Bridgeline Digital, Inc.
Form 10-Q
August 14, 2012
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q
(Mark One)
x QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2012

OR

o 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 x No o

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

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

The number of shares of Common Stock par value $0.001 per share, outstanding as of August 10, 2012 was 15,203,538

1

Bridgeline Digital, Inc.

Quarterly Report on Form 10-Q

For the Quarterly Period ended June 30, 2012

Index

Bridgeline Digital, Inc.

Quarterly Report on Form 10-Q

For the Quarterly Period ended June 30, 2012

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,” “beli “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, our ability to maintain our listing on the Nasdaq Capital Market, 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, our ability to maintain an effective system of internal controls, or risks associated with our contracts with the U.S. federal government. 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, 2011 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” we mean Bridgeline Digital, Inc.

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, 2012	September 30, 2011
Current assets:		
Cash and cash equivalents	$1,942	$2,528
Accounts receivable and unbilled receivables, net	4,794	4,274
Prepaid expenses and other current assets	661	494
Total current assets	7,397	7,296
Equipment and improvements, net	2,936	1,779
Intangible assets, net	1,706	1,527
Goodwill	21,598	20,122
Other assets	806	685
Total assets	$34,443	$31,409
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$1,160	$1,291
Accrued liabilities	1,030	1,081
Accrued earnouts, current	729	295
Debt, current	1,424	1,750
Capital lease obligations, current	235	216
Deferred revenue	1,411	1,169
Total current liabilities	5,989	5,802
Accrued earnouts, net of current portion	990	772
Debt, net of current portion	3,203	3,017
Capital lease obligations, net of current portion	142	215
Other long term liabilities	1,141	395
Total liabilities	$11,465	$10,201
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; 15,203,538 and 12,306,207 shares issued and outstanding, respectively	15	12
Additional paid-in capital	40,819	38,083
Accumulated deficit	(17,676)	(16,770)
Accumulated other comprehensive loss	(180)	(117)

Total stockholders’ equity	22,978	21,208
Total liabilities and stockholders’ equity	$34,443	$31,409

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

BRIDGELINE DIGITAL, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Dollars in thousands, except share and per share data)
(Unaudited)

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2012	2011	2012	2011
Revenue:				
Web application development services	$ 5,055	$ 5,483	$ 15,804	$ 16,408
Managed service hosting	631	509	1,858	1,476
Subscription and perpetual licenses	686	540	1,899	1,790
Total revenue	6,372	6,532	19,561	19,674
Cost of revenue:				
Web application development services	2,611	2,978	8,237	8,955
Managed service hosting	98	94	289	355
Subscription and perpetual licenses	117	161	337	521
Total cost of revenue	2,826	3,233	8,863	9,831
Gross profit	3,546	3,299	10,698	9,843
Operating expenses:				
Sales and marketing	1,965	1,631	5,526	5,054
General and administrative	923	1,066	2,924	2,985
Research and development	370	448	1,253	1,300
Depreciation and amortization	446	325	1,296	1,006
Impairment of intangible asset	----	----	281	----
Total operating expenses	3,704	3,470	11,280	10,345
Loss from operations	(158)	(171)	(582)	(502)
Interest income (expense), net	(98)	(54)	(234)	(166)
Loss before income taxes	(256)	(225)	(816)	(668)
Provision for income taxes	21	21	90	63
Net loss	$ (277)	$ (246)	$ (906)	$ (731)
Net loss per share:				
Basic and diluted	$ (0.02)	$ (0.02)	$ (0.07)	$ (0.06)
Number of weighted average shares:				
Basic and diluted	12,971,259	12,306,207	12,543,019	12,148,287

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, 2012	Nine Months Ended June 30, 2011
Cash flows from operating activities:		
Net loss	$(906)	$(731)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Amortization of intangible assets	571	582
Impairment of intangible asset	281	-
Depreciation	725	454
Other amortization	130	263
Stock-based compensation	256	286
Contingent earnout liability adjustment	(780)	-
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable and unbilled receivables	(76)	(234)
Prepaid expenses and other assets	(18)	(288)
Accounts payable and accrued liabilities	(761)	(361)
Deferred revenue	(9)	583
Other liabilities	(205)	(45)
Total adjustments	114	1,240
Net cash (used in)/provided by operating activities	(792)	509
Cash flows from investing activities:		
Equipment and improvements	(855)	(321)
Acquisitions, net of cash acquired	(35)	-
Software development capitalization costs	(182)	(43)
Contingent acquisition payments	(324)	(510)
Net cash used in investing activities	(1,396)	(874)
Cash flows from financing activities:		
Proceeds from sale of common stock, net of issuance costs	2,242	857
Proceeds from exercise of employee stock options	128	121
Borrowings from bank line of credit	1,876	4,450
Payments on bank line of credit	(2,021)	(6,674)
Payments on acquired debt	(221)	-
Payments on subordinated promissory notes	(138)	(84)
Principal payments on capital leases	(201)	(165)
Net cash provided by/(used in) financing activities	1,665	(1,495)
Effect of exchange rate changes on cash and cash equivalents	(63)	(18)
Net (decrease)/increase in cash and cash equivalents	(586)	(1,878)
Cash and cash equivalents at beginning of period	2,528	3,045
Cash and cash equivalents at end of period	$1,942	$1,167
Supplemental disclosures of cash flow information:		
Cash paid for:		
Interest	$234	$148
Income taxes	$34	$27
Non cash activities:		

Equipment purchased under capital leases	$137	$577
Equipment and other assets included in accounts payable	$13	$35
Accrued contingent consideration (earnouts)	$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 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. iAPPS enables customers to enhance and optimize the value of their web properties. Combined with award-winning interactive development capabilities, Bridgeline helps customers cost-effectively accommodate the changing needs of today's rapidly evolving web properties; allowing them to maximize revenue, improve customer loyalty, enhance employee knowledge, and reduce operational costs. Bridgeline's iAPPS product suite combined with its digital services assists customers in maximizing on-line revenue, improving customer service and loyalty, enhancing employee knowledge, and reducing operational costs by leveraging web-based technologies.

The iAPPS product suite 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 2010, 2011 and 2012. iAPPS Content Manager and iAPPS Commerce were selected as finalists for the 2011 and 2012 CODiE Awards for Best Content Management Solution and Best Electronic Commerce Solution, globally. iAPPS Content Manager was the winner of the 2010 CODiE Award for Best Content Management Solution, globally. B2B Interactive has selected Bridgeline Digital as one of the Top Interactive Technology companies in the United States for the past four consecutive years.

