold improvements	2 -5	384	378
Furniture and fixtures	7	20	18
Computer equipment and software	3	1,583	1,448
		2,229	2,038
Less accumulated depreciation		(1,821)	(1,620)
Property and equipment, net		\$ 408	\$ 418

Depreciation of property and equipment and amortization of leasehold improvements and software totaled \$65,000 and \$89,000 the three-month periods ended September 30, 2018 and 2017, respectively. Depreciation of property and equipment and amortization of leasehold improvements and software totaled \$206,000 and \$189,000 for the nine-month periods ended September 30, 2018 and 2017, respectively.

Accounts Payable and Accrued Expenses

Accounts payable and accrued expenses consisted of the following (in \$'000):

	September 30,	December 31,
	2018	2017
Accounts payable	\$ 1,602	\$ 1,413
Accrued expenses	912	847
Compensation, benefits & related taxes	561	567
Other accrued expenses	13	14
Total accounts payable and accrued expenses	\$ 3,088	\$ 2,841

Note 3 – Long term borrowings

Long-term borrowings consisted of the following (in \$'000):

	September 30,	December 31,
	2018	2017
Notes Payable due July 2022	\$ 1,995	\$ 1,995
Accrued interest – long term	122	47
Less unamortized discount and debt issuance costs	(322)	(386)
	1,795	1,656
Current portion of long-term borrowing	-	-
Non-current portion of long-term borrowing	\$ 1,795	\$ 1,656

In February 2015, we entered into a multiple advance term loan agreement and related agreements with MHW SPV II, LLC (“MHW”), an entity affiliated with the Chairman of our Board of Directors, for a loan in the maximum amount of \$2 million. We borrowed \$945,000 under this loan agreement on February 3, 2015 and executed a promissory note to evidence this loan and the terms of repayment which requires interest-only payments until maturity.

In July 2017, we amended and restated the terms of this multiple advance term loan agreement whereby we increased the maximum principal amount of loans to \$2.5 million for up to sixty days, and \$2 million thereafter. The term of the loan was modified to be five years from the date of modification, thereby extending the term of the \$945,000 loan to July 19, 2022. As part of this modification, the interest rate on the \$945,000 loan remains at a fixed annual rate of 12%, however it was changed so that 6% is paid in cash monthly in arrears, and 6% is payable in kind, to be evidenced by additional promissory notes having an aggregate principal amount equal to the accrued but unpaid interest. We can prepay the loan at any time, subject to a prepayment fee of (a) 4% if the prepayment is made prior to July 20, 2018, (b) 2% if the prepayment is made between July 20, 2018 and July 19, 2019, and (c) 1% if the prepayment is made between July 20, 2019 and July 19, 2020. The obligations under the loan are secured by substantially all of our assets pursuant to the terms of a security agreement.

In conjunction with entering into the loan agreement, the Company and MHW also entered into a warrant granting MHW the right to purchase up to 1,115,827 shares of the Company’s common stock. As part of the July 2017 modification, we also modified the warrant to change the exercise price of the shares and to extend the term of the warrant to July 19, 2022. The warrant is now exercisable for a period of five years from July 19, 2017 at an exercise price of \$0.10 for the first 390,539 shares, \$0.20 for the next 390,539 shares and \$0.30 for the final 334,749 shares.

The exercise price and number of shares of common stock issuable on exercise of the warrant will be subject to adjustment in the event of any stock split, reverse stock split, recapitalization, reorganization or similar transaction. The fair value of the modified warrant was determined to be approximately \$167,000 and the incremental value of the warrant compared to the original warrant was approximately \$6,000. This amount was added to the remaining unamortized value of the original warrant such that approximately \$93,000 will be amortized using the straight-line method (which approximates the effective interest rate method) over the term of the loan. Approximately \$5,000 of this amount was amortized during each of the three-month periods ended September 30, 2018 and 2017, respectively. Approximately \$14,000 and \$22,000 was amortized during the nine-month periods ended September 30, 2018 and 2017, respectively.

