Bridgeline Digital, Inc.
Form 10-Q
August 14, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2013

OR

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

For the transition period from ______________ to ______________

Commission File Number 333-139298

Bridgeline Digital, Inc.

(Exact name of registrant as specified in its charter)

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

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

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

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

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

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

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

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

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

The number of shares of Common Stock par value $0.001 per share, outstanding as of August 9, 2013 was 17,672,281

Bridgeline Digital, Inc.

Quarterly Report on Form 10-Q

For the Quarterly Period ended June 30, 2013

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Bridgeline Digital, Inc.

Quarterly Report on Form 10-Q

For the Quarterly Period ended June 30, 2013

Statements contained in this Report on Form 10-Q that are not based on historical facts are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements may be identified by the use of forward-looking terminology such as "should," "could," "may," "will," "expect," "believe," "estimate," "anticipate," "intends," "continue," or similar terms or variations of those terms or the negative of those terms. These statements appear in a number of places in this Form 10-Q and include statements regarding the intent, belief or current expectations of Bridgeline Digital, Inc. Forward-looking statements are merely our current predictions of future events. Investors are cautioned that any such forward-looking statements are inherently uncertain, are not guaranties of future performance and involve risks and uncertainties. Actual results may differ materially from our predictions. Important factors that could cause actual results to differ from our predictions include the impact of the weakness in the U.S. and international economies on our business, our inability to manage our future growth effectively or profitably, fluctuations in our revenue and quarterly results, our license renewal rate, the impact of competition and our ability to maintain margins or market share, the limited market for our common stock, the volatility of the market price of our common stock, the performance of our products, our ability to respond to rapidly evolving technology and customer requirements, our ability to protect our proprietary technology, the security of our software, our dependence on our management team and key personnel, our ability to hire and retain future key personnel, or our ability to maintain an effective system of internal controls. Although we have sought to identify the most significant risks to our business, we cannot predict whether, or to what extent, any of such risks may be realized, nor is there any assurance that we have identified all possible issues which we might face. We assume no obligation to update our forward-looking statements to reflect new information or developments. We urge readers to review carefully the risk factors described in our Annual Report on Form 10-K for the fiscal year ended September 30, 2012 as well as in the other documents that we file with the Securities and Exchange Commission. You can read these documents at www.sec.gov.

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

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PART I—FINANCIAL INFORMATION

Item 1. Financial Statements.

BRIDGELINE DIGITAL, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

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

(Unaudited)

ASSETS	**June 30,** 2013	**September 30,** 2012
Current assets:		
Cash and cash equivalents	$1,715	$ 2,126
Accounts receivable and unbilled receivables, net	3,379	3,977
Prepaid expenses and other current assets	954	648
Total current assets	6,048	6,751
Equipment and improvements, net	3,341	2,735
Intangible assets, net	1,029	1,527
Goodwill	21,880	21,545
Other assets	1,676	1,132
Total assets	$33,974	$ 33,690
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$1,265	$ 1,132
Accrued liabilities	926	1,306
Accrued earnouts, current	322	375
Debt, current	1,541	1,424
Capital lease obligations, current	431	230
Deferred revenue	2,548	1,144
Total current liabilities	7,033	5,611
Accrued earnouts, net of current portion	586	990
Debt, net of current portion	2,501	2,988
Capital lease obligations, net of current portion	604	127
Other long term liabilities	912	1,004

Total liabilities	$11,636	$ 10,720
Commitments and contingencies		
Stockholders' equity:		
Preferred stock - $0.001 par value; 1,000,000 shares authorized; none issued and outstanding	-	-
Common stock -$0.001 par value; 20,000,000 shares authorized; 17,672,281 and 15,203,538 shares issued and outstanding,	18	15
Additional paid-in capital	43,066	40,847
Accumulated deficit	(20,609)	(17,716)
Accumulated other comprehensive loss	(137)	(176)
Total stockholders' equity	22,338	22,970
Total liabilities and stockholders' equity	$33,974	$ 33,690

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

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BRIDGELINE DIGITAL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

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

(Unaudited)

	Three Months Ended		**Nine Months Ended**	
	June 30, **2013**	**2012**	June 30, **2013**	**2012**
Revenue:				
Web application development services	$4,276	$5,055	$13,614	$15,804
Managed service hosting	409	631	1,456	1,858
Subscription and perpetual licenses	915	686	2,726	1,899
Total revenue	5,600	6,372	17,796	19,561
Cost of revenue:				
Web application development services	2,341	2,611	7,566	8,237
Managed service hosting	76	98	224	289
Subscription and perpetual licenses	330	117	770	337
Total cost of revenue	2,747	2,826	8,560	8,863
Gross profit	2,853	3,546	9,236	10,698
Operating expenses:				
Sales and marketing	2,275	1,965	6,266	5,526
General and administrative	1,140	923	3,440	2,924
Research and development	515	370	893	1,253
Depreciation and amortization	412	446	1,226	1,296
Impairment of intangible asset	-	-	-	281
Total operating expenses	4,342	3,704	11,825	11,280
Loss from operations	(1,489)	(158)	(2,589)	(582)
Interest income (expense), net	(59)	(98)	(194)	(234)
Loss before income taxes	(1,548)	(256)	(2,783)	(816)
Provision for income taxes	21	21	110	90
Net loss	$(1,569)	$(277)	$(2,893)	$(906)
Net loss per share:				
Basic and diluted	$(0.10)	$(0.02)	$(0.19)	$(0.07)
Number of weighted average shares:				
Basic and diluted	15,037,767	12,971,259	14,902,419	12,543,019

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

BRIDGELINE DIGITAL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

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

(Unaudited)

	Three Months Ended		**Nine Months Ended**	
	June 30,		June 30,	
	2013	**2012**	**2013**	**2012**
Net Loss	$(1,569)	$(277)	$(2,893)	$(906)
Other comprehensive income (loss):				
Net change in foreign currency translation adjustment	(12)	(27)	39	(63)
Other comprehensive income (loss):	(12)	(27)	39	(63)
Comprehensive loss	$(1,581)	$(304)	$(2,854)	$(969)

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

BRIDGELINE DIGITAL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

(Unaudited)

	Nine Months Ended June 30,	
	2013	**2012**
Cash flows from operating activities:		
Net loss	$(2,893)	$(906)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Amortization of intangible assets	391	571
Impairment of intangible asset	-	281
Depreciation	835	725
Other amortization	201	130
Stock-based compensation	334	256
Contingent earnout liability adjustment	(497)	(780)
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable and unbilled receivables	562	(76)
Prepaid expenses and other assets	(162)	(18)
Accounts payable and accrued liabilities	(512)	(761)
Deferred revenue	1,381	(9)
Other liabilities	(92)	(205)
Total adjustments	2,441	114
Net cash used by operating activities	(452)	(792)
Cash flows from investing activities:		
Equipment and improvements	(545)	(855)
Acquisitions, net of cash acquired	-	(35)
Software development capitalization costs	(739)	(182)
Contingent acquisition payments	(314)	(324)
Net cash used in investing activities	(1,598)	(1,396)
Cash flows from financing activities:		
Proceeds from sale of common stock, net of issuance costs	2,062	2,242
Proceeds from exercise of employee stock options	75	128
Proceeds from employee stock purchase plan	74	-
Borrowings from bank line of credit	725	1,876
Payments on bank term loan	(275)	-
Payments on bank line of credit	(652)	(2,021)
Payments on acquired debt	-	(221)

Payments on subordinated promissory notes	(168)	(138)
Principal payments on capital leases	(241)	(201)
Net cash provided by financing activities	1,600	1,665
Effect of exchange rate changes on cash and cash equivalents	39	(63)
Net decrease in cash and cash equivalents	(411)	(586)
Cash and cash equivalents at beginning of period	2,126	2,528
Cash and cash equivalents at end of period	$1,715	$1,942
Supplemental disclosures of cash flow information:		
Cash paid for:		
Interest	$194	$234
Income taxes	$13	$34
Non cash activities:		
Equipment purchased under capital leases	$912	$137
Equipment and other assets included in accounts payable	$-	$13
Accrued contingent consideration (earnouts)	$83	$1,207
Common stock issued in connection with acquisition	$-	$412

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

BRIDGELINE DIGITAL, INC.

NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

1. Description of Business

Overview

Bridgeline Digital enables its customers to maximize the performance of their mission critical websites, intranets, and online stores. Bridgeline is the developer of the award-winning iAPPS Web Engagement Management (WEM) product platform and related digital solutions. The iAPPS platform deeply integrates Web Content Management, eCommerce, eMarketing, and web Analytics capabilities within the heart of websites or eCommerce web stores to help marketers deliver online experiences that attract, engage, and convert their customers across all digital channels. Bridgeline's iAPPS platform combined with its digital services assists customers in maximizing on-line revenue, improving customer service and loyalty, enhancing employee knowledge, and reducing operational costs.

