BRUNSWICK CORP
Form DEF 14A
March 24, 2016
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

SCHEDULE 14A

(Rule 14a-101)

INFORMATION REQUIRED IN PROXY STATEMENT

SCHEDULE 14A INFORMATION

Proxy Statement Pursuant to Section 14(a) of the Securities Exchange Act of 1934 (Amendment No.)

Filed by the Registrant Filed by a Party other than the Registrant

Check the appropriate box:
Preliminary Proxy Statement
CONFIDENTIAL, FOR USE OF THE COMMISSION ONLY (AS PERMITTED BY RULE 14a-6(e)(2))
Definitive Proxy Statement
Definitive Additional Materials
Soliciting Material Pursuant to ss.240.14a-12

BRUNSWICK CORPORATION

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if Other Than the Registrant)

Payment of Filing Fee (Check the appropriate box):

No fee required.

Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

(1) Title of each class of securities to which transaction applies:

(2) Aggregate number of securities to which transaction applies:

(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

(4) Proposed maximum aggregate value of transaction:

(5) Total fee paid:

Fee paid previously with preliminary materials.

Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration

statement number, or the Form or Schedule and the date of its filing.

(1) Amount Previously Paid:

(2) Form, Schedule or Registration Statement No.:

(3) Filing Party:

(4) Date Filed:

March 24, 2016

Dear Brunswick Shareholder:

We are pleased to invite the shareholders of Brunswick Corporation to attend the Company's Annual Meeting of Shareholders, to be held on Wednesday, May 4, 2016, at 9:00 a.m. CDT at the Ritz-Carlton Hotel, 160 East Pearson Street, Chicago, Illinois 60611.

As a Brunswick shareholder, you have been able to share in our financial and operational successes. Our total shareholder return for the last three fiscal years was an outstanding 77.3%. Our Board of Directors, the management team and our over 13,000 global employees are dedicated to continuing to add value for our shareholders.

In 2015, Brunswick concentrated on executing its growth plan, which included investing in innovative products, capacity expansion and focusing on both core businesses and strategic acquisitions in growing markets. In 2016, Brunswick will continue to drive profitable growth through product leadership, research and development programs, targeted acquisitions and expansion into new adjacent markets.

We will begin mailing a notice to our shareholders on March 24, 2016, containing instructions about online access to our 2016 Proxy Statement and our Annual Report on Form 10-K for the year ended December 31, 2015, as well as instructions regarding how to receive paper copies of these documents if you prefer.

Your vote is very important. Whether or not you plan to attend the meeting, we urge you to vote via the Internet, by telephone or by signing and returning a proxy card. Please vote as soon as possible so that your shares will be represented.

Thank you for your continued support of Brunswick.

Sincerely,

Mark D. Schwabero

Chairman and Chief Executive Officer

Brunswick Corporation 1 N. Field Court Lake Forest, IL 60045-4811
Telephone 847.735.4700

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Notice of Annual Meeting of Shareholders

May 4, 2016

9:00 a.m. CDT

Ritz-Carlton Hotel, 160 E. Pearson Street, Chicago, Illinois

March 24, 2016

Dear Brunswick Shareholder:

The Annual Meeting of Shareholders of Brunswick Corporation will be held at the Ritz-Carlton Hotel, 160 E. Pearson Street, Chicago, Illinois, on Wednesday, May 4, 2016, at 9:00 a.m. CDT. At the Annual Meeting, we will consider and vote upon the following matters:

(1) The election to the Company's Board of Directors of the three nominees named in the attached Proxy Statement;
(2) The approval of the compensation of our named executive officers on an advisory basis;
(3) The ratification of the Audit Committee's appointment of Deloitte & Touche LLP as our independent registered public accounting firm for the fiscal year ending December 31, 2016; and
(4) Any other business that may properly come before the meeting.

Sincerely,

Christopher F. Dekker

Secretary

Brunswick Corporation 1 N. Field Court Lake Forest, IL 60045-4811
Telephone 847.735.4700

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Proxy Summary

This summary highlights information contained elsewhere in this Proxy Statement. This summary does not contain all of the information that you should consider, and you should read the entire Proxy Statement carefully before voting. Page references are supplied to help you find further information in this Proxy Statement.

Eligibility to Vote

You can vote if you were a shareholder of record at the close of business on March 4, 2016.

How to Cast Your Vote

You can vote by any of the following methods:

- Internet (www.proxyvote.com) until 5:00 p.m. EDT on May 3, 2016;
- Telephone 1-800-690-6903 until 5:00 p.m. EDT on May 3, 2016;
- Completing, signing and returning your proxy or voting instruction card to arrive by May 3, 2016; or
- In person, at the Annual Meeting: If you are a shareholder of record, your admission ticket is attached to your proxy card. If your shares are held in the name of a broker, bank or other nominee, you must bring proof of ownership with you to the meeting.
- If you hold shares in the Brunswick Retirement Savings Plan or the Brunswick Rewards Plan, you must direct the trustee of these plans how to vote these shares by one of the above methods not later than 5:00 p.m. EDT on April 29, 2016.

Voting Matters

	Board Vote Recommendation	**Page Reference (for more detail)**
Election of Directors	FOR each Director Nominee	12
Advisory Vote on the Approval of Executive Compensation	FOR	43
Ratification of the Appointment of Auditors	FOR	47

Business Highlights

(for more detail please see Brunswick's Annual Report on Form 10-K filed with the SEC on February 17, 2016)

Our results in 2015 represent the sixth consecutive year of strong improvements in operating performance. The Company sought to achieve the following financial objectives in 2015:

- *Deliver revenue growth*
  - Ended the year with a 7 percent increase in net sales when compared with 2014
- *Experience increases in earnings before income taxes, as well as a slight improvement in gross margin percentage*
  - Reported earnings before income taxes of $315.2 million in 2015 compared with earnings before income taxes of $287.9 million in 2014
  - Improved gross margins by 10 basis points when compared with 2014
- *Continue to generate strong free cash flow and execute against the Company's capital strategy*
  - Ended the year with $668.8 million of cash and marketable securities, a net increase of $32.9 million
  - Funded investments in growth, both organically through capital expenditures and through acquisition opportunities, such as the $29.7 million investment in marine parts and accessories and Fitness segment acquisitions during 2015
  - Contributed $73.6 million to the Company's defined benefit pension plans, which included an amount made in connection with lump sum payments to certain pension plan participants in 2015
  - Enhanced shareholder returns by repurchasing $120.0 million of our common stock under the Company's share repurchase program in 2015 and increased cash dividends paid to shareholders in 2015 to $48.3 million from $41.7 million in 2014

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We achieved excellent Total Shareholder Return (TSR) for the 3 years ended December 31, 2015

3-year TSR: 77.3%

STOCK PRICE HISTORY

*Closing stock price as reported on the New York Stock Exchange for each year.