Bridgeline's team of Microsoft© Gold Certified developers specialize in end-to-end interactive technology solutions which include digital strategy, user-centered design, rich media development, .NET development, and search engine optimization. .

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

Locations

The Company's corporate office is located north of Boston, Massachusetts. The Company maintains regional field offices serving the following geographical locations: Atlanta, GA; Baltimore, MD; Boston, MA; Chicago, IL; Denver, CO; New York, NY; Philadelphia, PA; Dallas, TX; 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, 2012, the Condensed Consolidated Statements of Operations for the three and nine months ended June 30, 2012 and 2011, respectively, and the Condensed Consolidated Statements of Cash Flows for the nine months ended June 30, 2012 and 2011, 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, 2011. These 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, 2012 and its results of operations for the three and nine months ended June 30, 2012 and 2011, respectively, and its cash flows for the nine months ended June 30, 2012 and 2011, respectively. The results for the three and nine months ended June 30, 2012 are not necessarily indicative of the results to be expected for the year ending September 30, 2012. The accompanying September 30, 2011 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.

BRIDGELINE DIGITAL, INC.
NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands, except share and per share data)

Recent Accounting Pronouncements

In December 2011, the FASB issued the FASB Accounting Standards Update No. 2011-11 “Balance Sheet: Disclosures about Offsetting Assets and Liabilities” (“ASU 2011-11”). This Update requires an entity to disclose information about offsetting and related arrangements to enable users of its financial statements to understand the effect of those arrangements on its financial position. The objective of this disclosure is to facilitate comparison between those entities that prepare their financial statements on the basis of U.S. GAAP and those entities that prepare their financial statements on the basis of IFRS. The amended guidance is effective for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods.

In December 2011, the FASB issued the FASB Accounting Standards Update No. 2011-12 “Comprehensive Income: Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05” (“ASU 2011-12”). This Update is a deferral of the effective date pertaining to reclassification adjustments out of accumulated other comprehensive income in ASU 2011-05. FASB is to going to reassess the costs and benefits of those provisions in ASU 2011-05 related to reclassifications out of accumulated other comprehensive income. Due to the time required to properly make such a reassessment and to evaluate alternative presentation formats, the FASB decided that it is necessary to reinstate the requirements for the presentation of reclassifications out of accumulated other comprehensive income that were in place before the issuance of Update 2011-05.

All other requirements in Update 2011-05 are not affected by this Update, including the requirement to report comprehensive income either in a single continuous financial statement or in two separate but consecutive financial statements. Public entities should apply these requirements for fiscal years, and interim periods within those years, beginning after December 15, 2011.

Management does not believe that any other recently issued, but not yet effective accounting pronouncements, if adopted, would have a material effect on the accompanying consolidated financial statements.

Subsequent Events

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

3. Accounts Receivable and Unbilled Receivables

Accounts receivable and unbilled receivables consists of the following:

	As of June 30, 2012	As of September 30, 2011
Accounts receivable	$ 4,340	$ 4,197
Unbilled receivables	631	365
Subtotal	4,971	4,562
Allowance for doubtful accounts	(177)	(288)
Accounts receivable and unbilled receivables, net	$ 4,794	$ 4,274

BRIDGELINE DIGITAL, INC.
NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands, except share and per share data)

4. Acquisitions

MarketNet, Inc.

On May 31, 2012, the Company completed the acquisition of MarketNet, Inc. (“MarketNet”), an interactive technology company based in Dallas, Texas. Bridgeline acquired all of the outstanding capital stock of MarketNet for consideration consisting of (i) $20 thousand in cash and (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. This 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 estimated and accrued $607 thousand of the contingent cash consideration to be achieved and $262 thousand (valued at $1.38 per share) of the contingent stock consideration to be achieved. The contingent common stock has been issued and is being held in escrow pending satisfaction of the applicable targets. MarketNet’s operating results are reflected in the Company’s condensed consolidated financial statements as of the acquisition date.

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 further reduced by $100 thousand due to the Seller’s inability to meet an agreed upon target for working capital. 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’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.

BRIDGELINE DIGITAL, INC.
NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands, except share and per share data)

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		443
Other Assets		123
Fixed Assets		91
Intangible Assets		1,030
Goodwill		1,228
Total Assets		2,950
Current Liabilities		1,190
Liabilities, net of current		73
Total liabilities assumed		1,263
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.

As part of the MarketNet acquisition, of the $600 thousand allocated to intangible assets, $440 thousand is allocated to customer relationships and $160 thousand is allocated to non-compete agreements, with an average useful life of five years. These amounts are preliminary and will be adjusted when the formal valuations are completed.

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

The following unaudited pro forma financial information reflects the combined results of operations for Bridgeline for the nine months ended June 30, 2012 and 2011, including certain adjustments, as if the acquisitions had occurred on October 1, 2010. 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):

	Nine Months Ended June 30, 2012	Nine Months Ended June 30, 2011
Total revenue	$ 21,269	$ 23,531
Net loss	$ (906)	$ (731)
Net loss per share:		

Basic and diluted	$	(0.07	) $	(0.06)
Number of weighted average shares:				
Basic and diluted		12,543		12,148

10

BRIDGELINE DIGITAL, INC.
NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands, except share and per share data)

e.Magination network, LLC.

On July 9, 2010, the Company acquired certain assets and assumed certain liabilities of e.Magination network, LLC, and e.Magination IG (combined "e.Magination"), a Baltimore, Maryland based web application development company. Consideration consisted of (i) $2.65 million in cash, (ii) contingent consideration of up to $647 thousand (which reflects a post acquisition adjustment to the purchase price) payable quarterly in cash over 12 quarters beginning with the quarter ending September 30, 2010, with half of the earnout based on the achievement of quarterly revenue of $1.35 million and half of the earnout based on the achievement of quarterly earnings from operations of $225 thousand by the Maryland business unit, (iii) additional contingent consideration of up to $300 thousand (which reflects a post acquisition adjustment to the purchase price) payable quarterly in cash over 12 quarters beginning with the quarter ending September 30, 2010 based on the achievement of quarterly earnings from operations of $300 thousand by the Maryland business unit, and (iv) contingent consideration of up to $675 thousand payable quarterly in Bridgeline common stock over four quarters beginning with the quarter ending December 31, 2012, with half of the earnout based on the achievement of quarterly revenue of $1.35 million and half of the earnout based on the achievement of quarterly earnings from operations of $225 thousand of the Maryland business unit. The contingent common stock will be held in escrow pending the satisfaction of the applicable earnout targets. To the extent that both the quarterly revenue target and the quarterly earnings from operations target are not met in any particular quarter, both the quarterly cash earnout period and the quarterly common stock earnout period will be extended for up to four additional quarters.