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

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

Locations

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

2. Summary of Significant Accounting Policies

Basis of Presentation and Principles of Consolidation

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

Unaudited Interim Financial Information

The accompanying interim Condensed Consolidated Balance Sheet as of June 30, 2013, the Condensed Consolidated Statements of Operations for the three and nine months ended June 30, 2013 and 2012, respectively, the Condensed Consolidated Statements of Comprehensive Income for the three and nine months ended June 30, 2013 and 2012, respectively, and the Condensed Consolidated Statements of Cash Flows for the nine months ended June 30, 2013 and 2012, respectively, are unaudited. The unaudited interim condensed consolidated statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("US GAAP") and in the opinion of the Company's management have been prepared on the same basis as the audited consolidated financial statements as of and for the year ended September 30, 2012. These consolidated condensed financial statements include all adjustments, consisting of normal recurring adjustments and accruals, necessary for the fair presentation of the Company's financial position at June 30, 2013 and its results of operations for the three and nine months ended June 30, 2013 and 2012, respectively, and its cash flows for the nine months ended June 30, 2013 and 2012, respectively. The results for the three months ended June 30, 2013 are not necessarily indicative of the results to be expected for the year ending September 30, 2013. The accompanying September 30, 2012 Condensed Consolidated Balance Sheet has been derived from the audited financial statements at that date, but does not include all of the information and footnotes required by US GAAP for complete financial statements.

Subsequent Events

On August 1, 2013 the Company completed the acquisition of Transformational Technologies, Inc., d/b/a Elements Local, a franchise web platform developer based in central coast California. The Company acquired all the outstanding capital stock of Elements Local for consideration consisting of (i) 0.4 million in cash, (ii) 0.6 million in common stock, (iii) the assumption of $0.2 million in debt and (iv) contingent consideration of $1.3 million to be paid in a combination of cash and stock. The contingent consideration is payable quarterly over the 12 consecutive calendar quarters following the acquisition, contingent upon the acquired business achieving certain quarterly revenue targets during the period. To the extent that the quarterly revenue target is not met in any particular quarter, the earn-out period will be extended for up to four additional quarters. Subsequent events have been evaluated through the date the accompanying condensed consolidated financial statements were issued.

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BRIDGELINE DIGITAL, INC.

NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

Recent Accounting Pronouncements

In June 2011, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2011-05 ("ASU 2011-05"), *Presentation of Comprehensive Income*, which amends ASC Topic 220, *Comprehensive Income*. ASU 2011-05 eliminates the option to present the components of other comprehensive income as a part of the statement of stockholders' equity and requires other comprehensive income to be presented as part of a single continuous statement of comprehensive income or in a statement of other comprehensive income immediately following the statement of operations. While the new guidance changes the presentation of comprehensive income, there are no changes to the components that are recognized in net income or other comprehensive income. ASU 2011-05 is effective for fiscal years beginning after December 15, 2011 and must be retrospectively applied to all reporting periods presented. The Company adopted ASU 2011-05 on October 1, 2012. The adoption of ASU 2011-05 did not have an impact on the Company's financial condition, results of operations or cash flows.

3. Accounts Receivable and Unbilled Receivables

Accounts receivable and unbilled receivables consists of the following:

	As of June 30, 2013	**As of** September 30, 2012
Accounts receivable	$3,176	$ 3,794
Unbilled receivables	280	381
Subtotal	3,456	4,175
Allowance for doubtful accounts	(77)	(198)
Accounts receivable and unbilled receivables, net	$3,379	$ 3,977

4. Acquisitions

MarketNet, Inc.

On May 31, 2012, the Company completed the acquisition of MarketNet, Inc. ("MarketNet"), an interactive technology company that provides web application development based in Dallas, Texas. The Company acquired all of the outstanding capital stock of MarketNet for consideration consisting of (i) $20 thousand in cash, (ii) assumption of debt of $244 thousand and (ii) contingent consideration of up to $650 thousand in cash and 204,331 shares of Bridgeline Digital common stock, valued at $250 thousand ($1.22 per share). The cash consideration was reduced by $58 thousand due to the Seller's inability to meet an agreed upon target for working capital at the time of acquisition and was applied against Marketnet's earnout payment for the three months ended December 31, 2012. The contingent consideration is payable quarterly over the 12 consecutive calendar quarters following the acquisition, contingent upon the acquired business achieving certain quarterly revenue and quarterly operating income targets during the period. To the extent that either the quarterly revenue target or the quarterly operating income target is not met in a particular quarter, the earn-out period will be extended for up to four additional quarters. MarketNet is also eligible to earn additional bonus equity consideration of 200,000 shares, if annual net revenues of the acquired business exceed a certain threshold in any fiscal year through September 30, 2015. The Company is required to assess the probability of the acquired business achieving the contingent cash and stock payments which requires management to make estimates and judgments based on forecasts of future performance. As a result, the Company reduced the initial estimate of $607 thousand for the contingent cash consideration to be achieved and $262 thousand for the contingent stock consideration to be achieved by $8 thousand and $30 thousand, respectively. The contingent common stock has been issued and is being held in escrow pending satisfaction of the applicable targets. MarketNet achieved its quarterly revenue and operating income targets for the first two quarterly periods after the acquisition date and its operating income target for the periods ending March 31, 2013 and June 30, 2013. MarketNet's operating results are reflected in the Company's condensed consolidated financial statements as of the acquisition date.

BRIDGELINE DIGITAL, INC.

NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

Magnetic Corporation

On October 3, 2011, the Company completed the acquisition of Magnetic Corporation ("Magnetic"), a web technology company based in Tampa, Florida. Bridgeline acquired all of the outstanding capital stock of Magnetic for consideration consisting of (i) $150 thousand in cash and (ii) contingent consideration of up to $600 thousand in cash and 166,666 shares of Bridgeline Digital common stock, valued at $150 thousand ($0.90 per share). The cash consideration was reduced by $100 thousand due to the Seller's inability to meet an agreed upon target for working capital at the time of acquisition. The contingent consideration is payable quarterly over the 12 consecutive calendar quarters following the acquisition, contingent upon the acquired business achieving certain quarterly revenue and quarterly operating income targets during the period. The contingent common stock has been issued and is being held in escrow pending satisfaction of the applicable targets. To the extent that either the quarterly revenue target or the quarterly operating income target is not met in a particular quarter, the earn-out period will be extended for up to four additional quarters. The Company is required to assess the probability of the acquired business achieving the contingent cash and stock payments which requires management to make estimates and judgments based on forecasts of future performance. As a result, the Company estimated and accrued $600 thousand of the contingent cash consideration to be achieved and $150 thousand of the contingent stock consideration to be achieved. Magnetic achieved its quarterly revenue and operating income targets for all periods since the acquisition date. Magnetic's operating results are reflected in the Company's condensed consolidated financial statements as of the acquisition date, which corresponds to the Company's commencement of fiscal 2012.

The estimated fair value of net assets acquired from the MarketNet and Magnetic acquisitions are summarized as follows:

Net assets acquired:	**Amount**
Cash	$ 35
Accounts Receivable, net	327
Other Assets	181
Fixed Assets	91
Intangible Assets	910
Goodwill	1,426
Total Assets	2,970
Current Liabilities	1,210

Liabilities, net of current	73
Total liabilities assumed	1,283
Net assets acquired:	$ 1,687
Purchase Price:	
Cash Paid	$ 70
Contingent earnouts - payable in cash	1,206
Contingent earnouts - payable in common stock	411
	$ 1,687

As part of the Magnetic acquisition, of the $430 thousand allocated to intangible assets, $350 thousand is allocated to customer relationships and $80 thousand is allocated to non-compete agreements, with an average useful life of five years.

The Company completed its formal valuation of intangibles acquired in the MarketNet transaction during the three months ended June 30, 2013. As a result, the Company’s initial estimate of $600 thousand allocated to intangible assets was reduced to $480 thousand. $370 thousand was allocated to customer relationships with and estimated useful life of 5 years and $110 thousand allocated to non-compete agreements with an estimated useful life of 7 years.

The goodwill recorded as a result of the Magnetic and MarketNet acquisitions is nondeductible for tax purposes.

BRIDGELINE DIGITAL, INC.

NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

The following unaudited pro forma financial information reflects the combined results of operations for Bridgeline for the three and nine months ended June 30, 2012, including certain adjustments, as if the acquisition of MarketNet had occurred on October 1, 2011. This information does not necessarily reflect the results of operations that would have occurred had the acquisitions taken place at the beginning of the period, and is not necessarily indicative of the results which may be obtained in the future (in thousands, except per share data):

	Three Months Ended June 30, 2013	**Nine Months** Ended June 30, 2013
Total revenue	$6,829	$21,284
Net loss	$(239)	$(920)
Net loss per share:		
Basic and diluted	$(0.02)	$(0.07)
Number of weighted average shares:		
Basic and diluted	12,988,287	12,560,047

Contingent earnout liabilities for acquisitions completed after September 30, 2009 were recorded at fair value based on valuation models that utilize relevant factors such as estimated probabilities of the acquisitions achieving the performance targets throughout the earnout period. During the three months ended June 30, 2013, total estimated contingent earnout liabilities, cash and stock, were reduced by $181 thousand which comprised $31 thousand of contingent cash earnouts and $150 thousand of contingent stock earnouts. The following table summarizes the changes in accrued earnout liabilities for the nine months ended June 30, 2013:

Balance at September 30, 2012	$1,365
Contingent earnout liability accruals	83
Contingent earnout liability payments	(314)
Contingent earnout reduced by working capital adjustment	(55)
Contingent earnout liability estimate adjustment	(171)
Balance at June 30, 2013	$908

5. Intangible Assets

Changes in the carrying amount of intangible assets are as follows:

	As of June, 2013			
	Gross Amount	**Accumulated** Amortization	**Impairment**	**Net** Amount
Intangible assets:				
Domain and trade names	$26	$ (26)	$ -	$ -
Customer related	4,126	(2,969)	(281)	876
Non-compete agreements	831	(678)	-	153
Acquired software	362	(362)	-	-
Total intangible assets	$5,345	$ (4,035)	$ (281)	$ 1,029

	As of September 30, 2012			
	Gross Amount	**Accumulated** Amortization	**Impairment**	**Net** Amount
Intangible assets:				
Domain and trade names	$26	$ (26)	$ -	$ -
Customer related	4,187	(2,654)	(281)	1,252
Non-compete agreements	877	(602)	-	275
Acquired software	362	(362)	-	-
Total intangible assets	$5,452	$ (3,644)	$ (281)	$ 1,527

BRIDGELINE DIGITAL, INC.

NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

Total amortization expense related to intangible assets for the three months ended June 30, 2013 and 2012 was $117 thousand and $194 thousand, respectively, and amortization expense related to intangible assets for the nine months ended June 30, 2013 and 2012 was $391 thousand and $571 thousand, respectively. They are reflected in operating expenses on the Condensed Consolidated Statements of Operations.

6. Goodwill

Changes in the carrying amount of goodwill follows:

	As of June 30, 2013	**As of** September 30, 2012
Balance at beginning of period	$21,545	$ 20,122
Acquisitions	-	1,175
Contingent acquisition payments	83	248
Purchase price allocation adjustments	252	-
Balance at end of period	$21,880	$ 21,545

7. Debt

Bank Term Loan

In March 2010, the Company entered into an Amended and Restated Loan and Security Agreement SVB (the "Loan Agreement") with Silicon Valley Bank ("SVB"). The Loan Agreement has a two year term which expired on March 31, 2012. In May 2011, the Company amended its loan arrangement (the "Amendment") with SVB, extending the maturity date of the line of credit for one year to March 31, 2013. The Amendment also revised certain financial covenants and amended the out of formula borrowings to be structured as a $2 million term loan and interest on the term loan will be at SVB's prime rate plus 1.75%. In May 2012, the Company amended its loan agreement (the "2012 Amendment") with SVB, extending the maturity date of the line of credit for one year to March 31, 2014. The 2012 Amendment also revised certain financial covenants. In February 2013, the Company amended its loan agreement (the "February 2013 Amendment") with SVB, extending the maturity date of the line of credit for one year to March 31, 2015. The 2013 Amendment also revised certain financial covenants. The Company would not have been in compliance with one of its covenants for the three months ended December 31, 2012 if the amendment was not completed. The Company was compliant with its financial covenants as of March 31, 2013. In July 2013, the Company amended its loan arrangement (the "July 2013 Amendment") with Silicon Valley Bank. The July 2013 Amendment increased the borrowing availability on accounts receivable, revised certain financial covenants, and increased the interest rate on the line of credit from prime plus 1.25% to prime plus 2.25% and increased the interest rate on the term loan from prime plus 1.75% to prime plus 2.75%. Both these rates may return to the previous levels upon achievement of certain financial measures. In addition, the repayment schedule for the term loan was accelerated to end in April 2014. There was $611 thousand remaining on the term loan as of June 30, 2013. The July 2013 Amendment also included a waiver by Silicon Valley Bank of certain financial covenant defaults. The Company would not have been in compliance with certain of its financial covenants as of June 30, 2013 if the July 2013 Amendment was not completed and the waiver was not granted.

BRIDGELINE DIGITAL, INC.

NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

Promissory Notes

In May 2012, the Company assumed two Promissory Notes in connection with the acquisition of MarketNet, Inc. The first Promissory Note in the amount of $63 thousand is payable in eight equal installments of $8 thousand, including interest accrued at 5%, and matures in May 2014. The first installment was due in July 2012. The second Promissory Note in the amount of $80 thousand is payable in twelve equal installments of $7 thousand, including interest accrued at 5%, and matures in May 2015. The first installment was due in July 2012.

Debt consists of the following:

	As of June 30, 2013	**As of** September 30, 2012
Line of credit borrowings	$3,230	$ 3,182
Bank term loan	642	892
Subordinated promissory notes	170	338
Total debt	$4,042	$ 4,412
Less current portion	$1,541	$ 1,424
Long term debt, net of current portion	$2,501	$ 2,988

8. Other Long Term Liabilities

Deferred Rent

In connection with new leases for the Company's headquarters in Burlington, Massachusetts and a new location in New York, the Company made investments in leasehold improvements at these locations of approximately $1.4 million, of which the respective landlords funded approximately $857 thousand. The capitalized leasehold improvements are being amortized over the initial lives of each lease. The improvements funded by the landlords are treated as lease incentives. Accordingly, the funding received from the landlords was recorded as fixed asset additions and a deferred rent liability on the Condensed Consolidated Balance Sheet. As of June 30, 2013, $120 thousand was reflected in Accrued Liabilities and $549 thousand is reflected in Other Long Term Liabilities. The deferred rent liability is being amortized as a reduction of rent expense over the lives of the leases.

9. Shareholder's Equity

Common Stock

On June 16, 2013 the Company sold 2,300,000 shares of common stock at $1.00 per share for gross proceeds of $2.3 million in a private placement. Net proceeds to the Company after offering expenses were approximately $2.1 million. In addition, the Company issued the investors and the placement agent and its affiliates five year warrants to purchase an aggregate of 690,000 shares of Bridgeline's common stock at a price equal to $1.25 per share. The Company agreed to provide piggyback registration rights with respect to the shares of common stock sold in the offering and underlying the warrants.

On May 31, 2012, the Company sold 2,173,913 shares of common stock at $1.15 per share for gross proceeds of $2.5 million in a private placement. Net proceeds to the Company after offering expenses were approximately $2.3 million. In addition, the Company issued the placement agent and its affiliates five year warrants to purchase an aggregate of 217,913 shares of Bridgeline's common stock at a price equal to $1.40 per share. The Company agreed to provide piggyback registration rights with respect to the shares of common stock sold in the offering and underlying the warrants.

In connection with the acquisition of MarketNet on May 31, 2012, contingent consideration of 204,331 shares of Bridgeline Digital common stock is contingently issuable to the sole stockholder of MarketNet. The contingent consideration is payable quarterly over the 12 consecutive calendar quarters following the acquisition, contingent upon the acquired business achieving certain operating and revenue targets. The common stock has been issued and is being held in escrow pending satisfaction of the applicable earnout targets. In addition, MarketNet is also eligible to earn additional bonus equity consideration of 200,000 shares of Bridgeline Digital common stock if a certain annual revenue threshold is met in any fiscal year during the next three years. As of June 30, 2013, the sole stockholder of MarketNet had earned 51,084 shares of common stock.

BRIDGELINE DIGITAL, INC.

NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

In connection with the acquisition of Magnetic Corporation on October 3, 2011, contingent consideration of 166,666 shares of Bridgeline Digital common stock is contingently issuable to the sole stockholder of Magnetic. The contingent consideration is payable quarterly over the 12 consecutive calendar quarters following the acquisition, contingent upon the acquired business achieving certain operating and revenue targets. The common stock has been issued and is being held in escrow pending satisfaction of the applicable earnout targets. As of June 30, 2013, the sole stockholder of Magnetic had earned 97,223 shares of common stock.

Employee Stock Purchase Plan

On April 12, 2012, the Company's stockholders approved and adopted the Bridgeline Digital, Inc. 2012 Employee Stock Purchase Plan (the "ESPP"). Under the terms of the ESPP, the Company will grant eligible employees the right to purchase shares of Bridgeline common stock through payroll deductions at a price equal to 85% of the fair market value of Bridgeline common stock on the purchase termination date of defined offering or purchase periods. Each offering period is six months in duration. The ESPP permits the Company to offer up to 300,000 shares of common stock. The maximum number of shares of common stock that may be purchased by all participants in any purchase period may not exceed 150,000 shares. During the nine months ended June 30, 2013, 56,112 shares were purchased by employees.