On July 19, 2017, we also borrowed an additional \$650,000 from MHW Partners, an entity affiliated with MHW. This loan ranks parri-passu with the \$945,000 promissory notes held by MHW and is subject to the same loan agreement. Similar to the notes held by MHW, the note issued to MHW Partners bears interest at 12% per annum payable in cash monthly in arrears at a rate of 6% per annum and payable in kind at a fixed rate of 6% per annum and has a maturity date of July 19, 2022. We can prepay the note issued to MHW Partners at any time, subject to a prepayment fee of (a) 4% if the prepayment is made prior to July 20, 2018, (b) 2% if the prepayment is made between July 20, 2018 and July 19, 2019, and (c) 1% if the prepayment is made between July 20, 2019 and July 19, 2020.

The obligations under the loan agreement and this promissory note are secured by substantially all of the Company's assets pursuant to the terms of an amended and restated security agreement. This security agreement amends and restates the security agreement entered into with MHW in February 2015.

In conjunction with entering into this new loan, we entered into a warrant granting MHW Partners the right to purchase up to 767,500 shares of our common stock. The warrant is exercisable for a period of 5 years from July 19, 2017, at an exercise price of \$0.10 for the first 268,625 shares, \$0.20 for the next 268,625 shares and \$0.30 for the final 230,250 shares. The exercise price and number of shares of common stock issuable upon exercise of this warrant will be subject to adjustment in the event of any stock split, reverse stock split, recapitalization, reorganization or similar transactions. The fair value of the warrant granted was approximately \$115,000. Using the relative-fair value allocation method, the debt proceeds were allocated between the debt value and the fair value of the warrants, resulting in a recognition of a discount on the loan of approximately \$98,000 and a corresponding increase to additional paid-in capital. This discount will be amortized using the effective interest rate method over the term of the loan. Approximately \$5,000 was amortized during each of the three-month periods ended September 30, 2018 and 2017, respectively, and approximately \$15,000 and \$5,000 was amortized during the nine-month periods ended September 30, 2018 and 2017, respectively.

Peter H. Woodward, the Chairman of our Board of Directors, is a principal of MHW Capital Management LLC, which is the investment manager of MHW and MHW Partners. MHW Capital Management LLC is entitled to a performance related fee tied to any appreciation in the valuation of the common stock in excess of the applicable strike price under the warrant.

On October 6, 2017, we entered into an amendment to our multiple advance term loan agreement and the related security agreement with MHW and MHW Partners, to add new lenders to the loan and security agreements. Upon execution, Mr. Glen Ikeda and Mr. Andrew Berg became new lenders to the Company. In accordance with the terms of the Amendment, Mr. Ikeda then provided a loan in the amount of \$300,000 and Mr. Berg provided a loan in the amount of \$100,000 (collectively the “New Loans”).

The New Loans have a maturity date of July 19, 2022. The New Loans do not bear interest and we are permitted to make optional prepayments at any time without premium or penalty, provided that if we prepay the outstanding principal amount of a New Loan prior to the second anniversary of the date of the applicable note, then the total amount of such prepayment will not exceed 95% of the total principal amount of the applicable note and any remaining principal amount under the note shall be fully and finally cancelled, extinguished, forgiven and terminated without further action of any party.

Concurrent with the new loans, we entered into a warrant with Mr. Ikeda granting Mr. Ikeda the right to purchase up to 954,231 shares of our common stock. This warrant is exercisable until July 19, 2022, at an exercise price of \$0.10 for the first 498,981 shares, \$0.20 for the next 273,981 shares and \$0.30 for the final 181,269 shares. The exercise price and number of shares of common stock issuable on exercise of this warrant will be subject to adjustment in the event of any stock split, reverse stock split, recapitalization, reorganization or similar transaction.

Concurrent with the new loans, we entered into a warrant with Mr. Berg granting Mr. Berg the right to purchase up to 318,077 shares of our common stock. This warrant is exercisable until July 19, 2022, at an exercise price of \$0.10 for the first 166,327 shares, \$0.20 for the next 91,327 shares and \$0.30 for the final 60,423 shares. The exercise price and number of shares of common stock issuable on exercise of this warrant will be subject to adjustment in the event of any stock split, reverse stock split, recapitalization, reorganization or similar transaction.

The fair value of the two warrants granted in connection with the New Loans was approximately \$367,000. Using the relative fair-value allocation method, the debt proceeds were allocated between the debt value and the fair value of the warrants, resulting in a recognition of a discount on the new loans of approximately \$191,000, with a corresponding increase to additional paid-in capital. This discount will be amortized to interest expense over the term of the loan using the straight-line method (which approximates the effective interest rate method). Approximately \$10,000 was amortized during the three-month period ended September 30, 2018 and approximately \$30,000 was amortized during the nine-month period ended September 30, 2018.