Because certain minimum financial requirements were not met and earnouts were not required to be paid, the Company recorded a $740 thousand reduction of contingent earnout liabilities in the nine months ended June 30, 2012. The $740 thousand is included in General and Administrative Expenses in the Consolidated Statement of Operations. Of the $740 thousand adjustment, $441 thousand reduced accrued contingent liabilities and $299 thousand was consideration payable in stock and allocated to additional paid-in capital.

TMX Interactive, Inc.

Because certain minimum financial requirements were not met and earnouts were not required to be paid, the Company recorded a $40 thousand reduction of contingent earnout liabilities in the nine months ended June 30, 2012. The $40 thousand is included in General and Administrative Expenses in the Consolidated Statement of Operations.

BRIDGELINE DIGITAL, INC.
NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands, except share and per share data)

5. Intangible Assets

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

	As of June 30, 2012		
	Gross Amount	Accumulated Amortization	Net Amount
Intangible assets:			
Domain and trade names	$ 26	$ (26)	$ -
Customer related	4,187	(2,790)	1,397
Non-compete agreements	878	(569)	309
Acquired software	362	(362)	-
Total intangible assets	$ 5,453	$ (3,747)	$ 1,706

	As of September 30, 2011		
	Gross Amount	Accumulated Amortization	Net Amount
Intangible assets:			
Domain and trade names	$ 26	$ (26)	$ -
Customer related	3,397	(2,032)	1,365
Non-compete agreements	637	(475)	162
Acquired software	362	(362)	-
Total intangible assets	$ 4,422	$ (2,895)	$ 1,527

Total amortization expense related to intangible assets for the three and nine months ended June 30, 2012 and 2011 is as follows:

Amortization expense charged to:	Three Months Ended June 30,		Nine Months Ended June 30,	
	2012	2011	2012	2011
Operating expense *	$184	$184	$571	$552
Cost of revenue	-	-	-	30
Total	$184	$184	$571	$582

* Included in amortization expense for the nine months ended June 30, 2012 was a charge to operations of $281 thousand for impairment charges related to assets assumed from our fiscal 2010 acquisition of e.Magination and its wholly-owned subsidiary eMagination IG, LLC (now Bridgeline Intelligence Group, Inc). 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. The impairment charge is included in operating expenses in the Company’s Condensed Consolidated Statements of Operations.

BRIDGELINE DIGITAL, INC.
NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands, except share and per share data)

6. Goodwill

Changes in the carrying amount of goodwill follows:

	As of June 30, 2012	As of September 30, 2011
Balance at beginning of period	$ 20,122	$ 20,036
Acquisitions	1,228	-
Contingent acquisition payments	248	86
Balance at end of period	$ 21,598	$ 20,122

Contingent consideration ("earnouts") related to acquisitions completed before September 30, 2009 are accounted for as an increase to goodwill at the time such earnouts are paid or earned. 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. For the year ended September 30, 2011 the Company's assessment was that goodwill was not impaired and did not record a goodwill impairment charge.

7. Fair Value of Financial Instruments

The fair value of cash and cash equivalents and trade receivables approximates their carrying values due to their short maturities. The fair value of non-current assets and liabilities approximate their carrying value unless otherwise stated. The fair value of subordinated debt, bank term loans and credit lines also approximate their carrying values.

In accordance with FASB ASC Topic 820, "Fair Value Measurements and Disclosures", the estimated fair values of amounts reported in the consolidated financial statements have been determined using available market information and valuation methodologies, as applicable. Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Entities are required to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value based on the following value hierarchy:

Level 1 Quoted prices in active markets for identical assets or liabilities;

Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities; and

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The following table summarizes the financial liabilities measured at fair value on a recurring basis:

	As of June 30, 2012	As of September 30, 2011

Level 3:		
Contingent earnout liabilities	$ 1,719	$ 1,067

The contingent earnout liabilities 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.

BRIDGELINE DIGITAL, INC.
NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands, except share and per share data)

The following table summarizes the changes in earnout liabilities for the nine months ended June 30, 2012.

Balance at September 30, 2011	$1,067
Contingent earnout liability accruals	1,457
Contingent earnout liability payments	(324)
Contingent earnout liability valuation adjustment	(481)
Balance at June 30, 2012	$1,719

8. 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 expires 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.

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, 2012	As of September 30, 2011
Line of credit borrowings	$2,419	$2,392
Bank term loan	1,828	2,000
Subordinated promissory note	380	375
Total debt	$4,627	$4,767
Less current portion	$1,424	$1,750
Long term debt, net of current portion	$3,203	$3,017

9. 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 $950 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. The deferred rent liability is being amortized as a reduction of rent expense over the lives of the leases.

BRIDGELINE DIGITAL, INC.
NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands, except share and per share data)

10. Shareholder's Equity

Common Stock

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. Though there is no plan to register the common stock issued in this offering, in the event the Company does register other common stock the Company agreed to provide piggyback registration rights with respect to the shares of common stock sold in the offering and underlying the warrants.

In 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 equity consideration of 200,000 shares of Bridgeline Digital common stock if a certain annual revenue threshold is met in any fiscal year during the next three years.

In connection with the acquisition of Magnetic Corporation on October 3, 2011, contingent consideration of 166,666 shares of Bridgeline Digital common stock is contingently issuable to the sole stockholder of Magnetic. The contingent consideration is payable quarterly over the 12 consecutive calendar quarters following the acquisition, contingent upon the acquired business achieving certain operating and revenue targets. The common stock has been issued and is being held in escrow pending satisfaction of the applicable earnout targets. For the nine months ended June 30, 2012, the sole stockholder of Magnetic earned 41,666 shares of common stock.

Employee Stock Options

In order to increase employee retention and morale, in October 2011, the Company offered its employees the opportunity to have certain outstanding options modified by (i) reducing the grant exercise price to $0.67, the fair market value of the common stock as of the modification date and (ii) starting a new three year vesting schedule. The aggregate fair value of the modified options of approximately $90 thousand was calculated using the difference in value between the original terms and the new terms as of the modification date. The incremental cost of the modified option over the original option will be recognized as additional compensation expense over the new three year vesting period beginning on the date of modification. This opportunity was generally limited to options issued subsequent to the October 2008 repricing described in Note 11 to the Company's Annual Report on Form 10-K for fiscal 2011. Options to purchase a total of 697,667 shares of common stock were exchanged for new grants in the October 28, 2011 repricing.

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. The first purchase period will be June 2012 through November 2012.

