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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2017
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 number 001-33601

GlobalSCAPE, Inc.

(Exact Name of Registrant as Specified in its Charter)

Delaware	**74-2785449**
State or Other Jurisdiction of Incorporation or Organization	I.R.S. Employer Identification No.
4500 Lockhill-Selma, Suite 150	
San Antonio, Texas	**78249**
Address of Principal Executive Offices	Zip Code

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

Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report

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

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

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

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

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

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PRECEDING FIVE YEARS:

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes ☐ No ☐

APPLICABLE ONLY TO CORPORATE ISSUERS

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. As of October 31, 2017 there were 21,793,131 shares of common stock outstanding.

GlobalSCAPE, Inc.
Quarterly Report on Form 10-Q
For the Quarter ended September 30, 2017
Index

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Part I. Financial Information

Item 1. Financial Statements

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

	September 30, 2017 *(Unaudited)*	December 31, 2016
Assets		
Current assets:		
Cash and cash equivalents	$ 11,447	$ 8,895
Certificates of deposit, short term	2,768	2,754
Accounts receivable, net	4,475	6,288
Federal income tax receivable	1,051	292
Prepaid and other expenses	368	531
Total current assets	20,109	18,760
Certificates of deposit, long term	12,960	12,779
Capitalized software development costs, net	3,803	3,743
Goodwill	12,712	12,712
Deferred tax asset, net	1,022	1,050
Property and equipment, net	505	456
Other assets	91	245
Total assets	$ 51,202	$ 49,745
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 1,378	$ 930
Accrued expenses	2,007	1,603
Deferred revenue	12,012	13,655
Total current liabilities	15,397	16,188
Deferred revenue, non-current portion	3,907	3,790
Other long term liabilities	174	152
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, 22,196,712 and 21,920,912 shares issued at September 30, 2017, and December 31, 2016, respectively	22	22
Additional paid-in capital	23,280	21,756
Treasury stock, 403,581 shares, at cost, at September 30, 2017 and December 31, 2016	(1,452)	(1,452)
Retained earnings	9,874	9,289
Total stockholders' equity	31,724	29,615
Total liabilities and stockholders' equity	$ 51,202	$ 49,745

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

GlobalSCAPE, Inc.
Condensed Consolidated Statements of Operations and Comprehensive Income
(In thousands, except per share amounts)
(Unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Operating Revenues:				
Software licenses	$ 2,488	$ 3,322	$ 7,768	$ 8,381
Maintenance and support	5,360	4,637	15,702	13,635
Professional services	368	702	1,652	2,107
Total Revenues	8,216	8,661	25,122	24,123
Cost of revenues				
Software licenses	725	862	2,234	2,284
Maintenance and support	446	362	1,283	1,142
Professional services	402	393	1,120	1,269
Total cost of revenues	1,573	1,617	4,637	4,695
Gross profit	6,643	7,044	20,485	19,428
Operating expenses				
Sales and marketing	3,079	2,880	9,564	8,765
General and administrative	2,575	1,634	6,178	5,046
Research and development	594	519	2,530	1,750
Total operating expenses	6,248	5,033	18,272	15,561
Income from operations	395	2,011	2,213	3,867
Interest income (expense), net	75	28	221	88
Income before income taxes	470	2,039	2,434	3,955
Income tax expense	194	705	870	1,397
Net income	$ 276	$ 1,334	$ 1,564	$ 2,558
Comprehensive Income	$ 276	$ 1,334	$ 1,564	$ 2,558
Net income per common share -				
Basic	$ 0.01	$ 0.06	$ 0.07	$ 0.12
Diluted	$ 0.01	$ 0.06	$ 0.07	$ 0.12
Weighted average shares outstanding:				
Basic	21,792	21,122	21,672	21,061
Diluted	22,247	21,674	22,145	21,640
Cash dividends declared per share	$ 0.015	$ 0.015	$ 0.045	$ 0.045

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

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

	For the Nine Months Ended September 30, 2017	2016
Operating Activities:		
Net income	$ 1,564	$ 2,558
Items not involving cash at the time they are recorded in the statement of operations:		
Provision for sales returns and doubtful accounts receivable	15	58
Depreciation and amortization	1,604	1,522
Share-based compensation	1,053	753
Deferred taxes	28	(36)
Excess tax benefit from share-based compensation	-	5
Subtotal before changes in operating assets and liabilities	4,264	4,860
Changes in operating assets and liabilities:		
Accounts receivable	1,798	(2,249)
Prepaid expenses	163	86
Deferred revenue	(1,526)	770
Accounts payable	448	(237)
Accrued expenses	404	(197)
Other assets	154	30
Accrued interest receivable	(195)	(49)
Other long-term liabilities	22	10
Income tax receivable and payable	(759)	600
Net cash provided by operating activities	4,773	3,624
Investing Activities:		
Software development costs capitalized	(1,464)	(1,298)
Purchase of property and equipment	(249)	(168)
Net cash (used in) investing activities	(1,713)	(1,466)
Financing Activities:		
Proceeds from exercise of stock options	471	333
Excess tax benefit from share-based compensation	-	(5)
Dividends paid	(979)	(950)
Net cash (used in) financing activities	(508)	(622)
Net increase in cash	2,552	1,536
Cash at beginning of period	8,895	15,885
Cash at end of period	$ 11,447	$ 17,421
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Interest	$ -	$ -
Income taxes	$ 1,616	$ 776