Note 4 — Sale of Business Component

On January 31, 2017, we completed the sale of certain identified assets and liabilities associated with a specific customer contract from our project management business for \$350,000 pursuant to an Asset Purchase Agreement (“APA”) dated December 12, 2016 with Tech Site Services, LLC, a privately held Maryland company. The sale price was subject to certain post-closing adjustments relating to working capital and obtaining the consent of the customer as a condition of closing. Tech Site Services, LLC also must pay us an earn-out payment equal to 10% of all revenue generated under the customer contract in excess of \$2.5 million in each 12-month period during the two-year period after the closing of this transaction.

The transaction closed on January 31, 2017. The APA contains representations, warranties, covenants and indemnification provisions customary for a transaction of this type. Many of the representations made by us are subject to, and qualified by materiality or similar concepts. Both parties have agreed to indemnify the other party for certain losses arising from the breach of the APA and for certain other liabilities, subject to specified limitations. In connection with the transaction both parties will provide transition services with respect to the business activities that were sold.

The customer contract and intellectual property sold had a net book value of \$0. As a result of the sale, Tech Site Services LLC assumed liabilities of \$7,000, resulting in \$343,000 of cash proceeds that was paid to us upon closing. Additionally, we incurred approximately \$29,000 in legal, escrow and other expenses that would not have been incurred otherwise. As a result, we recorded a net gain of approximately \$321,000 in our consolidated statement of operations for the three-month period ended March 31, 2017.

On July 1, 2016, we adopted ASU 2014-08 regarding discontinued operations. As a result, we evaluated the sale of a portion of our project maintenance business component in light of this new standard. We concluded that the sale of a portion of our project management business component in January 2017 was not a “material shift” (as defined in ASU 2014-08) for us and therefore, is not considered a discontinued operation. In accordance with ASU 2014-08, the following information is being provided:

Three Months Ended Sept 30, 2018	Nine Months Ended Sept 30, 2017
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Pre-tax profit related to project management business sold	\$-	\$ 23	\$-	\$ 70
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Note 5 - Net Income Per-Share

Basic and diluted income per share are based on the weighted average number of shares of common stock and potential common stock outstanding during the period. Potential common stock, for the purposes of determining diluted income per share, includes the effects of dilutive unvested restricted stock, options to purchase common stock and convertible securities. The effect of such potential common stock is computed using the treasury stock method or the if-converted method, as applicable.

The following table presents a reconciliation of the numerators and denominators of the basic and diluted income per share computations for income from continuing operations. In the table below, income represents the numerator and shares represents the denominator (in thousands except per share amounts).

Three Months Ended	Nine Months Ended
-------------------------------	------------------------------

	September 30,		September 30,	
	2018	2017	2018	2017
Basic net income per share:				
Numerator:				
Net income	\$652	\$298	\$1,050	\$527
Denominator:				
Weighted-average shares of common stock outstanding	16,288	15,497	16,178	15,507
Basic net income per share	\$0.04	\$0.02	\$0.06	\$0.03
Diluted net income per share:				
Numerator:				
Net income	\$652	\$298	\$1,050	\$527
Less interest expense on convertible debt	-	-	-	-
	\$652	\$298	\$1,050	\$527
Denominator:				
Weighted-average shares of common stock outstanding	16,288	15,497	16,178	15,507
Dilutive options and warrants outstanding	3,277	1,538	3,029	1,013
Effect of conversion of convertible notes	-	-	-	4
Number of shares used in diluted per-share computation	19,565	17,035	19,207	16,524
Diluted net income per share	\$0.03	\$0.02	\$0.05	\$0.03

For the three and nine-month periods ended September 30, 2017 potentially dilutive shares of 1,548,000, respectively, were excluded from the calculation of dilutive shares because their effect would have been anti-dilutive in those periods.