Common Stock Warrants

In July 2007, the Company issued 150,000 warrants to the underwriter's of the Company's initial public offering (the "IPO Warrants") with an original exercise price of $7.50 per share. In October 2010, 57,000 IPO warrants were cancelled (see below). After adjustments for anti-dilution provisions, the IPO Warrants are exercisable to purchase shares of the Company's common stock at an exercise price of $7.39. The IPO Warrants expired in July 2012.

BRIDGELINE DIGITAL, INC.
NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands, except share and per share data)

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.

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.

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.

As of June 30, 2012: (i) IPO Warrants to purchase 93,000 shares at an exercise price of $7.39 remain outstanding; (ii) placement agent warrants to purchase 64,000 shares and 217,931 at an exercise price of $1.45 and $1.40 respectively are outstanding; and (iii) warrants issued to a non-employee consultant to purchase 25,000 shares at an exercise price of $1.00 and 25,000 shares at an exercise price of $2.00 are outstanding. The IPO Warrants that were issued in the initial public offering expired in July 2012.

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, 2011	2,280,204	$ 1.00	207,000	$ 4.13
Granted	2,030,167	0.78	217,931	1.40
Exercised	(152,421)	0.83	—	—
Forfeited, cancelled or expired	(1,174,997)	1.01	—	—
Outstanding, June 30, 2012	2,982,953	$ 0.85	424,931	$ 2.73

11. Comprehensive Loss

Comprehensive loss includes net (loss) income, as well as other changes in stockholder's equity that result from transactions and economic events other than those with the stockholders.

Comprehensive loss was as follows:

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2012	2011	2012	2011

Net loss	$ (277)	$ (246)	$ (906)	$ (731)
Net change in foreign currency translation adjustment	(27)	(25)	(63)	(18)
Comprehensive loss	$ (304)	$ (271)	$ (969)	$ (749)

BRIDGELINE DIGITAL, INC.
NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands, except share and per share data)

12. 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,	
	2012	2011	2012	2011
Net loss	$(277)	$(246)	$(906)	$(731)
Weighted average common shares outstanding - basic	12,971	12,306	12,543	12,148
Effect of dilutive securities (primarily stock options)	-	-	-	-
Weighted average common shares outstanding - diluted	12,971	12,306	12,543	12,148
Net (loss) income per share - basic	$(0.02)	$(0.02)	$(0.07)	$(0.06)
Net (loss) income per share - diluted	$(0.02)	$(0.02)	$(0.07)	$(0.06)

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 and nine months ended June 30, 2011, options to purchase shares of the Company's common stock of 187,167 and 302,938 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 675,000 shares to be issued in connection with the e.Magination acquisition. Options to purchase shares of the Company's common stock of 1,134,279 and 232,168 for the three and nine months ended June 30, 2012 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 and nine months ended June 30, 2012 were 675,000 shares to be issued in connection with the e.Magination acquisition, 125,000 shares issued and being held in escrow in connection with the Magnetic acquisition and 404,331 shares to be issued and being held in escrow in connection with the MarketNet acquisition.

13. Income Taxes

Income tax expense was $21 thousand for the three months ended June 30, 2012 and 2011, and $90 thousand and $63 thousand for the nine months ended June 30, 2012 and 2011, respectively. Income tax expense consists of the estimated liability for Federal and state income taxes owed by the Company, including the alternative minimum tax. Net operating loss carry forwards are estimated to be sufficient to offset additional taxable income for all periods presented.

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

14. Related Party Transactions

The Company has retained the services of one of its outside directors as a management consultant to assist the executive management team. The term of the engagement is one year, expiring in January 2013, at a rate of $4,000 per month. The consulting arrangement may be terminated by either party with thirty days written notice.

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 Senior Vice President and General Manager of Bridgeline Tampa. The lease term is three years and rent is $85 thousand per year.

BRIDGELINE DIGITAL, INC.
NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands, except share and per share data)

15. 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 seeks 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 have asserted counterclaims against Bridgeline and Thomas Massie alleging that Bridgeline has breached Mr. Roche's employment agreement by improperly terminating Mr. Roche for cause and also alleging breach of the Asset Purchase Agreement by Bridgeline. This lawsuit remains unresolved as of June 30, 2012.

Ingeniador, LLC vs. Interwoven, Inc., Bridgeline Digital, Inc., et al

On April 26, 2012, the Company was informed that on such date the United States District Court for the District of Puerto Rico entered a default judgment against the Company as part of a patent infringement lawsuit brought by Ingeniador, LLC against 16 companies, including Bridgeline. The Company sought to have the default judgment set aside as it was never informed of the lawsuit and was not offered an opportunity to address the complaint. Ingeniador, LLC alleges Bridgeline has been infringing its patent rights and is seeking monetary damages. On June 15, 2012 the court granted the Company's request to set aside the default judgment and the case was dismissed entirely.

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, 2011 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 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. iAPPS enables customers to enhance and optimize the value of their web properties. Combined with award-winning interactive development capabilities, Bridgeline helps customers cost-effectively accommodate the changing needs of today’s rapidly evolving web properties; allowing them to maximize revenue, improve customer loyalty, enhance employee knowledge, and reduce operational costs. Bridgeline’s iAPPS product suite combined with its digital services assists customers in maximizing on-line revenue, improving customer service and loyalty, enhancing employee knowledge, and reducing operational costs by leveraging web-based technologies.

The iAPPS product suite 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 2010, 2011 and 2012. iAPPS Content Manager and iAPPS Commerce were selected as finalists for the 2011 and 2012 CODiE Awards for Best Content Management Solution and Best Electronic Commerce Solution, globally. iAPPS Content Manager was the winner of the 2010 CODiE Award for Best Content Management Solution, globally. B2B Interactive has selected Bridgeline Digital as one of the Top Interactive Technology companies in the United States for the past four consecutive years.

Bridgeline’s team of Microsoft© Gold Certified developers specialize in end-to-end interactive technology solutions which include digital strategy, user-centered design, rich media development, .NET development, and search engine optimization. .

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

Customer Information

We currently have over 500 active customers. For the three and nine months ended June 30, 2012 and 2011 no customer represented 10% or more of total revenue.

Strategic Alliances

In June 2012, Bridgeline announced a strategic alliance with United Parcel Service ("UPS"). Bridgeline and UPS signed a multi-year agreement to offer B2B and B2C eCommerce web stores with an end-to-end eCommerce offering comprised of Bridgeline's iAPPS Commerce product suite, related Bridgeline's eCommerce digital services, and UPS logistics and fulfillment services. The combined Bridgeline and UPS offering provides customers with the ability to manage the eCommerce and supply chain fulfillment needs and was designed to benefit the mid-market and larger online commerce operations. To align the technology offering, Bridgeline integrated the UPS warehouse management system into the framework of the iAPPS eCommerce platform.

