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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

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**FORM 10-Q**

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

For the Quarterly Period ended September 30, 2010

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_.

Commission File No. 001-33601

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**GlobalSCAPE, Inc.**

(Exact name of registrant as specified in its charter)

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**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**4500 Lockhill-Selma, Suite 150**  
**San Antonio, Texas**  
(Address of Principal Executive Office)

**74-2785449**  
(I.R.S. Employer  
Identification No.)

**78249**  
(Zip Code)

**(210) 308-8267**  
(Registrant's Telephone Number, Including Area Code)

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

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

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

Large accelerated filer

Accelerated filer

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

Smaller reporting company

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

As of November 10, 2010, there were 17,818,851 shares of common stock outstanding.

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**GlobalSCAPE Inc.**  
**Quarterly Report on Form 10-Q**  
**For the Quarter ended September 30, 2010**

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## Part I. Financial Information

### Item 1. Financial Statements

**GlobalSCAPE, Inc.**  
**Condensed Balance Sheets**  
(in thousands except share amounts)

	<u>September 30,</u> <u>2010</u>	<u>December 31,</u> <u>2009</u>
	<u>(Unaudited)</u>	
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 10,141	\$ 7,026
Short term investments	—	1,205
Accounts receivable (net of allowance for doubtful accounts of \$59 and \$217 on September 30, 2010 and December 31, 2009, respectively)	2,861	2,162
Federal income tax receivable	276	36
Current deferred tax assets	809	130
Prepaid expenses	293	132
Total current assets	<u>14,380</u>	<u>10,691</u>
Fixed assets, net	1,389	1,653
Investment - CoreTrace, at cost	2,278	2,278
Intangible assets, net	606	833
Goodwill	619	619
Deferred tax assets	—	46
Other assets	43	53
Total assets	<u>\$ 19,315</u>	<u>\$ 16,173</u>
<b>Liabilities and Stockholders' Equity</b>		
Current liabilities:		
Accounts payable	\$ 296	\$ 316
Accrued expenses	1,183	764
Deferred revenue	4,992	4,071
Total current liabilities	<u>6,471</u>	<u>5,151</u>
Deferred tax liabilities	26	—
Other long term liabilities	1,169	1,079
Commitments and contingencies	—	—
Stockholders' equity:		
Preferred stock, par value \$0.001 per share, 10,000,000 authorized, no shares issued or outstanding	—	—
Common stock, par value \$0.001 per share, 40,000,000 authorized, 18,222,432 and 17,686,252 issued at September 30, 2010 and December 31, 2009, respectively	18	18
Additional paid-in capital	11,777	10,802
Treasury stock, 403,581 shares, at cost, at September 30, 2010 and December 31, 2009.	(1,452)	(1,452)
Retained earnings	1,306	575
Total stockholders' equity	<u>11,649</u>	<u>9,943</u>
Total liabilities and stockholders' equity	<u>\$ 19,315</u>	<u>\$ 16,173</u>

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

**GlobalSCAPE, Inc.**  
**Condensed Statements of Operations**  
(in thousands, except per share amounts)  
(Unaudited)

	<u>Three months ended September 30,</u>		<u>Nine months ended September 30,</u>	
	<u>2010</u>	<u>2009</u>	<u>2010</u>	<u>2009</u>
<b>Operating Revenues:</b>				
Licenses	\$ 2,652	\$ 2,633	\$ 7,652	\$ 7,798
Maintenance and support	2,005	1,581	5,642	4,356
All others	112	82	353	128
Total Revenues	<u>4,769</u>	<u>4,296</u>	<u>13,647</u>	<u>12,282</u>
<b>Operating Expenses:</b>				
Cost of revenues	142	102	389	230
Selling, general and administrative expenses	3,326	2,396	9,449	7,825
Research and development expenses	832	729	2,203	2,094
Depreciation and amortization	201	187	599	537
Total operating expenses	<u>4,501</u>	<u>3,414</u>	<u>12,640</u>	<u>10,686</u>
Income from operations	268	882	1,007	1,596
Other income (expense), net	—	3	6	(38)
Income before income taxes	268	885	1,013	1,558
Provision for income taxes	35	309	282	283
Net Income	<u>\$ 233</u>	<u>\$ 576</u>	<u>\$ 731</u>	<u>\$ 1,275</u>
Net income per common share - basic	\$ 0.01	\$ 0.03	\$ 0.04	\$ 0.07
Net income per common share - diluted	\$ 0.01	\$ 0.03	\$ 0.04	\$ 0.07
<b>Weighted average shares outstanding:</b>				
Basic	17,652	17,254	17,430	17,238
Diluted	18,610	18,243	18,174	17,800

The accompanying notes are an integral part of these financial statements

**GlobalSCAPE, Inc.**  
**Condensed Statement of Stockholders' Equity**  
(in thousands, except share amounts)  
(Unaudited)

	<u>Common Stock</u>		<u>Additional paid-in Capital</u>	<u>Treasury Stock</u>	<u>Retained Earnings</u>	<u>Total</u>
	<u>Shares</u>	<u>Amount</u>				
Balance at December 31, 2009	17,686,252	\$ 18	\$ 10,802	\$(1,452)	\$ 575	\$ 9,943
Shares issued upon exercise of stock options	478,100	—	153			153
Tax benefit from stock-based compensation			51			51
Stock-based compensation expense	—	—	756	—	—	756
Restricted stock activity	58,080	—	15			15
Net income	—	—	—	—	731	731
Balance at September 30, 2010	<u>18,222,432</u>	<u>\$ 18</u>	<u>\$ 11,777</u>	<u>\$(1,452)</u>	<u>\$ 1,306</u>	<u>\$11,649</u>

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

**GlobalSCAPE, Inc.**  
**Condensed Statements of Cash Flows**  
(in thousands)  
(Unaudited)

	<u>For the nine months ended September 30,</u>	
	<u>2010</u>	<u>2009</u>
<b>Operating Activities:</b>		
Net income	\$ 731	\$ 1,275
Adjustments to reconcile net income to net cash provided by operating activities:		
Bad debt recoveries	(148)	(164)
Depreciation and amortization	599	537
Loss on disposition of assets	52	53
Stock-based compensation	756	769
Deferred taxes	(607)	(342)
Excess tax benefits from exercise of stock based compensation	66	—
Changes in operating assets and liabilities:		
Accounts receivable	(551)	190
Prepaid expenses	(161)	(50)
Federal income tax	(306)	319
Other assets	10	(7)
Accounts payable	(20)	(210)
Accrued expenses	419	76
Deferred revenues	921	1,981
Deferred compensation	—	(216)
Other long-term liabilities	90	14
Net cash provided by operating activities	<u>1,851</u>	<u>4,225</u>
<b>Investing Activities:</b>		
Proceeds from sale of property and equipment	—	1
Purchase of property and equipment	(160)	(519)
Purchase of short-term investments	(350)	(1,405)
Redemption of short-term investments	1,555	—
Net cash provided by (used in) investing activities	<u>1,045</u>	<u>(1,923)</u>
<b>Financing Activities:</b>		
Proceeds from exercise of stock options	153	33
Tax benefit from stock-based compensation	66	—
Net cash provided by financing activities	<u>219</u>	<u>33</u>
Net increase in cash	3,115	2,335
Cash at beginning of period	7,026	6,319
Cash at end of period	<u>\$ 10,141</u>	<u>\$ 8,654</u>
<b>Supplemental disclosure of cash flow information:</b>		
Cash paid during the period for:		
Income taxes	<u>\$ 1,125</u>	<u>\$ 311</u>

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

**GlobalSCAPE, Inc.**  
**Notes to Condensed Financial Statements**  
**Nine Months Ended September 30, 2010**  
**(Unaudited)**

**1. Nature of Business**

GlobalSCAPE, Inc. (“GlobalSCAPE” or the “Company”), founded in April 1996, develops and distributes secure information exchange solutions for individuals and businesses to safely send files over the Internet and within other network environments. We have developed managed file transfer (“MFT”) software, including file management products and managed e-mail attachment solutions, that support compliance requirements, provide increased security, and enable delivery of large files. We have also developed Wide-Area File Services (“WAFS”) and Continuous Data Protection (“CDP”) software which further enhances the ability to share and backup files within the infrastructure of a company’s wide and local area networks, or WAN and LAN, at WAN and LAN speeds. Most recently, in 2010, we have entered the endpoint security market as a reseller of innovative application whitelisting software.