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

GlobalSCAPE, Inc.
Notes to Condensed Consolidated Financial Statements
As of September 30, 2017 and For the Three and Nine
Months Then Ended
(Unaudited)

1. Nature of Business

GlobalSCAPE, Inc., and its wholly-owned subsidiary (together referred to as the “Company”, “GlobalSCAPE”, or “we”) provides secure information exchange capabilities for enterprises and consumers through the development and distribution of software, delivery of managed and hosted solutions, and provisioning of associated services. Our solution portfolio facilitates transmission of critical information such as financial data, medical records, customer files, vendor files, personnel files, transaction activity, and other similar documents between diverse and geographically separated network infrastructures while supporting a range of information protection approaches to meet privacy and other security requirements. In addition to enabling secure, flexible transmission of critical information using servers, desktop and notebook computers, and a wide range of network-enabled mobile devices, our products also provide customers with the ability to monitor and audit file transfer activities. Our primary product is Enhanced File Transfer, or EFT. We have other products that complement our EFT product.

In June 2017, we introduced a data integration product that we planned to sell under the brand name Kenetix. We licensed the technology for this product from a third party. This product is a cloud-based, integration-as-a-service, or iPaaS, solution used to connect applications, microservices, application program interfaces (or API’s), data and processes within and between organizations. We have experienced issues with the third-party technology and have determined to suspend marketing of the product as we evaluate options and determine whether the licensor can effectively address the issues.

We also sell other products that are synergistic to EFT including Mail Express, WAFS, and CuteFTP. Collectively, these products constitute less than 10% of our total revenue.

Throughout these notes unless otherwise noted, our references to the 2017 quarter and the 2016 quarter refer to the three months ended September 30, 2017 and 2016, respectively. Our references to the 2017 nine months and the 2016 nine months refer to the nine months ended September 30, 2017 and 2016, respectively.

2. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with Rule 10-01 of Regulation S-X, “Interim Financial Statements”, as prescribed by the United States Securities and Exchange Commission, or SEC. Accordingly, they do not include all information and footnotes required under United States generally accepted accounting principles, or GAAP, for complete financial statements. In the opinion of management, all accounting entries necessary for a fair presentation of our financial position and results of operations 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 our Annual Report on Form 10-K/A for the fiscal year ended December 31, 2016, filed with the SEC on June 14, 2018, which we refer to as the 2016 Form 10-K/A, as well as *Management’s Discussion and Analysis of Financial Condition and Results of Operations* also included in our 2016 Form 10-K/A and in this report.

We follow accounting standards set by the Financial Accounting Standards Board, or FASB. This board sets GAAP, which we follow in preparing financial statements that report our financial position, results of operations, and sources and uses of cash. We also follow the reporting regulations of the SEC.

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 our financial statements. It is possible the actual results could differ from these estimates and assumptions and could have a material effect on the reported amounts of our financial position and results of operations.

3. Significant Accounting Policies

Principles of Consolidation

The accompanying condensed consolidated financial statements are prepared in conformity with GAAP. All intercompany accounts and transactions have been eliminated.

Changes in Accounting Methods, Reclassifications and Revisions

As part of our ongoing enhancement and refinement of our financial reporting to fairly present our results of operations and financial position, we may make changes from time-to-time in accounting methods and in the classification and presentation of our business activities in our financial statements. To ensure comparability between periods, we revise previous period financial statements presented to conform them to the method of presentation in our current period financial statements. If the changes increase or decrease previously reported amounts of revenue or expenses, we adjust retained earnings as of the beginning of the earliest period presented for the cumulative effect, if any, on that balance. If these changes affect our financial statements for previously reported interim periods not presented herein, we present revised financial statements for those periods when they are reported in the future.