Director Nominees (page 12)

Name	**Age**	**Director since**	**Occupation**	**Independent (Yes/No)**	**Committee Memberships**	**Other Public Company Boards**
Nolan D. Archibald	72	1995	Retired; Executive Chairman of Stanley, Black & Decker, Inc.	Yes	• Finance • Executive	• Huntsman Corporation • Lockheed Martin Corporation
David C. Everitt	63	2012	Retired; President, Agricultural and Turf Division -North America, Asia, Australia and Sub-Saharan and South Africa, and Global Tractor and Turf Products of Deere & Company	Yes	• Human Resources and Compensation • Nominating and Corporate Governance • Qualified Legal Compliance	• Agrium, Inc. • Allison Transmission Holdings, Inc. • Harsco Corporation
Roger J. Wood	53	2012	Retired; President and Chief Executive Officer of Dana Holding Corporation	Yes	• Audit • Finance	• Tenneco Inc.

Governance Highlights

- Mr. Mark D. Schwabero serves as our Chairman and Chief Executive Officer
- Mr. Manuel A. Fernandez serves as our Lead Independent Director
- 9 of 10 directors are independent under the Board's Principles and Practices and the NYSE Listed Company Manual
- All of the members of the Audit, Finance, Human Resources and Compensation, Nominating and Corporate Governance and Qualified Legal Compliance Committees are independent
- Our directors collectively attended 98 percent of the 2015 Board and committee meetings

The Board of Directors believes that having our Chief Executive Officer serve as Chairman of the Board is in the best interest of the shareholders at this time because this structure ensures a seamless flow of communication between management and the Board, in particular with respect to the Board's oversight of the Company's strategic direction, as well as the Board's ability to ensure management's focused execution of that strategy. Our strong Lead Independent Director position ensures robust and independent Board oversight.

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Executive Compensation (page 24)

Compensation Element	Metric(s)	Role within Compensation Program	How Designed and Determined
Base Salary	n/a	Foundation of total pay, as incentives and benefits are a function of base salary.	Reviewed annually, targeting median of peer group. We consider external competitiveness, individual performance and internal equity when determining executives' base salaries.
Annual Incentive Plan	• Earnings Per Share (EPS) • Divisional Earnings Before Interest and Taxes (EBIT)	Primary element used to reward accomplishments against established business and individual goals within a given year.	Target funding based on planned performance for the year, as approved by the Board of Directors, with actual funding tied to annual performance against target metrics and limited to no more than 200 percent of target funding.
Performance Shares	• Cash Flow Return On Investment (CFROI) • Operating Margin • Relative Total Shareholder Return (TSR)	Focus management team on creating and sustaining value for shareholders.	Annual performance share grants for named executive officers (NEOs) represent 50 percent of targeted equity value. Three-year performance plan with shares earned based on achievement of CFROI and Operating Margin targets and Brunswick's TSR performance relative to the TSR of an established peer group, as measured over a three-year period.
Restricted Stock Units (RSUs)	• Absolute TSR	Reinforce retention and reward Brunswick's sustained TSR.	Annual RSU grants for NEOs represent 50 percent of targeted equity value. RSUs cliff vest at the end of a three-year period.

WHAT WE DO

We tie a very high percentage of executive pay to performance

We require executives to achieve performance-based goals tied to shareholder return

We target median compensation levels and review market data of our peer group when making executive compensation decisions

We apply strict share ownership guidelines to NEOs and directors

We disclose complete information on annual incentive plans

We require vested shares from our equity compensation programs to be held until share ownership guidelines are met

WHAT WE DON'T DO

We have no tax gross-ups (including perks, excise tax)

We have no modified single-trigger or single-trigger CIC severance agreements (we only use double-trigger CIC severance provisions)

We expressly forbid option repricing without shareholder approval in all of our equity plans

All of our active equity plans expressly forbid exchanges of underwater options for cash

We do not allow hedging of shares by our directors or employees

We do not allow pledging of shares by our directors or employees

We consider, and attempt to mitigate, risk in our compensation program

We use an independent compensation consultant

We have an established clawback policy

Starting in 2016, we implemented double-trigger equity award vesting acceleration upon a Change in Control (CIC)

We do not pay dividends or dividend equivalents on unearned performance shares

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2015 Executive Total Targeted Compensation Mix (page 26)

Component	**CEO**	**Other NEOs**
Base Salary	14 %	25 %
Annual Incentives	21 %	23 %
Long-Term Incentives	65 %	52 %

2015 Executive Compensation Summary (page 34)

Name and Principal Position	**Year**	**Salary**	**Stock Awards**	**Non-Equity Incentive Plan Compensation**	**Change in Pension Value and Non-qualified Deferred Compensation Earnings**	**All Other Compensation**	**Total**
Dustan E. McCoy(1) Former Chairman and Chief Executive Officer	2015	$ 1,125,000	$ 6,500,604	$1,777,000	$188,089	$452,777	**$ 10,043,4**
Mark D. Schwabero(2) Chairman and Chief Executive Officer	2015	$744,231	$ 2,502,375	$784,000	$-	$181,097	**$4,211,703**
William L. Metzger Senior Vice President and Chief Financial Officer	2015	$517,500	$ 1,000,904	$545,000	$29,292	$121,285	**$2,213,981**

John C. Pfeifer Vice President and President – Mercury Marine	2015	$479,423	$	1,000,904	$429,000	$191		$115,019	**$2,024,537**
B. Russell Lockridge(3) Vice President and Chief Human	1,250		728						
Total revenue	6,613		5,387		13,142		10,866		
Cost of revenue:									
Web application development services	2,963		2,273		5,976		4,451		
Managed service hosting	115		159		261		288		
Subscription and perpetual licenses	178		167		361		300		
Total cost of revenue	3,256		2,599		6,598		5,039		
Gross profit	3,357		2,788		6,544		5,827		
Operating expenses:									
Sales and marketing	1,779		1,170		3,422		2,420		
General and administrative	1,022		1,032		1,920		2,201		
Research and development	470		250		852		325		
Depreciation and amortization	333		306		681		609		
Total operating expenses	3,604		2,758		6,875		5,555		
(Loss) income from operations	(247	)	30		(331	)	272		
Interest income (expense), net	(61	)	5		(112	)	(1	)	
(Loss) income before income	(308	)	35		(443	)	271		

taxes				
Provison for income taxes	21	15	42	31
Net (loss) income	$ (329)	$ 20	$ (485)	$ 240
Net (loss) income per share:				
Basic	$ (0.03)	$ 0.00	$ (0.04)	$ 0.02
Diluted	$ (0.03)	$ 0.00	$ (0.04)	$ 0.02
Number of weighted average shares:				
Basic	12,254,793	11,186,145	12,069,326	11,184,156
Diluted	12,254,793	11,755,919	12,069,326	11,650,060