Our MFT products enable our customers to protect the privacy of critical information such as financial data, medical records, customer files, and other similar sensitive documents. In addition, these products help ensure compliance with many government and commercial regulations relating to the protection of information while allowing users to reduce IT costs, increase efficiency, track and audit transactions, and automate processes. These products also support exchange of very large files that typically cannot be delivered efficiently through e-mail systems. Our WAFS and CDP products provide data replication, acceleration of file transfer, sharing/collaboration, and continuous data backup and recovery to our customers. Our endpoint security solutions protect against malicious software and unauthorized activity on servers and personal computers by, for example, allowing only designated (“whitelisted”) applications to run on a protected system.

We deliver these solutions to individuals and businesses for installation at their premises and as hosted solutions and support these customers, through a range of implementation, customization, and training services. On-premises solutions provide software that is activated for use at the customer location. Hosted solutions deliver the product capabilities using software and hardware installed and maintained at GlobalSCAPE’s corporate headquarters or at partner locations such as Rackspace Hosting, Inc. data centers.

**2. Basis of Presentation**

The accompanying unaudited condensed financial statements have been prepared in accordance with Rule 10-01 of Regulation S-X, “Interim Financial Statements.” Accordingly, they do not include all information and footnotes required under generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normally recurring accruals) considered necessary for a fair presentation have been made. The results of operations for any interim period are not necessarily indicative of the results to be expected for the full year. The information included in this Form 10-Q should be read in conjunction with the financial statements and the notes thereto included in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2009, as well as *Management’s Discussion and Analysis of Financial Condition and Results of Operations* also included in our 2009 Form 10-K and in this Report.

The Company follows accounting standards set by the Financial Accounting Standards Board, commonly referred to as the “FASB.” The FASB sets generally accepted accounting principles (“GAAP”) that the Company follows to ensure we consistently report our financial condition, results of operations, and cash flows.

The preparation of financial statements in accordance with GAAP requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities known to exist as of the date the financial statements are published, and the reported amounts of revenues and expenses during the reporting period. Uncertainties with respect to such estimates and assumptions are inherent in



the preparation of the Company's financial statements; accordingly, it is possible that the actual results could differ from these estimates and assumptions, which could have a material effect on the reported amounts of the Company's financial position and results of operations.

### ***Significant Accounting Policies***

There have been no changes in our significant accounting policies during the nine months ended September 30, 2010 from those described in our 2009 Form 10-K except for the addition of hosting revenue which was added due to the addition of a new product line. Listed below is a condensed version of the Company's critical accounting policies.

*Revenue Recognition* – The Company markets and distributes software products; revenue is recognized when the following conditions have been met:

- Persuasive evidence of an arrangement exists;
- Delivery has occurred or services have been rendered;
- There is a fixed or determinable amount; and
- Collection is reasonably assured

If the Company determines that any one of the four criteria is not met, we will defer recognition of revenue until all the criteria are met.

License revenue is derived primarily from the licensing of various products and technology. Generally, license revenue is recognized upon delivery of the product, assuming all other conditions for revenue recognition noted above have been met.

The Company also enters into perpetual software license agreements through direct sales to customers and indirect sales with distributors and resellers. The license agreements generally include product maintenance and support agreements, for which the related revenue is deferred and recognized ratably over the term of the agreements. In any given period if the amount of revenue that is deferred, which is equal to the total of that period's maintenance and support sales, is greater than the amount recognized, then revenue will decrease and vice versa.

In arrangements that include multiple elements, including perpetual software licenses and maintenance and/or services, revenue is allocated and deferred for the undelivered items based on vendor specific-objective evidence ("VSOE"). When VSOE of fair value exists for all elements in a multiple element arrangement, revenue is allocated to each element based on the relative fair value of each of the elements. VSOE of fair value is established by the price charged when the same element is sold separately. In a multiple element arrangement whereby VSOE of fair value of all undelivered elements exists but VSOE of fair value does not exist for one or more delivered elements, revenue is recognized using the residual method. Under the residual method, the fair value of the undelivered elements is deferred and the remaining portion of the arrangement fee is recognized as revenue, assuming collection is probable. Deferred revenue consists primarily of the unamortized balance of product maintenance.

We recognize hosting revenue, including setup fees on a monthly basis, over the contractual term of the customer contract. We believe our customers generally will continue to utilize our services beyond the initial contract term which typically ranges from one to three years. As a result, setup fees are recognized ratably over the estimated average life of a customer relationship. Amounts that have been invoiced are recorded in accounts receivable and either deferred revenue or revenue, depending on whether the revenue recognition criteria have been met.

*Allowance for Doubtful Accounts* – We regularly assess the collectability of outstanding customer invoices and, in so doing, we maintain an allowance for estimated losses resulting from the non-collection of customer receivables. In estimating this allowance, we consider factors such as: historical collection experience; a customer's current creditworthiness; customer concentration; age of the receivable balance; and general economic conditions that may affect a customer's ability to pay. Actual customer collections could differ from our estimates.

*Goodwill and Intangible Assets* – Goodwill and certain indefinite-lived assets are not amortized, but are evaluated at least annually for impairment. The determination of whether the carrying value of goodwill and other intangible assets has been impaired requires the Company to make estimates and assumptions about future business trends and growth. If an event occurs that would cause the Company to revise its estimates and assumptions used in analyzing the value of goodwill or other intangibles, such revision could result in an impairment charge that could have a material impact on the Company’s financial condition or results of operations.

*Income Taxes* – The objectives of accounting for income taxes are to recognize the amount of taxes payable or refundable for the current year and deferred tax liabilities and assets for the future tax consequences of events that have been recognized in an entity’s financial statements or tax returns. Accruals for uncertain tax positions are provided for in accordance with FASB guidance.

### ***Recent Accounting Pronouncements***

In October 2009, the FASB amended its guidance regarding the accounting model for revenue arrangements that include both tangible products and software elements. This guidance requires that hardware components of a tangible product containing software components always be excluded from the software revenue recognition. This guidance also provides information on how to allocate consideration to deliverables in an arrangement that includes both tangible products and software. This guidance is effective in fiscal years beginning on or after June 15, 2010. We have evaluated the effect of the adoption of this guidance as of September 30, 2010, and believe that it will have no material effect on our financial statements.

In October 2009, the FASB amended its guidance regarding revenue recognition on multiple-deliverable arrangements. This guidance amends the criteria for separating consideration in multiple-deliverable arrangements. This guidance also establishes a selling price hierarchy for determining the selling price of a deliverable. The selling price used for each deliverable will be based on VSOE if available, third-party evidence if VSOE is not available, or estimated selling price if neither VSOE nor third-party evidence is available. This amendment also replaces the term *fair value* in the revenue allocation guidance with *selling price* to clarify that the allocation of revenue is based on entity-specific assumptions rather than assumptions of a marketplace participant. This guidance eliminates the residual method of allocation and requires arrangement consideration be allocated at the inception of the arrangement to all deliverables using the relative selling price method. The guidance also requires the best estimate of selling price be determined in a manner that is consistent with that used to determine the price to sell the deliverable on a standalone basis. Finally, this guidance significantly expands the disclosures related to multiple-deliverable revenue arrangements.

This guidance is effective in fiscal years beginning on or after June 15, 2010. We have evaluated the effect of the adoption of this guidance as of September 30, 2010, and believe that it will have no material effect on our financial statements.

### **3. Goodwill and Other Intangible Assets**

As of September 30, 2010, GlobalSCAPE had goodwill of approximately \$619,000 associated with the acquisition of Avail, Inc. (“Avail”) in 2006. No events occurred during the nine months ended September 30, 2010 that would have been considered a triggering event under current accounting guidance and require an impairment test as of that date.

Intangible assets represent amounts acquired in the acquisition of Avaiill, and consisted of the following as of September 30, 2010 (in thousands):

	<u>Gross Carrying Amount</u>	<u>Accumulated Amortization</u>	<u>Life (Years)</u>
<b>Amortized intangible assets:</b>			
Software	\$ 1,775	\$ (1,245)	5
Customer list	180	(108)	5
Patent	7	(3)	18
<b>Total</b>	<u>\$ 1,962</u>	<u>\$ (1,356)</u>	

Estimated Amortization Expense

For remainder of 2010	\$ 75
For the Year-ended 12/31/2011	301
For the Year-ended 12/31/2012	226
For the Year-ended 12/31/2013	1
For the Year-ended 12/31/2014	1
Thereafter	2
<b>Total</b>	<u>\$ 606</u>

Acquired intangibles are generally amortized on a straight-line basis over their weighted average lives. Intangible assets amortization expense was approximately \$226,000 for each of the nine months ended September 30, 2010 and September 30, 2009. No events occurred during the nine months ended September 30, 2010 that would have caused the Company to evaluate the need to record an impairment.