Note 6 – Related Party Transactions

We have \$945,000 principal outstanding at September 30, 2018 in promissory notes payable to MHW, net of remaining discount of \$70,000. Per the terms of the notes, we paid interest of approximately \$ 30,000 and \$29,000 during the three-month periods ended September 30, 2018 and 2017, respectively, and we paid interest of \$89,000 and \$86,000 during the nine-month periods ended September 30, 2018 and 2017, respectively. We have \$650,000 principal outstanding at September 30, 2018 in promissory notes payable to MHW Partners, net of remaining discount of \$73,000. Per the terms of the notes, we paid interest of \$21,000 and \$16,000 during the three-month periods ended September 30, 2018 and 2017, respectively, and we paid interest of \$61,000 and \$16,000 during the nine-month periods ended September 30, 2018 and 2017, respectively. Peter H. Woodward, the Chairman of our Board of Directors, is a principal of MHW Capital Management, LLC which is the investment manager of MHW and MHW Partners. MHW Capital Management LLC is entitled to a performance-related fee equal to 10% of any appreciation in the valuation of the common stock in excess of the applicable strike price under the warrant issued to MHW.

Note 7 – Segment Reporting

Segment information reported in the tables below represents the operating segments of the Company organized in a manner consistent with which separate information is available and for which segment results are evaluated regularly by our chief operating decision-maker in assessing performance and allocating resources. Our activities are organized into two major segments: facilities and systems integration. Our facilities unit is involved in the design, project management and maintenance of data center and mission-critical business operations. Our systems integration unit integrates IT equipment for OEM vendors and customers to be used inside data center environments, including modular data centers. All of our revenues are derived from the U.S. market. Segment operating results reflect earnings before stock-based compensation, acquisition related expenses, other expenses, net, and provision for income taxes.

Revenue and operating results by reportable segment reconciled to reportable net income for the three and nine-month periods ended September 30, 2018 and 2017 and other segment-related information is as follows (in thousands):

Three Month Periods		Nine Month Periods	
ended Sept 30, 2018	2017	ended Sept 30, 2018	2017

Revenues:

Facilities	\$4,250	\$3,249	\$10,796	\$8,465
Systems integration services	2,121	1,649	5,791	5,020
Total revenues	\$6,371	\$4,898	\$16,587	\$13,485

Income from operations:

Facilities	\$957	\$723	\$2,322	\$1,795
Systems integration services	(186)	(330)	(917)	(1,029)
Total income from operations	\$771	\$393	1,403	\$766

Depreciation expense:

Facilities	\$7	\$8	\$23	\$25
Systems integration services	58	68	178	240
Consolidated depreciation expense	\$65	\$76	\$201	\$265

Interest expense

Facilities	\$65	\$46	\$194	\$131
Systems integration services	37	36	112	102
Consolidated interest expense	\$102	\$82	\$306	\$233

Sept. 30, **Dec. 31,**

2018 **2017**

Total Assets		
Facilities	\$4,565	\$2,682
Systems integration services	1,260	1,572
Other consolidated activities	3,486	2,473
Total assets	\$9,311	\$6,727

Other consolidated activities include assets not specifically attributable to each business segment including cash and cash equivalents, prepaid expenses and other assets that are managed at a corporate level.

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

The following discussion should be read in conjunction with, and is qualified in its entirety by reference to, the consolidated financial statements and notes thereto included in Item 1 of this Form 10-Q and the consolidated financial statements and notes thereto and our Management’s Discussion and Analysis of Financial Condition and Results of Operations for the year ended December 31, 2017 included in our 2017 Annual Report on Form 10-K. This report contains forward-looking statements, within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, that involve risks and uncertainties. Our expectations with respect to future results of operations that may be embodied in oral and written forward-looking statements, including any forward-looking statements that may be included in this report, are subject to risks and uncertainties that must be considered when evaluating the likelihood of our realization of such expectations. Our actual results could differ materially. The words “believe,” “expect,” “intend,” “plan,” “project,” “will” and similar phrases as they relate to us are intended to identify such forward-looking statements. In addition, please see the “Risk Factors” in Part 1, Item 1A of our 2017 Annual Report on Form 10-K for a discussion of items that may affect our future results.

Overview

TSS, Inc. (“TSS”, the “Company”, “we”, “us” or “our”) provides comprehensive services for the planning, design, deployment, maintenance, and refurbishment of end-user and enterprise systems, including the mission-critical facilities they are housed in. We provide a single source solution for enabling technologies in data centers, operations centers, network facilities, server rooms, security operations centers, communications facilities and the infrastructure systems that are critical to their function. Our services include technology consulting, design and engineering, project management, systems integration, systems installation and facilities management.

Our headquarters are in Round Rock, Texas, and we also have an office in Dulles, Virginia.

