

TSS, Inc.  
Form 10-Q  
November 16, 2015

**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, 2015

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 Road**

**Round Rock, 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" 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

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

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

|   |                   |
|---|-------------------|
| <b>Number of shares of common stock outstanding as of November 13, 2015</b> | <b>15,632,004</b> |
|---|-------------------|

TSS, INC.

**QUARTERLY REPORT ON FORM 10Q**

**For the Quarterly Period Ended September 30, 2015**

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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, 2014.

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 in the Form 10-Q, 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<br>30,<br>2015<br>(unaudited) | December 31,<br>2014 |
|---|---|----------------------|
| <b>Current Assets:</b>  |   |                      |
| Cash and cash equivalents   | \$ 993                                  | \$ 1,378             |
| Contract and other receivables, net   | 3,239                                   | 3,951                |
| Costs and estimated earnings in excess of billings on uncompleted contracts | 900                                     | 1,042                |
| Inventories, net  | 74                                      | 154                  |
| Prepaid expenses and other current assets                                   | 503                                     | 243                  |
| Total current assets  | 5,709                                   | 6,768                |
| Property and equipment, net   | 672                                     | 670                  |
| Goodwill  | 1,907                                   | 1,907                |
| Intangible assets, net  | 876                                     | 979                  |
| Other assets  | 74                                      | 91                   |
| Total assets  | \$ 9,238                                | \$ 10,415            |
| <b>Current Liabilities:</b>   |   |                      |
| Convertible notes payable, current portion, net                             | \$ 575                                  | \$ 149               |
| Borrowings under credit facility  | 1,392                                   | 1,171                |
| Accounts payable and accrued expenses                                       | 4,770                                   | 5,547                |
| Billings in excess of costs and estimated earnings on uncompleted contracts | 2,429                                   | 2,009                |
| Total current liabilities   | 9,166                                   | 8,876                |
| Convertible notes payable, less current portion, net                        | -                                       | 575                  |
| Non-current notes payable, net of discount                                  | 793                                     | -                    |
| Other liabilities   | 5                                       | 18                   |
| Total liabilities   | 9,964                                   | 9,469                |
| Commitments and Contingencies   | -                                       | -                    |
| Stockholders' Equity (Deficit):   |   |                      |

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|   |          |             |
|---|----------|-------------|
| Preferred stock, \$.0001 par value; 1,000 shares authorized at September 30, 2015 and December 31, 2014; none issued  | -        | -           |
| Common stock, \$.0001 par value; 49,000 shares authorized at September 30, 2015 and December 31, 2014; 16,276 and 15,853 issued at September 30, 2015 and December 31, 2014, respectively | 2        | 2           |
| Additional paid-in capital  | 68,200   | 67,651      |
| Treasury stock 644 shares at cost at September 30, 2015 and December 31, 2014, respectively   | (1,512   | ) (1,512 )  |
| Accumulated deficit   | (67,416  | ) (65,195 ) |
| Total stockholders' equity (deficit)  | (726     | ) 946       |
| Total liabilities and stockholders' equity  | \$ 9,238 | \$ 10,415   |

See accompanying notes to the consolidated financial statements.

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

|  | Three Months Ended Sept. 30 |            | Nine Months Ended Sept. 30 |             |
|--|-----------------------------|------------|----------------------------|-------------|
|  | 2015                        | 2014       | 2015                       | 2014        |
| <b>Results of Operations:</b>                |                             |            |                            |             |
| Revenue                                      | \$ 6,292                    | \$ 6,213   | \$ 19,411                  | \$ 19,575   |
| Cost of revenue                              | 4,292                       | 4,051      | 13,565                     | 13,518      |
| Gross profit                                 | 2,000                       | 2,162      | 5,846                      | 6,057       |
| Selling, general and administrative expenses | 2,383                       | 2,326      | 7,412                      | 8,036       |
| Depreciation and amortization                | 144                         | 129        | 422                        | 371         |
| Total operating costs                        | 2,527                       | 2,455      | 7,834                      | 8,407       |
| Loss from operations                         | (527 )                      | (293 )     | (1,988 )                   | (2,350 )    |
| <b>Other income (expense):</b>               |                             |            |                            |             |
| Interest expense                             | (74 )                       | (73 )      | (233 )                     | (210 )      |
| Loss from operations before income taxes     | (601 )                      | (366 )     | (2,221 )                   | (2,560 )    |
| Income tax provision                         | -                           | -          | -                          | -           |
| Net loss                                     | \$ (601 )                   | \$ (366 )  | \$ (2,221 )                | \$ (2,560 ) |
| <b>Basic and diluted loss per share:</b>     |                             |            |                            |             |
| Loss per common share                        | \$ (0.04 )                  | \$ (0.02 ) | \$ (0.14 )                 | \$ (0.17 )  |
| Weighted average common shares outstanding   | 15,632                      | 15,075     | 15,527                     | 14,935      |

See accompanying notes to the consolidated financial statements.