#### 4. Financial Instruments and Investments

Accounting guidance defines fair value as the price that would be received upon sale of an asset or paid upon transfer of a liability in an orderly transaction between market participants at the measurement date and in the principal or most advantageous market for that asset or liability. The fair value should be calculated based on assumptions that market participants would use in pricing the asset or liability, not an assumption specific to the entity. In addition, the fair value of liabilities should include consideration of non-performance risk, including our own credit risk.

The Company's investments currently consist of an investment in a software company, which is accounted for under the cost method. The current carrying amount of this cost method investment is approximately \$2.3 million. The Company believes that the current carrying amount approximates fair value and has not evaluated it for impairment as there have been no indicators that would indicate the value of the investment has declined below cost.

Accounts receivable and accounts payable are reflected in the accompanying financial statements, at cost, which approximate fair value because of their short term maturity.

#### 5. Stock-Based Compensation

GlobalSCAPE has stock-based compensation plans available to grant incentive stock options, non-qualified stock options, and restricted stock to employees and non-employee members of the Board of Directors.

Approximately \$756,000 and \$769,000 of compensation cost related to stock options and restricted stock awards were recognized in operating results in the nine months ended September 30, 2010 and 2009, respectively.

In June 2010, GlobalSCAPE's stockholders approved the GlobalSCAPE, Inc. 2010 Employee Long-Term Equity Incentive Plan ("2010 EIP"). The 2010 EIP authorizes the issuance of up to three million shares of common stock for stock-based incentives including stock options and restricted stock awards. The exercise price, term and other conditions applicable to each stock option or stock award granted under the 2010 EIP are determined by the Compensation Committee of the Board of Directors. The exercise price of stock options is set on the grant date and may not be less than the fair market value per share of our stock on that date (at market close). The stock options will expire after ten years.

### Stock Options

The fair value of each option award is estimated on the date of grant using the Black-Scholes option-pricing model. Expected volatility is based on historical volatility of GlobalSCAPE stock. We used the simplified method to derive an expected term. The expected term represents an estimate of the time options are expected to remain outstanding. The risk-free rate for periods within the contractual life of the option is based on the U.S. treasury yield curve in effect at the time of grant. The following table sets forth the assumptions used to determine compensation cost for our stock options consistent with the requirements established by FASB:

	Three- months ended September 30, 2010	Nine-months ended September 30, 2010
Expected volatility	83%	83%
Expected annual dividend yield	0	0
Risk free rate of return	1.6%	2.6%
Expected option term (years)	5	5

The following table summarizes information about stock option activity for the nine months ended September 30, 2010:

	Number of Options	Weighted Average Share Price	Weighted Average Remaining Contractual Term (years)	Average Intrinsic Value (\$M)
Outstanding at December 31, 2009	3,653,327	\$ 1.57	7.89	\$ 1.25
Granted	390,000	2.02		
Exercised	478,100	0.32		
Forfeited	130,800	1.80		
Outstanding at September 30, 2010	<u>3,434,427</u>	<u>\$ 1.79</u>	<u>7.85</u>	<u>\$ 3.37</u>
Exercisable at September 30, 2010	<u>1,767,472</u>	<u>\$ 1.99</u>	<u>7.04</u>	<u>\$ 1.50</u>

The weighted average fair value of options granted during the nine months ended September 30, 2010 was \$1.32. The total intrinsic value of options (which is the amount by which the stock price exceeded the exercise price of the options on the date of exercise) exercised during the nine months ended September 30, 2010 was \$1,030,000. During the nine months ended September 30, 2010, the amount of cash received from the exercise of stock options was \$153,000.

At September 30, 2010, there was approximately \$1.5 million of total unrecognized compensation cost related to non-vested stock option awards which is expected to be recognized over a weighted-average period of 1.84 years.

### *Stock Awards*

The 2006 Non-Employee Directors Long Term Incentive Plan allows for the issuance of either stock options or restricted stock awards. Restricted stock awards for 53,420 and 58,080 were granted in accordance with the terms of the plan in June 2010 and 2009, respectively.

The fair value of stock awards is based upon the market price of the underlying common stock as of the date of grant. Stock awards are amortized over their applicable vesting period, one year, using the straight-line method.

The following table summarizes information about stock awards activity for the nine months ended September 30, 2010:

	<u>Number of Shares</u>	<u>Weighted Average Grant- Date Fair Value</u>
Nonvested balance at December 31, 2009	58,080	\$ 1.24
Granted	53,420	2.01
Vested	58,080	1.24
Forfeited	—	—
Nonvested balance at September 30, 2010	<u>53,420</u>	<u>\$ 2.01</u>

At September 30, 2010, there was approximately \$72,000 of total unrecognized compensation cost related to stock awards which is expected to be recognized over a weighted-average period of eight months.

### **6. Warrants**

On November 13, 2006, the Company entered into a securities purchase agreement with accredited investors and granted warrants to purchase 1,352,000 shares of our common stock to the investors with an exercise price of \$3.15 per share. The warrants have a five-year term and are currently exercisable. There have been exercises of 80,000, and as of September 30, 2010, there are 1,272,000 warrants outstanding.

## 7. Earnings per Common Share

The components of earnings per share are as follows (in thousands except per share amounts):

	<u>Three months ended September 30,</u>		<u>Nine months ended September 30,</u>	
	<u>2010</u>	<u>2009</u>	<u>2010</u>	<u>2009</u>
<b>Numerators</b>				
Numerators for basic and diluted earnings per share:				
Net income	\$ 233	\$ 576	\$ 731	\$ 1,275
<b>Denominators</b>				
Denominators for basic and diluted earnings per share:				
Weighted average shares outstanding basic	17,652	17,254	17,430	17,238
<b>Dilutive potential common shares</b>				
Stock options and awards (1)	958	989	744	562
Common stock warrants (2)	—	—	—	—
Denominator for dilutive earnings per share	18,610	18,243	18,174	17,800
Net income (loss) per common share	\$ 0.01	\$ 0.03	\$ 0.04	\$ 0.07
Net income (loss) per common share – diluted	\$ 0.01	\$ 0.03	\$ 0.04	\$ 0.07

- (1) For the three and nine months ended September 30, 2010, 11,067 and 283,995 options were not included in dilutive shares, as the effect would have been anti-dilutive. For the three and nine months ended September 30, 2009, 939,967 and 1,746,567 options were not included in dilutive shares, as the effect would have been anti-dilutive.
- (2) For the three and nine months ended September 30, 2010, no warrants were included in dilutive shares, as the effect would have been anti-dilutive. For the three and nine months ended September 30, 2009, no warrants were included in dilutive shares, as the effect would have been anti-dilutive.

## 8. Commitments and Contingencies

The Company from time to time may be involved in litigation relating to claims arising out of its ordinary course of business. There are no pending claims against the Company that would have a material adverse effect on the financial statements of the Company.

## 9. Uncertain tax positions

At December 31, 2009, we had a liability of approximately \$90,000 related to an uncertain tax position. In September 2010, the statute of limitations on this position expired and the liability was reversed. This resulted in a onetime tax benefit of approximately \$59,000 and reduced our effective tax rate for the three months ended September 30, 2010.

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

This Quarterly Report on Form 10-Q contains "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities and Exchange Act of 1934, as amended. "Forward looking statements" are those statements that describe management's beliefs and expectations about the future. We have identified forward-looking statements by using words such as "anticipate," "believe," "could," "estimate," "may," "expect," and "intend." Although we believe these expectations are reasonable, our operations involve a number of risks and uncertainties, including those described in the "Risk Factors" section of our 2009 Form 10-K and other documents filed with the Securities and Exchange Commission. GlobalSCAPE's actual results could differ materially from those discussed in any forward-looking statements included in this Quarterly Report.