Common Stock Warrants

On June 16, 2013, the Company issued five year warrants to the investors and the placement agent in the Company's private placement. The warrants are exercisable to purchase 690,000 shares of the Company's common stock at a price equal to $1.25 per share.

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

On October 29, 2010, the Company issued four year warrants to the placement agent in the Company's private placement. The warrants are exercisable to purchase 64,000 shares of the Company's common stock at a price equal to $1.45 per share. In return for such warrants, the placement agent agreed to cancel 71,231 warrants issued to the placement agent in April 2006 and 57,000 IPO Warrants. In December 2012 all 64,000 warrants were exercised using a cashless feature where the holders forfeited 41,401 shares in lieu of paying the exercise price.

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

Summary of Option and Warrant Activity and Outstanding Shares

	Stock Options		**Stock Warrants**	
	Options	**Weighted** Average Exercise Price	**Warrants**	**Weighted** Average Exercise Price
Outstanding, September 30, 2012	2,989,620	$ 0.86	331,931	$ 1.42
Granted	441,500	$ 1.63	690,000	$ 1.25
Exercised	(83,532)	$ 0.90	(22,599)	$ 1.45
Forfeited or expired	(268,505)	$ 1.25	(41,401)	$ 1.45
Outstanding, June 30, 2013	3,079,083	$ 0.94	957,931	$ 1.30

BRIDGELINE DIGITAL, INC.

NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

10. Accumulated Other Comprehensive Loss

The following table presents changes in accumulated other comprehensive loss for nine months ended June 30, 2013 (in thousands):

	Cumulative Foreign Currency Translation Adjustment
Balance at September 30, 2012	$ (176)
Current period other comprehensive income	39
Balance at June 30, 2013	$ (137)

11. Net Loss Per Share

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

(in thousands, except per share data)	**Three Months Ended** June 30,		**Nine Months Ended** June 30,	
	2013	**2012**	**2013**	**2012**
Net loss	$(1,569)	$(277)	$(2,893)	$(906)

Weighted average common shares outstanding - basic	15,038	12,971	14,902	12,543
Effect of dilutive securities (primarily stock options)	-	-	-	-
Weighted average common shares outstanding - diluted	15,038	12,971	14,902	12,543
Net loss per share - basic and diluted	$(0.10)	$(0.02)	$(0.19)	$(0.07)

Basic net income per share is computed by dividing net income available to common shareholders by the weighted average number of common shares outstanding. Diluted net income per share is computed by using the weighted average number of common shares outstanding during the period plus the dilutive effect of outstanding stock options and warrants using the " treasury stock" method.

For the three months ended June 30, 2013, options and warrants to purchase shares of the Company's common stock of 923,205 were excluded from the computation of diluted net loss per share as the effect was anti-dilutive to the Company's net loss. Also excluded for the three months ended June 30, 2013 were 994,662 contingent shares to be issued in connection with prior acquisitions.

For the nine months ended June 30, 2013, options and warrants to purchase shares of the Company's common stock of 1,260,430 were excluded from the computation of diluted net loss per share as the effect was anti-dilutive to the Company's net loss. Also excluded for the three months ended June 30, 2013 were 994,662 contingent shares to be issued in connection with prior acquisitions.

For the three months ended June 30, 2012, options and warrants to purchase shares of the Company's common stock of 1,328,518 were excluded from the computation of diluted net loss per share as the effect was anti-dilutive to the Company's net loss. Also, excluded were 1,118,331 contingent shares to be issued in connection with the prior acquisitions.

For the nine months ended June 30, 2012, options and warrants to purchase shares of the Company's common stock of 378,795 were excluded from the computation of diluted net loss per share as the effect was anti-dilutive to the Company's net loss. Also, excluded were 1,118,331 contingent shares to be issued in connection with the prior acquisitions.

12. Income Taxes

Income tax expense was $21 thousand for the three months ended June 30, 2013 and 2012. Income tax expense consists of the estimated liability for federal, state and foreign income taxes owed by the Company, including the alternative minimum tax and deferred tax liabilities related to indefinite-lived, tax deductible goodwill acquired in previous acquisitions. Net operating loss carry forwards are estimated to be sufficient to offset additional taxable income for all periods presented.

BRIDGELINE DIGITAL, INC.

NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

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

13. Related Party Transactions

As part of the Magnetic acquisition, the Company entered into an operating lease for the Bridgeline Tampa location with the previous owner of Magnetic who now serves as the Regional Senior Vice President and General Manager of Bridgeline Tampa. The lease term is three years and rent is $85 thousand per year.

14. Legal Proceedings

Bridgeline Digital, Inc. vs. e.Magination network, LLC and its principal owner, Daniel Roche.

In August 2010, Bridgeline initiated a lawsuit against e.Magination network, LLC and its principal owner, Daniel Roche, in the Federal District Court of Massachusetts. Bridgeline sought damages for accounts receivable allegedly collected by Mr. Roche and e.Magination and used to pay obligations of e.Magination and Mr. Roche (accounts receivable contractually belonging to Bridgeline). e.Magination and Mr. Roche asserted counterclaims against Bridgeline and Thomas Massie alleging that Bridgeline had breached Mr. Roche's employment agreement by improperly terminating Mr. Roche for cause and also alleging breach of the Asset Purchase Agreement by Bridgeline. In the latter half of the three months ended June 30, 2013 the parties entered into a settlement agreement pursuant to which Bridgeline will pay Mr. Roche a total of $300 thousand, $163 thousand, which was accrued as of June 30, 2013 in accrued liabilities and general and administrative expenses on the Condensed and Consolidated Balance Sheets and Condensed and Consolidated Statements of Operations, respectively, and the payment of previously earned contingent consideration which was accrued at the date of acquisition. These amounts are to be paid over 18 months beginning August 2013.

15. Subsequent Event

On August 1, 2013 the Company completed the acquisition of Transformational Technologies, Inc., d/b/a Elements Local, a franchise web platform developer based in central coast California. The Company acquired all the outstanding capital stock of Elements Local for consideration consisting of (i) 0.4 million in cash, (ii) 0.6 million in common stock, (iii) the assumption of $0.2 million in debt and (iv) contingent consideration of $1.3 million to be paid in a combination of cash and stock. The contingent consideration is payable quarterly over the 12 consecutive calendar quarters following the acquisition, contingent upon the acquired business achieving certain quarterly revenue targets during the period. To the extent that the quarterly revenue target is not met in any particular quarter, the earn-out period will be extended for up to four additional quarters. Subsequent events have been evaluated through the date the accompanying condensed consolidated financial statements were issued.

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

This section contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in the forward-looking statements as a result of a variety of factors and risks including risks described in our Annual Report on Form 10-K for the fiscal year ended September 30, 2012 as well as in the other documents that we file with the Securities and Exchange Commission. You can read these documents at www.sec.gov.

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

Overview

Bridgeline Digital enables its customers to maximize the performance of their mission critical websites, intranets, and online stores. Bridgeline is the developer of the award-winning iAPPS® Web Engagement Management (WEM) product platform and related digital solutions. The iAPPS platform deeply integrates Web Content Management, eCommerce, eMarketing, and web Analytics capabilities within the heart of websites or eCommerce web stores to help marketers deliver online experiences that attract, engage, and convert their customers across all digital channels. Bridgeline's iAPPS platform combined with its digital services assists customers in maximizing on-line revenue, improving customer service and loyalty, enhancing employee knowledge, and reducing operational costs.

In fiscal 2012 Bridgeline Digital announced the release of a new product, iAPPS ds ("distributed subscription"), a platform that empowers franchise and large dealer networks with state-of-the-art web engagement management while providing superior oversight of corporate branding. iAPPS ds deeply integrates content management, eCommerce, eMarketing and web analytics and is a self-service web platform that is offered to each authorized franchise or dealer for a monthly subscription fee. On August 1, 2013, we acquired franchise web developer Transformational Technologies, Inc., d/b/a Elements Local ("Elements Local"), expanding Bridgeline Digital's presence in the franchise market place. Please see *Acquisitions* section for more detail on the Elements Local acquisition.

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

In 2012, KMWorld Magazine Editors selected Bridgeline Digital as one of the 100 Companies That Matter in Knowledge Management and also selected iAPPS as a Trend Setting Product in 2012. iAPPS Content Manager and iAPPS Commerce were selected as finalists for the 2012 and 2013 CODiE Awards for Best Content Management Solution and Best Electronic Commerce Solution, globally. In 2013 the Web Marketing Association sponsored Internet Advertising Competition honored Bridgeline Digital with three awards for iAPPS customer websites. In addition, in 2013 Bridgeline Digital won fifteen Horizon Interactive Awards for outstanding development of web applications and websites and B2B Magazine has selected Bridgeline Digital as one of the Top Interactive Technology companies in the United States.

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

Customer Information

We currently have over 2,500 customers. For the three and nine months ended June 30, 2013 and 2012 no customer represented 10% or more of total revenue.