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

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BRIDGELINE DIGITAL, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in thousands)
(Unaudited)

	Six Months Ended March 31, 2011	2010
Cash flows from operating activities:		
Net (loss) income	$(485)	$240
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Amortization of intangible assets	398	283
Depreciation	312	371
Other amortization	175	117
Stock-based compensation	187	173
Changes in operating assets and liabilities:		
Accounts receivable and unbilled receivables	(191)	(256)
Prepaid expenses and other assets	(308)	(140)
Accounts payable and accrued liabilities	(327)	(73)
Deferred revenue	277	249
Other liabilities	(18)	(3)
Total adjustments	505	721
Net cash provided by operating activities	20	961
Cash flows from investing activities:		
Purchases of property and improvements	(213)	(116)
Software development capitalization costs	-	(338)
Contingent acquisition payments	(413)	(878)
Net cash used in investing activities	(626)	(1,332)
Cash flows from financing activities:		
Proceeds from sale of common stock, net of issuance costs	857	-
Proceeds from exercise of employee stock options	121	5
Borrowings from bank line of credit	4,450	3,000
Payments on bank line of credit	(4,625)	(2,350)
Payments on subordinated promissory notes	(42)	-
Principal payments on capital leases	(82)	(42)
Net cash provided by financing activities	679	613
Effect of exchange rate changes on cash and cash equivalents	7	(9)
Net increase in cash and cash equivalents	80	233
Cash and cash equivalents at beginning of period	3,045	3,060
Cash and cash equivalents at end of period	$3,125	$3,293
Supplemental disclosures of cash flow information:		
Cash paid for:		
Interest	$110	$11
Income taxes	$27	$87
Non cash activities:		
Equipment purchased under capital leases	$573	-
Equipment and other assets included in accounts payable	$50	$10
Accrued contingent consideration (earnouts)	-	$287

Other assets included in accrued expenses	-	$87

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, Inc. ("Bridgeline" or the "Company"), a Delaware corporation, is a developer of a unified web engagement management product suite named iAPPS® and award-winning interactive technology solutions that help organizations optimize business processes. Bridgeline's iAPPS® product suite, combined with its interactive development capabilities assist customers in maximizing revenue, improving customer service and loyalty, enhancing employee knowledge, and reducing operational costs by leveraging web based technologies.

Bridgeline's iAPPS product suite provides solutions that deeply integrate web Content Management, eCommerce, eMarketing, and web Analytics capabilities within the mission critical website, on-line stores, intranets, extranets, or portals in which they reside; enabling business users 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 changing web properties.

The iAPPS product suite is delivered through a SaaS ("Software as a Service") business model, in which the Company delivers software over the Internet while providing maintenance, daily technical operation and support; or via traditional perpetual licensing business model, in which the iAPPS software resides on a dedicated server in either the customer's facility or Bridgeline's co-managed hosting facility.

Bridgeline's team of Microsoft® Gold Certified developers specialize in end-to-end interactive technology solutions which include digital strategy, user center design, web application development, SharePoint development, rich media development, search engine optimization and web application hosting management.

In 2010, KM Magazine Editors selected iAPPS as the Trend Setting Product of the Year. iAPPS Content Manager won the 2010 Codie Award for the Best Content Management Solution Globally. In addition, in 2011, B2B Interactive selected Bridgeline as one of the Top Interactive Technology companies in the United States.

Locations

The Company's corporate office is located north of Boston, Massachusetts. The Company maintains regional offices serving the following geographical locations: Atlanta, GA; Baltimore, MD; Boston, MA; Chicago, IL; Denver, CO; New York, NY; Philadelphia, PA; and Virginia. The Company has two wholly-owned subsidiaries, e.magination IG, LLC, located in Maryland and 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 March 31, 2011, the Condensed Consolidated Statements of Operations for the three and six months ended March 31, 2011 and 2010, respectively, and the Condensed Consolidated Statements of Cash Flows for the six months ended March 31, 2011 and 2010, 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, 2010. 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 March 31, 2011 and its results of operations for the three and six months ended March 31, 2011 and 2010, respectively, and its cash flows for the six months ended March 31, 2011 and 2010, respectively. The results for the three and six months ended March 31, 2011 are not necessarily indicative of the results to be expected for the year ending September 30, 2011. The accompanying September 30, 2010 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 2010, the Financial Accounting Standards Board ("FASB") issued an update with respect to Accounting Standards Codification (ASC) Topic 350, Intangibles—Goodwill and Other. Accounting Standards Update 2010-28 ("ASU 2010-28"), When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts—a consensus of the FASB Emerging Issues Task Force, modifies goodwill impairment testing for reporting units with zero or negative carrying amounts. This guidance affects all nongovernmental entities that have recognized goodwill and have one or more reporting units whose carrying amount for purposes of performing Step 1 of the goodwill impairment testing is zero or negative. The new guidance within ASU 2010-28 modifies Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. For those reporting units, an entity must evaluate whether it is more likely than not that a goodwill impairment exists, regardless of the mathematical results of the Step 1 test. In making that determination, the entity should consider whether there are any adverse qualitative factors that could impact the amount of goodwill. The qualitative factors are consistent with the existing guidance and examples in paragraph 350-20-35-30, including an adverse change in legal factors or in the business climate, unanticipated competition, a loss of key personnel or a more-likely-than-not expectation that all, or part, of a reporting unit will be disposed of. As a result of ASU 2010-28, an entity no longer has the ability to assert that a reporting unit is not required to perform Step 2 because the carrying amount of the reporting unit is zero or negative despite the existence of qualitative factors that indicate the goodwill is more likely than not impaired. This change may result in goodwill impairments being reported sooner than under current practice. The new guidance is effective for public entities for fiscal years and interim periods within those years beginning after December 15, 2010, with early adoption not permitted. The Company does not expect the provisions of ASU 2010-28 to have a material effect on its financial position, results of operations or cash flows.