Method of Amortization of Deferred Revenue Related to M&S Contracts

In previously issued financial statements for our fiscal years prior to 2016 and for the first three quarters of 2016, we amortized deferred revenue related to maintenance and support, or M&S, contracts by recording a full month of amortization in the first month of a contract. We used that method based on our intent to match revenue from our M&S contracts to the expense we incur when delivering M&S services. We acknowledge that the more common and widespread practice is to amortize deferred revenue based upon the specific number of days the M&S contract is in place during that month. Both methods result in the recognition of the same amount of revenue over the term of the M&S contract but yield differing amounts of revenue being recognized in the first month and last month of an M&S contract.

Commencing with the issuance of our financial statements as of December 31, 2016, and for the year then ended, we changed our method of amortizing deferred revenue related to M&S contracts such that our condensed consolidated statements of operations and balance sheets included herein are now prepared using the specific number of days method. This change decreased M&S revenue and net income for the three months and nine months ended September 30, 2016, as reported herein by immaterial amounts relative to amounts previously reported for that period. This change increased deferred revenue as of September 30, 2016, by an immaterial amount relative to the amount previously reported as of that date. This change has no effect on the total amount of revenue we will realize from our M&S contracts.

Method of Recording M&S Billings

We may invoice a customer for M&S to be provided commencing on a date in a month subsequent to the month in which we invoice the customer. We typically receive a purchase order from our customers for M&S prior to invoicing them, and it is not uncommon for a customer to pay us in advance of that M&S commencement date either on their own or when we request such payment. Accordingly, in our consolidated balance sheets issued prior to 2016 and for the first three quarters of 2016, we recorded an account receivable and deferred revenue for these invoices as of the date of the invoice. Commencing with the preparation and issuance of our consolidated financial statements as of December 31, 2016, we determined that a reasonable, alternate and more conservative method would be to wait until the commencement date of the M&S contract had arrived to record the account receivable and deferred revenue for any such invoices for which we have not been paid as of the balance sheet date. This change had the effect of decreasing our reported amounts of accounts receivable and deferred revenue relative to the method we previously used but does not affect any of our reported amounts of revenue or net income.

Reclassification of Sales Engineer Expenses

We employ sales engineers who assist our sales staff in addressing technical considerations by our customers prior to their purchasing our product. Our use of sales engineers has expanded in recent quarters. Prior to 2016 and for the first three quarters of 2016, we classified the expense of sales engineers as part of costs of revenue – professional services. Commencing with the preparation and issuance of our financial statements as of December 31, 2016, we began classifying these expenses as part of sales and marketing expense to more appropriately present the current nature of the activities of our sales engineers. This change has the effect of decreasing cost of revenue – professional services and increasing sales and marketing expense. It does not affect any of our reported amounts of revenue or net income.

Reclassification of Reserve for Uncertain Tax Position

As described in Note 9, we maintain a reserve for uncertain tax positions. Prior to 2016 and for the first three quarters of 2016, we classified that reserve as a current liability since it was not material to our financial statements taken as a whole. Commencing with the preparation of our financial statements as of December 31, 2016, we determined it appropriate to classify it as a component of other long term liabilities. This change has the effect of decreasing current income taxes payable and increasing other long term liabilities.

Reclassification of Professional Services Revenue

In preparing our condensed consolidated statement of operations and comprehensive income for the 2017 quarter and 2017 nine months, we classified as professional services certain revenue that had been previously reported as M&S revenue for 2016. We made that change to better reflect the nature of that revenue. We have made the same reclassification in our condensed consolidated statement of operations and comprehensive income for the 2016 quarter and 2016 nine months presented herein.

Adjustments Related to the Audit Committee Investigation and Audit of 2016 Financial Statements

The Company has concluded that its previously issued consolidated financial statements for the year ended December 31, 2016 should be restated due to misstatements related to certain revenue transactions incorrectly recognized during the year ended December 31, 2016 as well as other transactions identified during the Audit Committee's investigation and management's analysis and for the changes in the Company's accounting methods, reclassifications and revisions described above in this Note 3.

The impact of all of the misstatements described above on the condensed consolidated financial statements as of and for the three and nine months ended September 30, 2016 are as follows:

Condensed Consolidated Balance Sheet
(in thousands)
As of September 30, 2016
(unaudited)