Acquisitions

Elements Local

On August 1, 2013 we completed the acquisition of Transformational Technologies, Inc, d/b/a Elements Local, a franchise web platform developer based in central coast California. Elements Local has developed a SaaS platform that incorporates brand reputation management tools, web content management, social media, marketing and web analytics. Elements Local is a respected web platform brand and we believe the acquisition will both strengthen the iAPPS ds brand and accelerate our penetration into the Franchise market. Elements Local currently has 35 franchisor customers with approximately 3,200 franchises on their platform, including national franchise brands such as SportsClips®, MAACO®, Glass Doctor®, Molly Maids® and Mr. Handyman®. We acquired all the outstanding capital stock of Elements Local for consideration consisting of (i) 0.4 million in cash, (ii) 0.6 million in common stock, (iii) the assumption of $0.2 million in debt and (iv) contingent consideration of $1.3 million to be paid in a combination of cash and stock. The contingent consideration is payable quarterly over the 12 consecutive calendar quarters following the acquisition, contingent upon the acquired business achieving certain quarterly revenue targets during the period. To the extent that the quarterly revenue target is not met in any particular quarter, the earn-out period will be extended for up to four additional quarters. We are required to assess the probability of the acquired business achieving the contingent cash and stock payments which requires management to make estimates and judgments based on forecasts of future performance.

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MarketNet, Inc.

On May 31, 2012, we completed the acquisition of MarketNet, Inc. (“MarketNet”), an interactive technology company that provides web application development based in Dallas, Texas. We acquired all of the outstanding capital stock of MarketNet for consideration consisting of (i) $20 thousand in cash, (ii) assumption of debt of $244 thousand and (ii) contingent consideration of up to $650 thousand in cash and 204,331 shares of Bridgeline Digital common stock, valued at $250 thousand ($1.22 per share). The cash consideration was reduced by $58 thousand due to the Seller’s inability to meet an agreed upon target for working capital at the time of acquisition and was applied against MarketNet’s earnout payment for the three months ended December 31, 2012. The contingent consideration is payable quarterly over the 12 consecutive calendar quarters following the acquisition, contingent upon the acquired business achieving certain quarterly revenue and quarterly operating income targets during the period. To the extent that either the quarterly revenue target or the quarterly operating income target is not met in a particular quarter, the earn-out period will be extended for up to four additional quarters. MarketNet is also eligible to earn additional bonus equity consideration of 200,000 shares, if annual net revenues of the acquired business exceed a certain threshold in any fiscal year through September 30, 2015. We are required to assess the probability of the acquired business achieving the contingent cash and stock payments which requires management to make estimates and judgments based on forecasts of future performance. As a result, we reduced the initial estimate of $607 thousand for the contingent cash consideration to be achieved and $262 thousand for the contingent stock consideration to be achieved by $8 thousand and $30 thousand, respectively. The contingent common stock has been issued and is being held in escrow pending satisfaction of the applicable targets. MarketNet achieved its quarterly revenue and operating income targets for the first two quarterly periods after the acquisition date and the operating income targets for the two periods ended March 31, 2013 and June 30, 2013. MarketNet’s operating results are reflected in our condensed consolidated financial statements as of the acquisition date.

Magnetic Corporation

On October 3, 2011, we completed the acquisition of Magnetic Corporation (“Magnetic”), a web technology company based in Tampa, Florida. Bridgeline acquired all of the outstanding capital stock of Magnetic for consideration consisting of (i) $150 thousand in cash and (ii) contingent consideration of up to $600 thousand in cash and 166,666 shares of Bridgeline Digital common stock, valued at $150 thousand ($0.90 per share). The cash consideration was reduced by $100 thousand due to the Seller’s inability to meet an agreed upon target for working capital at the time of acquisition. The contingent consideration is payable quarterly over the 12 consecutive calendar quarters following the acquisition, contingent upon the acquired business achieving certain quarterly revenue and quarterly operating income targets during the period. The contingent common stock has been issued and is being held in escrow pending satisfaction of the applicable targets. To the extent that either the quarterly revenue target or the quarterly operating income target is not met in a particular quarter, the earn-out period will be extended for up to four additional quarters. We are required to assess the probability of the acquired business achieving the contingent cash and stock payments which requires management to make estimates and judgments based on forecasts of future performance. As a result, we estimated and accrued $600 thousand of the contingent cash consideration to be achieved and $150 thousand of the contingent stock consideration to be achieved. Magnetic achieved its quarterly revenue and operating income targets for all periods since the acquisition date. Magnetic's operating results are reflected in the Company's condensed consolidated financial statements as of the acquisition date, which corresponds to the Company's commencement of fiscal 2012.

Results of Operations for the Three and Nine months ended June 30, 2013 compared to the Three and Nine months ended June 30, 2012

Total revenue for the three months ended June 30, 2013 was $5.6 million compared with $6.4 million for the prior period. We had a net loss of ($1.6) million for the three months ended June 30, 2013 compared with net loss of ($277) thousand for the prior period. Net loss per share was ($0.10) for the three months ended June 30, 2013 compared to ($0.02) for the prior period.

Total revenue for the nine months ended June 30, 2013 was $17.8 million compared with $19.6 million for the prior period. We had a net loss of ($2.9) million for the nine months ended June 30, 2013 compared with net loss of ($906) thousand for the prior period. Net loss per share was ($0.19) for the nine months ended June 30, 2013 compared to ($0.07) for the prior period.

The following table sets forth the percentages of revenue for items included in our unaudited condensed consolidated statement of operations presented in our Quarterly Reports on Form 10-Q for the periods presented.

Revenue:	**Three Months** Ended June 30, 2013	**Three Months** Ended June 30, 2012	**$** Change	**%** Change	**Nine Months** Ended June 30, 2013	**Nine Months** Ended June 30, 2012	**$** Change	**%** Change
Web application development services								
iAPPS application development services	$ 3,384	$ 3,354	30	1 %	$ 10,359	$ 9,893	466	5 %
% of total revenue	*60 %*	*53 %*			*58 %*	*51 %*		
Other application development services	892	1,701	(809)	(48%)	3,256	5,911	(2,655)	(45%)
% of total revenue	*16 %*	*27 %*			*18 %*	*30 %*		
Subtotal web application development services	4,276	5,055	(779)	(15%)	13,615	15,804	(2,189)	(14%)
% of total revenue	*76 %*	*79 %*			*77 %*	*81 %*		
Managed service hosting	409	631	(222)	(35%)	1,456	1,858	(402)	(22%)
% of total revenue	*7 %*	*10 %*			*8 %*	*9 %*		
Subscription and perpetual licenses	915	686	229	33 %	2,726	1,899	827	44 %
% of total revenue	*16 %*	*11 %*			*15 %*	*10 %*		
Total revenue	**5,600**	**6,372**	**(772)**	**(12%)**	**17,797**	**19,561**	**(1,764)**	**(9%)**
Cost of revenue:								
Web application development services								
iAPPS application development costs	1,795	1,512	283	19 %	5,485	4,651	834	18 %
% of iAPPS application development revenue	*53 %*	*45 %*			*53 %*	*47 %*		
Other application development costs	546	1,099	(553)	(50%)	2,081	3,586	(1,505)	(42%)
% of other application development revenue	*61 %*	*65 %*			*64 %*	*61 %*		
Subtotal web application development costs	2,341	2,611	(270)	(10%)	7,566	8,237	(671)	(8%)
% of web application development services revenue	*55 %*	*52 %*			*56 %*	*52 %*		

Managed service hosting	76	98	(22)	(22%)	224	289	(65)	(22%)
% of managed service hosting revenue	*19%*	*16%*			*15%*	*16%*		
Subscription and perpetual licenses	330	117	213	182%	770	337	433	128%
% of subscription and perpetual revenue	*36%*	*17%*			*28%*	*18%*		
Total cost of revenue	2,747	2,826	(79)	(3%)	8,560	8,863	(303)	(3%)
Gross profit	**2,853**	**3,546**	**(693)**	(20%)	**9,237**	**10,698**	**(1,461)**	(14%)
Gross profit margin	***51%***	***56%***			***52%***	***55%***		
Operating expenses:								
Sales and marketing	2,275	1,965	310	16%	6,266	5,526	740	13%
% of total revenue	*41%*	*31%*			*35%*	*28%*		
General and administrative	1,140	923	217	24%	3,440	2,924	516	18%
% of total revenue	*20%*	*14%*			*19%*	*15%*		
Research and development	515	370	145	39%	893	1,253	(360)	(29%)
% of total revenue	*9%*	*6%*			*5%*	*6%*		
Depreciation and amortization	412	446	(34)	(8%)	1,226	1,296	(70)	(5%)
% of total revenue	*6%*	*7%*			*7%*	*7%*		
Impairment of intangible asset	-	-	-	0%	-	281	(281)	(100%)
% of total revenue	*0%*	*0%*			*0%*	*1%*		
Total operating expenses	**4,342**	**3,704**	**638**	**17%**	**11,825**	**11,280**	**545**	**5%**
Loss from operations	(1,489)	(158)	(1,331)	842%	(2,588)	(582)	(2,006)	345%
Interest income (expense) net	(59)	(98)	39	(40%)	(194)	(234)	40	(17%)
Loss before income taxes	(1,548)	(256)	(1,292)	505%	(2,782)	(816)	(1,966)	241%
Provision for income taxes	21	21	-	0%	110	90	20	22%
Net loss	**$(1,569)**	**$(277)**	**$(1,292)**	466%	**$(2,892)**	**$(906)**	**$(1,986)**	219%
Adjusted EBITDA	**$(899)**	**$429**	**$(1,328)**	(310%)	**$(828)**	**$1,381**	**$(2,209)**	(160%)

Revenue

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

Web Application Development Services

Web application development services revenue is comprised of iAPPS development related services and other web development related services generated from non iAPPS related engagements.