In December 2010, the FASB issued Accounting Standards Update 2010-29 ("ASU 2010-29"), Business Combinations (Topic 805) - Disclosure of Supplementary Pro Forma Information for Business Combinations. This Accounting Standards Update requires a public entity to disclose pro forma information for business combinations that occurred in the current reporting period. The disclosures include pro forma revenue and earnings of the combined entity for the current reporting period as though the acquisition date for all business combinations that occurred during the year had been as of the beginning of the annual reporting period. If comparative financial statements are presented, the pro forma revenue and earnings of the combined entity for the comparable prior reporting period should be reported as though the acquisition date for all business combinations that occurred during the current year had been as of the beginning of the comparable prior annual reporting period. The amendments in this Update affect any public entity as defined by Topic 805 that enters into business combinations that are material on an individual or aggregate basis. The amendments in this Update are effective prospectively for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010. Early adoption is permitted. The Company does not expect the provisions of ASU 2010-29 to have a material effect on its financial position, results of operations or cash flows.

Subsequent Events

In May 2011, the Company amended its loan arrangement (the "Amendment") with Silicon Valley Bank ("SVB"). Under the terms of the existing agreement with SVB, the Company's line of credit was limited to the lesser of (i) $5 million and (ii) 80% of eligible receivables as defined, and up to $2 million could be borrowed in out of formula borrowings for specified periods of time (provided the total amount outstanding does not exceed $5 million).

The Amendment: (i) extended the maturity date of the line of credit for one year to March 31, 2013; (ii) revised certain financial covenants; and (iii) 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%. Interest on the term loan will be paid until April 1, 2012 and on and after April 2, 2012, principal and interest on the term loan will be paid over 36 months ending on April 1, 2015.

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

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

3. Accounts Receivable and Unbilled Receivables

Accounts receivable and unbilled receivables consists of the following:

	As of March 31, 2011	As of September 30, 2010
Accounts receivable	$ 4,082	$ 3,854
Unbilled receivables	327	361
Subtotal	4,409	4,215
Allowance for doubtful accounts	(289)	(286)
Accounts receivable and unbilled receivables, net	$ 4,120	$ 3,929

4. Intangible Assets

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

	As of March 31, 2011		
	Gross Asset	Accumulated Amortization	Net Amount
Intangible assets:			
Customer related & non-compete agreements	$4,034	$(2,140)	$1,894
Domain and trade names	26	(26)	—
Acquired software	362	(362)	—
Total intangible assets	$4,422	$(2,528)	$1,894

	As of September 30, 2010		
	Gross Asset	Accumulated Amortization	Net Amount
Intangible assets:			
Customer related & non-compete agreements	$ 4,034	$ (1,772)	$ 2,262
Domain and trade names	26	(26)	—
Acquired software	362	(332)	30
Total intangible assets	$ 4,422	$ (2,130)	$ 2,292

Total amortization expense related to intangible assets for the three and six months ended March 31, 2011 and 2010 is as follows:

	Three Months Ended March 31,		Six Months Ended March 31,	
	2011	2010	2011	2010
Amortization expense charged to:				
Cost of revenue	$ 6	$ 23	$ 30	$ 45
Operating expense	184	119	368	238
Total	$ 190	$ 142	$ 398	$ 283

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

5. Goodwill

Changes in the carrying amount of goodwill follows:

		As of March 31, 2011
Balance at beginning of period	$	20,036
Purchase price allocation adjustments		3
Balance at end of period	$	20,039

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, 2010, the Company did not record a goodwill impairment charge.

6. Debt

Debt consists of the following:

		As of March 31, 2011		As of September 30, 2010
Line of credit borrowings	$	4,825	$	5,000
Subordinated promissory note		458		500
Total debt		5,283		5,500
Less current portion		(2,341)		(2,475)
Debt, net of current portion	$	2,942	$	3,025

7. Shareholder's Equity

Common Stock

On October 29, 2010, the Company sold 1,000,000 shares of common stock at $1.00 per share for gross proceeds of $1,000,000 in a private placement. Net proceeds to the Company after offering expenses were approximately $857,000.

Common Stock Warrants

In April 2006, the Company issued 280,000 warrants to note holders of Senior Secured Notes issued in a private placement (which have been repaid) (the "Debt Warrants") and issued 112,000 warrants to the underwriters of the debt offering (the "Underwriter's Debt Warrants"). The Debt Warrants are exercisable to purchase shares of the Company's common stock at an exercise price of $0.001 per share any time within five years from the date of grant. After adjustments for anti-dilution provisions, the Underwriter's Debt Warrants are exercisable to purchase shares of the Company's common stock at an exercise price of $4.93 per share any time within five years from the date of grant.

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. 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 are currently exercisable and will expire 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 vest over a one year period and expire on October 15, 2015. Of the warrants issued, 25,000 have an exercise price of $1.00 per share and 25,000 have 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 $1.45 per share. In return for such warrants, the placement agent agreed to cancel 71,231 Underwriter's Debt Warrants and 57,000 IPO Warrants.

As of March 31, 2011: (i) Debt Warrants to purchase 240,000 shares have been exercised and 40,000 Debt Warrants remain outstanding with an exercise price of $0.001. These warrants expire in April 2011; (ii) Underwriter's Debt Warrants to purchase 71,231 shares at an exercise price of $5.00 have been cancelled and 40,769 Underwriter's Debt Warrants remain outstanding with an exercise price of $4.93. These warrants expire in April 2011; (iii) IPO Warrants to purchase 57,000 shares at an exercise price of $7.50 have been cancelled and 93,000 IPO Warrants remain outstanding with an exercise price of $7.39; (iv) placement agent warrants to purchase 64,000 shares at an exercise price of $1.45 are outstanding; and (v) 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.