	As Previously Reported	Adjustments	As Revised
Assets			
Current assets:			
Cash and cash equivalents	$ 17,421		$ 17,421
Short term investments	3,303		3,303
Accounts receivable, net	8,870	(741)	8,129
Federal income tax receivable	104	(104)	-
Prepaid and other expenses	425		425
Total current assets	30,123	(845)	29,278
Long term investments			
Property and equipment, net	463		463
Capitalized software development costs, net	3,961		3,961
Goodwill	12,712		12,712
Deferred tax asset, net	976		976
Other assets	30		30
Total assets	$ 48,265	$ (845)	$ 47,420
Liabilities and Stockholders' Equity			
Current liabilities:			
Accounts payable	622	(20)	602
Accrued expenses	1,841	(145)	1,696
Deferred revenue	13,005	219	13,224
Income taxes payable	517	(457)	60
Total current liabilities	15,985	(403)	15,582
Deferred revenue, non-current portion	3,688	126	3,814
Other long term liabilities	34	110	144
			-
Stockholders' Equity:			-
Preferred stock	-		-
Common stock	21		21
Additional paid-in capital	20,632	96	20,728
Treasury stock	(1,452)		(1,452)
Retained earnings	9,357	(774)	8,583
Total stockholders' equity	28,558	(678)	27,880
Total liabilities and stockholders' equity	$ 48,265	$ (845)	$ 47,420

Condensed Consolidated Statement of Operations and Comprehensive Income
(in thousands, except per share amounts)
For the Three Months Ended September 30, 2016
(unaudited)

	As Previously Reported	Adjustments	As Revised
Operating revenues:			
Software licenses	$ 3,373	(51)	$ 3,322
Maintenance and support	4,713	(76)	4,637
Professional services	667	35	702
Total revenues	8,753	(92)	8,661
Costs of revenues			
Software licenses	873	(11)	862
Maintenance and support	363	(1)	362
Professional services	534	(141)	393
Total costs of revenues	1,770	(153)	1,617
Gross Profit	6,983	61	7,044
Operating expenses			
Sales and marketing	2,759	121	2,880
General and administrative	1,638	(4)	1,634
Research and development	528	(9)	519
Total operating expenses	4,925	108	5,033
Income from operations	2,058	(47)	2,011
Interest income (expense), net	28		28
Income before income taxes	2,086	(47)	2,039
Income tax expense	687	18	705
Net income	$ 1,399	$ (65)	$ 1,334
Comprehensive income	$ 1,399	$ (65)	$ 1,334
Net income per common share - basic	$ 0.07	$ (0.00)	$ 0.06
Net income per common share - diluted	$ 0.06	$ (0.00)	$ 0.06

Condensed Consolidated Statement of Operations and Comprehensive Income
(in thousands, except per share amounts)
For the Nine Months Ended September 30, 2016
(unaudited)

	As Previously Reported	Adjustments	As Revised
Operating revenues:			
Software licenses	$ 8,565	(184)	$ 8,381
Maintenance and support	13,843	(208)	13,635
Professional services	2,013	94	2,107
Total revenues	24,421	(298)	24,123
Costs of revenues			
Software licenses	2,303	(19)	2,284
Maintenance and support	1,145	(3)	1,142
Professional services	1,689	(420)	1,269
Total costs of revenues	5,137	(442)	4,695
Gross Profit	19,284	144	19,428
Operating expenses			
Sales and marketing	8,453	312	8,765
General and administrative	5,083	(37)	5,046
Research and development	1,727	23	1,750
Total operating expenses	15,263	298	15,561
Income from operations	4,021	(154)	3,867
Interest income (expense), net	88		88
Income before income taxes	4,109	(154)	3,955
Income tax expense	1,348	49	1,397
Net income	$ 2,761	$ (203)	$ 2,558
Comprehensive income	$ 2,761	$ (203)	$ 2,558
Net income per common share - basic	$ 0.13	$ (0.01)	$ 0.12
Net income per common share - diluted	$ 0.13	$ (0.01)	$ 0.12

Condensed Consolidated Statements of Cash Flows
(in thousands)
For the Nine Months Ended September 30, 2016
(unaudited)

	As Previously Reported	Adjustments	As Revised
Operating Activities:			
Net income	$ 2,761	(203)	$ 2,558
Adjustments to reconcile net income to net cash provided by operating activities:			
Bad debt expense	67	(9)	58
Depreciation and amortization	1,522		1,522
Share-based compensation	721	32	753
Deferred taxes	(36)		(36)
Excess tax deficiency from exercise of share based compensation	5		5
Subtotal before changes in operating assets and liabilities	5,040	(180)	4,860
Changes in operating assets and liabilities:			
Accounts receivable	(2,856)	607	(2,249)
Prepaid expenses	86		86
Deferred revenues	1,081	(311)	770
Accounts payable	(217)	(20)	(237)
Accrued expenses	(52)	(145)	(197)
Other assets	30		30
Accrued interest receivable	(49)		(49)
Other long-term liabilities	(10)	20	10
Income tax receivable and payable	571	29	600
Net cash provided by (used in) operating activities	3,624	-	3,624
Investing Activities:			
Software development costs	(1,298)		(1,298)
Purchase of property and equipment	(168)		(168)
Net cash provided by (used in) investing activities	(1,466)	-	(1,466)
Financing Activities:			
Proceeds from exercise of stock options	333		333
Tax deficiency (benefit) from stock-based compensation	(5)		(5)
Dividends paid	(950)		(950)
Net cash provided by (used in) financing activities	(622)	-	(622)
Net increase (decrease) in cash	1,536		1,536
Cash at beginning of period	15,885	-	15,885
Cash at end of period	$ 17,421	$ -	$ 17,421
Supplemental disclosure of cash flow information:			
Cash paid during the period for:			
Interest	$ -		$ -
Income taxes	$ 776		$ 776