Revenue from iAPPS application development services in the three months ended June 30, 2013 increased $30 thousand, or 1%, to $3.4 million compared to the prior period. Revenue from non-iAPPS application development services decreased $809 thousand, or 48%, compared to the prior period. The decrease in non-iAPPS application development services is due to our continued concentration on selling higher-margin iAPPS related engagements to both new and existing customers. As a result, total revenue from web application development services for the three months ended June 30, 2013, decreased $779 thousand, or 15%, to $4.3 million compared to the prior period.

Web application development services revenue as a percentage of total revenue for the three months ended June 30, 2013 decreased to 76% from 79% compared to the prior period. The decrease is attributable to the decrease in web application development services revenue discussed above and an increase in iAPPS license related revenue.

Revenue from iAPPS application development services in the nine months ended June 30, 2013 increased $0.5 million, or 5%, to $10.4 million compared to the prior period. The increase in iAPPS related revenue is due to the expansion of our iAPPS customer base by selling more iAPPS licenses, which was offset by longer than expected implementation times as the size and scope of iAPPS related projects has increased. Revenue from non-iAPPS application development services decreased $2.7 million, or 45%, compared to the prior period. The decrease in non-iAPPS application development services is due to our continued concentration on selling higher-margin iAPPS engagements to both new and existing customers. As a result, total revenue from web application development services for nine months ended June 30, 2013, decreased $2.2 million, or 14%, to $13.6 million compared to the prior period.

Web application development services revenue as a percentage of total revenue for the nine months ended June 30, 2013 decreased to 77% from 81% compared to the prior period. The decrease is attributable to the decrease in web application development services revenue discussed above and an increase in iAPPS related license revenue.

Managed Service Hosting

Revenue from managed service hosting for the three months ended June 30, 2013 decreased $222 thousand, or 35%, to $409 thousand compared to the prior period. The decrease is due to our efforts to engage with customers that are aligned with our core competencies and proactively end engagements with a number of smaller hosting customers obtained through previous acquisitions.

Managed services revenue as a percentage of total revenue for the three months ended June 30, 2013 decreased to 7% from 10% compared to the prior period due to the decrease in managed services revenue discussed above.

Revenue from managed service hosting for the nine months ended June 30, 2013 decreased $402 thousand, or 22%, to $1.5 million compared to the prior period. The decrease is due to our efforts to engage with customers that are aligned with our core competencies and proactively end our engagements with a number of smaller hosting customers obtained through previous acquisitions.

Managed services revenue as a percentage of total revenue for the nine months ended June 30, 2013 decreased to 8% from 9% compared to the prior period due to the decrease in managed services revenue discussed above.

Subscription and Perpetual Licenses

Revenue from subscription and perpetual licenses for the three months ended June 30, 2013 increased $0.2 million, or 33%, to $0.9 million compared to the prior period. The increase is due to license revenues from our new product, iAPPS ds, increases in iAPPS SaaS licenses sold, incremental non-iAPPS SaaS licenses from our acquisition of MarketNet and incremental annual maintenance revenue.

Subscription and perpetual license revenue as a percentage of total revenue for the three months ended June 30, 2013 increased to 16% from 11% compared to the prior period and a result of the increased license sales and revenues discussed above.

Revenue from subscription and perpetual licenses for the nine months ended June 30, 2013 increased $0.8 million, or 44%, to $2.7 million compared to the prior period. The increase is due to license revenues from our new product, iAPPS ds, increases in iAPPS SaaS licenses sold, incremental non-iAPPS SaaS licenses from our acquisition of MarketNet and incremental annual maintenance revenue.

Subscription and perpetual license revenue as a percentage of total revenue for the nine months ended June 30, 2013 increased to 15% from 10% compared to the prior period and a result of the increased license sales and revenues discussed above.

Costs of Revenue

Total cost of revenue for the three months ended June 30, 2013 decreased $80 thousand, or 3%, to $2.7 million compared to the prior period. Total cost of revenue for the nine months ended June 30, 2013 decreased $0.3 million, or 3%, to $8.6 million compared to the prior period. These decreases are primarily due to a reduction of labor costs and, to a lesser extent, efficiencies in costs for managed service hosting as we continue to make investments in our co-managed network operation center to support our core iAPPS customer base. These reductions in cost were offset by an increase in costs of subscription and perpetual licenses.

Cost of Web Application Development Services

Cost of web application development for the three months ended June 30, 2013 decreased $0.3 million, or 10%, to $2.3 million compared to the prior period. Cost of web application development for the nine months ended June 30, 2013 decreased $0.7 million, or 8%, to $7.6 million compared to the prior period. The decreases in both periods are due to reduced labor costs.

The cost of web application development services as a percentage web application development services revenue increased for both the three and nine months ended June 30, 2013 when compared to prior periods due to the decreases in non-iAPPS web application development revenue in both periods.

Cost of Managed Service Hosting

Cost of managed service hosting for the three months ended June 30, 2013 decreased $22 thousand, or 22%, to $76 thousand compared to the prior period. Cost of managed service hosting for the nine months ended June 30, 2013 decreased $65 thousand, or 22%, to $224 thousand compared to the prior period. The decreases in managed service hosting costs for both periods are due to cost efficiencies as we continue to consolidate hosting engagements on to our co-managed network operations center, reducing third party hosting costs.

The cost of managed service hosting as a percentage of managed service hosting revenue increased in the three months ended June 30, 2013 compared to the prior period due to an increase in the aforementioned ending of engagements with a number of smaller hosting customers obtained through previous acquisitions.

The cost of managed service hosting as a percentage of managed service hosting revenue decreased in the nine months ended June 30, 2013 compared to the prior period due to cost savings from consolidating hosting arrangements on to our co-managed network operations center.

Cost of Subscription and Perpetual License

Cost of subscription and perpetual licenses for the three months ended June 30, 2013 increased $0.2 million, or 182%, compared to the prior period. This is primarily due to the 33% increase in subscription and perpetual license revenue as more of the direct costs associated with our co-managed network operations center are being used to support subscription license revenue and software amortization costs of $90 thousand related to significant enhancements to our iAPPS platform that began in April 2013.

The cost of subscription and perpetual licenses as a percentage of subscription and perpetual license revenue for the three months ended June 30, 2013 increased to 36% from 17% compared to the prior period. This is primarily due to a decrease in perpetual license sales when compared to the prior period as perpetual licenses sales can fluctuate from quarter to quarter and have a significantly lower direct cost than subscription licenses and an increase in software amortization.

Cost of subscription and perpetual licenses for the nine months ended June 30, 2013 increased $0.4 million, or 128%, compared to the prior period. This is primarily due to the 44% increase in subscription and perpetual license revenue as more of the direct costs associated with our co-managed network operations center are being used to support subscription license revenue, software amortization costs of $90 thousand related to significant enhancements to our iAPPS platform that began in April 2013, investments made in our co-managed network operations center during the period and, to a lesser extent, incremental costs on lower margin, non-iAPPS SaaS licenses from the MarketNet acquisition.

The cost of subscription and perpetual licenses as a percentage of subscription and perpetual license revenue for the nine months ended June 30, 2013 increased to 28% from 18% compared to the prior period. This is primarily due to a decrease in perpetual license sales when compared to the prior period as perpetual licenses sales can be lumpy and have a significantly lower direct cost than subscription licenses and an increase in software amortization.

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We expect the increase in costs of subscription and perpetual licenses as a percentage of license revenue to be temporary and should begin to decrease in the three months ended September 30, 2013 due to the acquisition of Elements Local and the expansion of our iAPPS customer base by selling more iAPPS licenses, including iAPPS ds.

Operating Expenses

Sales and Marketing Expenses

Sales and marketing expenses for the three months ended June 30, 2013 increased $310 thousand, or 16%, to $2.3 million compared to the prior period. The increase is due to incremental sales and marketing expenses from the acquisition of MarketNet and an increase in sales and marketing related investments as we continue to focus on marketing our iAPPS web engagement products, including iAPPS ds.