**TSS, Inc.****Consolidated Statements of Changes in Stockholders' Equity (Deficit)****For the Nine Months Ended September 30, 2015****(in thousands, except share amounts)****(unaudited)**

|  | Common Stock |        | Additional      | Treasury Stock |             | Accumulated  | Total                |
|--|--------------|--------|-----------------|----------------|-------------|--------------|----------------------|
|  | Shares       | Amount | Paid-in Capital | Shares         | Amount      | Deficit      | Stockholders' Equity |
| Balance January 1, 2015                | 15,853       | \$ 2   | \$ 67,651       | 644            | \$ (1,512 ) | \$ (65,195 ) | \$ 946               |
| Cancellation of restricted shares      | (57 )        | -      | -               | -              | -           | -            | -                    |
| Restricted shares granted to employees | 480          | -      | -               | -              | -           | -            | -                    |
| Stock-based compensation               | -            | -      | 381             | -              | -           | -            | 381                  |
| Warrants issued with debt              | -            | -      | 168             | -              | -           | -            | 168                  |
| Net loss                               | -            | -      | -               | -              | -           | (2,221 )     | (2,221 )             |
| Balance at Sept. 30, 2015              | 16,276       | \$ 2   | \$ 68,200       | 644            | \$ (1,512 ) | \$ (67,416 ) | \$ (726 )            |

See accompanying notes to the consolidated financial statements.

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

|   | Nine Months Ended<br>September 30,<br>2015 | 2014        |
|---|--|-------------|
| Cash Flows from<br>Operating Activities:  |  |             |
| Net loss  | \$ (2,221 )                                | \$ (2,560 ) |
| Adjustments to<br>reconcile net loss to<br>net cash used in<br>operating activities:    |  |             |
| Depreciation and<br>amortization  | 422  | 371         |
| Amortization of<br>discount on notes<br>payable   | 42   | 48          |
| Provision for<br>doubtful accounts  | (11 )                                      | 12          |
| Stock-based<br>compensation   | 381  | 362         |
| Changes in operating<br>assets and liabilities:   |  |             |
| Restricted cash   | -  | 500         |
| Contract and other<br>receivables   | 723  | 2,473       |
| Costs and estimated<br>earnings in excess of<br>billings on<br>uncompleted<br>contracts | 142  | (705 )      |
| Inventories, net  | 80   | 56          |
| Prepaid expenses<br>and other assets  | (282 )                                     | 139         |
| Accounts payable<br>and accrued<br>expenses   | (777 )                                     | (2,943 )    |
| Billings in excess of<br>costs and estimated  | 420  | 638         |

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|   |        |   |        |   |
|---|--------|---|--------|---|
| earnings on<br>uncompleted<br>contracts                   |        |   |        |   |
| Other liabilities   | (13    | ) | (7     | ) |
| Net cash used in<br>operating activities                  | (1,094 | ) | (1,616 | ) |
| Cash Flows from<br>Investing Activities:                  |        |   |        |   |
| Capital expenditures                                      | (282   | ) | (364   | ) |
| Net cash used in<br>investing activities                  | (282   | ) | (364   | ) |
| Cash Flows from<br>Financing Activities:                  |        |   |        |   |
| Payment on<br>convertible notes<br>payable                | (175   | ) | (175   | ) |
| Proceeds from line<br>of credit                           | 221    |   | (229   | ) |
| Proceeds from<br>issuance of debt                         | 945    |   | -      |   |
| Net cash provided by<br>(used in) financing<br>activities | 991    |   | (404   | ) |
| Net decrease in cash<br>and cash equivalents              | (385   | ) | (2,384 | ) |
| Cash and cash<br>equivalents at<br>beginning of period    | 1,378  |   | 3,291  |   |
| Cash and cash<br>equivalents at end of<br>period          | \$ 993 |   | \$ 907 |   |
| Supplemental<br>disclosure of cash<br>flow information:   |        |   |        |   |
| Cash paid for<br>interest                                 | \$ 176 |   | \$ 162 |   |
| Cash paid for taxes                                       | \$ 76  |   | \$ 45  |   |
| Supplemental<br>non-cash financing<br>information:        |        |   |        |   |
| Issuance of<br>warrants in<br>connection with debt        | \$ 168 |   | \$ -   |   |

See accompanying notes to the consolidated financial statements.

**TSS, Inc.**

**Notes to Consolidated Statements**

**September 30, 2015**

**(unaudited)**

**Note 1 – Significant Accounting Policies**

*Description of Business*

TSS, Inc. (“TSS”, the “Company”, “we”, “us” or “our”) provides comprehensive services for the planning, design, construction and maintenance of mission-critical facilities and information infrastructure as well as systems integration services related to this infrastructure. We provide a single source solution for highly technical mission-critical facilities such as 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, construction management, facilities management and systems integration. Our corporate offices are in Round Rock, Texas, and we also have facilities in Dulles, Virginia, Columbia, Maryland and Los Altos, California.

The accompanying consolidated balance sheet as of December 31, 2014, 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 condensed 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 and cash flows. These interim financial statements should be read in conjunction with the financial statements and accompanying notes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2014.

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, stockholders’ deficit and declining current ratio, by themselves, raise substantial doubt about our ability to continue to operate our business as a going concern. We continue to seek additional funding to support our ongoing operations. In February 2015 we borrowed \$945,000 under a 5-year multiple advance term loan agreement with a

group of investors including some entities associated with the Chairman of our Board of Directors. During 2014 we also adjusted our overhead structure to reduce our level of overhead as business conditions and our revenue mix changed. We believe that there are further adjustments that could be made to our business if we were required to do so.