Acquisitions

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. Bridgeline acquired all of the outstanding capital stock of MarketNet for consideration consisting of (i) $20 thousand in cash and (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. This 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 estimated and accrued $607 thousand of the contingent cash consideration to be achieved and $262 thousand (valued at $1.38 per share) of the contingent stock consideration to be achieved. The contingent common stock has been issued and is being held in escrow pending satisfaction of the applicable targets. MarketNet’s operating results are reflected in the Company’s 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 further reduced by $100 thousand due to the Seller’s inability to meet an agreed upon target for working capital. 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’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, 2012 compared to the Three and Nine Months Ended June 30, 2011

Total revenue for the three months ended June 30, 2012 was $6.4 million compared with $6.5 million for the three months ended June 30, 2011. We had a net loss of $(277) thousand for the three months ended June 30, 2012 compared with net loss of $(246) thousand for the three months ended June 30, 2011. Net loss per share was $(0.02) for the three months ended June 30, 2012 and 2011

Total revenue for the nine months ended June 30, 2012 was $19.6 million compared with $19.7 million for the nine months ended June 30, 2011. We had a net loss of $(906) thousand for the nine months ended June 30, 2012 compared with net loss of $(731) thousand for the nine months ended June 30, 2011. Net loss per share for the nine months ended June 30, 2012 was $(0.07) compared with net loss per share of $(0.06) for the nine months ended June 30, 2011.

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.

	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011	$ Change	% Change	Nine Months Ended June 30, 2012	Nine Months Ended June 30, 2011	$ Change	% Change
Revenue:								
Web application development services								
iAPPS application development services	$3,354	$2,452	902	37%	$9,893	$6,835	3,058	45%
% of total revenue	53%	38%			51%	35%		
Other application development services	1,701	3,031	(1,330)	(44%)	5,911	9,573	(3,662)	(38%)
% of total revenue	27%	46%			30%	49%		
Subtotal web application development services	5,055	5,483	(428)	(8%)	15,804	16,408	(604)	(4%)
% of total revenue	79%	84%			81%	83%		
Managed service hosting	631	509	122	24%	1,858	1,476	382	26%
% of total revenue	10%	8%			9%	8%		
Subscription and perpetual licenses	686	540	146	27%	1,899	1,790	109	6%
% of total revenue	11%	8%			10%	9%		
Total revenue	6,372	6,532	(160)	(2%)	19,561	19,674	(113)	-1%
Cost of revenue:								
Web application development services								
iAPPS application development costs	1,512	1,180	332	28%	4,651	3,281	1,370	42%
% of iAPPS application development revenue	45%	48%			47%	48%		
Other application development costs	1,099	1,798	(699)	(39%)	3,586	5,674	(2,088)	(37%)
% of other application development revenue	65%	59%			61%	59%		
	2,611	2,978	(367)	(12%)	8,237	8,955	(718)	(8%)

Subtotal web application development costs								
% of web application development services revenue	52 %	54 %			52 %	55 %		
Managed service hosting	98	94	4	4 %	289	355	(66)	(19 %)
% of managed service hosting revenue	16 %	18 %			16 %	24 %		
Subscription and perpetual licenses	117	161	(44)	(27 %)	337	521	(184)	(35 %)
% of subscription and perpetual revenue	17 %	30 %			18 %	29 %		
Total cost of revenue	2,826	3,233	(407)	(13 %)	8,863	9,831	(968)	(10 %)
Gross profit	3,546	3,299	247	7 %	10,698	9,843	855	9 %
Gross profit margin	56 %	51 %			55 %	50 %		
Operating expenses:								
Sales and marketing	1,965	1,631	334	20 %	5,526	5,054	472	9 %
% of total revenue	31 %	25 %			28 %	26 %		
General and administrative	923	1,066	(143)	(13 %)	2,924	2,985	(61)	(2 %)
% of total revenue	14 %	16 %			15 %	15 %		
Research and development	370	448	(78)	-17 %	1,253	1,300	(47)	-4 %
% of total revenue	6 %	7 %			6 %	7 %		
Depreciation and amortization	446	325	121	37 %	1,296	1,006	290	29 %
% of total revenue	7 %	5 %			7 %	5 %		
Impairment of intangible asset	-	-	-	-	281	-	281	(100 %)
% of total revenue	-	-			7 %	-		
Total operating expenses	3,704	3,470	234	7 %	11,280	10,345	935	9 %
Loss from operations	(158)	(171)	13	(8 %)	(582)	(502)	(80)	16 %
Interest income (expense) net	(98)	(54)	(44)	81 %	(234)	(166)	(68)	41 %
Loss before income taxes	(256)	(225)	(31)	14 %	(816)	(668)	(148)	22 %
Provision for income taxes	21	21	-	0 %	90	63	27	43 %
Net loss	$(277)	$(246)	$(31)	13 %	$(906)	$(731)	$(175)	24 %
Adjusted EBITDA	$429	$342	$87	25 %	$1,381	$1,083	$298	28 %

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 web application development services decreased $428 thousand, or 8%, to $5.1 million for the three months ended June 30, 2012. However, revenue from iAPPS related application development increased $902 thousand, or 37% to $3.4 million compared to the three months ended June 30, 2011 as we continue to concentrate on selling higher-margin iAPPS engagements to both new and existing customers. The decrease compared to the prior period is due to a decreases in non-iAPPS application development services revenues of $1.3 million attributable to a stoppage in non-iAPPS related development services from a customer due to a loss of their funding, as well as our decision to stop servicing low margin non-iAPPS opportunities.

Web application development services revenue as a percentage of total revenue decreased to 79% from 84% for the three months ended June 30, 2012 compared to the prior period. The decrease is attributable to a larger mix of iAPPS license related revenue and managed service hosting revenue as compared to sales of web application development services.

Revenue from web application development services decreased $604 thousand, or 4% to $15.8 million for the nine months ended June 30, 2012. However, revenue from iAPPS application development services increased $3.1 million, or 45%, to $9.9 million compared to the nine months ended June 30, 2011. Non-iAPPS application development services revenue decreased $3.7 million, or 38%, to $5.9 million compared to the nine months ended June 30, 2011. The decrease in non-iAPPS application development services revenue is attributable to a stoppage in non-iAPPS related development services from a customer due to a loss of their funding, as well as our decision to stop servicing low margin non-iAPPS customers.