Sales and marketing expenses as a percentage of total revenue for the three months ended June 30, 2013 increased to 41% from 31% compared to the prior period. This is due to the decrease in non-iAPPS application development revenue for the same period and the increase in expenses described above.

Sales and marketing expenses for the nine months ended June 30, 2013 increased $740 thousand, or 13%, to $6.3 million compared to the prior period. The increase is due to incremental sales and marketing expenses from the acquisition of MarketNet and an increase in marketing related expenses as we continue to focus on marketing our iAPPS products, including our new product, iAPPS ds.

Sales and marketing expenses as a percentage of total revenue for the nine months ended June 30, 2013 increased to 35% from 28% compared to the prior period. This is due to the decrease in non-iAPPS application development revenue for the same period and the increase in expenses described above.

General and Administrative Expenses

General and administrative expenses for the three months ended June 30, 2013 increased $217 thousand, or 24%, to $1.1 million compared to the prior period.   The increase was primarily due to costs associated with the settlement of

Bridgeline Digital, Inc. vs. e.Magination network, LLC and its principal owner, Daniel Roche, which is described in further detail in Part II – Other Information: *Legal Proceedings*.

General and administrative expenses as a percentage of total revenue for the three months ended June 30, 2013 increased to 20% from 14% compared to the prior period. This is due to the decrease in non-iAPPS application development revenue for the same period.

General and administrative expenses for the nine months ended June 30, 2013 increased $516 thousand, or 18%, to $3.4 million compared to the prior period.   This was due to expenses associated with the settlement referred to above and the prior period reflecting a larger reduction of expense for changes in estimate of settlement of contingent earnout payments from prior acquisitions that, in our estimation, will not be achieved.

General and administrative expenses as a percentage of total revenue for the nine months ended June 30, 2013 increased to 19% from 15% compared to the prior period. This was due to the increase in expense discussed above and the decrease non-iAPPS application development revenue for the same period.

Research and Development

Research and development expense for the three months ended June 30, 2013 increased by $145 thousand, or 39%, to $515 thousand compared to the prior period. The increase in research and development expense is due to a decrease in capitalization of $113 thousand of software development costs in the three months ended June 30, 2013 compared to the prior period. Beginning in May 2012, we began capitalizing costs related to enhancements to our iAPPS product platform, iAPPS V.5, which was released in the current period. The remainder of the increase is due to incremental costs associated with the release of iAPPS V.5. Software development costs capitalized in the current period were $69 thousand and were related to internal projects.

Research and development expense as a percentage of total revenue for the three months ended June 30, 2013 increased to 9% from 6% compared to the prior period. This was due the capitalization of costs discussed above.

Research and development expense for the nine months ended June 30, 2013 decreased by $360 thousand, or 29%, to $893 thousand compared to the prior period. The decrease in research and development expense is due to the capitalization of $670 thousand of software development costs related to enhancements to our iAPPS product platform in the first six months of 2013. Software development costs capitalized in the prior period were $182 thousand.

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Research and development expense as a percentage of total revenue for the three months ended June 30, 2013 decreased to 5% from 6% compared to the prior period. This was due the capitalization of costs discussed above.

Depreciation and Amortization

Depreciation and amortization expense for the three months ended June 30, 2013 decreased by $34 thousand, or 8%, compared to the prior period. This decrease was due to several intangibles from previous acquisitions reaching the end of their useful life since March 31, 2012, offset by incremental expense from the MarketNet acquisition.

Depreciation and amortization as a percentage of revenue were 6% and 7% for the three months ended June 30, 2013 and 2012, respectively.

Depreciation and amortization expense for the nine months ended June 30, 2013 decreased by $70 thousand, or 5%, compared to the prior period. This decrease was due to several intangibles from previous acquisitions reaching the end of their useful life since March 31, 2012, offset by incremental expense from the MarketNet acquisition.

Depreciation and amortization as a percentage of revenue were 7% for both the nine months ended June 30, 2013 and 2012.

Impairment of Intangible Assets

In the first quarter of fiscal 2012, the Company stopped servicing low margin non-iAPPS opportunities acquired from e.Magination IG, LLC. It was therefore determined that a portion of the customer list was impaired.

Income Taxes

The provision for income tax expense was $21 thousand for the three months ended June 30, 2013 and 2012. The provision for income tax expense was $110 thousand for the nine months ended June 30, 2013 compared to $90 thousand for the prior period. This increase is due to deferred tax liabilities related to indefinite lived, tax deductible assets from previous acquisitions.

Income tax expense represents the estimated liability for federal, state and foreign income taxes owed by the Company, including the alternative minimum tax and deferred tax liabilities related to indefinite lived, tax deductible assets from previous acquisitions. The Company has net operating loss carryforwards and other deferred tax benefits that are available to offset future taxable income.

Loss from Operations

The loss from operations was ($1.5) million for three months ended June 30, 2013, compared to a loss of ($158) thousand in the prior period. The loss from operations was ($2.6) million for nine months ended June 30, 2013, compared to a loss of ($582) thousand in the prior period. These increases were primarily attributable to the decrease in non-iAPPS application development services revenue.

Adjusted EBITDA

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

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

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

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

	Three Months Ended		**Nine Months Ended**	
	June 30,		June 30,	
	2013	**2012**	**2013**	**2012**
Net loss	$(1,569)	$(277)	$(2,893)	$(906)
Provision for income tax	21	21	110	90
Interest expense (income), net	59	98	194	234
Amortization of intangible assets	118	184	390	571
Impairment of intangible asset	-	-	-	281
Depreciation	295	262	836	725
EBITDA	(1,076)	288	(1,363)	995
Other amortization	122	40	201	130
Stock based compensation	55	101	334	256
Adjusted EBITDA	$(899)	$429	$(828)	$1,381

The decreases in Adjusted EBITDA are primarily due to the decrease in non-iAPPS application development services.

Liquidity and Capital Resources

Cash Flows

Operating Activities

Cash used by operating activities was $452 thousand for the nine months ended June 30, 2013 compared to cash used by operating activities of $792 thousand for the prior period. The decrease in cash used by operating activities is due to an increase in deferred revenue as the majority of our iAPPS ds customers elect annual subscriptions. This increase was offset by lower net income, adjusted for non-cash items such as amortization and depreciation, compared to the prior period.

Investing Activities

Cash used in investing activities was $1.6 million for the nine months ended June 30, 2013 compared to $1.4 million for the prior period. The increase is due to $557 thousand of additional software development expenditures related to significant enhancements of our iAPPS platform in the current period, offset by a $310 thousand decrease in spending on equipment and improvements for the nine months ended June 30, 2013 as we had two office relocations in the three months ended December 31, 2011.

Financing Activities

Cash provided by financing activities was $1.6 million for the nine months ended June 30, 2013 compared to $1.7 million for the prior period. The decrease in cash provided by financing activities is primarily due to smaller proceeds from the sale of common stock during the nine months ended June 30, 2013 compared to the prior period, offset by the payment of $221 thousand in acquired debt in the Magnetic and Marketnet acquisitions during the prior period.

In June 2013 we sold 2.3 million shares of common stock in a private placement with proceeds, net of issuance costs, of $2.1 million. The company also issued 690,000 warrants as part of the private placement with a strike price of $1.25.

Capital Resources and Liquidity Outlook

Due to the unexpected accelerated decrease in non-iAPPS application development services and additional investments required for our SaaS environment housed in our co-managed networks operations center, the proceeds from the June 2013 private placement were primarily used for operations and investing activities. We believe that cash generated from operations and the increase in borrowing availability on our bank line of credit will be sufficient to fund the company's working capital and capital expenditure needs in the foreseeable future. We may choose to explore additional financing sources if needed to support our merger and acquisition strategy.

In February 2013, the Company amended its loan arrangement (the " February 2013 Amendment") with Silicon Valley Bank extending the maturity date of the line of credit for one year to March 31, 2015. The February 2013 Amendment also revised certain financial covenants, including the covenants for the three months ending June 30, 2013. We would not have complied with one of our financial covenants as of December 31, 2012 had the amendment not been completed. We were in compliance with our financial covenants as of March 31, 2013. In July 2013, the Company amended its loan arrangement (the "July 2013 Amendment") with Silicon Valley Bank. The July 2013 Amendment increased our borrowing availability on accounts receivable, revised certain financial covenants, and increased the interest rate on our line of credit from prime plus 1.25% to prime plus 2.25% and increased the interest rate on our term loan from prime plus 1.75% to prime plus 2.75%. Both these rates may return to the previous levels upon achievement of certain financial measures. In addition, the repayment schedule for the term was accelerated to end in April 2014 from April 2015. There was $611 thousand remaining on the term loan as of June 30, 2013. The July 2013 Amendment also included a waiver by Silicon Valley Bank of certain financial covenant defaults. The Company would not have been in compliance with certain of its financial covenants as of June 30, 2013 if the July 2013 Amendment was not completed and the waiver was not granted

Off-Balance Sheet Arrangements

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

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

Commitments and Contingencies

New contractual obligations as of June 30, 2013 that include equipment acquired under capitalized lease agreements were valued at $0.8 million with payments extending through July 2015.