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, 2010	2,345,705	$ 1.01	302,000	$ 5.58
Granted	150,000	1.58	114,000	1.47
Exercised	(117,999)	1.03	—	—
Forfeited, cancelled or expired	(351,167)	1.28	(128,231)	6.11
Outstanding, March 31, 2011	2,026,539	$ 1.00	287,769	$ 3.67

8. Comprehensive Income

Comprehensive income 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) income was as follows:

	Three Months Ended March 31,		Six Months Ended March 31,	
	2011	2010	2011	2010
Net(loss) income	$ (329)	$ 20	$ (485)	$ 240

Net change in foreign currency translation adjustment	5	(15)	7	(13)
Comprehensive (loss) income	$ (324)	$ 5	$ (478)	$ 227

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

9. Net Income Per Share

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

(in thousands, except per share data)	Three Months Ended March 31, 2011	Three Months Ended March 31, 2010	Six Months Ended March 31, 2011	Six Months Ended March 31, 2010
Net (loss) income	$(329)	$20	$(485)	$240
Weighted average common shares outstanding - basic	12,255	11,186	12,069	11,184
Effect of dilutive securities (primarily stock options)	-	570	-	466
Weighted average common shares outstanding - diluted	12,255	11,756	12,069	11,650
Net (loss) income per share - basic	$(0.03)	$0.00	$(0.04)	$0.02
Net (loss) income per share - diluted	$(0.03)	$0.00	$(0.04)	$0.02

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 six months ended March 31, 2011, options to purchase shares of the Company's common stock of 467,490 and 433,275 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 288,750 and 358,750 for the three and six months ended March 31, 2010 were not included in the computation of diluted net income per share because the exercise price of the options was greater than the weighted average market price of the common stock during the period and were anti-dilutive.

10. Income Taxes

Income tax expense was $21 thousand and $15 thousand for the three months ended March 31, 2011 and 2010, respectively, and $42 thousand and $31 thousand for the six months ended March 31, 2011 and 2010, 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.

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

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, 2010 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 a developer of a unified web engagement management product suite named iAPPS® and award-winning interactive technology solutions that help organizations optimize business processes. Bridgeline's iAPPS product suite combined with its interactive development capabilities assist customers in maximizing revenue, improving customer service and loyalty, enhancing employee knowledge, and reducing operational costs by leveraging web based technologies.

Bridgeline Digital's iAPPS product suite provides solutions that deeply integrate web Content Management, eCommerce, eMarketing, and web Analytics capabilities within the mission critical website, on-line stores, intranets, extranets, or portals in which they reside; enabling business users to enhance and optimize the value of their web properties. Combined with award-winning interactive development capabilities, Bridgeline helps customers cost-effectively accommodate the needs of today's rapidly changing web properties.

The iAPPS product suite is delivered through a SaaS ("Software as a Service") business model, in which we deliver our software over the Internet while 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 2010, KM Magazine Editors selected iAPPS as the Trend Setting Product of the Year. iAPPS Content Manager won the 2010 Codie Award for the Best Content Management Solution Globally.

Bridgeline's team of Microsoft® Gold Certified developers specialize in end-to-end interactive technology solutions which include digital strategy, user center design, web application development, SharePoint development, rich media development, search engine optimization and web application hosting management.

In 2011, B2B Interactive selected Bridgeline Digital as one of the Top Interactive Technology companies in the United States.

Customer Information

We had approximately 553 customers at March 31, 2011 compared with approximately 636 customers at March 31, 2010, a decrease of 13%. The Company has proactively been terminating engagements with a number of smaller hosting customers obtained through previous acquisitions for which the Companies core competencies are not aligned and margins are not conducive to growth. Approximately 400 of the Company's customers, or 72%, pay a monthly subscription fee or a monthly managed service hosting fee.

For the three and six months ended March 31, 2011 and 2010 no customer represented 10% or more of total revenue.

Results of Operations for the Three and Six Months Ended March 31, 2011 compared to the Three and Six Months Ended March 31, 2010

Total revenue for the three months ended March 31, 2011 was \$6.6 million compared with \$5.4 million for the three months ended March 31, 2010, an increase of 23%. We had a net loss of \$329 thousand for the three months ended March 31, 2011 compared with net income of \$20 thousand for the three months ended March 31, 2010. Net loss per share for the three months ended March 31, 2011 was \$(0.03) compared with net income per share of \$0.00 for the three months ended March 31, 2010.

Total revenue for the six months ended March 31, 2011 was \$13.1 million compared with \$10.9 million for the six months ended March 31, 2010, an increase of 21%. We had a net loss of \$485 thousand for the six months ended March 31, 2011 compared with net income of \$240 thousand for the six months ended March 31, 2010. Net loss per share for the six months ended March 31, 2011 was \$(0.04) compared with net income per share of \$0.02 for the six months ended March 31, 2010.

The following items affected the results of operation for the three and six months ended March 31, 2011 as compared with the three and six months ended March 31, 2010:

- We released iAPPS® Commerce in the first quarter of fiscal 2010, iAPPS® Marketier in the third quarter of fiscal 2010, and iAPPS Version 4.5 in the fourth quarter of fiscal 2010.

- We completed two acquisitions in fiscal 2010 that are included in our results of operations from the date of acquisition. We acquired TMX Interactive, Inc. ("TMX", now Bridgeline Philadelphia) in May 2010 and e.Magination network, LLC. ("e.magination", now Bridgeline Baltimore) in July 2010.

- In the six months ended March 31, 2010, we capitalized $338 thousand of software development costs. However, in the six months ended March 31, 2011, capitalization of software developments costs was immaterial.

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

Revenue:	Three Months Ended March 31, 2011	Three Months Ended March 31, 2010	$ Change	% Change	Six Months Ended March 31, 2011	Six Months Ended March 31, 2010	$ Change	% Change
Web application development services	$ 5,381	$ 4,525	856	19 %	$ 10,924	$ 9,138	1,786	20 %
% of total revenue	81 %	84 %			83 %	84 %		
Managed service hosting	501	506	(5)	(1 %)	968	1,000	(32)	(3 %)
% of total revenue	8 %	9 %			7 %	9 %		
Subscription and perpetual licenses	731	356	375	105 %	1,250	728	522	72 %
% of total revenue	11 %	7 %			10 %	7 %		
Total revenue	6,613	5,387	1,226	23 %	13,142	10,866	2,276	21 %
Cost of revenue:								
Web application development services	2,963	2,273	690	30 %	5,976	4,451	1,525	34 %
% of web application development revenue	55 %	50 %			55 %	49 %		
Managed service hosting	115	159	(44)	(28 %)	261	288	(27)	(9 %)
	23 %	31 %			27 %	29 %		