### Overview

We develop and distribute secure information exchange solutions for individuals and businesses to safely send files over the Internet and within other network environments. We have developed managed file transfer ("MFT") software, including file management products and managed e-mail attachment solutions, that support compliance requirements, provide increased security, and enable delivery of large files. We have also developed Wide-Area File Services ("WAFS") and Continuous Data Protection ("CDP") software which further enhances the ability to share and backup files within the infrastructure of a company's wide and local area networks, or WAN and LAN, at WAN and LAN speeds. Most recently, in 2010, we have entered the endpoint security market as a reseller of innovative application whitelisting software.

Our solution portfolio facilitates delivery of critical information such as financial data, medical records, customer files, and other similar documents while supporting a range of information protection approaches to meet privacy and other security requirements. In addition, these solutions help ensure compliance with many government regulations relating to the protection of information while allowing users to reduce IT costs, increase efficiency, track and audit transactions, and automate processes. Our WAFS and CDP products also provide data replication, acceleration of file transfer, sharing/collaboration, and continuous data backup and recovery to our customers. Our endpoint security solutions protect against malicious software and unauthorized activity on servers and personal computers by, for example, allowing only designated ("whitelisted") applications to run on a protected system.

We believe that we are strongly positioned to provide secure transfer, sharing, and replication of files that need to be transmitted inside the user's firewall to distributed offices, or outside the user's firewall to business and trading partners. We believe the secure information exchange aspects of our MFT products provide a basis for us to address customer needs in adjacent markets such as business to business ("B2B"), data loss prevention, and endpoint security where our MFT solutions may be directly applicable or interoperate with other products offered by partners, acquired by GlobalSCAPE, or developed internally.

Our capabilities have evolved from personal and server-based file transfer software to include managed e-mail attachment and software-as-a-service, or SaaS, information sharing solutions in the cloud environment. Most recently, in the second quarter of 2010, we announced our newest solution offering that integrates our Enhanced File Transfer Server ("EFT Server") with hosting infrastructure provided by Rackspace Hosting, Inc. ("Rackspace"). The resulting Managed Information Xchange, ("MIX") solution is the initial offering released as part of the GlobalSCAPE Managed Solutions line of business. The MIX solution extends our ability to offer cloud-based solutions to current and future customers on a subscription basis.

The following is a brief description of our products and solutions:

**File Management Products** — Our file management products are best known for the "CuteFTP" product line but also include robust enterprise solutions. These products help users securely move and copy files on the Internet. Some of our products encrypt the transfers for security using technology similar to the security utilized by a Web browser to protect transmitted data. A substantial portion of our revenues are derived from licensing our server and client-based file management products. Our file management solutions include EFT Server, CuteFTP Pro, CuteFTP Home, CuteFTP Lite and CuteFTP Mac Pro. During the first three quarters of 2010, we continued to enhance our enterprise file management solutions, releasing a multi-platform version of our DMZ Gateway application which operates on Windows and Unix/Linux-based systems, broadening the already considerable market reach of EFT Server. We also developed upgraded versions of EFT Server and the CuteFTP solutions.

**Wide-Area File Services and Continuous Data Protection Products** — Our WAFS products provide a file sharing, collaboration, and replication solution over multiple sites. WAFS enables total file concurrency across multiple servers deployed around the world by mirroring changes made to data on any server across all other servers. By keeping all data updated on each location's file server, each site has instant access to the very latest version. WAFS efficiently utilizes network bandwidth by intelligently and safely communicating only compressed and encrypted file changes between locations. CDP can be added to WAFS to provide enterprises with a file access and data protection combination that centralizes data storage and IT administration facilities without compromising data sharing and protection. Redundancy can also be enhanced as file servers backup file changes in real time to the customer's backup site which can be at the same or a remote location. Our solutions also allows for the backup server to keep past versions of each file (and deleted files), allowing customer to restore files and compare files based on different points in time.

**Managed E-mail Attachment Solutions** — Our managed e-mail attachment solution, Mail Express, addresses the needs of businesses that prefer to use their legacy e-mail infrastructure to deliver and manage e-mail attachments. E-mail traditionally has been ill-suited for delivery of certain attachments due to typical infrastructure and administrator-defined limitations on e-mail attachment size. In many cases, these limitations preclude sending or receiving e-mail attachments larger than even 10 or 20 MB. The Mail Express solution allows delivery of multi-GB files as e-mail attachments by seamlessly replacing the attachments with links to the files which are then hosted on a server other than the email server. We believe that this approach can ease the load on the e-mail infrastructure and the long-term storage requirements associated with e-mail attachments. Mail Express also allows enhanced tracking and auditing access to file attachments through read receipts and log files. During the third quarter of 2010, we released Mail Express 3.0, a major enhancement to the prior versions of this software. Mail Express 3.0 includes simplified workflow and distributed administration through which end users can configure certain attributes of the solution in accordance with a centrally defined policy.

**Software as a Service Solution** — Our SaaS solution, CuteSendIt, is a file transfer service for individuals, professionals, and businesses. CuteSendIt uses cloud computing approaches to deliver files through a hosted web portal. This solution approach meets the needs of users who do not have, or wish to invest in, file transfer infrastructure such as FTP servers or even client application software. Users access the CuteSendIt application over the Internet using a standard web browser, securely upload files (up to multi-GB) through the portal, and compose a brief message to accompany the file delivery. CuteSendIt then sends the message to the recipients as the body of an e-mail message. This e-mail message also includes links to the files uploaded through the CuteSendIt web portal. Anyone with an Internet connection can access, and self-provision this service at [www.cutesendit.com](http://www.cutesendit.com). There is no software to install with CuteSendIt and no specific knowledge of file transfer is needed to use it. CuteSendIt currently is free to use for a limited number of transfers, and offers various monthly and yearly fee-based plans that meet specific file transfer requirements.

**Endpoint Security** — Endpoint security solutions include antivirus, anti-spyware, application whitelisting, data and file encryption, and other product categories. Whitelisting is a relatively new entrant into this security market. Unlike traditional "blacklisting" solutions which rely on detecting and defeating millions of malicious software applications and unique malware executables, whitelisting allows users to lock servers, personal computers, and other devices into a known, trusted state and allows only approved applications to run. In December 2009, we announced a strategic investment in CoreTrace Corporation, a privately held software company based in Austin, Texas. CoreTrace develops and sells a leading enterprise application whitelisting solution, BOUNCER by CoreTrace™. In 2010, we entered into a reseller agreement with CoreTrace for this product.

**Hosted and Managed Solutions** — Our MIX offering, which became commercially available in the third quarter of 2010, allows customers to outsource all or part of their complex and demanding information exchange needs to reduce costs, improve operational efficiencies, track and audit transactions, and provide a greater level of security. We believe outsourcing select IT infrastructure will continue to increase in popularity as businesses manage to tighter financial margins, face increasing budgetary pressures, and look for efficiencies across their business operations. The MIX solution will allow customers to automate manual or inefficient processes, consolidate automated transactions, and eliminate inefficiencies, from a lower-cost, secure platform. GlobalSCAPE believes hosted information exchange solutions appeal both to small- and medium-size businesses, as well as large enterprises that require proven, flexible IT infrastructure outsourcing services so they can focus on their core competencies.



## Outlook

We believe that the future success of our business will be dependent upon our ability to:

- expand our solution portfolio, including into adjacent markets;
- continue enhancing our existing solutions;
- increase channel sales;
- increase government sales;
- increase our market visibility and recognition; and
- access capital markets.

**Expand our Solution Portfolio.** The Company's primary market is for managed file transfer products. According to Gartner, this is a \$550 million per year market which is growing at more than 20% year over year. This market is significantly smaller than potential adjacent markets. For example, web, network, and endpoint security is a more than \$9 billion market; cloud computing is a more than \$68 billion market. However, our entry into such markets will require that we effectively define and then develop, acquire, or partner for viable solutions applicable to these markets. We also must market, sell, and support these solutions effectively. Each of these success factors has inherent risks due to, for example, our limited corporate expertise in the adjacent markets and the possibility that the specific buyers of solutions in these adjacent markets may be different from the buyers with whom we interact throughout our current MFT sales cycle. In addition, entry into these markets will require strategic investments that may adversely impact our financial results by, for example, resulting in lower earnings for some time compared to prior periods. To mitigate these risks, we are leveraging the skills and experience of our executive leadership and the capabilities provided by outside consultants, including our marketing firm and individual contractors.