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 or significantly affect our level of liquidity, which may require us to take measures to reduce our operating costs or obtain funding in order 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*

We recognize revenue when pervasive evidence of an arrangement exists, the contract price is fixed or determinable, services have been rendered or goods delivered, and collectability is reasonably assured. Our revenue is derived from fixed-price contracts, time-and-materials contracts, cost-plus-fee contracts (including guaranteed maximum price contracts), facility service and maintenance contracts, and product shipments.

Revenue from fixed price contracts is recognized on the percentage of completion method. We apply Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) 605-35, *Construction-Type and Production-Type Contracts*, recognizing revenue on the percentage-of-completion method using costs incurred in relation to total estimated project costs. This method is used because management considers costs incurred and costs to complete to be the best available measure of progress in the contracts. Contract costs include all direct materials, subcontract and labor costs and those indirect costs related to contract performance, such as indirect labor, payroll taxes, employee benefits and supplies.

Revenue on cost-plus-fee contracts is recognized to the extent of costs incurred, plus an estimate of the applicable fees earned. Fixed fees under cost-plus-fee contracts are recorded as earned in proportion to the allowable costs incurred in performance of the contract.

Billings in excess of costs and estimated earnings on uncompleted contracts are classified as current liabilities. Costs and estimated earnings in excess of billings on uncompleted contracts, or work in process, are classified as current assets for the majority of our projects. Work in process on contracts is based on work performed but not yet billed to customers as per individual contract terms.

Certain of our contracts involve the delivery of multiple elements including design management, system installation and facilities maintenance. Revenues from contracts with multiple element arrangements are recognized as each element is earned based on the relative selling price of each element provided the delivered elements have value to customers on a standalone basis. Amounts allocated to each element are based on its objectively determined fair value, such as the sales price for the service when it is sold separately or competitor prices for similar services.

Revenue and related costs for master and other service agreements billed on a time and materials basis are recognized as the services are rendered based on actual labor hours performed at contracted billable rates, and costs incurred on behalf of the customer. Services are also performed under master and other service agreements billed on a fixed fee basis. Under fixed fee master service and similar type service agreements for facilities and equipment, we furnish various unspecified units of service for a fixed price. These services agreements are recognized on the proportional performance method or ratably over the course of the service period and costs are recorded as incurred in performance.

We recognize revenue from assembled products when the finished product is shipped and collection of the resulting receivable is reasonably assured. In arrangements where a formal acceptance of products or services is required by the customer, revenue is recognized upon meeting such acceptance criteria.

#### *Allowance for Doubtful Accounts*

We estimate an allowance for doubtful accounts based on factors related to the specific credit risk of each customer. Historically our credit losses have been minimal. We perform credit evaluations of new customers and may require prepayments or use of bank instruments such as trade letters of credit to mitigate credit risk. As we expand our product offerings and customer base, our risk of credit loss has increased. We monitor outstanding amounts to limit our credit exposure to individual accounts. We continue to pursue collection even if we have fully provided for an account balance.

*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 suffer. The loss of or a significant reduction in orders from this customer or the failure to provide adequate products or services to them would significantly reduce our revenue. We also periodically perform large construction projects which may comprise a significant portion of our revenues during the construction phase, and which may cause large fluctuations in our quarterly revenues.

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

|                              | Three months ended Sept. 30, |      | Nine Months Ended Sept. 30, |      |    |   |    |   |
|------------------------------|------------------------------|------|-----------------------------|------|----|---|----|---|
|                              | 2015                         | 2014 | 2015                        | 2014 |    |   |    |   |
| US-based IT OEM              | 37                           | %    | 50                          | %    | 44 | % | 41 | % |
| US-based data center company | 5                            | %    | 7                           | %    | 8  | % | 12 | % |
| US-based retail company      | 20                           | %    | 9                           | %    | 12 | % | 9  | % |
| US-based technology company  | 11                           | %    | -                           |      | 4  | % | -  |   |

No other customers represented more than 10% of our revenues for any periods presented. Our US-based IT OEM customer represented 11% of our accounts receivable at September 30, 2015 and 29% of our accounts receivable at December 31, 2014. A U.S.-based retail company represented 28% of our accounts receivable at September 30, 2015, a US-based pharmaceutical company represented 11% of our accounts receivable at September 30, 2015, and a US-based technology company represented 16% of our accounts receivable at September 30, 2015. A US-based retail customer represented 13% of our accounts receivable at December 31, 2014. No other customer represented more than 10% of our accounts receivable at September 30, 2015 or at December 31, 2014.

### *Revision of Prior Period Financial Statements*

During the three-month period ended September 30, 2015 we discovered an error that impacted the Company's previously issued consolidated balance sheets. The error related to the cancellation of previously-issued restricted shares that had been reported as a treasury share transaction, resulting in an overstatement of both our issued number of shares outstanding and the number of treasury shares outstanding.

In evaluating whether our previously issued consolidated balance sheets were materially misstated, we considered the guidance in ASC Topic 250, *Accounting Changes and Error Correction*, ASC Topic 250-10-S99-1, *Assessing Materiality*, and ASC Topic 250-10-S99-2, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements*. We concluded that this error was not material to any of the prior reporting periods and therefore, amendments of previously filed reports were not required. However the errors in our consolidated financial statements would impact comparisons to prior periods. As such the revision for the correction is reflected in the financial information of the applicable prior periods and will be reflected in future filings containing such financial information.