% of managed service hosting revenue								
Subscription and perpetual licenses	178	167	11	7%	361	300	61	20%
% of subscription and perpetual revenue	24%	47%			29%	41%		
Total cost of revenue	3,256	2,599	657	25%	6,598	5,039	1,559	31%
Gross profit	3,357	2,788	569	20%	6,544	5,827	717	12%
Gross profit margin	51%	52%			50%	54%		
Operating expenses:								
Sales and marketing	1,779	1,170	609	52%	3,422	2,420	1,002	41%
% of total revenue	27%	22%			26%	22%		
General and administrative	1,022	1,032	(10)	(1%)	1,920	2,201	(281)	(13%)
% of total revenue	15%	19%			15%	20%		
Research and development	470	250	220	88%	852	325	527	162%
% of total revenue	7%	5%			6%	3%		
Depreciation and amortization	333	306	27	9%	681	609	72	12%
% of total revenue	5%	6%			5%	6%		
Total operating expenses	3,604	2,758	846	31%	6,875	5,555	1,320	24%
(Loss) income from operations	(247)	30	(277)	(923%)	(331)	272	(603)	(222%)
Interest income (expense) net	(61)	5	(66)	(1,320%)	(112)	(1)	(111)	11,100%
(Loss) income before income taxes	(308)	35	(343)	(980%)	(443)	271	(714)	(263%)
Provision for income taxes	21	15	6	40%	42	31	11	35%
Net (loss) income	$ (329)	$ 20	$ (349)	(1,745%)	$ (485)	$ 240	$ (725)	(302%)
Adjusted EBITDA	$ 256	$ 528	(273)	(52%)	$ 741	$ 1,216	(475)	(39%)

Revenue

Our revenue is derived from three sources: (i) web application development services (ii) managed service hosting and (iii) subscription and perpetual licenses. Total revenue for the three months ended March 31, 2011 was $6.6 million compared with $5.4 million for the three months ended March 31, 2010, an increase of 23%. Total revenue for the six months ended March 31, 2011 was $13.1 million compared with $10.9 million for the six months ended March 31, 2010, an increase of 21%.

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 increased $856 thousand, or 19% to $5.4 million from $4.5 million for the three months ended March 31, 2011 compared to the three months ended March 31, 2010. The increases in the three months ended March 31, 2011 over the comparable period are primarily related to our acquisitions of TMX (May 2010) and e.Magination (July 2010) completed in the last two quarters of fiscal 2010. Also contributing to the increases are services engagements generated from sales of our iAPPS product.

Web application development services revenue as a percentage of total revenue decreased to 81% from 84% for the three months ended March 31, 2011 compared to the three months ended March 31, 2010. The decrease as a percentage of total revenues for the three months ended March 31, 2011 compared to the three months ended March 31, 2010 is attributable to a larger mix of iAPPS perpetual license revenue compared to overall services revenues.

Revenue from web application development increased $1.8 million, or 20% to $10.9 million from $9.1 million for the six months ended March 31, 2011 compared to the six months ended March 31, 2010. The increases in Web application development for the six months ended March 31, 2011 over the comparable period are primarily related to our acquisitions of TMX (May 2010) and e.Magination (July 2010) completed in the last two quarters of fiscal 2010. Also contributing to the increases are services engagements generated from sales of our iAPPS product.

Web application development services revenue as a percentage of total revenue decreased to 83% from 84% for the six months ended March 31, 2011 compared to the six months ended March 31, 2010. The decrease as a percentage of total revenues for the six months ended March 31, 2011 compared to the six months ended March 31, 2010 is attributable to a larger mix of iAPPS perpetual license revenue compared to overall services revenues.

Managed Service Hosting

Revenue from managed service hosting decreased $5 thousand to $501 thousand from $506 thousand for the three months ended March 31, 2011 compared to the three months ended March 31, 2010. Revenue from managed service hosting decreased $32 thousand to $968 thousand from $1.0 million for the six months ended March 31, 2011 compared to the six months ended March 31, 2010.

The decreases in the three and six months ended March 31, 2011 over the comparable periods are attributable to our efforts to engage with customers that are aligned with our core competencies and proactively end our engagements with a number of smaller hosting customers obtained through previous acquisitions. Managed services revenue as a percentage of total revenue decreased to 8% from 9% for the three months ended March 31, 2011 compared to the three months ended March 31, 2010, and decreased to 7% from 9% for the three months ended March 31, 2011 compared to the three months ended March 31, 2010 as a result of the increase in license revenue.

Subscription and Perpetual Licenses

Revenue from subscription and perpetual licenses increased $375 thousand, or 105% to $731 thousand from $356 thousand for the three months ended March 31, 2011 compared to the three months ended March 31, 2010. Revenue from subscription and perpetual licenses increased $522 thousand, or 72% to $1.3 million from $728 thousand for the six months ended March 31, 2011 compared to the six months ended March 31, 2010.

The increases are primarily due to increases in iAPPS perpetual license revenue and annual maintenance renewals recognized in the three and six months ended March 31, 2011 compared to the three and six months ended March 31, 2010. Subscription and perpetual license revenue as a percentage of total revenue increased to 11% from 7% for the three months ended March 31, 2011 compared to the three months ended March 31, 2010, and increased to 10% from 7% for the six months ended March 31, 2011 compared to the six months ended March 31, 2010 as a result of the increase in perpetual license revenue and annual maintenance revenue. Historically, revenue from perpetual licenses has fluctuated from quarter to quarter.

Costs of Revenue

Total cost of revenue increased $657 thousand, or 25% to $3.3 million from $2.6 million for the three months ended March 31, 2011 compared to the three months ended March 31, 2010. Total cost of revenue increased $1.6 million, or 31% to $6.6 million from $5.0 million for the six months ended March 31, 2011 compared to the six months ended March 31, 2010.

Cost of Web Application Development Services

Cost of web application development services increased $690 thousand, or 30% to $3.0 million from $2.3 million for the three months ended March 31, 2011 compared to the three months ended March 31, 2010. The cost of web application development services as a percentage of application development services revenue increased to 55% from 50% for the three months ended March 31, 2011 compared to the three months ended March 31, 2010. Cost of web application development services increased $1.5 million, or 34% to $6.0 million from $4.5 million for the six months ended March 31, 2011 compared to the six months ended March 31, 2010. The cost of web application development services as a percentage of application development services revenue increased to 55% from 49% for the six months ended March 31, 2011 compared to the six months ended March 31, 2010.

The increases in the cost of web application development services in the three and six months ended March 31, 2011 over the comparable periods are attributable to the increase in the number of web application development related employees obtained from the two acquisitions completed during the last two quarters of fiscal 2010 and is commensurate with an increase in revenues.