As we expand our solution portfolio, we are managing the associated strategic investments to drive longer-term financial performance which could include revenue growth and, subsequently, increased earnings in accordance with our previously communicated plans. We intend to continue using strategic partnerships or acquisitions as necessary to further enhance our solution portfolio, expand our sales channels, and enter adjacent markets as we have done, for example, through our prior strategic investment in CoreTrace Corporation in late 2009.

We continued to expand our solution portfolio during the third quarter of 2010 by launching our MIX solution. This innovative subscription service integrates our market-leading EFT Server solution with infrastructure provided by Rackspace to enable secure information exchange through a private cloud. The cloud-based subscription service establishes a cost effective alternative to software licensing and on-premises implementations, and provides an elastic service capability that is adaptable to evolving customer environments and capacity requirements.

We also announced an expanded relationship with Network Automation during the third quarter. Network Automation is a market leader in automation software that streamlines and integrates business processes without expensive programming. The company provides business process automation software to more than 9,000 small, mid-market, and Global Fortune 1000 clients in over 40 countries. We began our original equipment manufacturer (OEM) partner relationship with Network Automation in July 2008, embedding Network Automation's AutoMate product as an Advanced Workflow Engine (AWE) module to our EFT Server solution. We expanded our relationship with Network Automation during the third quarter to become a worldwide reseller of their AutoMate 7 and AutoMate Business Process Automation (BPA) Server 7 solutions.

Our expanded solution portfolio, in parallel with continuing enhancement and development of our existing solutions, potentially establishes a stronger basis for increasing channel and government sales, and improving our market visibility.

***Continue Enhancing and Developing Our Existing Solutions.*** Our future success depends on our ability to respond to the rapidly changing needs of our customers by developing or introducing new products, product upgrades, and services on a timely basis. We have established an internal solution roadmap to guide our activities in this area and released the MIX solution (as a cloud-based implementation of our EFT Server software) and a major enhancement of our Mail Express software in the third quarter in accordance with this roadmap.

We have in the past incurred, and we believe that we will continue to incur, significant research and development expenses as we strive to remain competitive and, for example, potentially develop upgraded solutions as necessary to increase sales of products like CuteFTP and WAFS that have declined over time. Innovation, new product development, and go-to-market activities involve a significant commitment of time and resources and are subject to a number of risks and challenges. We have focused on enhancing our leadership and implementing strong internal processes to guide development and go-to-market activities and mitigate the associated risks. These leadership and process enhancements have the potential added benefit, over time, of improving the efficiency and effectiveness of our customer support operations which account for more than 40 percent of our recognized revenue.

***Increase Channel Sales.*** We derive approximately one-third of our revenue through sales channels. However, much of this channel revenue, historically, results from sales engagements where GlobalSCAPE identifies a prospective customer, leads the sales process, and then works closely with a channel partner to complete and process the order. As part of our broader sales strategy, we are transitioning from the historical high-touch channel sales model to a lower-touch approach through which we will identify, train, provision, and support channel partners in multiple territories worldwide. These channel partners then will contribute to expanding our global sales presence and driving further adoption of our solutions in their respective territories. For example, during the third quarter we announced a partner agreement with Lifeboat Distribution, an international specialty software distributor for technically sophisticated products. Lifeboat Distribution serves leading corporate resellers, large account resellers, value added resellers (“VARs”), and solution providers across North America and throughout Latin America and the Caribbean. Through our new partner relationship with Lifeboat Distribution, we are working to expand our existing reseller network in these geographies.

In parallel with our channel sales focus, we will continue to align and equip our sales force to deliver increased direct sales while also mitigating possible channel conflict which is a potential risk inherent in channel sales programs. Our investments in equipping channel partners also will require balancing investments in other areas.

***Increase Government Sales.*** Sales to the U.S. Government remain an important aspect of our business. We intend to increase our government sales by leveraging our presence with the Department of Defense, expanding the number of our channel partners such as Carahsoft, and by positioning the Company to work with large system integrators. We also will continue to seek additional sales to federal agencies which are required to meet Small Business Administration goals. Under SBA auspices, 23% of government business is set aside for “small business” concerns, like GlobalSCAPE, as defined by government-specified size standards.

Government contracts typically have a long sales cycle and the funding of our programs is subject to the overall U.S. Government budget and appropriation decisions and processes which are driven by numerous factors, including geo-political events and macroeconomic conditions, and are beyond our control. In addition, U.S. Government contracts generally also permit the government to terminate the contract, in whole or in part, without prior notice, at the government’s convenience or for default based on performance. However, we have been successful in winning multiple, large government contracts and intend to continue pursuing these and other more recurring government business, working with partners such as Carahsoft and, most recently, McLane Advanced Technologies (“MAT”). MAT is a global logistics and technology solutions company recognized as a technology

leader in the Distribution and Defense industries. In the third quarter, we announced that we are a subcontractor on the MAT industry team that won a \$52.3 million re-compete contract for the US Army Standard Army Maintenance System (“SAMS-E”). The MAT team includes Northrop Grumman Information Systems, GlobalSCAPE, Logistics and Technology Services, CALIBRE Systems, HCI Integrated Solutions, SAIC, and Joint Logistics Managers. Work on this contract will begin in late 2010 for a period of up to three years. We will provide professional and technical services to support the SAMS-E program, including the Secure FTP Server and CuteFTP secure information exchange solutions integrated into the SAMS-E environment. We may also deliver enhanced software solutions for SAMS-E under the new contract. Our subcontractor relationship with MAT builds on our prior successes in selling our solutions to the US Army and other government agencies, and potentially allows us to expand our presence in the government market directly through our relationship with the MAT SAMS-E team and indirectly through our enhanced visibility in the government sector.

***Increase Our Market Visibility.*** To grow our business, we believe that we must increase the recognition of GlobalSCAPE as a provider of secure information exchange solutions. We have continued to increase our market visibility through marketing communication activities such as press releases and media outreach. We also have achieved substantial market recognition, in the form of certifications, validations, and analyst ranking, for our continued development of secure information exchange solutions. For example, we have received Federal Information Processing Standards (“FIPS”) 140-2 validation of the GlobalSCAPE Cryptographic Module embedded in Enhanced File Transfer Server. Enhanced File Transfer Server version 6 and the latest version of CuteFTP Pro also received the Certificate of Networthiness from the U.S. Army Network Technology Command during 2009. Our receipt of this certificate enables Army installations worldwide to install and operate these server and client-based secure information exchange solutions. Overall, we believe we have a strong combination of capabilities which led to Gartner’s retaining GlobalSCAPE in the market leader quadrant of the Magic Quadrant for Managed File Transfer during 2009. We believe our solutions will continue to provide the best-value for businesses seeking to establish or enhance their secure information exchange capabilities.

We continue to receive other significant recognition, in addition to analyst ranking and technical certifications and validations. Most recently, in the second quarter of 2010, we were chosen as a 2010 “Best Places to Work in IT” honoree by IDG’s Computerworld. Each year, Computerworld ranks the top 100 work environments for technology professionals. Organizations that are selected are those that challenge their IT staff with exciting projects, offer them access to and training with today’s advanced technology, and provide great benefits and compensation. During the second quarter of 2010, we also were selected as one of the “Best Places to Work” for 2010 by the San Antonio Business Journal.

Previously, during the first quarter of 2010, we announced that Network Products Guide, the industry’s leading information technology research and advisory guide, had named EFT Server a winner of the 2010 Product Innovation Awards for Managed File Transfer. During 2009, we were named to Deloitte’s Technology Fast 500, a ranking that recognizes the fastest growing technology, media, telecommunications, life sciences, and clean technology companies in North America on the basis of five-year revenue growth. We also were ranked among the top 50 workplaces in San Antonio for 2009 by the San Antonio Express-News. The full list and ranking were noted in the Express-News Special Edition Top Workplaces 2009 publication on October 11, 2009. The 50 companies were selected on the basis of a comprehensive analysis conducted by Workplace Dynamics, LLC, in a survey of employees throughout San Antonio. Qualities measured include company leadership, compensation and training, workplace flexibility, and diversity. In addition, we received a Technology Superstar Award from the SATAI Network, a technology acceleration and commercialization foundation based in San Antonio. The annual Technology Superstar Award recognizes companies that are poised to become leaders in the South Texas technology community.