The consolidated balance sheet at December 31, 2014 reflects corrections to the number of common shares outstanding and the number of treasury shares outstanding, which were both overstated by 52,000 shares.

### *Recently Issued Accounting Pronouncements*

In April 2015, the FASB issued ASU 2015-03, *Interest-Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs*, an accounting pronouncement related to the presentation of debt issuance costs. This guidance requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability. The recognition and measurement guidance for debt issuance costs are not affected by the amendments in this guidance. This update will be effective for us beginning in fiscal year 2016, with early adoption permitted, and is applied on a retrospective basis. As of September 30, 2015 and December 31, 2014 we had \$44,000 and \$49,000, respectively, of debt issuance costs reported as assets on our consolidated balance sheet. We do not anticipate that adoption of this guidance will have a material impact on our consolidated financial statements when we implement this in fiscal year 2016.

In August 2014, the FASB issued ASU No. 2014-15, *Presentation of Financial Statements – Going Concern (Topic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern* ("ASU 2014-15"). ASU 2014-15 requires that management assess an entity's ability to continue as a going concern by incorporating and expanding upon certain principles that are currently in U.S. auditing standards. ASU 2014-15 is effective for annual



periods ending after December 15, 2016, and for annual periods and interim periods thereafter. We plan to adopt ASU 2014-15 as of the end of our fiscal year ending December 31, 2016 and are currently evaluating the impact of this pronouncement on our consolidated statements of financial position and results of operations.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers*, an accounting pronouncement related to revenue recognition (FASB ASC Topic 606), which amends the guidance in former ASC Topic 605, *Revenue Recognition*, and provides a single, comprehensive revenue recognition model for all contracts with customers. This standard contains principles that an entity will apply to determine the measurement of revenue and timing of when it is recognized. The entity will recognize revenue to reflect the transfer of goods or services to customers at an amount that the entity expects to be entitled to in exchange for those goods or services. This pronouncement is effective for fiscal years, and interim periods within those years, beginning after December 15, 2017, and early adoption is not permitted. We are currently evaluating the impact of this pronouncement on our consolidated financial statements.

**Note 2 – Supplemental Balance Sheet Information**

*Receivables*

Contract and other receivables, net, consisted of the following (in '000's):

|                                 | Sept. 30,<br>2015 | December 31,<br>2014 |
|---------------------------------|-------------------|----------------------|
| Contract and other receivables  | \$ 3,253          | \$ 3,976             |
| Allowance for doubtful accounts | (14 )             | (25 )                |
|                                 | \$ 3,239          | \$ 3,951             |

*Inventory*

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

|                  | Sept. 30,<br>2015 | December 31,<br>2014 |
|------------------|-------------------|----------------------|
| Work in process  | \$ 18             | \$ 33                |
| Raw materials    | 56                | 121                  |
| Inventories, net | \$ 74             | \$ 154               |

*Property and Equipment*

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

|                                 | Sept. 30,<br>2015 | December 31,<br>2014 |
|---------------------------------|-------------------|----------------------|
| Vehicles                        | \$ 32             | \$ 32                |
| Trade equipment                 | 223               | 210                  |
| Leasehold improvements          | 285               | 279                  |
| Furniture and fixtures          | 70                | 70                   |
| Computer equipment and software | 1,605             | 1,341                |
|                                 | 2,215             | 1,932                |
| Less accumulated depreciation   | (1,543 )          | (1,262 )             |
| Property and equipment, net     | \$ 672            | \$ 670               |

*Goodwill and Intangible Assets*

Goodwill and Intangible Assets, net, consist of the following (in '000's):

|          | Sept. 30,<br>2015 | December 31,<br>2014 |
|----------|-------------------|----------------------|
| Goodwill | \$ 1,907          | \$ 1,907             |

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|                               |        |        |
|-------------------------------|--------|--------|
| Trade name                    | 60     | 60     |
| Customer relationships        | 906    | 906    |
| Acquired software             | 234    | 234    |
|                               | 1,201  | 1,201  |
| Less accumulated amortization | (325 ) | (222 ) |
| Intangible assets, net        | \$ 876 | \$ 979 |

We recognized amortization expense related to intangibles of approximately \$34,000 and \$103,000 for the three and nine- month periods ended September 30, 2015, respectively.

US GAAP requires us to perform an impairment test of goodwill on an annual basis or whenever events or circumstances make it more likely than not that impairment of goodwill may have occurred. As part of the annual impairment test, we first have the option to make a qualitative assessment of goodwill for impairment. If we are able to determine, through the qualitative assessment, that the fair value of a reporting unit more likely than not exceeds its carrying value, no further evaluation is necessary. For those reporting units for which the qualitative assessment is either not performed or indicates that further testing may be necessary, we may then assess goodwill for impairment using a two-step process. The first step requires comparing the fair value of the reporting unit with its carrying amount, including goodwill. If that fair value exceeds the carrying amount, the second step of the process is not required to be performed, and no impairment charge is required to be recorded. If that fair value does not exceed that carrying amount, we must perform the second step, which requires an allocation of the fair value of the reporting unit to all assets and liabilities of that unit as if the reporting unit had been acquired in a purchase business combination and the fair value of the reporting unit was the purchase price. The goodwill resulting from that purchase price allocation is then compared to the carrying amount with any excess recorded as an impairment charge.