Revenue Recognition

We develop, market and sell software products. We recognize revenue from a sale transaction when the following conditions are met:

Persuasive evidence of an arrangement exists.
Delivery has occurred or services have been rendered.
The amount of the sale is fixed or determinable.
Collection of the sale amount is reasonably assured.

For a sale transaction not meeting any one of these four criteria, we defer recognition of revenue related to that transaction until all the criteria are met.

We earn the majority of our software license revenue from software products sold under perpetual software license agreements. At the time our customers purchase these products, they typically also purchase an M&S contract. These transactions are multiple element software sales for which we assess the presence of vendor specific objective evidence (“VSOE”) of the fair value of the undelivered elements to determine the portion of these sales to recognize as revenue upon delivery of the software product and the portion of these sales to record as deferred revenue at the time the product is delivered. We amortize the deferred revenue component to revenue in future periods on a straight-line method as we deliver the related future services to the customer. For transactions, if any, for which we cannot establish VSOE of the fair value of the undelivered elements, we initially record the entire transaction as deferred revenue and amortize that amount to revenue in future periods as we deliver the related future services to the customer.

We provide services under M&S contracts with terms generally ranging from one to three years. We require up-front payment of our M&S fee in an amount that covers the entire term of the agreement. We record deferred revenue at the commencement date of the contract or when we receive payment, whichever occurs first. We amortize the related deferred revenue over the term of the contract, based upon the specific number of days method. Deferred revenue related to services we will deliver within one year is presented as a current liability while deferred revenue related to services that we will deliver more than one year into the future is presented as a non-current liability. We reduce deferred revenue and recognize revenue ratably in future periods on a straight-line method as we deliver the M&S service.

For our products licensed and delivered on a monthly or other periodic subscription or software-as-a-service, or SaaS basis, we recognize subscription revenue, including initial setup fees, on a monthly basis ratably over the contractual term of the customer contract as we deliver our products and services. Amounts paid prior to this revenue recognition are presented as deferred revenue until earned.

We provide professional services to our customers consisting primarily of software installation support, operations support and training. We recognize revenue from these services as they are completed and accepted by our customers.

We collect sales tax on many of our sales. We do not include sales tax collected in our revenue. We record it as a liability payable to taxing authorities.

Cash and cash equivalents

Cash and cash equivalents includes all cash and highly liquid investments with original maturities of three months or less.

Property and Equipment

Property and equipment is comprised of furniture and fixtures, software, computer equipment and leasehold improvements which are recorded at cost and depreciated using the straight-line method over their estimated useful lives. Furniture, fixtures and equipment have a useful life of five to seven years, computer equipment and software have a useful life of three years and leasehold improvements have a useful life that is the shorter of the term of the lease under which the improvements were made or the estimated useful life of the asset.

Expenditures for maintenance and repairs are expensed as incurred.

Goodwill

Goodwill is not amortized. On at least an annual basis, we test goodwill for impairment at the reporting unit level using December 31 as the measurement date. We operate as a single reporting unit.

When testing goodwill, we first assess qualitative factors to determine whether it is more likely than not (that is, a likelihood of more than 50 percent) that the fair value of our reporting unit is less than its carrying amount, including goodwill. In performing this qualitative assessment, we assess events and circumstances relevant to us including, but not limited to:

- Macroeconomic conditions.
- Industry and market considerations.
- Cost factors and trends for labor and other expenses of operating our business.
- Our overall financial performance and outlook for the future.
- Trends in the quoted market value and trading of our common stock.

In considering these and other factors, we consider the extent to which any adverse events and circumstances identified could affect the comparison of our reporting unit's fair value with its carrying amount. We place more weight on events and circumstances that most affect our reporting unit's fair value or the carrying amount of our net assets. We consider positive and mitigating events and circumstances that may affect our determination of whether it is more likely than not that the fair value of our reporting unit is less than its carrying amount. We evaluate, on the basis of the weight of the evidence, the significance of all identified events and circumstances in the context of determining whether it is more likely than not that the fair value of our reporting unit is less than its carrying amount.