Our business is concentrated on the data center infrastructure and services market. This market is becoming increasingly competitive as commerce moves to cloud-based solutions and as data storage requirements continue to escalate for many industries. These underlying macroeconomic trends are driving demand for more information technology equipment and more efficient data center design and operation, resulting in continued growth in this market. We compete against many larger competitors who have greater resources than we do, which may affect our competitiveness in the market. We rely on several large customers to win contracts and to provide business to us under “Master Service Agreements”, and the loss of such customers would have a negative effect on our results.

RESULTS OF OPERATIONS

Revenue

Revenue consists of fees earned from the planning, design and project management for mission-critical facilities and information infrastructures, as well as fees earned from providing maintenance services for these facilities. We also earn revenue from providing system configuration and integration services to IT equipment vendors. Currently we derive all our revenue from the U.S. market.

We contract with our customers under five primary contract types: fixed-price service and maintenance contracts, time and material contracts, cost-plus-fee, guaranteed maximum price and fixed-price contracts. Cost-plus-fee and guaranteed maximum price contracts are typically lower risk arrangements and thus yield lower profit margins than time-and-materials and fixed-price arrangements which generate higher profit margins generally, relative to their higher risk. Certain of our service and maintenance contracts provide comprehensive coverage of all the customers equipment (excluding IT equipment) at a facility during the contract period. Where customer requirements are clear, we prefer to enter into comprehensive fixed-price arrangements or time-and-materials arrangements rather than cost-plus-fee and guaranteed maximum price contracts.

Most of our revenue is generated based on services provided either by our employees or subcontractors. To a lesser degree, the revenue we earn includes reimbursable travel and other costs to support the project. Since we earn higher profits from the labor services that our employees provide compared with use of subcontracted labor and other reimbursable costs, we seek to optimize our labor content on the contracts we are awarded to maximize our profitability.

We have been concentrating our sales efforts towards maintenance and integration services where we have traditionally earned higher margins. Historically our construction services were tied to a few, high-value contracts for the construction of new data centers at any point in time. In addition to contributing to large quarterly fluctuations in revenue depending upon project timing, these projects required additional working capital and generated lower margins than our maintenance and integration services. We re-focused our design and project management services towards smaller scaled jobs typically connected with addition/move/retrofit activities rather than new construction, to obtain better margins. We have also focused on providing maintenance services for modular data center applications as this emerging market expands. We continue to focus on increasing our systems integration revenues through more consistent revenue streams that will better utilize our assets in that business.

Revenues for the three-month period ended September 30, 2018 increased by \$1.5 million, or 30%, compared to the same period in 2017. This increase reflects a \$1 million or 316% increase in our facilities services revenues as the number of modular data center deployments increased compared to the prior year. We also experienced a \$0.5 million or 29% increase in our systems integration revenues resulting from an increase in overall activity including an increase in the build out of modular data center containers compared to the prior year. Our revenue of \$6.4 million in the three-month period ended September 30, 2018 was up 19%, or \$1, million from \$5.4 million in revenue we had in the second quarter of 2018.

For the nine-month period ended September 30, 2018 our revenues were \$16.6 million, an increase of \$3.1 million or 23% compared to the same period in 2017. This increase reflects a \$2.3 million or 28% increase in our facilities services revenues caused by higher deployment and refresh activities for modular data center deployments, and from a \$0.8 million or 15% increase in our systems integration revenues compared to 2017.

Cost of revenue

Cost of revenue includes the cost of component parts for our products, labor costs expended in the production and delivery of our services, subcontractor and third-party expense, equipment and other costs associated with our test and integration facilities, excluding depreciation of our manufacturing property and equipment, shipping costs, and the costs of support functions such as purchasing, logistics and quality assurance. The cost of revenue as a percentage of revenue was 61% for the three-month period ended September 30, 2018 compared to 58% for the same period in 2017 and 62% in the second quarter of 2018. For the nine-month period ended September 30, 2018 our cost of revenue as a percentage of total revenue was 61% compared to 58% for the same period in 2017. This increase in cost of revenue from 2017 reflects lower profitability margins in our systems integration activities in 2018 compared to the same period in 2017 and lower margins on our modular deployment activities compared to the prior year.