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, the Company will evaluate its indefinite lived intangible assets for impairment. We performed a quantitative analysis of our goodwill and intangibles as at December 31, 2014 as part of our annual testing for impairment. We used a combination of valuation methodologies including income and market-based valuation methods, with increased weighting on the income-based approaches and subject company stock-price methods as we felt these options more accurately captured the operations of our reporting units. Although there were events and circumstances in existence at December 31, 2014 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 substantially greater than the carrying value, including goodwill, for each of our reporting units. Thus we concluded that there was no impairment at December 31, 2014 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, 2015 that would have required an interim impairment analysis of our goodwill and other long-lived intangible assets.

#### *Accounts Payable and Accrued Expenses*

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

|   | September 30,<br>2015 | December 31,<br>2014 |
|---|-----------------------|----------------------|
| Accounts payable                            | \$ 2,956              | \$ 3,995             |
| Accrued expenses                            | 929                   | 961                  |
| Compensation, benefits & related taxes      | 593                   | 574                  |
| Other accrued expenses                      | 292                   | 17                   |
| Total accounts payable and accrued expenses | \$ 4,770              | \$ 5,547             |

#### **Note 3 – Long term borrowings**

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

|   | September 30,<br>2015 | December 31,<br>2014 |
|---|-----------------------|----------------------|
| Convertible notes payable                         | \$ 575                | \$ 750               |
| Unamortized discount on convertible notes payable | -                     | (26 )                |
| Notes Payable due Feb. 2020                       | 945                   | -                    |
| Unamortized discount on notes payable             | (152 )                | -                    |
|   | 1,368                 | 724                  |

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|  |        |   |        |   |
|--|--------|---|--------|---|
| Current portion of long-term borrowing     | (575   | ) | (149   | ) |
| Non-current portion of long-term borrowing | \$ 793 |   | \$ 575 |   |

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 the terms of this loan agreement on February 3, 2015 and executed a promissory note to evidence this loan and the terms of repayment.

The loan requires interest-only payments made monthly, beginning March 1, 2015, and bears annual interest at a fixed rate of 12%. The loan has a maturity date of February 3, 2020. We are able to prepay the loan at any time, subject to a prepayment fee of (a) 4% of the amount prepaid if the prepayment is made prior to February 3, 2016, (b) 2% of the amount prepaid if the prepayment is made between February 4, 2016 and February 3, 2017, and (c) 1% of the amount prepaid if the prepayment is made between February 4, 2017 and February 3, 2018.

The obligations under the loan are secured by substantially all of our assets pursuant to the terms of a security agreement. The parties also executed a subordination agreement to evidence their agreement that the loan is subordinated to the senior debt held by Bridge Bank.

In conjunction with entering into the loan agreement, the Company and MHW also entered into a warrant (the “Warrant”) granting MHW the right to purchase up to 1,115,827 shares of the Company’s common stock. The Warrant is exercisable for a period of five years from February 3, 2015 at an exercise price of \$0.50 for the first 472,500 shares, \$1.00 for the next 425,250 shares and \$1.30 for the final 218,077 shares. The exercise price and number of shares of common stock issuable upon 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 Warrant was approximately \$204,000. 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 the recognition of a discount on the loan of approximately \$168,000 and a corresponding increase to additional paid in capital. This discount will be amortized using the straight-line method which approximates the effective interest rate method over the term of the loan. \$8,000 was amortized during the three-month period ended September 30, 2015 and \$25,000 was amortized during the nine-month period ended September 30, 2015.

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. 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.

#### Note 4 – Net Loss Per-Share

Basic and diluted (loss) earnings 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 earnings per share, includes the effects of dilutive unvested restricted stock, options to purchase common stock and convertible securities including common stock warrants. 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 earnings per share computations for income (loss) from continuing operations. In the table below, income (loss) represents the numerator and shares represent the denominator (in thousands except per share amounts).

|              | Three Months Ended Sept. |           | Nine Months Ended Sept |             |
|--------------|--------------------------|-----------|------------------------|-------------|
|              | 30,                      |           | 30,                    |             |
|              | 2015                     | 2014      | 2015                   | 2014        |
| Numerator:   |                          |           |                        |             |
| Net loss     | \$ (601 )                | \$ (366 ) | \$ (2,221 )            | \$ (2,560 ) |
| Denominator: |                          |           |                        |             |

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|   |            |            |            |            |
|---|------------|------------|------------|------------|
| Weighted-average shares of common stock outstanding                   | 15,632     | 15,075     | 15,527     | 14,935     |
| Dilutive effect of employee stock options and restricted stock awards | -          | -          | -          | -          |
| Weighted-average shares for diluted net loss per share                | 15,632     | 15,075     | 15,527     | 14,935     |
| Basic & diluted net loss per share                                    | \$ (0.04 ) | \$ (0.02 ) | \$ (0.14 ) | \$ (0.17 ) |

For the three and nine-month periods ended September 30, 2015 and 2014, potentially dilutive shares of 3,717,000 and 2,470,000 were excluded from the calculation of dilutive shares because their effect would have been anti-dilutive due to the net loss reported in each period.