If, after assessing the totality of these qualitative events and circumstances, we determine it is not more likely than not that the fair value of our reporting unit is less than its carrying amount, we conclude there is no impairment of goodwill and perform no further testing, in accordance with GAAP. If we conclude otherwise, we proceed with performing the first step, and if necessary, the second step, of the two-step goodwill impairment test prescribed by GAAP.

As of December 31, 2016, after assessing the totality of the relevant events and circumstances, we determined it not more likely than not that the fair value of our reporting unit was less than its carrying amount. Accordingly, we concluded there was no impairment of goodwill as of that date. There have been no material events or changes in circumstances since that time indicating that the carrying amount of goodwill may exceed its fair market value and that interim testing needed to be performed.

Capitalized Software Development Costs

When we complete research and development for a software product and have in place a program plan and a detail program design or a working model of that software product, we capitalize production costs incurred for that software product from that point forward until it is ready for general release to the public. Thereafter, we amortize capitalized software production costs to expense using the straight-line method over the estimated useful life of that product, which is generally three years. We periodically assess the carrying value of capitalized software development costs and our method of amortizing them relative to our estimates of realizability through sales of products in the marketplace.

Research and Development

We expense research and development costs as incurred.

Advertising Expense

We expense advertising costs as incurred as a component of our sales and marketing expenses. Advertising expense was approximately $480,277 and $480,315 in the 2017 quarter and the 2016 quarter, respectively, and $1,508,114 and $1,447,774 in the 2017 nine months and 2016 nine months, respectively.

Share-Based Compensation

We measure the cost of share-based payment transactions at the grant date based on the calculated fair value of the award. We recognize this cost as an expense ratably over the recipient's requisite service period during which that award vests or becomes unrestricted.

For stock option awards, we estimate their fair value at the grant date using the Black-Scholes option-pricing model considering the following factors:

- We estimate expected volatility based on historical volatility of our common stock.
- We use primarily the simplified method to derive an expected term which represents an estimate of the time options are expected to remain outstanding. We use this method because our options are plain-vanilla options, and we believe our historical option exercise experience is not adequately indicative of our future expectations.
- We base the risk-free rate for periods within the contractual life of the option on the U.S. treasury yield curve in effect at the time of grant.
- We estimate a dividend yield based on our historical and expected future dividend payments.

For restricted stock awards, we use the quoted price of our common stock on the grant date as the fair value of the award.

Income Taxes

We account for income taxes using the asset and liability method. We record deferred tax assets and liabilities based on the difference between the tax bases of assets and liabilities and their carrying amount for financial reporting purposes, as measured by the enacted tax rates and laws that will be in effect when the differences are expected to reverse. Deferred tax assets and liabilities are carried on the balance sheet with the presumption that they will be realizable in future periods in which we generate taxable income.

We assess the likelihood that deferred tax assets will be realized from future taxable income. Based on this assessment, we provide any necessary valuation allowance on our balance sheet with a corresponding increase in the tax provision on our statement of operations. Any valuation allowances we establish are determined based upon a number of assumptions, judgments, and estimates, including forecasted earnings, future taxable income, and the relative proportions of revenue and income before taxes in the various domestic jurisdictions in which we operate.

We account for uncertainty in income taxes using a two-step process to determine the amount of tax benefit to be recognized. First, we evaluate the tax position to determine the likelihood that it will be sustained upon external examination. If the tax position is deemed "more-likely-than-not" to be sustained, we assess the tax position to determine the amount of benefit to recognize in the consolidated financial statements. The amount of the benefit we recognize is the largest amount that we believe has a greater than 50 percent likelihood of being realized upon ultimate settlement. Unrecognized tax benefits represent tax positions for which reserves have been established.

Earnings Per Share

We compute basic earnings per share using the weighted-average number of common shares outstanding during the periods. We compute diluted earnings per share using the weighted-average number of common shares outstanding plus the number of common shares that would be issued assuming conversion of all potentially dilutive common shares outstanding.

Awards of non-vested restricted stock and options are considered potentially dilutive common shares for the purpose of computing earnings per common share. We apply the treasury stock method to non-vested options under which the assumed proceeds include the amount the employee must pay to exercise the option plus the amount of unrecognized cost attributable to future periods less any expected tax benefits.

Recent accounting pronouncements

The Financial Accounting Standards Board, or FASB, has issued the Accounting Standard Updates (ASU) described below that we believe may be relevant to our business and to the preparation of our financial statements.

ASU 2017-09, Compensation—Stock Compensation (Topic 718): Scope of Modification Accounting (issued September 2017) – This update provides guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting. It states that in these situations, modification accounting should be applied unless the fair value of the modified award is the same as the fair value of the original award immediately before the original award was modified, the vesting conditions of the modified award are the same as the vesting conditions of the original award immediately before the original award was modified, and the classification of the modified award as equity or a liability is the same as the classification of the original award immediately before the original award was modified. We do not expect this pronouncement to have a material effect on how we account for the changes to the terms or conditions of a share-based payment award.