Since we earn higher profits on our own direct labor services than when we use subcontractors or third-party services, we expect gross margins to improve when our labor services mix increases relative to the use of subcontracted labor or third-party material. Our direct labor costs are relatively fixed in the short-term, and the utilization of direct labor is critical to maximizing our profitability. As we continue to bid and win contracts that require specialized skills that we do not possess, we would expect to have more third-party subcontracted labor to help us fulfill those contracts. In addition, we can face hiring challenges in internally staffing larger contracts. While these factors could lead to a higher ratio of cost of services to revenue, the ability to outsource these activities without carrying a higher level of fixed overhead allows us to increase income, broaden our revenue base and have a favorable return on invested capital.

A large portion of our revenue is derived from fixed price contracts. Under these contracts, we set the price of our services and assume the risk that the costs associated with our performance may be greater than we anticipated. Our profitability is therefore dependent upon our ability to estimate accurately the costs associated with our services.

These costs may be affected by a variety of factors, such as lower than anticipated productivity, conditions at the work sites differing materially from what was anticipated at the time we bid on the contract, and higher than expected costs of materials and labor. Certain agreements or projects could have lower margins than anticipated or losses if actual costs for contracts exceed our estimates, which could reduce our profitability and liquidity.

Gross Profit

Our gross profit margin for the three-month period ended September 30, 2018 was 39% compared to a gross profit margin of 42% in the third quarter of 2017 and a gross profit margin of 38% in the second quarter of 2018. For the nine-month period ended September 30, 2018 our gross profit margin was 39% compared to a gross profit margin of 42% for the same period in 2017. This decrease in margin compared to 2017 was primarily attributable to lower pricing and profitability in our systems integration business compared to 2017. With higher revenue compared to 2017, the lower margin resulted in our gross profit being \$2.5 million for the quarter, compared to a gross profit of \$2.1 million in the third quarter of 2017. Year-to-date, our gross profit of \$6.4 million is \$0.7 million or 13% higher than the \$5.7 million gross profit we earned in 2017.

Selling, General and Administrative Expenses

Selling, general and administrative expenses primarily consists of compensation and related expenses, including variable sales compensation, for our executive, administrative and sales and marketing personnel, as well as related travel, selling and marketing expenses, professional fees, facility costs, insurances and other corporate costs. For the three-month period ended September 30, 2018, our selling, general and administrative expenses increased by \$76,000 or 5% compared to the same period of 2017. For the nine-month period ended September 30, 2018, our selling, general and administrative expenses decreased by \$129,000 or 3% compared to the same period of 2017. This decrease was mainly due to lower headcount related costs following the sale of a portion of our project management business in the first quarter of 2017.

Gain on sale of Business Component

In January 2017, we completed the sale of certain identified assets and liabilities connected with a specific customer contract from our project management business for \$350,000. The buyer assumed net liabilities of \$7,000 resulting in cash proceeds of \$343,000. Additionally, we incurred approximately \$29,000 in legal, escrow and other costs that would not have been incurred otherwise. As a result, we recorded a net gain of approximately \$321,000 from the sale of these assets during the first quarter of 2017.

Operating income

For the three-month period ended September 30, 2018, we recorded an operating profit of \$771,000. This compares to an operating profit of \$393,000 that we had in the third quarter of 2017. For the nine-month period ended September 30, 2018, we recorded an operating profit of \$1,403,000 which is \$637,000 or 83% higher than the operating profit of \$766,000 that we recorded in the same period in 2017. The 2017 results included the \$321,000 gain from the sale of a specific customer contract.

LIQUIDITY AND CAPITAL RESOURCES

Our primary sources of liquidity at September 30, 2018 are our cash and cash equivalents on hand and projected cash flows from operating activities.

If we continue to meet the cash flow projections in our current business plan, we expect that we will have adequate capital resources necessary to continue operating our business for at least the next twelve months. Our business plan and our assumptions around the adequacy of our liquidity are based on estimates regarding expected revenues and future costs. However, there are potential risks, including that our revenues may not meet our projections, our costs may exceed our estimates, or our working capital needs may be greater than anticipated. Further, our estimates may change, and future events or developments may also affect our estimates. Any of these factors may change our expectation of cash usage in the remainder of 2018 and beyond or significantly affect our level of liquidity, which may require us to seek additional financing or take other measures to reduce our operating costs to continue operating.