**Note 5 – Related Party Transactions**

We lease our facility in Columbia, Maryland from an entity that is 50% owned by Gerard Gallagher, a director and our Chief Technical Officer. This lease expires in July 2016. Rents paid under this agreement were \$69,000 for each of the three -month periods ended September 30, 2015 and 2014, respectively and \$207,000 for each of the nine-month periods ended September 30, 2015 and 2014, respectively.

We have \$575,000 principal outstanding at September 30, 2015 in convertible notes payable to Mr. Gallagher. The notes bear interest at 4% per annum and are subordinated to our borrowings to Bridge Bank under our revolving credit facility. Per the terms of the notes, we paid interest of \$6,000 and \$8,000 during the three month periods ended September 30, 2015 and 2014, respectively. We repaid principal against the notes of \$25,000 during each of the three -month periods ended September 30, 2015 and 2014. For the nine month periods ended September 30, 2015 and 2014, we paid interest of \$19,000 and \$24,000 respectively. We repaid principal against the notes of \$175,000 in each of the nine-month periods ended September 30, 2015 and 2014.

We have \$945,000 principal outstanding at September 30, 2015 in promissory notes payable to MHW, During the three and nine-month periods ended September 30, 2015 we paid interest of \$29,000 and \$74,000 respectively to MHW.

#### Note 6 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 construction and maintenance, and systems integration services. Our facilities construction and maintenance unit is involved in the design, construction 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. We determined that the systems integration business should be reported as a separate segment because it is increasingly becoming a greater proportion of our total business, operates with a different business model, and is managed and evaluated separately from our other business. All of our revenues are derived from the U.S. market. Segment operating results reflect earnings (losses) before stock-based compensation, acquisition related expenses, other expenses, net, and provision for income taxes.

Revenue and operating result by reportable segment reconciled to reportable net loss for the three and nine-month periods ended September 30, 2015 and 2014 and other segment-related information is as follows (in thousands):

|  | Three Month Periods<br>ended Sept. 30, |          | Nine Month Periods<br>ended Sept. 30, |            |
|--|--|----------|---------------------------------------|------------|
|  | 2015                                   | 2014     | 2015                                  | 2014       |
| Revenues:                                |  |          |                                       |            |
| Facilities construction and maintenance  | \$5,285                                | \$4,308  | \$14,940                              | \$14,359   |
| System integration services              | 1,007                                  | 1,905    | 4,471                                 | 5,216      |
| Total revenues                           | \$6,292                                | \$6,213  | \$19,411                              | \$19,575   |
| Income (loss) from operations:           |  |          |                                       |            |
| Facilities construction and maintenance. | \$1,231                                | \$790    | \$3,102                               | \$2,090    |
| System integration services              | (181 )                                 | 469      | 97                                    | 1,068      |
| Other consolidated activities            | (1,577 )                               | (1,552 ) | (5,187 )                              | (5,508 )   |
| Consolidated loss from operations        | \$(527 )                               | \$(293 ) | \$(1,988 )                            | \$(2,350 ) |
| Depreciation expense:                    |  |          |                                       |            |
| System integration services              | \$79                                   | 50       | \$217                                 | 118        |
| Other consolidated activities            | 20                                     | 21       | 63                                    | 78         |



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|   |      |      |       |       |
|---|------|------|-------|-------|
| Consolidated depreciation expense       | \$99 | \$71 | \$280 | \$196 |
| Interest expense                        |      |      |       |       |
| Facilities construction and maintenance | \$—  | \$—  | \$—   | \$—   |
| System integration services             | —    | —    | —     | —     |
| Other consolidated activities           | 74   | 73   | 233   | 210   |
| Consolidated interest expense           | \$74 | \$73 | \$233 | \$210 |

|   | <b>Sept. 30</b> | <b>Dec. 31</b> |
|---|-----------------|----------------|
|   | <b>2015</b>     | <b>2014</b>    |
| Total Assets                            |                 |                |
| Facilities construction and maintenance | \$5,742         | \$5,617        |
| System integration services             | 2,007           | 3,146          |
| Other consolidated activities           | 1,489           | 1,652          |
| Total assets                            | \$9,238         | \$10,415       |

Other consolidated activities relate to operating costs not specifically attributable to each business segment including sales, marketing, executive and administrative support functions, including activities such as finance, human resources and IT.

## **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 financial statements and notes thereto included in Item 1 of this Form 10-Q and the 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, 2014 included in our 2014 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 I, Item 1A of our 2014 Annual Report on Form 10-K and in Part II, Item 1A of this Form 10-Q for a discussion of items that may affect our future results.*

### **Overview**

TSS, Inc. provides comprehensive services for the planning, design, development and maintenance of mission-critical facilities and information infrastructure, as well as integration services. We provide a single source solution for highly technical mission-critical facilities such as data centers, operation 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, construction management, systems integration, system installations and facilities management.

Our headquarters are in Round Rock, Texas, and we have offices in Columbia, Maryland, Dulles, Virginia, and Los Altos, California.

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 increasingly efficient data center design, construction and operation, resulting in increasing capital expenditures 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 construction of mission-critical facilities and information infrastructures, as well as fees earned from providing maintenance services on these facilities. We also earn revenue from providing system configuration and integration services to IT equipment vendors. Currently we derive most of our revenue from the U.S. market.