ASU 2017-04, Intangibles – Goodwill and Other (issued January 2017) - To simplify the subsequent measurement of goodwill, Step 2 was eliminated from the goodwill impairment test. In computing the implied fair value of goodwill under Step 2, an entity had to perform procedures to determine the fair value at the impairment testing date of its assets and liabilities (including unrecognized assets and liabilities) following the procedure that would be required in determining the fair value of assets acquired and liabilities assumed in a business combination. Instead, under the amendments in this update, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value. Any loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. Additionally, an entity should consider income tax effects from any tax deductible goodwill on the carrying amount of the reporting unit when measuring the goodwill impairment loss, if applicable. This update also eliminated the requirements for any reporting unit with a zero or negative carrying amount to perform a qualitative assessment and, if it fails that qualitative test, to perform Step 2 of the goodwill impairment test. Therefore, the same impairment assessment applies to all reporting units. An entity is required to disclose the amount of goodwill allocated to each reporting unit with a zero or negative carrying amount of net assets. An entity still has the option to perform the qualitative assessment for a reporting unit to determine if the quantitative impairment test is necessary. A public business entity that is an SEC filer is required to adopt the amendments in this update for its annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2019. We expect that the application of the provisions of this update will not have a material effect on our consolidated financial statements.

ASU 2016-15, Statement of Cash Flows – Classification of Certain Cash Receipts and Cash Payments (issued June 2016) - This pronouncement provides guidance as to the treatment of transactions in a statement of cash flows with respect to eight specific cash flow issues. During 2017 and 2016, we had no transactions of the type cited in the statement and do not anticipate having any such transactions in the foreseeable future. Accordingly, we do not expect this pronouncement to have a material effect on how we present items in our consolidated statement of cash flows.

ASU 2016-13, Financial Instruments – Credit Losses (issued June 2016) - Among the provisions of this ASU is a requirement that assets measured at amortized cost, which includes trade accounts receivable, be presented at the net amount expected to be collected. This pronouncement requires that an entity reflect all of its expected credit losses based on current estimates which will replace the current standard requiring that an entity need consider only past events and current conditions in measuring an incurred loss. We are subject to this guidance effective with consolidated financial statements we issue for the year ending December 31, 2020, and the quarterly periods during that year. We do not expect the amounts we report as accounts receivable in those future periods under this guidance to be materially affected relative to current guidance.

ASU 2016-09, Improvements to Employee Share-Based Payment Accounting (issued March 2016) – This standard discontinued the recording in equity of tax benefits or tax deficiencies that arise from differences between share-based payment compensation expense recorded for financial statement purposes and that expense deductible for tax purposes. This new standard requires that the tax effect of all such differences be recorded and reported in the statement of operations. This standard also requires that tax-related cash flows resulting from share-based payments be reported as operating activities in the statement of cash flows which is a change from the current requirement to present such tax-related items as an inflow from financing activities and an outflow from operating activities. As prescribed by this standard, we adopted it beginning January 1, 2017, and followed it in the preparation of our condensed consolidated financial statements as of September 30, 2017, and for the three months and nine months then ended.

This standard also permits an accounting policy election for the impact of forfeitures on the recognition of expense for share-based payment awards. Forfeitures may be either estimated (as has been the requirement in the past) or recognized when they occur. We elected to continue estimating forfeitures consistent with our existing practices thereby resulting in no change to our application of GAAP for this aspect of computing share-based compensation.

ASU 2016-02, Leases (issued February 2016) - The main difference between existing GAAP and this ASU 2016-02 is the presentation by lessees on their financial statements of lease assets and lease liabilities arising from operating leases. Since this new standard retains the distinction between finance and operating leases, the effect of leases in the statement of operations and the statement of cash flows will be largely unchanged from existing GAAP. Our only lease of significance is our operating lease for our corporate office space for which we will present a right-to-use asset and a lease liability on our consolidated balance sheet when we implement this standard. We are in the process of determining those amounts. In accordance with this standard, we will implement it beginning with our interim and annual consolidated financial statements for 2019. The extent of the effect of this standard on our consolidated financial statements for 2019 and later will depend upon the leases, if any, that we have in effect at that date.

ASU 2015-17, Income Tax: Balance Sheet Classification of Deferred Taxes (issued November 2015) - This pronouncement requires that all deferred tax assets and liabilities for a tax jurisdiction, along with any related valuation allowance, be classified as noncurrent on the balance sheet. We have implemented this ASU in the accompanying condensed consolidated financial statements in the manner described in Note 9 below.