Cost of Managed Service Hosting

Cost of managed service hosting decreased $44 thousand or 28% to $115 thousand from $159 thousand for the three months ended March 31, 2011 compared to the three months ended March 31, 2010. The cost of managed services as a percentage of managed services revenue decreased to 23% from 31% the three months ended March 31, 2011 compared to the three months ended March 31, 2010. Cost of managed service hosting decreased $27 thousand or 9% to $261 from $288 thousand for the six months ended March 31, 2011 compared to the six months ended March 31, 2010. The cost of managed services as a percentage of managed services revenue decreased to 27% from 29% the six months ended March 31, 2011 compared to the six months ended March 31, 2010.

The decreases in managed service hosting costs for the three and six months ended March 31, 2011 over the comparable periods are due to our efforts to streamline costs in relation to ending engagements with lower margin hosting customers. We will continue to make investments to our hosting environment to support our core customer base, which is a higher margin business.

Cost of Subscription and Perpetual License

Cost of subscription and perpetual licenses increased $11 thousand, or 7% to $178 thousand from $167 thousand for the three months ended March 31, 2011 compared to the three months ended March 31, 2010. The cost of subscription and perpetual licenses as a percentage of subscription and perpetual license revenue decreased to 24% from 47% for the three months ended March 31, 2011 compared to the three months ended March 31, 2010. Cost of subscription and perpetual licenses increased $61 thousand, or 20% to $361 from $300 thousand for the six months ended March 31, 2011 compared to the six months ended March 31, 2010. The cost of subscription and perpetual licenses as a percentage of subscription and perpetual license revenue decreased to 29% from 41% for the six months ended March 31, 2011 compared to the six months ended March 31, 2010.

The increases in subscription and perpetual license costs for the three and six months ended March 31, 2011 over the comparable periods is commensurate with the increase in revenues. The decrease in costs as a percentage of revenue is due to a larger mix of perpetual license revenue to subscription revenue during the current period as compared to the prior period, as perpetual licenses are a higher margin business. Costs to support subscription and license revenues are relatively fixed, resulting in a higher margin revenue base.

Operating Expenses

Sales and Marketing Expenses

Sales and marketing expenses increased $609 thousand, or 52% to $1.8 million from $1.2 million for the three months ended March 31, 2011 compared to the three months ended March 31, 2010. Sales and marketing expenses represented 27% and 22% of total revenue for the three months ended March 31, 2011 and 2010, respectively. Sales and marketing expenses increased $1.0 million, or 41% to $3.4 million from $2.4 million for the six months ended March 31, 2011 compared to the six months ended March 31, 2010. Sales and marketing expenses represented 26% and 22% of total revenue for the six months ended March 31, 2011 and 2010, respectively.

The increases are primarily attributable to the increase in the number of sales related employees obtained from the two acquisitions completed during the last two quarters of fiscal 2010 and an increase in sales commissions commensurate with the increase in revenues.

General and Administrative Expenses

General and administrative expenses decreased $10 thousand, or 1% to $1.0 million for the three months ended March 31, 2011 compared to the three months ended March 31, 2010. General and administrative expenses represented 15% and 19% of total revenue for the three months ended March 31, 2011 and 2010, respectively. General and administrative expenses decreased $281 thousand, or 13% to $1.9 million from $2.2 million for the six months ended March 31, 2011 compared to the six months ended March 31, 2010. General and administrative expenses represented 15% and 20% of total revenue for the six months ended March 31, 2011 and 2010, respectively.

The decrease in general and administrative expenses is primarily due to improved general and administrative staff efficiencies and reduced compensation and consulting expenses. The decrease as a percentage of revenue is a result of streamlining personnel and corporate costs to support the increases in revenues without a commensurate increase in costs.

Research and Development

Research and development expense increased by $220 thousand, or 88% to $470 thousand from $250 thousand for the three months ended March 31, 2011 compared to the three months ended March 31, 2010. Research and development expense increased by $527 thousand, or 162% to $852 thousand from $325 thousand for the six months ended March 31, 2011 compared to the six months ended March 31, 2010. Capitalized software development costs were immaterial for the three and six months ended March 31, 2011. Capitalized software costs were $168 thousand and $338 thousand for three and six months ended March 31, 2010. Had such costs not been capitalized, research and development expense would have been $418 thousand and $663 thousand for the three and six months ended March 31, 2010.

The increase in research and development expense is primarily due to an increase in the number of research and development employees combined with the decrease in capitalized software costs quarter over quarter and year over year. We will continue to invest in enhancements for our iAPPS Product Suite.

Depreciation and Amortization

Depreciation and amortization expense increased by $27 thousand, or 9% to $333 thousand from $306 thousand for the three months ended March 31, 2011 compared to the three months ended March 31, 2010. Depreciation and amortization expense increased by $72 thousand, or 12% to $681 thousand from $609 thousand for six months ended March 31, 2011 compared to the six months ended March 31, 2010. Depreciation and amortization represented 5% and 6% of revenue for the six months ended March 31, 2011 and 2010, respectively.

This increase is primarily attributable to additional amortization expense for intangible assets resulting from the two acquisitions completed in the second half of fiscal 2010.

Income Taxes

The provision for income tax expense was $21 thousand and $15 thousand for three months ended March 31, 2011 compared to the three months ended March 31, 2010, and $42 thousand and $31 thousand for six months ended March 31, 2011 compared to the six months ended March 31, 2010. 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.

Income (Loss) from Operations

The loss from operations was $247 thousand and $331 thousand for the three and six months ended March 31, 2011, as compared to income from operations of $30 thousand and $272 thousand for the three and six months ended March 31, 2010.

The loss from operations for the three months and six months ended March 31, 2011 is attributable to an increase in personnel costs for employees obtained through the two acquisitions completed during the last two quarters of fiscal 2010, as well as a decrease in capitalization of software development costs for the three and six months ended March 31, 2011 as compared to the same periods of the previous year.

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 provides 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 March 31,		Six Months Ended March 31,	
	2011	2010	2011	2010
Net (loss) income	$(329)	$20	$(485)	$240
Provision for income tax	21	15	42	31
Interest expense (income), net	61	(5)	112	1
Amortization of intangible assets	190	142	398	283
Depreciation	150	187	312	371
EBITDA	93	359	379	926
Other amortization	91	66	175	117
Stock based compensation	72	103	187	173
Adjusted EBITDA	$256	$528	$741	$1,216

The decrease in Adjusted EBITDA is primarily related to a lower amount of net income for the current period as compared with the prior periods and additional costs related to acquisitions.