We contract with our customers under five primary contract types: cost-plus-fee, guaranteed maximum price, time-and-materials, fixed-price contracts and fixed price service and maintenance contracts, including product shipment. 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. Where customer requirements are clear, we prefer to enter into time-and-materials and fixed-price 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 in order 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 generate lower margins than our maintenance and integration services. We have re-focused our construction services towards smaller scaled jobs typically connected with addition/move/retrofit activities rather than new construction, where we can obtain better margins. We have also focused on providing maintenance services for modular data center applications as this emerging market expands.

Revenues for the three-month period ended September 30, 2015 increased by \$79,000, or 1% compared to the same period in 2014. This increase was driven by a \$977,000 or 23% increase in our facilities construction and maintenance business due to increased equipment sales and increased activity in our project management operations. This increase was offset by a \$898,000 or 47% decrease in our systems integration business compared to 2014 attributable to a decrease in demand for our services from our largest channel partner. Our revenue of \$6.3 million in the three-month period ended September 30, 2015 was 8% or \$445,000 higher than the \$5.8 million in revenue we had in the second quarter of 2015, primarily due to higher equipment sales and a greater number of projects in our facilities design, construction and maintenance business.

For the nine month period ended September 30, 2015, our revenue of \$19.4 million was 1% or \$164,000 lower than the \$19.6 million we had in the same period of 2014. This decrease was primarily due to \$0.8 million less in our systems integration business, offset by \$0.6 million in higher equipment sales in the same period of 2015 in our construction related services.

Our facility construction projects tend to be larger in value than the contracts for our other products and services and from a smaller number of customers. These projects have greater transaction values and can contribute to large quarterly fluctuations in revenue due to the timing of such projects and their fulfillment. We have historically had such projects with values that exceeded \$10 million annually. A small number of these transactions could lead to a significant increase in revenue but cause greater volatility in our quarterly revenue depending on the deployment timetable of the projects. These projects also increase our liquidity risk because they tend to be longer in duration and require larger amounts of working capital to fulfill. We attempt to manage these fluctuations through customer and vendor payment terms, including paid-when-paid terms, as part of our working capital management.

#### *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, including 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 68% for the three-month period ended September 30, 2015 compared to 65% for the same period in 2014 and 75% in the second quarter of 2015. This slight increase from the second quarter reflects our efforts to control labor costs in our systems integration business. The increase from the prior year reflects changes in our revenue mix and a decrease in our higher margin maintenance and system integration businesses, including lower utilization of our systems integration facility in the current quarter as this business experienced a decline in volume.

Since we earn higher profits on our own labor services, we expect the ratio of cost of services to revenue to decline when our labor services mix increases relative to the use of subcontracted labor or third-party material. Conversely, as

subcontracted labor or third-party material purchases for customer projects increase relative to our own labor services, we expect the ratio of cost of services to revenue to increase. 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 larger contracts or 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 quickly. While these factors could lead to a higher ratio of cost of services to revenue, the economics of these larger jobs are nonetheless generally favorable because they 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*

For the three-month period ended September 30, 2015 our gross profit was 32% of revenue, compared to a gross profit margin of 35% in the third quarter of 2014 and a gross profit margin of 25% in the second quarter of 2015. This decrease from the same period in 2014 reflects a decrease in our higher-margin activities such as systems integration, particularly since the first quarter of 2015. Many of the costs of our system integration facility are fixed, and lower revenue levels quickly impact the gross profit of this operation. We were able to reduce our temporary labor costs in this period which drove the improvement in profit compared to the prior quarter. For the nine-month periods ended September 30, 2015 and 2014 our gross profit was 30% and 31% of revenue, respectively. Our ability to improve gross margins will depend, in part, upon our ability to further increase sales of our higher-margin services including maintenance and integration services, improve our service margins through further pricing and operating efficiency including utilization of our direct labor, and increasing our total revenues to a level that will allow us to increase the utilization of our integration and service operations.

*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, 2015 our selling, general and administrative expenses increased by \$57,000 or 2% compared to the same period of 2014. This increase was primarily due to higher temporary headcount costs offset by lower professional fees compared to 2014. For the nine-month period ended September 30, 2015 our selling, general and administrative expenses decreased by \$624,000 or 8% compared to the same period of 2014. This decrease was from lower headcount and lower professional fees, particularly legal and accounting costs, compared to 2014.

*Operating loss*

For the three-month period ended September 30, 2015 our operating loss was \$0.5 million. This was an increase of \$234,000 from the operating loss of \$0.3 million that we had in the third quarter of 2014. For the nine-month period ended September 30, 2015, our operating loss of \$2.0 million was \$362,000 or 15% lower than the \$2.4 million loss that we had in the comparable period of 2014. This improvement was primarily driven by lower operating expenses.

**LIQUIDITY AND CAPITAL RESOURCES**

Our primary sources of liquidity at September 30, 2015 are our cash and cash equivalents on hand, our bank credit facility and projected cash flows from operating activities. During the first quarter of 2015 we entered into a new term loan agreement with an affiliate of the Chairman of our Board of Directors. Under this loan agreement we borrowed \$945,000 under a 5-year interest-only loan. The obligations under the loan are secured by substantially all of our assets pursuant to the terms of a security agreement. The parties also executed a subordination agreement to evidence their agreement that the loan is subordinate to the senior debt held by Bridge Bank.

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 2015 and beyond or significantly affect our level of liquidity, which may limit our opportunities to grow our business.