Our quarterly operating results have shown mixed but improving results over the past eighteen months with large quarterly fluctuations in revenue and operating results. Our quarterly revenues have fluctuated between \$4.2 million to

\$7.3 million. Our gross profit margin has ranged from 33% to 42%, and our operating results have varied from an operating loss of \$0.1 million to an operating profit of \$0.8 million. Until this current quarter, we have operated the business with a net working capital deficit. Due to nine quarters of operating profitability, in the second quarter of 2018 we eliminated the deficit in our stockholder's equity. Due to these fluctuations and our liquidity position, we continue to look at alternative sources of funding to strengthen our balance sheet. In the second half of 2017 we completed 2 additional debt financings that have helped us manage our liquidity and provided funding for our business. There can be no guarantee that we will not require additional funding and that such financing will be available to us when we require it or that we will complete any such financing.

As of September 30, 2018 and December 31, 2017, we had cash and cash equivalents of \$3.2 million and \$2.3 million, respectively.

Significant uses of cash

Operating activities:

Cash provided by operating activities for the nine-month period ended September 30, 2018 was \$1.1 million compared to cash used in operating activities of \$1 million for the nine-month period ended September 30, 2017. This increase in cash provided was primarily driven by the receipt of advance payments on annual maintenance contracts which caused our level of deferred revenues to increase by \$1.0 million, and from the improved profitability. These changes were offset by higher receivables in 2018 due to the timing of renewals of customer maintenance contracts.

Investing activities:

Cash used in investing activities for the nine-months ended September 30, 2018 was \$196,000 for purchases of property and equipment. This compares to cash provided by investing activities of \$0.2 million during the nine-month period ended September 30, 2017 which primarily reflected the proceeds of \$314,000 received from the sale of a specific customer contract in our project management business offset by \$141,000 in purchases of property and equipment

Financing activities:

Cash used in financing activities was \$338,000 for the nine-month period ended September 30, 2017, which was due to repayment of promissory notes payable of \$250,000, repayment of amounts borrowed under our receivables factoring agreement of \$737,000 and repurchase of treasury stock of \$1,000. This was offset by the receipt of \$650,000 in proceeds from the issuance of new debt. There only financing activities in the nine-month period ended September 30, 2018 was the repurchase of treasury stock of \$2,000 and issuance of new equity pursuant to stock option exercises of \$3,000.

Future uses of cash

Our history of negative working capital, and stockholders' deficits may, in themselves, cause uncertainty about our ability to continue to operate our business as a going concern. During 2016, we sold off a portion of our facilities maintenance operation and, in the first quarter of 2017, we sold a customer contract from our project management operations. Combined, these actions provided \$1.3 million in liquidity to the business. During the fourth quarter of 2016, we also made the decision to outsource certain service offerings which further allowed us to reduce our headcount and our level of overhead expenses, and we closed our office facility in Maryland. In July 2017, we borrowed an additional \$650,000 of long-term debt and extended the repayment term of our existing long-term debt by a further two years. In October 2017, we borrowed an additional \$400,000 in long-term debt under our multiple advance term-loan facility. We believe that there are further adjustments to reduce costs and improve profitability that could be made to our business if we were required to do so. We have recorded operating profits for the last nine quarters and believe that by focusing our business on facilities maintenance and systems integration activities, we have a higher probability of sustaining profitability and improving our overall liquidity position. During the quarter ended June 30, 2018 we eliminated the deficit in our stockholders' equity because of this improved profitability and in the quarter ended September 30, 2018 we eliminated the deficit in our working capital. We anticipate that our level of working capital will continue to fluctuate due to the level and timing of payments related to our facilities maintenance business, and we may likely have future negative working capital. We believe we can continue to operate the business with negative working capital and that these payments relating to facilities maintenance contracts will be a critical source of liquidity as we operate.

Our business plans and our assumptions around the adequacy of our liquidity are based on estimates regarding estimated revenues and future costs and our ability to secure sources of funding if needed. However, our revenue may not meet our expectations, or our costs may exceed our estimates. Further, our estimates may change, and future events or developments may also affect our estimates. Any of these factors may change our expectation of our cash usage during 2018 and beyond and significantly affect our level of liquidity, which may require us to seek additional financing or take other measures to reduce our operating costs in order to continue operating. Any action to reduce operating costs may negatively affect our range of services that we offer or our ability to deliver such services, which could materially impact our financial results. The consolidated financial statements included in this report do not include any adjustments that might result from the Company not being able to continue as a going concern.