***Access Capital Markets.*** We have an impressive history of strong financial performance. Our primary sources of capital have been cash flow from operations and cash on hand. However, our potential entry into adjacent markets or accelerated growth within our current market may require additional capital. If an acquisition or other opportunity requiring a significant capital investment were to arise, we would likely be required to seek capital from external sources such as a commercial bank or other lender or the sale of debt or equity securities. There is no assurance that such external capital will be available to us on acceptable terms or at all. In addition, in the event such capital were debt, we would be required to utilize a portion of our cash flow from operations for debt service and would also likely be required to comply with financial covenants which could limit our ability to continue to grow our business.

## Liquidity and Capital Resources

The Company continues to enjoy a strong working capital position resulting from net profits from operations over 24 of the last 26 quarters. At September 30, 2010, the Company had net working capital of \$7.9 million. The primary component of current liabilities at September 30, 2010 was \$5.0 million of deferred revenues which will be recognized over the remaining term (generally one to twelve months) of the maintenance and support contracts. At September 30, 2010, our principal commitments consisted of obligations outstanding under operating leases, royalty agreements with third parties and trade accounts payable. The commitments related to royalty agreements are contingent on sales volumes and do not require minimum royalties. We plan to continue to expend significant resources on product development in future periods and may also use our cash to acquire or license technology, products, or businesses. At September 30, 2010, we had \$10.1 million of cash available, in a depository account and we continue to generate cash in excess of our operational needs. The Company's Board of Directors has taken a conservative position as to investments that can be made with our on hand cash, and in light of continuing weak economic conditions has chosen to maintain its cash balances in deposit accounts and certificates of deposit.

Our cash on hand currently allows us to operate from a position of financial strength. However, because our principal sources of capital are cash on hand and cash flow from operations, if our sales were to decline, our available capital would also decline. If sales decline significantly or if our liquidity is otherwise under duress, management may substantially reduce personnel and personnel-related costs, reduce or substantially eliminate capital expenditures and/or reduce or substantially eliminate research and development expenditures. We may also sell equity securities or enter into credit arrangements in order to finance future acquisitions or licensing activities, to the extent available.

The Board of Directors determined that the Company should concentrate on increasing revenues in 2010 and subsequent years. This has entailed increased spending on research and development, personnel, partner relationships and public relations. It was expected that these investments would decrease net income and earnings per share in the current year, but would help provide for future revenue growth in 2010 and beyond.

Net cash provided by operating activities for the nine months ended September 30, 2010 and 2009 was approximately \$1.9 million and \$4.2 million, respectively. The decrease in 2010 was largely due to an increase in accounts receivable as compared to a decrease in 2009; and while deferred revenues increased in both years, they contributed more to cash flow in 2009 due to a \$2.7 million order from the U.S. Army received in April 2009.

Net cash provided by (used in) investing activities for the nine months ended September 30, 2010 and 2009 was approximately \$1.0 million and (\$1.9 ) million, respectively. The cash provided by investing activities for 2010 was from short-term investment redemptions, net of property and equipment purchases. Cash used in investing activities for 2009 was for the purchase of short-term investments and for additional furniture and fixtures and leasehold improvements as we made renovations to our office space.

Net cash provided by financing activities during the nine months ended September 30, 2010 and 2009 was approximately \$219,000 and \$33,000 respectively. During 2010, there was an increase in proceeds the Company received from the exercise of stock options as well as tax benefits from stock options.

## Contractual Obligations

There have been no significant changes in our contractual obligations during the nine months ended September 30, 2010 as compared to the contractual obligations disclosed in *Management's Discussion and Analysis of Financial Condition and Results of Operations*, set forth in Part II, Item 7, of our 2009 Form 10-K. Our obligations mainly consist of the lease on our office space and leases on equipment.

## Comparison of the Three Months ended September 30, 2010 and 2009

	Three Months ended September 30,		\$ Change	% Change
	2010	2009		
	(\$ in thousands)			
Total revenues	\$ 4,769	\$ 4,296	473	11.0%
Cost of revenues	142	102	40	39.2%
Selling, general and administrative expenses	3,326	2,396	930	38.8%
Research and development expenses	832	729	103	14.1%
Depreciation and amortization	201	187	14	7.5%
Total operating expense	4,501	3,414	1,087	31.8%
Income from operations	268	882	(614)	-69.6%
Other income (expense)	—	3	(3)	-100.0%
Income tax expense (benefit)	35	309	(274)	-88.7%
Net income	\$ 233	\$ 576	(343)	-59.5%

**Revenue.** Revenues are comprised of the gross selling price of software and the earned portion of maintenance and support agreements. For the three months ended September 30, 2010, total revenues increased by approximately \$473,000 or 11% from the same quarter in 2009. Revenues increased due to continued strong sales of the EFT Server solutions, an increase in average sales price and an increase in maintenance and support renewals.

The following table reflects revenue by product including the related maintenance and support for each product (\$ in thousands):

Product	Revenue for the Three Months ended September 30,			
	2010		2009	
EFT Server Enterprise	\$2,869	60.2%	\$2,254	52.5%
EFT Server	911	19.1%	993	23.1%
CuteFTP Professional	346	7.3%	367	8.5%
CuteFTP Home	61	1.3%	91	2.1%
Wide Area File Services	456	9.6%	471	11.0%
Continuous Data Protection	(1)	0.0%	25	0.6%
All Others	127	2.7%	95	2.2%
Total Operating Revenues	<u>\$4,769</u>	<u>100.0</u>	<u>\$4,296</u>	<u>100.0</u>
Maintenance and support (as a % of total revenue)	<u>\$2,005</u>	<u>42.0%</u>	<u>\$1,581</u>	<u>36.8%</u>

Overall, sales of our EFT Server Enterprise and EFT Server products increased by approximately \$533,000 or 16.4% for the quarter. These products represented approximately 79.3% of our total revenues in the three months ending September 30, 2010 as compared to 75.6%, in the same period in 2009. EFT Server Enterprise revenues increased by 27% largely due to an increase in the average sales price of EFT Server Enterprise reflecting the continuing market strength of this solution. EFT Server revenue decreased due to customers' choosing to upgrade to the EFT Server Enterprise. Such upgrades are consistent with the strategy and expectations established with the release of the EFT Server 6 solution in early 2009.

Revenues from the CuteFTP Home and CuteFTP Professional products decreased by \$51,000 or 11.1% in the quarter ended September 30, 2010, as compared to the same period in 2009, and accounted for approximately 8.6% and 10.6% of total revenues for the three months ended September 30, 2010 and 2009, respectively. This decline continued the general reduction in CuteFTP product revenues, both in absolute terms and as a percentage of revenue, experienced since 2006. The consumer FTP product market has substantial low-cost, and even free, solutions that have put increasing pressure on CuteFTP product revenues. However, the current year-to-year decline is less than in prior periods and may reflect attainment of more balanced need for commercially supported solutions like CuteFTP versus free, but potentially unmaintained, products. Additional pressure on this product line comes from social media companies and services that allow consumers to share images and video. Our reliance on the current CuteFTP products will continue to decline as we emphasize sales of our more complex enterprise products and potentially enter adjacent markets.

Sales of our WAFS and CDP software decreased by \$41,000 or 8.3% for the quarter. The WAFS and CDP products are largely used by architecture, engineering, and construction firms to transfer large files between offices. Approximately \$20,000 of this decrease was due to an increase in renewals sold which resulted in the deferral of more maintenance and support sales than was recognized in revenue. The remaining decrease was largely due to a decrease in new units sold which was offset by an increase in the average sales price. WAFS and CDP software accounted for approximately 9.6% of total revenue for the third quarter of 2010 compared to 11.6% for the same period in 2009.

Products and services included in the "All Others" revenue category primarily consist of professional services, training and Mail Express product sales. This revenue increased by approximately \$32,000, or 34%, for the quarter. This increase was largely due to the introduction of our Solution Quickstart services. Our pre-packaged Quick Start services accelerate implementation of our file transfer solutions for our customers by allowing them to leverage our staff of GlobalSCAPE Certified Professionals in the installation, configuration, and management of our products. The Quickstart service also includes knowledge transfer that allows customers to more effectively operate the solutions on an ongoing basis.

Because of the more complex and business-critical nature of the EFT Server, EFT Server Enterprise, WAFS, and CDP products, purchasers require maintenance and support. Maintenance and support pricing is reflective of the license cost of the products and the additional support needed to maintain and support the products and customers. Our maintenance and support revenues for the quarter increased by 27.3% compared to the same period in 2009 due to an increase the amount earned as compared to the amount deferred in the current quarter.