Web application development services revenue as a percentage of total revenue decreased to 81% from 83% compared to the nine months ended June 30, 2011. The decrease as a percentage of total revenues is primarily attributable to a 26% increase in managed service hosting as a number of customers who purchased perpetual iAPPS licenses also chose us to host their website

Managed Service Hosting

Revenue from managed service hosting increased $122 thousand, or 24%, to $631 thousand compared to the three months ended June 30, 2011. Revenue from managed service hosting increased $382 thousand, or 26%, to $1.9 million compared to the nine months ended June 30, 2011. The increases are attributable to an increase in iAPPS related hosting arrangements for perpetual licenses sold, incremental revenues generated from our acquisition of Magnetic in October 2011, and, to a lesser extent, incremental revenues from our MarketNet acquisition.

Managed services revenue as a percentage of total revenue increased to 10% from 8% compared to the three months ended June 30, 2011, and increased to 9% from 8% compared to the nine months ended June 30.

Subscription and Perpetual Licenses

Revenue from iAPPS subscription and perpetual licenses increased $146 thousand, or 27%, to $686 thousand compared to the three months ended June 30, 2011. Revenue from iAPPS subscription and perpetual licenses increased $109 thousand, or 6%, to $1.9 million compared to the nine months ended June 30, 2011. The increases are primarily attributable to increases in the number of SaaS licenses sold and annual maintenance renewals recognized, offset by a decrease in perpetual licenses sold. Historically, revenue from perpetual licenses has fluctuated from quarter to quarter.

iAPPS subscription and perpetual license revenue as a percentage of total revenue increased to 11% from 8% compared to the three months ended June 30, 2011, and increased to 10% from 9% compared to the nine months ended June 30, 2011.

Costs of Revenue

Total cost of revenue decreased $407 thousand, or 13%, to $2.8 million compared to the three months ended June 30, 2011. Total cost of revenue decreased $968 thousand, or 10%, to $8.9 million compared to the nine months ended June 30, 2011. These decreases are due to increases in iAPPS related application development services (discussed below) and our decision to stop servicing low margin opportunities related to our prior acquisition of e.Magination IG, LLC.

Cost of Web Application Development Services

Cost of web application development services decreased $367 thousand, or 12%, to $2.6 million compared to the three months ended June 30, 2011. The cost of web application development services as a percentage of application development services revenue decreased to 52% from 54% compared to the prior period. Cost of web application development services decreased $718 thousand, or 8%, to $8.2 million compared to the nine months ended June 30, 2011. The cost of web application development services as a percentage of application development services revenue decreased to 52% from 55% compared to the prior period.

The decreases in the cost of web application development services in the three and nine months ended June 30, 2012 over the comparable periods are primarily attributable to an increase in iAPPS application development services as iAPPS related engagements command higher margins and a decrease in personnel as a result of our decision to stop servicing certain non-iAPPS low margin opportunities.

Cost of Managed Service Hosting

Cost of managed service hosting remained relatively flat for the three months ended June 30, 2012 compared to the prior period. The cost of managed services as a percentage of managed services revenue decreased to 16% from 18% compared to the three months ended June 30, 2011.

Cost of managed service hosting decreased $66 thousand, or 19%, to $289 thousand compared to the nine months ended June 30, 2011. The cost of managed services as a percentage of managed services revenue decreased to 16% from 24% compared to the nine months ended June 30, 2011.

The decreases in managed service hosting costs for the three and nine months ended June 30, 2012 over the comparable periods are due to our efforts to streamline costs in relation to ending engagements with various small, low margin hosting customers. We will continue to make investments to our co-managed network operations center to support our core iAPPS customer base.

Cost of Subscription and Perpetual License

Cost of subscription and perpetual licenses decreased $44 thousand, or 27%, to $117 thousand compared to the three months ended June 30, 2011. The cost of subscription and perpetual licenses as a percentage of subscription and perpetual license revenue decreased to 17% from 30% compared to the three months ended June 30, 2011. Cost of subscription and perpetual licenses decreased $184 thousand, or 35%, to $337 thousand compared to the nine months ended June 30, 2011. The cost of subscription and perpetual licenses as a percentage of subscription and perpetual license revenue decreased to 18% from 29% compared to the nine months ended June 30, 2011.

The decreases in subscription and perpetual license costs for both the three and nine months ended June 30, 2012 compared to the prior periods is attributable to cost efficiencies realized on our iAPPS SaaS environment and a decrease in amortization of software costs associated with the development of iAPPS.

Operating Expenses

Sales and Marketing Expenses

Sales and marketing expenses increased $334 thousand, or 20%, to $2.0 million compared to the three months ended June 30, 2011. Sales and marketing expenses represented 31% and 25% of total revenue for the three months ended June 30, 2012 and 2011, respectively. Sales and marketing expenses increased $472 thousand, or 9%, to $5.5 million compared to the nine months ended June 30, 2011. Sales and marketing expenses represented 28% and 26% of total revenue for the nine months ended June 30, 2012 and 2011, respectively.

The increases for the three and nine months ended June 30, 2012 compared to the prior periods primarily are attributable to incremental sales and marketing expenses from the acquisitions of Magnetic and MarketNet and an increase in marketing related expenses.

General and Administrative Expenses

General and administrative expenses decreased $143 thousand, or 13%, to $923 thousand compared to the three months ended June 30, 2011. General and administrative expenses represented 14% of total revenue compared to 16% in the prior period. This was due to a decrease in general and administrative expenses of $467 thousand recorded for the adjustment of contingent earnout payments from prior acquisitions that will not be achieved, offset by an increase in staffing and personnel costs.

General and administrative expenses decreased $61 thousand, or 2%, to $2.9 million compared to the nine months ended June 30, 2011. General and administrative expenses remained flat at 15% of total revenue. The decrease in general and administrative expenses is primarily due to the reduction of $780 thousand recorded for the adjustment of contingent earnout payments from prior acquisitions that will not be achieved, offset by personnel costs and increases in staffing.

Research and Development

Research and development expense decreased by $78 thousand, or 17%, to $370 thousand compared to the three months ended June 30, 2011. Research and development expense decreased by $47 thousand, or 4%, to $1.3 million compared to the nine months ended June 30, 2011.

The decrease in research and development expense is due to the capitalization of $182 thousand of software development costs related to enhancements to our iAPPS product suite in the nine months ended June 30, 2012. Software development costs of $43 thousand were capitalized in the previous period.

Depreciation and Amortization

Depreciation and amortization expense increased by $121 thousand, or 37%, to $446 thousand compared to the three months ended June 30, 2011. Depreciation and amortization represented 7% and 5% of revenue for the three months ended June 30, 2012 and 2011, respectively. Depreciation and amortization expense increased by $290 thousand, or 29%, to $1.3 million compared to the nine months ended June 30, 2011. Depreciation and amortization represented 7% and 5% of revenue for the nine months ended June 30, 2012 and 2011, respectively.