Our Business Financing Agreement with Bridge Bank provides for a total line of credit of up to \$6 million, subject to our borrowing base, and a maturity date of May 2016. The revolving loans made to us under this loan facility are secured by a lien on substantially all of our assets. As of September 30, 2015, we had outstanding borrowings of \$1.392 million under this loan facility and, based on the borrowing base formula, we had approximately \$0.4 million available to borrow under this loan facility. We are currently in compliance with all loan covenants under the loan facility. For further information regarding this credit facility, refer to our Annual Report on Form 10-K for the year ended December 31, 2014.

Although our operating results have shown mixed results in 2015, we have been able to continue to lower operating expenses and manage our working capital to ensure sufficient liquidity to operate the business. We continue to look at alternative sources of funding to strengthen our balance sheet and to further improve our liquidity. We are currently evaluating a number of alternatives including various potential debt, convertible debt and equity issuances but we have not yet agreed upon the terms or amount of any such financing. There can be no guarantee that such financing will be available to us in amounts or on terms reasonably acceptable to us or that we will complete any such financing.

As of September 30, 2015 and December 31, 2014, we had cash and cash equivalents of \$1.0 million and \$1.4 million, respectively.

#### *Significant uses of cash*

#### *Operating activities:*

Cash used in operating activities for the nine-month period ended September 30, 2015 was \$1.1 million, compared to \$1.6 million in the same period of 2014. This decrease was primarily driven by reductions in the amount of cash used for working capital, which was due to lower payables outlays attributable to the absence of large construction-related projects that we had in 2014

Changes in our working capital are driven by changes in the timing of product orders and delivery of products and services. We derive revenue from different products and services and some of these, in particular our construction services, can be large in value, exceeding \$10 million in certain cases. As we or our subcontractors perform work on these large contracts, we have significant fluctuations in the level of our receivables and payables, especially on a quarterly basis. We completed a large construction project during 2014, but did not have any such similar scale projects in progress during 2015. Due to the timing and completion of these projects, this contributed to a \$1.7 million decrease in funds received from accounts receivable compared to the prior year, offset by a \$2.2 million decrease in our accounts payable compared to the prior year.





*Investing activities:*

Cash used in investing activities in 2015 consists of purchases of property and equipment. Our capital expenditures were approximately \$282,000 as we invested in sales management and time management software.

*Financing activities:*

Cash provided by financing activities for the nine-month period ended September 30, 2015 was \$991,000 compared to cash used in financing activities of \$404,000 in the comparable period of 2014. In 2015 we borrowed \$945,000 from new long-term debt, drew down an additional \$221,000 under our bank credit facility and repaid \$175,000 against our notes payable to Mr. Gallagher. In 2014 we repaid \$175,000 against our notes payables to Mr. Gallagher and due to changes in eligible assets, repaid \$229,000 under our bank credit facility.

*Future uses of cash*

Our history of operating losses, declining current ratio and our stockholders' deficit cause substantial doubt about our ability to continue to operate our business as a going concern. In the second quarter of 2014 we extended the term of our bank credit facility to ensure availability of this resource through May 2016. In October 2014 we entered into a customer financing program with our largest customer that allows us to accelerate the receipt of cash from receivables owed by that customer that resulted in the accelerated receipt of \$3.1 million from outstanding receivables. In September 2014 we also restructured the repayment terms of our notes payable held by Mr. Gallagher, a director and our Chief Technical Officer, to defer payments of a large portion of this obligation to 2016, further reducing short term liquidity requirements on our business.

We continue to seek additional funding to support our ongoing operations. In the first quarter of 2015 we borrowed \$945,000 under a 5-year multiple advance term loan agreement. During 2014 we also adjusted our overhead structure to reduce our level of overhead as business conditions and our revenue mix shifted consistent with our strategic focus. We believe that there are further adjustments that could be made to our business if we were required to do so.

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 these 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

during 2015 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 in order 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. These consolidated financial statements 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 convertible debt or equity securities, the ownership of our existing stockholders could 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, funds generated from operations including the funds from our customer financing programs, and borrowings under our revolving credit facility. All of the above risks and the other risks defined in our Annual Report for the year ended December 31, 2014, may have a material adverse effect on our business results or liquidity. 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 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, 2015 and December 31, 2014, we had no off balance sheet arrangements.

### ***Critical Accounting Policies and Pronouncements***

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, 2014. 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, 2015. Based upon that evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that, as a result of the material weaknesses of the Company's internal controls over financial reporting discussed below, our disclosure controls and procedures were not effective as of September 30, 2015.

The Company's monitoring controls and flow of financial reporting information regarding the supervision and review of documentation supporting revenue transactions, journal entries and period-end cut-off procedures and account reconciliations and establishing and reviewing accrued expenses and accounts payable balances were not operating effectively as of December 31, 2014. During 2015 we have hired new accounting staff and strengthened our controls over the review of journal entries and account reconciliations to remediate this material weakness. We are also in the process of implementing new cut-off procedures surrounding revenue and expense cut-offs to further remediate this material weakness, however we have not yet tested the effectiveness of these new procedures. We will test the relevant internal control over financial reporting to determine whether that implementation has effectively remediated that material weakness before the end of our financial year.

### **Changes in Internal Control over Financial Reporting**

Except as described above, there were no changes in the Company's internal control over financial reporting for the three months ended September 30, 2015 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 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

- 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 16, 2015 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)