If we raise additional funds through the issuance of debt or equity securities, the ownership of our existing stockholders may be significantly diluted. If we obtain additional debt financing, a substantial portion of our operating cash flow may be dedicated to the payment of principal and interest on such indebtedness, and the terms of the debt securities issued could impose significant restrictions on our operations. We do not know whether we will be able to secure additional funding, or funding on terms acceptable to us, to continue our operations as planned. If financing is not available, we may be required to reduce, delay or eliminate certain business activities or to sell all or parts of our operations.

Our primary liquidity and capital requirements are to fund working capital for current operations. Our primary sources of funds to meet our liquidity and capital requirements include cash on hand, and funds generated from operations including the funds from our customer financing programs. We believe that if future results do not meet expectations, we can implement reductions in selling, general and administrative expenses to better achieve profitability and therefore improve cash flows, or that we could take further steps such as the issuance of new equity or debt or the sale of part or all of our operations. However, the timing and effect of these steps may not completely alleviate a material effect on liquidity.

Off-Balance Sheet Arrangements

As of September 30, 2018 and December 31, 2017, we had no off -balance sheet arrangements.

Critical Accounting Policies and Pronouncements

Except with respect to adoption of our new revenue recognition policy on January 1, 2018, there have been no material changes to our critical accounting policies and estimates as set forth in the Annual Report for the year ended December 31, 2017. See also Item 1. Financial Statements *Note 1 – Significant Accounting Policies* regarding Recent Accounting Pronouncements.

Item 3. Quantitative and Qualitative Disclosures about Market Risk.

Not applicable.

Item 4. Controls and Procedures.

Our management performed an evaluation under the supervision and with the participation of our Chief Executive Officer (principal executive officer) and our Chief Financial Officer (principal financial officer) of the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) or 15d-15(e) of the Securities Exchange Act of 1934, as amended) as of September 30, 2018. Based upon that evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that, as of September 30, 2018, the Company's disclosure controls and procedures were effective such that information relating to the Company (including its combined subsidiaries) required to be disclosed in the Company's SEC reports (1) is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and (2) is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding financial disclosures.

Changes in Internal Control over Financial Reporting

There were no changes in the Company's internal control over financial reporting for the three months ended September 30, 2018 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting as such term is defined in Rule 13a-15 and 15d-15 of the Exchange Act of 1934, as amended.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings.

Currently, we are not a party to any material litigation in any court, and management is not aware of any contemplated proceeding by any governmental authority against us. From time to time, we are involved in various legal matters and proceedings concerning matters arising in the ordinary course of business. We currently believe that any ultimate liability arising out of these matters and proceedings will not have a material adverse effect on our financial position, results of operations or cash flows.

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

Monthly Period During the Quarter Ended September 30, 2018	Total Shares Purchased	Average Price paid per Share	Total Shares Purchased as Part of Publicly Announced Plans	Approximate Dollar Amount of Shares Yet To Be Purchased Under Plans
Jul. 1, 2018 - Jul. 31, 2018	1,961	\$ 0.51	-	-
Aug. 1, 2018 – Aug. 31, 2018	-	\$ -	-	-
Sep. 1, 2018 – Sep. 30, 2018	1,266	\$ 0.79	-	-
Total	3,227	\$ 0.62	-	-

(a) All of these shares were acquired from associates to satisfy the exercise price due upon exercise of previously awarded stock options.

Item 6. Exhibits.

- 31.1* Certification of TSS, Inc. Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2* Certification of TSS, Inc. Interim Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1** Certification of TSS, Inc. Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2** Certification of TSS, Inc. Interim Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
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- 101.INS * XBRL Instance Document
101.SCH * XBRL Taxonomy Extension Schema
101.CAL * XBRL Taxonomy Extension Calculation Linkbase
101.DEF * XBRL Taxonomy Extension Definition Linkbase
101.LAB * XBRL Taxonomy Extension Label Linkbase
101.PRE* XBRL Taxonomy Extension Presentation Linkbase

* Filed herewith.

**Furnished herewith.

SIGNATURES

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

TSS, INC.

Date: November 14, 2018 By: /s/ Anthony Angelini
Anthony Angelini
President and Chief Executive Officer
(Principal Executive Officer)

By: /s/ John K. Penver
John K. Penver
Chief Financial Officer
(Principal Financial Officer)