**Cost of Revenues.** Cost of revenues consists primarily of royalties paid to companies for their technology that we license, a portion of our bandwidth costs, hosted management expenses and travel expenses associated with customer training. The increase in cost of revenues was largely due to an increase of approximately \$16,000 in royalties and the addition of approximately \$26,000 in hosted server expenses. The increase in royalties was due to increased sales of a licensed technology. The hosted server expenses are associated with our new MIX solution that launched in July, 2010.

**Selling, General and Administrative.** Selling, general, and administrative expenses as a percentage of revenue were 70% in the third quarter of 2010 as compared to 56% in the same period in 2009. The net increase in these expenses of approximately \$930,000 or 38.8% was caused by several items: salaries and wages and related payroll taxes, commission expense, bonus expense, stock compensation expense, health insurance expense, legal fees, consulting fees, and bad debt expense. These increases were offset by a decrease in advertising expense.

The approximate \$341,000 increase in salaries and wages and related payroll taxes was due to an overall increase in staffing of ten additional people mainly in the sales and support departments when compared to the third quarter of 2009. Commission expense increased by \$102,000 due to higher revenues in the third quarter of 2010. Bonus expense increased by \$194,000 when compared to the third quarter of 2009 due to a higher accrual rate in 2010 in anticipation of paying out increased bonuses compared to 2009 due to increased revenues. Stock compensation expense increased by approximately \$54,000 due to two large grants given to two employees hired during the quarter. Health insurance increased by approximately \$38,000 due to an increase in staffing. Legal fees increased by approximately \$87,000 due to the Uniloc litigation which has been resolved. Consulting fees increased by approximately \$35,000 due to the hiring of two additional consultants. One consultant was hired to develop international business, and the other consultant was hired to develop the MIX product line. The net \$57,000 increase in bad debt consists of a \$94,000 decrease due to a change in the bad debt estimate plus a \$151,000 increase due to an increase in accounts receivable.

Advertising expense decreased by approximately \$78,000 due to the continued optimization of Google ad-words and similar search ads. We have reduced the amount that we spend on search terms while sustaining delivery of sales leads that result in viable sales opportunities.

**Research and Development.** The net increase in research and development expenses of approximately \$103,000 consists of a \$58,000 increase in external research and development, a \$35,000 increase in salaries and wages, and a \$36,000 increase in bonus expense, offset by a decrease of \$28,000 in transition costs. The increase in external research and development was due to the contracting of additional offshore developers. The increase in salaries and wages was due to the hiring of new software engineers in 2010. The increase in bonus expense was due to a higher accrual rate in 2010 in anticipation of paying increased bonuses as well as the addition of three employees to the bonus pool. The decrease in transition costs was related to the closing of the Andover office in 2009.

**Depreciation and Amortization.** Depreciation and amortization consists of depreciation expense related to our fixed assets and amortization of capitalized development costs and intangible assets. Depreciation and amortization combined has remained relatively stable between the years with an increase of only \$14,000. This increase was largely due to property additions in 2010 and 2009.

**Other Income (Expense), net.** Other income/expense mainly consists of interest income. Other income decreased by approximately \$3,000 due to a decrease in short-term investments in the third quarter of 2010.

**Income Taxes.** Our effective tax rates were 12.9 % and 35% for the three months ended September 30, 2010 and 2009, respectively. The effective tax rate was less in 2010 due to the reversal of an uncertain tax position liability which was previously recorded in 2008. The liability was reversed due to the statute of limitations expiring. Other significant items that affected our effective income tax rate in the three months ended September 30, 2010 related to the deduction for domestic production activities (“DPAD”) which was offset by non-deductible incentive stock option expense and state income tax expense. The rate on the DPAD deduction increased from 6% to 9% in 2010.

## Comparison of the Nine Months ended September 30, 2010 and 2009

	Nine Months ended September 30,		\$ Change	% Change
	2010	2009		
	(\$ in thousands)			
Total revenues	\$ 13,647	\$ 12,282	1,365	11.1%
Cost of revenues	389	230	159	69.1%
Selling, general and administrative expenses	9,449	7,825	1,624	20.8%
Research and development expenses	2,203	2,094	109	5.2%
Depreciation and amortization	599	537	62	11.5%
Total operating expense	<u>12,640</u>	<u>10,686</u>	<u>1,954</u>	<u>18.3%</u>
Income from operations	1,007	1,596	(589)	-36.9%
Other income (expense)	6	(38)	44	
Income tax expense (benefit)	282	283	(1)	-0.4%
Net income	<u>\$ 731</u>	<u>\$ 1,275</u>	<u>(544)</u>	<u>-42.7%</u>

**Revenue.** Revenues are comprised of the gross selling price of software and the earned portion of maintenance and support agreements. For the nine months ended September 30, 2010, total revenues increased by approximately \$1.4 million or 11.1% from the same period in 2009 which included a \$2.7 million U.S. Army order, of which \$1.2 million was recognized during the first nine months of 2009. Revenues increased largely due to an increase in average sales price and an increase in maintenance and support sales.

The following table reflects revenue by product including the related maintenance and support for each product (\$ in thousands):

Product	Revenue for the Nine Months ended September 30,			
	2010		2009	
Enhanced File Transfer Server Enterprise	\$ 7,927	58.1%	\$ 5,749	46.8%
Enhanced File Transfer Server	2,726	20.0%	3,523	28.7%
CuteFTP Pro	953	7.0%	1,102	9.0%
CuteFTP Home	212	1.6%	359	2.9%
WAFS	1,376	10.1%	1,350	11.0%
CDP	44	0.3%	41	0.3%
All Others	409	3.0%	157	1.3%
Total Operating Revenues	<u>\$13,647</u>	<u>100.0</u>	<u>\$12,281</u>	<u>100.0</u>
Maintenance and support (as a % of total revenue)	<u>\$ 5,642</u>	<u>41.3%</u>	<u>\$ 4,356</u>	<u>35.5%</u>

Overall sales of our EFT Server Enterprise and EFT Server products increased by approximately \$1.4 million or 14.9% for the nine months. These products represented approximately 78.1% of our total revenues in the nine months ending September 30, 2010 as compared to 75.5%, in the same period in 2009. The increase was largely due to an increase in average sales price and an increase in maintenance and support sales. The increase also is noteworthy because it comes despite the inclusion of a large, non-recurring US Army order for EFT Server in the second quarter of 2009.



Revenues from the CuteFTP Home and CuteFTP Professional products decreased by \$296,000 or 20.3% in the nine months ended September 30, 2010, as compared to the same period in 2009, and accounted for approximately 8.6% and 11.9% of total revenues for the nine months ended September 30, 2010 and 2009, respectively. This decline continued the general reduction in CuteFTP product revenues, both in absolute terms and as a percentage of revenue, experienced since 2006. The consumer FTP product market has substantial low-cost, and even free, solutions that have put increasing pressure on CuteFTP product revenues. Additional pressure on this product line comes from social media companies and services that allow consumers to share images and video. Our reliance on the current CuteFTP products will continue to decline as we emphasize sales of our more complex enterprise products and potentially enter adjacent markets.

Sales of our WAFS and CDP software increased by \$29,000, or 2.1%, during the nine month period ended September 30, 2010. The WAFS and CDP products are largely used by architecture, engineering, and construction firms to transfer large files between offices. The increase was due to an increase in the number of licenses sold and a higher average sales price. Generally, on a month by month comparison basis, WAFS sales are still decreasing; however they are decreasing at a much slower pace and with several significant sales in the second quarter have provided for an overall increase. In addition, we believe that this increase in revenue during the first nine months reflects greater market acceptance of the WAFS software, resulting from the considerable development effort devoted to this solution, as described in prior reports. These products accounted for approximately 10.4% of total revenue for the first nine months ending September 30, 2010 compared to 11.3% for the same period in 2009.

Products and services included in the "All Others" revenue category primarily consist of professional services, training and Mail Express product sales. This revenue increased by approximately \$252,000 or 161% for the nine month period ended September 30, 2010. Other revenue accounted for 3% of total revenue for the nine month period in 2010 as compared to 1.3% for the same period in 2009. This increase was largely due to the introduction of our new Solution Quickstart service which accounted for \$175,000 of the total increase. Other notable increases were in training services, Mail Express, and two new professional service offerings: Customer Application services and Business Process services. Custom Application services aid the integration of GlobalSCAPE products with our customers' business environments and include the development of personalized web portals, integration with existing automated processes, and accelerated product features. Business process services provide network architecture planning, project planning and management support for our enterprise customers.