The increases are primarily attributable to costs related to investments in our cloud-based infrastructure, amortization of leasehold improvements related to new office leases, and amortization of intangible assets acquired through acquisitions.

Impairment of Intangible Assets

The increase for the nine months ended June 30, 2012 compared to the nine months ended June 30, 2011 is attributable to an impairment charge recorded in the three months ended December 31, 2011. We incurred a charge to operations of $281 thousand for impairment charges related to an intangible asset assumed from our fiscal 2010 acquisition of e.Magination and its wholly-owned subsidiary eMagination IG, LLC. 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, 2012 and 2011, and $90 thousand and $63 thousand for the nine months ended June 30, 2012 compared to the nine months ended June 30, 2011. Income tax expense represents the estimated liability for Federal and state income taxes owed by the Company, including the alternative minimum tax. 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 $(158) thousand for three months ended June 30, 2012, an improvement of $13 thousand compared to the prior period. This improvement was due to an improvement in gross profit of $247 thousand, or 8% compared to the prior period, and a gain of $467 recorded for contingent earnout payments from prior acquisitions that will not be achieved, offset by increases in general and administrative expenses, sales and marketing expenses, and depreciation and amortization.

The loss from operations was $(582) thousand for nine months ended June 30, 2012 compared to a loss of $(502) thousand in prior period. This decrease was due to the increases in general and administrative expenses, sales and marketing expenses and depreciation and amortization, offset by an improvement in gross profit of $855 thousand, or 9%, compared to the prior period and a gain of $780 recorded for contingent earnout payments from a prior acquisitions that will not be achieved.

Adjusted EBITDA

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

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

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

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

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2012	2011	2012	2011
Net loss	$(277)	$(246)	$(906)	$(731)
Provision for income tax	21	21	90	63
Interest expense (income), net	98	54	234	166
Amortization of intangible assets	184	184	571	582
Impairment of intangible asset	-	-	281	-
Depreciation	262	142	725	454
EBITDA	288	155	995	534
Other amortization	40	88	130	263
Stock based compensation	101	99	256	286
Adjusted EBITDA	$429	$342	$1,381	$1,083

The increase in Adjusted EBITDA for the three and nine months ended June 30, 2012 as compared to the prior period is due to the aforementioned improvements in gross profit and the reduction of contingent earnout payments from a prior acquisition that will not be achieved, offset by increases in operating expenses as we continue to invest in sales and marketing, research and development, and other operating expenses in order to support iAPPS sales growth.

Liquidity and Capital Resources

Cash Flows

Operating Activities

Cash used by operating activities was $792 thousand for the nine months ended June 30, 2012 compared to cash provided by operating activities of $509 thousand for the nine months ended June 30, 2011. The decrease in cash provided by operating activities is primarily attributable increases in working capital and lower net income for the period.

Investing Activities

Cash used in investing activities was $1.4 million for the nine months ended June 30, 2012 compared to $874 thousand for the nine months ended June 30, 2011. This increase is due to an increase in capital expenditures to invest in our cloud-based infrastructure and an increase in software development costs related to enhancements to our iAPPS product suite, offset by a decrease in contingent acquisition payments.

Financing Activities

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.

Cash provided by financing activities was $1.7 million for the nine months ended June 30, 2012 compared to cash used by financing activities $1.5 million for the nine months ended June 30, 2011. The increase in cash provided by financing activities is due greater proceeds from sale of common stock, less issuance costs, compared to the prior period, offset by fewer payments, net of borrowings, on our bank line of credit.

Capital Resources and Liquidity Outlook

We believe that cash generated from operations and proceeds from our recent sale of common stock and our bank line of credit will be sufficient to fund the company's working capital and capital expenditure needs in the foreseeable future.

In May 2012, the Company amended its loan arrangement (the "2012 Amendment") with Silicon Valley Bank extending the maturity date of the line of credit for one year to June 30, 2014. The 2012 Amendment also revised certain financial covenants.

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

We lease our facilities in the United States and India. During the quarter ended December 31, 2011, the Company signed a new office lease for its Burlington, MA corporate office location. The lease term expires in January 2019, with future minimum lease payments totaling $1.8 million.

Other new contractual obligations as of June 30, 2012 include equipment acquired under capitalized lease agreements valued at $137 thousand with payments extending through June 2015.

As of June 30, 2012, we had an accrued contingent earnout liability of $1.7 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. We also have potential contingent acquisition payments of $330 thousand related to acquisitions completed prior to January 1, 2009, which are not required to be accrued until earned.

On April 26, 2012, the Company was informed that on such date the United States District Court for the District of Puerto Rico entered a default judgment against the Company as part of a patent infringement lawsuit brought by Ingeniador, LLC against 16 companies, including Bridgeline. On June 15, 2012 the court granted our request to have the default judgment set aside and dismissed the case entirely.

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 29, 2011.

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 2012. 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. Though the Company's stock price declined from $1.22 at September 30, 2010 (the date of the fiscal 2010 annual test) to $0.53 at September 30, 2011, the Company did not consider the decline in stock price a triggering event as:

- The Company's performance since the last annual test has not deteriorated as both revenue and gross profit have increased and loss from operations was greater compared to fiscal 2010 due the Company's decision to invest in its iAPPS product suite; and

- The significant decrease in stock price is relatively recent as the stock price was $1.44 at December 31, 2010, $1.10 at March 31, 2011, and $0.95 at June 30, 2011 and is not related to a change in the market conditions that would affect the Company.

At September 30, 2011 (the date of the fiscal 2011 annual test), the fair value exceeded the carrying value by $4.3 million. This margin was based on a weighting applied to four different valuation methods which result in fair values ranging from $24.6 million to $27.2 million before the weightings were applied. Had the four methodologies been weighted differently, the percentage by which the fair value exceeded the carrying value may have been larger.

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.

In evaluating goodwill impairment, the Company considers a number of factors including discounted cash flow projections, guideline public company comparisons, acquisition transactions of comparable third party companies and capitalization value. Evaluating the potential impairment of goodwill is highly subjective and requires the Company to make significant estimates and judgment at many points during the analysis, especially with regard to the Company's future cash flows.