As of June 30, 2013, we had an accrued contingent earnout liability of $0.9 million from acquisitions completed in prior fiscal years, which are scheduled to be paid out through fiscal 2015. Contingent earnout payments related to acquisitions are paid when and if certain revenue and earnings targets are achieved.

Critical Accounting Policies

These critical accounting policies and estimates by our management should be read in conjunction with Note 2 *Summary of Significant Accounting Policies* to the Consolidated Financial Statements that were prepared in accordance with accounting principles generally accepted in the United States of America ("US GAAP") that are included in our Annual Report on Form 10-K and filed with the Securities and Exchange Commission on December 5, 2012.

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

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

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

Revenue Recognition

Overview

We enter into arrangements to sell web application development services (professional services), software licenses or combinations thereof. Revenue is categorized into (i) Web Application Development Services (ii) Managed Service Hosting, and (iii) Subscriptions and Perpetual Licenses.

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

During fiscal 2010, we began to develop a reseller channel to supplement our direct sales force for our iAPPS Product Suite. We continued to develop this reseller channel in fiscal 2013. Resellers are generally located in territories where we do not have a direct sales force. Customers generally sign a license agreement directly with us. Revenue from perpetual licenses sold through resellers is recognized upon delivery to the end user as long as evidence of an arrangement exists, collectability is probable, and the fee is fixed and determinable. Revenue for subscription licenses is recognized monthly as the services are delivered.

Web Application Development Services

Web application development services include professional services primarily related to the Company's web development solutions that address specific customer needs such as information architecture and usability engineering, interface configuration, application development, rich media development, back end integration, search engine optimization, and project management.

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

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

Managed Service Hosting

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

Subscriptions and Perpetual Licenses

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

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

Multiple Element Arrangements

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

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

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

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

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

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

Customer Payment Terms

Payment terms with customers typically require payment 30 days from invoice date. Payment terms may vary by customer but generally do not exceed 45 days from invoice date. Invoicing for web application development services are either monthly or upon achievement of milestones and payment terms for such billings are within the standard terms described above. Invoicing for subscriptions and hosting are typically issued monthly and are generally due in the month of service.

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

Warranty

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

Reimbursable Expenses

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

Allowance for Doubtful Accounts

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

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

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

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

Accounting for Goodwill and Intangible Assets

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

For fiscal 2012 we performed the annual assessment of our goodwill during the fourth quarter of fiscal 2012, using the qualitative approach described above. Based on our qualitative assessment, we concluded that it was not more likely than not that the fair values of any of our reporting units were less than their carrying amounts, and therefore it was not necessary to perform the quantitative two-step impairment test. The key qualitative factors that led to our conclusion included the following: (i) our stock price more than doubled to $1.20 as of September 30, 2012. (ii) our strategic alliance with UPS Logistics and the successful launch of iAPPS ds with our first iAPPS ds customer, a franchisor with over 4,000 locations, has improved the predictability of our forecasts and (iii) inputs from recent transactions within the technology sector, such a revenue multiples used to value transactions, have either remained steady or improved since the fiscal 2011 assessment. We did not have an impairment of goodwill in fiscal 2012 or 2011.

The factors the Company considers important that could indicate impairment include its stock price, significant under performance relative to prior operating results, change in projections, significant changes in the manner of the Company's use of assets or the strategy for the Company's overall business, and significant negative industry or economic trends. To the extent there are unfavorable changes in assumptions used to determine the Company's fair value there can be no assurance that the Company will not have an impairment charge in the future.

During the three months ended June 30, 2013 the carrying value of goodwill increased as a result of a final contingent acquisition payment related to an acquisition completed prior to September 30, 2009, which was recorded as an increase to goodwill in the period it was earned, and the acquisition of MarketNet.

Accounting for Stock-Based Compensation

At June 30, 2013, we maintained one stock-based compensation plan and one employee stock purchase plan which are more fully described in Note 11 to the Consolidated Financial Statements of our Annual Report on Form 10-K filed with the Securities and Exchange Commission on December 5, 2012.

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

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

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

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

Item 3. Qualitative and Quantitative Disclosures About Market Risk.

Not required.

Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

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

As of June 30, 2013 we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective in enabling us to record, process, summarize and report information required to be included in our periodic filings with the Securities and Exchange Commission within the required time period.

Changes in Internal Control over Financial Reporting

There have been no changes in our internal controls over financial reporting that occurred during the quarter ended June 30, 2013 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings.

From time to time we are subject to ordinary routine litigation and claims incidental to our business. We are not currently involved in any legal proceedings, except as described below, that we believe are material beyond those previously disclosed in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on December 5, 2012.

Bridgeline Digital, Inc. vs. e.Magination network, LLC and its principal owner, Daniel Roche.

In August 2010, Bridgeline initiated a lawsuit against e.Magination network, LLC and its principal owner, Daniel Roche, in the Federal District Court of Massachusetts. Bridgeline sought damages for accounts receivable allegedly collected by Mr. Roche and e.Magination and used to pay obligations of e.Magination and Mr. Roche (accounts receivable contractually belonging to Bridgeline). e.Magination and Mr. Roche asserted counterclaims against Bridgeline and Thomas Massie alleging that Bridgeline had breached Mr. Roche's employment agreement by improperly terminating Mr. Roche for cause and also alleging breach of the Asset Purchase Agreement by Bridgeline. In the latter half of the three months ended June 30, 2013 the parties entered into a settlement agreement pursuant to which Bridgeline will pay Mr. Roche a total of $300 thousand, $163 thousand, which was accrued as of June 30, 2013 in accrued liabilities and general and administrative expenses on the Condensed and Consolidated Balance Sheets and Condensed and Consolidated Statements of Operations, respectively, and the payment of previously earned contingent consideration which was accrued at the date of acquisition. These amounts are to be paid over 18 months beginning August 2013.

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

The following summarizes all sales of our unregistered securities during the quarter ended June 30, 2013, other than sales of unregistered securities during the quarter ended June 30, 2013 that were previously disclosed on Form 8-K.. The securities in the below-referenced transactions were (i) issued without registration and (ii) were subject to restrictions under the Securities Act and the securities laws of certain states, in reliance on the private offering exemptions contained in Sections 4(2), 4(6) and/or 3(b) of the Securities Act and on Regulation D promulgated there under, and in reliance on similar exemptions under applicable state laws as transactions not involving a public offering. Unless stated otherwise, no placement or underwriting fees were paid in connection with these transactions.

During the fiscal quarter ended June 30, 2013, the Company granted 50,000 stock options under its Amended and Restated Stock Incentive Plan at a weighted average exercise price of $1.09 per share.

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

Item 6. Exhibits.

Exhibit No.	Description of Document
10.1	Securities Purchase Agreement between Bridgeline Digital, Inc. and the investors named therein, dated June 19, 2013 (incorporated by reference to Exhibit 10.1 to our Current Report on Form 8-K filed on June 24, 2013).
10.2	Form of Common Stock Purchase Warrant issued to investors, dated June 19, 2013 (incorporated by reference to Exhibit 10.3 to our Current Report on Form 8-K filed on June 24, 2013).
10.3	Form of Common Stock Purchase Warrant issued to placement agent, dated June 19, 2013 (incorporated by reference to Exhibit 10.3 to our Current Report on Form 8-K filed on June 24, 2013).
10.4	Seventh Loan Modification Agreement dated February 11, 2013 between Bridgeline Digital, Inc., Bridgeline Intelligence Group, Inc. and Silicon Valley Bank.
31.1	Certification required by Rule 13a-14(a) or Rule 15d-14(a).
31.2	Certification required by Rule 13a-14(a) or Rule 15d-14(a).
32.1	Certification required by Rule 13a-14(b) or Rule 15d-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. §1350).
32.2	Certification required by Rule 13a-14(b) or Rule 15d-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. §1350).
101.INS*	XBRL Instance
101.SCH*	XBRL Taxonomy Extension Schema
101.CAL*	XBRL Taxonomy Extension Calculation
101.DEF*	XBRL Taxonomy Extension Definition
101.LAB*	XBRL Taxonomy Extension Labels

101.PRE*	XBRL Taxonomy Extension Presentation

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

SIGNATURES

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

	Bridgeline Digital, Inc. (Registrant)
August 14, 2013	/s/ Thomas L. Massie **Thomas L. Massie**
Date	**President and Chief Executive Officer** (Principal Executive Officer)
August 14, 2013	/s/ Michael D. Prinn **Michael D. Prinn**
Date	**Executive Vice President and Chief Financial Officer** (Principal Financial and Accounting Officer)

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