Because of the more complex and business-critical nature of the EFT Server, EFT Server Enterprise, WAFS, and CDP products, purchasers require maintenance and support. Maintenance and support pricing is reflective of the license cost of the products and the additional support needed to maintain and support the products and customers. Our maintenance and support revenues for the nine months increased by 33.7% compared to the same period in 2009 due to an increase in the amount earned as compared to the amount deferred in the nine months ended September 30, 2010.

**Cost of Revenues.** Cost of revenues consists primarily of royalties, a portion of our bandwidth costs, hosted management expenses, and travel expenses associated with customer training. The increase in cost of revenues was largely due to an increase in royalties of approximately \$89,000, the addition of hosted server expenses of approximately \$26,000 and an increase in training expense of approximately \$35,000. The increase in royalties was due to increased sales of a licensed technology. The hosted server expenses are associated with the new MIX solution which launched in July, 2010, and the increase in training expenses was mostly due to travel expenses related to customer onsite training.

**Selling, General and Administrative.** Selling, general, and administrative expenses as a percentage of revenue were 69% for the nine months ended September 30, 2010 as compared to 64% in the same period last year. The net increase in these expenses of approximately \$1.6 million or 20.8% was caused by several items: salaries and wages and related payroll taxes, bonus expense, recruiting expense, health insurance, legal fees, consulting fees and travel expense. These increases were offset by decreases in accounting professional fees and advertising expense.

The approximate \$893,000 increase in salaries and wages and related payroll taxes was due to an overall increase in staffing of ten additional people, mainly in the sales and support departments. Bonus expense increased by \$343,000 when compared to the nine months ended September 30, 2009 due a higher accrual rate in 2010 in

anticipation of paying out increased bonuses. Recruiting expense consisted of fees paid to external recruiting agencies and increased by approximately \$58,000 due to the hiring of two software engineers, a systems administrator and a server support analyst. Health insurance increased by approximately \$83,000 due to the increase in staffing. The increase in legal fees of approximately \$195,000 was largely due to the Uniloc litigation which has been resolved, as well as increased trademark and other intellectual property work. Consulting fees increased by approximately \$54,000 due to the hiring of two consultants. One consultant was hired to develop international business and the other consultant was hired to develop the MIX solution. Travel expense increased by approximately \$53,000 due to an increase in international travel, attendance at trade shows and investor road shows.

Accounting professional fees decreased for the nine months ended September 30, 2010 by approximately \$42,000 because of additional audit work performed in 2009 for the year 2008 audit which did not recur in 2010 and additional analysis performed regarding goodwill impairment in 2009 which also did not recur in 2010. Advertising expense decreased by approximately \$291,000 due to the continued optimization of Google search ads. We have reduced the amount that we spend on search terms without affecting the amount of sales leads that are generated by the search results.

**Research and Development.** The net increase in research and development expenses of approximately \$109,000 consists of a \$118,000 increase in external research and development, a \$12,000 increase in salaries and wages, a \$27,000 increase in bonus expense, a \$40,000 decrease in stock compensation expense, and a \$28,000 decrease in transition costs. The increase in external research and development was due to the hiring of a third party to test new software and the hiring of additional offshore developers. The increase in salaries and wages was due to the hiring of new software engineers in 2010 and was offset by a role change for one member of our management team who moved into a sales role in October 2009. His compensation was formerly reported within research and development, but is now reported within selling, general, and administrative expenses. The increase in bonus expense is due to the addition of three employees to the bonus pool as well as an increase in the accrual rate due to the anticipation of paying out increased bonuses compared to the prior year. Stock compensation expense decreased due to the increase in the estimated forfeiture rate used to calculate the total expense to be recognized on stock based compensation. The decrease in transition costs was related to the closure of the Andover office in 2009.

**Depreciation and Amortization.** Depreciation and amortization consists of depreciation expense related to our fixed assets and amortization of capitalized development costs and intangible assets. Depreciation and amortization combined increased by approximately \$62,000 for the nine months ended September 30, 2010. This increase was due to property additions in 2010 and the second half of 2009.

**Other Income (Expense), net.** Other income/expense mainly consists of interest income. Other income for the nine months ended September 30, 2010 was from interest on short-term investments and interest on a Texas margins tax refund. Other expense for the nine months ended September 30, 2009 was a loss on fixed assets which was offset by interest on short-term investments. The loss on fixed assets of approximately \$53,000 in 2009 was largely due to not being able to sell the furniture that we removed during the renovation of our office space and having to completely write off the net book value of the property.

**Income Taxes.** Our effective tax rates were 27.8 % and 18.2% for the nine months ended September 30, 2010 and 2009, respectively. The effective tax rate was less in 2009 due to a large loss on stock option expense. For 2010, the most significant item that affected our effective income tax rate relates to the deduction for domestic production activities (“DPAD”) which was offset by non-deductible incentive stock option expense, and state income taxes. The rate on the DPAD deduction increased from 6% to 9% in 2010.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

To date, we have not utilized derivative financial instruments or derivative commodity instruments. We do not expect to employ these or other strategies to hedge market risk in the foreseeable future. We may invest our cash in money market funds, which are subject to minimal credit and market risk. We believe that the interest rate risk and other relevant market risks associated with these financial instruments are immaterial.

During the nine months ended September 30, 2010, approximately 30% of our sales came from customers outside the United States. All sales are received in U.S. dollars so we have no material exchange rate risk with regard to the sales. However, in July 2003, the European Union (EU) enacted Value Added Taxes (VAT) on electronic purchases. These taxes are charged to our non-business customers in the EU and, in our case, are remitted quarterly in pound sterling. The impact of this currency translation has not been material to our business.

**Item 4. Controls and Procedures**

As of the end of the period covered by this report, our Chief Executive Officer and Chief Financial Officer carried out an evaluation of the effectiveness of GlobalSCAPE's "disclosure controls and procedures" (as defined in the Securities Exchange Act of 1934 Rules 13a-15(e) and 15d-15(e)) and concluded that the disclosure controls and procedures were effective.

There were no changes in our internal controls over financial reporting during the three months ended September 30, 2010 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**

In January 2010, GlobalSCAPE was named as one of a number of defendants by Uniloc USA, Inc. and Uniloc (Singapore) Private Limited in a complaint filed in the United States District Court for the Eastern District of Texas Tyler Division for patent infringement of a single U.S. patent. The complaint alleged that GlobalSCAPE infringed on a patent that utilizes a system for activating software products through a registration process. In September 2010, the complaint was dismissed with prejudice and the Company did not make any payment in conjunction with the dismissal.

**Item 1A. Risk Factors.**

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, "Item 1A. Risk Factors" in our 2009 Form 10-K which could materially affect our business, financial condition or future results. The risks described in our 2009 Form 10-K are not the only risks facing GlobalSCAPE. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition, and/or operating results.

**Item 6. Exhibits****(a) Exhibits**

- 31.1 Certification by Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification by Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32 Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

### 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.

GLOBALSCAPE, INC.

November 10, 2010

Date

By: /s/ Mendy Marsh

Mendy Marsh

Vice President and Chief Financial Officer

(Principal Accounting Officer)

## CERTIFICATIONS

I, James R Morris, certify that:

1. I have reviewed this quarterly report on Form 10-Q of GlobalSCAPE, Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under my supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to me by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this quarterly report based on such evaluation; and

c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

a) all significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 10, 2010

/s/ James R Morris

James R Morris

President and Chief Executive Officer

CERTIFICATIONS

I, Mendy Marsh, certify that:

1. I have reviewed this quarterly report on Form 10-Q of GlobalSCAPE, Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under my supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to me by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this quarterly report based on such evaluation; and

c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

a) all significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 10, 2010

/s/ Mendy Marsh

Mendy Marsh

Vice President and Chief Financial Officer

CERTIFICATE PURSUANT TO 18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO SECTION 906 OF THE  
SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of GlobalSCAPE, Inc. on Form 10-Q for the period ending September 30, 2010 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned, James R Morris, Chief Executive Officer and Mendy Marsh, Chief Financial Officer, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of GlobalSCAPE, Inc.

November 10, 2010

/s/ James R Morris

James R Morris  
President and Chief Executive Officer

/s/ Mendy Marsh

Mendy Marsh  
Vice President and Chief Financial Officer