For the fiscal 2010 annual test, the Company weighted the Market Approach–Direct Market Capitalization Method 75% in its evaluation of the fair value of the Company's one reporting unit, which was a decrease from the 90% weighting used in fiscal 2009. For the fiscal 2011 annual test, the Company reduced the weighting further to 25% as the low level of market activity and substantial variation in price quotations based on the low activity of the Company's stock support the view that the Company's stock is inactive. The key assumption included in the Market Approach–Direct Market Capitalization Method was a control premium of 150%. This control premium was primarily based on an analysis of control premiums from a study of guideline merger and acquisition transactions. Specifically, the implied revenue multiples (the most commonly used valuation method for mergers and acquisitions in the technology industry) from the guideline transactions averaged 2.4 times revenue. The control premium of 150% implies a revenue multiple of 0.9 which the Company's management believes is reasonable and conservative. The control premium assumption of 150% was also corroborated by an analysis of potential synergies which could be realized by a market participant in an acquisition transaction. Using this control premium resulted in the fair value determined by the Market Approach–Direct Market Capitalization Method exceeding carrying value by $2.5 million. The Company believes the most significant change in circumstances that could affect the key assumptions in its valuation is a significant reduction in the observed revenue multiples implied by future mergers and acquisitions.

While there are inherent limitations in any valuation, the Company believes that placing a significant weighting of 75% on the Discounted Cash Flow Method, the Guideline Public Company Method, and the Guideline Transaction Method are more indicative of the fair value, or the price, that the Company would be sold at in an orderly transaction between market participants. The Company believes the most significant change in circumstances that could affect the key assumptions in our valuation are a significant reduction in the observed revenue multiples implied by future mergers and acquisitions and/or a significant deterioration of the Company's projected financial performance.

During the nine months ended June 30,2012 and the twelve month period ended September 30, 2011, the carrying value of goodwill increased as a result of the acquisitions of TMX, e.Magination, Magnetic and MarketNet, all of which included contingent earnout payments recorded at the time of the transaction. During the nine months ended June 30, 2012 we recorded a reduction to the estimates of contingent consideration to be earned for TMX and e.Magination of $780 thousand. Management has reviewed the factors and circumstances that caused the change in the estimate and determined that they do not reflect a triggering event.

In addition, any contingent acquisition payments related to acquisitions completed prior to September 30, 2009 are recorded as increases to goodwill as they are earned but not currently recorded. The Company is obligated to continue paying such quarterly contingent acquisition payments to former owners of acquired companies in the amount of $330 thousand that, if earned, would be recorded as an increase to goodwill. To the extent goodwill continues to increase as a result of such payments and to the extent there are unfavorable changes in assumptions used to determine the Company's fair value (including a decline in the Company's market capitalization), there can be no assurance that the Company will not have an impairment charge in the future.

Accounting for Stock-Based Compensation

At June 30, 2012, we maintained two stock-based compensation plans 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 29, 2011.

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 straight-line 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.

Stock Options Activity (Repricing Plans)

On October 28, 2011, the Company offered its employees the opportunity to have certain outstanding options modified by (i) reducing the grant exercise price to $0.67, the fair market value of the common stock as of the modification date and (ii) starting a new three year vesting schedule. The aggregate fair value of the modified options of approximately $90 thousand was calculated using the difference in value between the original terms and the new terms as of the modification date. The incremental cost of the modified option over the original option will be recognized as additional compensation expense over the new three year vesting period beginning on the date of modification. This opportunity was generally limited to options issued subsequent to the October 2008 repricing described above and in Note 11 to the Company's Annual Report on Form 10-K for fiscal 2011.

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 Senior Vice President of Finance and Chief Accounting 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, 2012 we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Accounting 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 Accounting 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, 2012 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings.

From time to time we are subject to ordinary routine litigation and claims incidental to our business. We are not currently involved in any legal proceedings that we believe are material beyond those previously disclosed in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on December 29, 2011 and that which is described below.

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 seeks 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 have asserted counterclaims against Bridgeline and Thomas Massie alleging that Bridgeline has breached Mr. Roche's employment agreement by improperly terminating Mr. Roche for cause and also alleging breach of the Asset Purchase Agreement by Bridgeline. This lawsuit remains unresolved as of June 30, 2012.

Ingeniador, LLC vs. Interwoven, Inc., Bridgeline Digital, Inc., et al

On April 26, 2012, the Company was informed that on such date the United States District Court for the District of Puerto Rico entered a default judgment against the Company as part of a patent infringement lawsuit brought by Ingeniador, LLC against 16 companies, including Bridgeline. The Company sought to have the default judgment set aside as it was never informed of the lawsuit and was not offered an opportunity to address the complaint. Ingeniador, LLC alleges Bridgeline has been infringing its patent rights and is seeking monetary damages. On June 15, 2012 the court granted the Company's request to have the default judgment set aside and the case was dismissed.

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, 2012, other than sales of unregistered securities during the quarter ended June 30, 2012 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, 2012, the Company granted 278,500 stock options under its Amended and Restated Stock Incentive Plan at a weighted average exercise price of $1.44 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
2.1	Agreement and Plan of Merger, dated as of May 31, 2012, by and among Bridgeline Digital, Inc., MarketNet, Inc. and Jill Bach(incorporated by reference to Exhibit 2.1 to our Current Report on Form 8-K filed on June 5, 2012).
10.1	Securities Purchase Agreement between Bridgeline Digital, Inc. and the investors named therein, dated May 31, 2012(incorporated by reference to Exhibit 10.1 to our Current Report on Form 8-K filed on June 5, 2012).
10.2	Form of Common Stock Purchase Warrant issued to Placement Agent, dated May 31, 2012(incorporated by reference to Exhibit 10.2 to our Current Report on Form 8-K filed on June 5, 2012).
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, 2012 Date	/s/ Thomas L. Massie Thomas L. Massie President and Chief Executive Officer (Principal Executive Officer)
August 14, 2012 Date	/s/ Michael D. Prinn Michael D. Prinn Senior Vice President Finance and Chief Accounting Officer (Principal Financial and Accounting Officer)

INDEX OF EXHIBITS

Exhibit No.	Description of Document
2.1	Agreement and Plan of Merger, dated as of May 31, 2012, by and among Bridgeline Digital, Inc., MarketNet, Inc. and Jill Bach(incorporated by reference to Exhibit 2.1 to our Current Report on Form 8-K filed on June 5, 2012).
10.1	Securities Purchase Agreement between Bridgeline Digital, Inc. and the investors named therein, dated May 31, 2012(incorporated by reference to Exhibit 10.1 to our Current Report on Form 8-K filed on June 5, 2012).
10.2	Form of Common Stock Purchase Warrant issued to Placement Agent, dated May 31, 2012(incorporated by reference to Exhibit 10.2 to our Current Report on Form 8-K filed on June 5, 2012).
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.