Liquidity and Capital Resources

Cash Flows

Operating Activities

Cash provided by operating activities was $20 thousand for the six months ended March 31, 2011 compared to cash provided by operating activities of $961 thousand for the six months ended March 31, 2010. The decrease in cash provided from operating activities is primarily attributable to lower net income for six months ended March 31, 2011 compared to the six months ended March 31, 2010. The decrease in net income is attributable to a decrease in capitalization of software development costs as compared to the prior period, as well as amortization of intangibles and personnel related costs resulting from our acquisitions completed in the second half of fiscal 2010. Accounts payable and accrued liabilities also decreased by $327 thousand in the six months ended March 31, 2011, as we made a managed effort to reduce liabilities.

Investing Activities

Cash used in investing activities was $626 thousand for the six months ended March 31, 2011 compared to $1.3 million for the six months ended March 31, 2010. This amount included expenditures for equipment and improvements of $213 thousand for the six months ended March 31, 2011 compared with $116 thousand for the six months ended March 31, 2010. Contingent acquisition payments were $413 thousand for the six months ended March 31, 2011 compared with $878 thousand for the six months ended March 31, 2010.

Financing Activities

Cash provided by financing activities was $679 thousand for the six months ended March 31, 2011 compared to $613 thousand for the six months ended March 31, 2010. The increase in cash provided by financing activities for the six months ended March 31, 2011 was primarily attributable to proceeds (net of issuance costs) from the sale of common stock of $857 thousand in October 2010. Also contributing to cash provided by financing activities were proceeds from exercises of employee stock options of $121 thousand, offset by repayment of subordinated promissory notes and capital lease obligations of $124 thousand. At March 31, 2011, $4.8 million was outstanding under the bank credit line.

Capital Resources and Liquidity Outlook

On October 29, 2010, we sold 1,000,000 shares of common stock at $1.00 per share for gross proceeds of $1 million in a private placement. Net proceeds after offering expenses were approximately $857 thousand.

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

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.

Contractual Obligations

We lease our facilities in the United States and India. During the first quarter of fiscal 2011, the Company signed new office leases for its Baltimore, Maryland location and its Bangalore, India location.

Other new contractual obligations as of March 31, 2011 include equipment acquired under capitalized lease agreements valued at $573 thousand with payments extending through March 2013.

As of March 31, 2011, we had an accrued contingent earnout liability of $1.6 million from acquisitions completed in prior fiscal years, which are scheduled to be paid out through fiscal 2014. 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 $1.3 million due related to acquisitions completed prior to September 30, 2009, which are not required to be accrued until earned.

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, 2010.

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. 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 30 to 45 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 of 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 judgement 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 are 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. For the year ended September 30, 2010, the Company did not record a goodwill impairment charge.

At September 30, 2010 (the date of the most recent test), the fair value exceeded the carrying value by 17%. This margin was based on a weighting applied to four different valuation methods which result in fair values ranging from $22.5 million to $28.2 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, changes 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 management to make significant estimates and judgment at many points during the analysis, especially with regard to the Company's future cash flows.

Management placed significant weight of 75% on its evaluation on the fair value derived using the Market Approach–Direct Market Capitalization Method. Management allocated a higher weighting to this method because it is based upon quoted prices of the Company's common stock. The key assumption included in Market Approach–Direct Market Capitalization Method was a control premium of 65%. This control premium was based on an analysis of control premiums from a study of guideline merger and acquisition transactions which was corroborated by an analysis of potential synergies which could be realized by a market participant in an acquisition transaction.

While there are inherent limitations in any valuation, we believe that placing a significant weighting of 75% on the Market Approach–Direct Market Capitalization is more objective than the other methods which are more assumption based. The 25% weighting on three other methods, which included the Discounted Cash Flow Method, the Guideline Public Company Method and the Guideline Transaction Method, supported the valuation based on the Market Approach–Direct Market Capitalization. We believe the most significant change in circumstances that could affect the key assumptions in our valuation is a significant reduction in our stock price.

During the twelve month period ended September 30, 2010, the carrying value of goodwill increased as a result of the acquisitions of TMX and e.Magination (both of which included contingent earnout payments recorded at the time of the transaction) and the accrual of contingent acquisition payments related to acquisitions completed prior to September 30, 2009 (which are recorded as increases to goodwill as they are earned but not currently recorded). The Company is obligated to continue paying quarterly contingent acquisition payments to former owners of acquired companies in the amount of $1.6 million based on the achievement of certain predefined operating metrics. The accrual of contingent acquisitions payments related to acquisitions completed prior to September 30, 2009 are estimated to be $1.3 million. If such payments are earned they will 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 another impairment charge in the future.

Accounting for Stock-Based Compensation

At March 31, 2011, 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, 2010.

The Company accounts for stock-based 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 turnover. 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 Plan)

In October 2008, the Board of Directors approved the Repricing Plan which affected approximately 1.6 million shares. The effect of the modification was to adjust the exercise price of the applicable options to the fair value of the underlying common stock on the date of modification. In addition, the vesting period on the applicable options was reset to the standard three year term set forth in our incentive stock option plan.

We estimated the fair value of the stock option modifications using the Black-Scholes-Merton option model and are recording additional stock-based compensation of approximately $300 thousand over the three year vesting period. While we believe that our estimates are based on outcomes that are reasonably likely to occur, if actual results differ significantly from those estimated or if future changes are made to our assumptions, the amount of recognized compensation expense could change significantly. For additional information refer to Footnote 11 of the Consolidated

Financial Statements in our Annual Report on Form 10-K for fiscal year ended September 30, 2010.

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 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 March 31, 2011 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 March 31, 2011 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 may be involved in litigation relating to claims arising out of our operations. 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, 2010.

Item 6. Exhibits.

Exhibit No.	Description of Document
10.1	Employment Agreement between Bridgeline Digital, Inc. and Michael D. Prinn dated January 19, 2011 (incorporated by reference to Exhibit 10.1 to our Current Report on Form 8-K filed on January 21, 2011).
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).

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)
May 16, 2011 Date	/s/ Thomas L. Massie Thomas L. Massie President and Chief Executive Officer (Principal Executive Officer)
May 16, 2011 Date	/s/ Michael D. Prinn Michael D. Prinn Vice President Finance and Chief Accounting Officer (Principal Financial and Accounting Officer)

INDEX OF EXHIBITS

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