ASU 2014-09, Revenue from Contracts with Customers (issued May 2014) - The core principle of this guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects consideration to which the entity expects to be entitled in exchange for those goods or services. We will implement these new principles effective with consolidated financial statements we issue for the year ending December 31, 2018, and the quarterly periods during that year.

We have assessed the effect of ASU 2014-09 on the amount and timing of revenue we expect to recognize from our business activities in 2018 and later. We do not expect there to be material differences in the amount and timing of revenue we recognize from similar business activities in future periods determined by applying ASU 2014-09 as compared to revenue we would have otherwise recognized by applying GAAP as it existed prior to 2018.

We have determined that the application of ASU 2014-09 will have a material effect on the timing of our recording of expenses resulting from the incremental costs we incur to obtain a contract with a customer to deliver goods and services. These incremental costs consist primarily of sales commissions paid to our sales people and royalties on certain of our products paid to third parties. For periods ended September 30, 2017, and earlier, we recorded the full amount of the sales commission and royalties paid on the full value of an M&S or SaaS contract as an expense on the inception date of the M&S contract. Under ASU 2014-09, we will account for such costs we incur in 2018 and later as follows:

- If these costs are associated with products and services for which we recognize revenue at a point in time (primarily sales of perpetual software licenses and professional services), we will expense these costs in full at the time we recognize that revenue.
- If these costs are associated with services for which we recognize revenue over time (primarily sales of M&S and SaaS subscriptions) for which we believe it is likely that the contract for those services will be renewed for additional terms in the future, provided we deem these costs to be recoverable, we will record these costs as deferred expense asset and amortize that cost to expense as follows:

  - o For the portion of the cost that we determine benefits us primarily only over the term of the specific underlying contract currently in force (such as the term of an M&S contract), we will recognize expense ratably each month over that term.
  - o For the portion of the cost that we determine benefits us over an overall customer relationship that is likely to span a period of time that is longer than an initial contract term (for example, an M&S contract renewed for multiple terms in the future), we will recognize expense ratably monthly over the estimated life of the customer relationship.

Our application of ASU 2014-09 to incremental costs we incur to obtain a contract with a customer will result in us recording, as an asset as of January 1, 2018, a deferred expense of $1.2 million applicable to contracts with customers in effect as of that date. We previously reported this amount as an expense in our consolidated financial statements for periods ending on and before December 31, 2017. We estimate that we will amortize this amount to expense at the rate of approximately $186,000 per quarter beginning in 2018. The incremental costs we incur to obtain contracts with customers during 2018 and later years, and the amount of such costs we record as a deferred expense and amortize to expense in subsequent periods, will depend upon the nature and scope of our future business activities, the nature and mix of the products and services we sell, the compensation plans we have in place for our sales people, and the royalty arrangements we enter into with third parties.

4. Certificates of Deposit

Our certificates of deposit are held at a bank and mature at various dates through December 2021. Certificates of deposit with contractual maturity dates less than one year from the balance sheet date are presented as current assets. Certificates of deposit with contractual maturity dates beyond one year from the balance sheet date are presented as non-current assets.

We have the ability to hold these certificates of deposit until their maturity dates and as of the date of this report intend to do so. We measure these investments on a recurring basis using Level 1 of the fair value hierarchy prescribed by GAAP which results in them being presented at original cost plus accrued interest earned. There is no amortization of original cost associated with our certificates of deposit.

5. Accounts Receivable, Net

We bill our customers and issue them an invoice when we have delivered our goods or services to them. In addition, when our customers agree to purchase or renew M&S services, we bill and invoice our customers at that time, which could be before the date we begin delivering those services. In that event, we exclude from accounts receivable (and from the related deferred revenue, see Note 3) the invoices we have issued for which the M&S services commencement date is in the future and which have not been paid by the customer as of the date of our consolidated financial statements. We continually assess the collectability of our accounts receivable. If we deem it less than probable that we will collect an amount due us, we write-off that balance against our allowance for doubtful accounts. Accordingly, we determine our accounts receivable, net, as follows ($ in thousands):

	September 30, 2017	December 31, 2016
Total invoices issued and unpaid	$ 5,111	$ 6,932
Less: Unpaid invoices relating to M&S contracts with a start date subsequent to the balance sheet date	(358)	(381)
Gross accounts receivable	4,753	6,551
Allowance for sales returns and doubtful accounts	(278)	(263)
Accounts receivable, net	$ 4,475	$ 6,288

6. Capitalized Software Development Costs, Net

Our capitalized software development costs balances and activities were as follows ($ in thousands):

	September 30, 2017	December 31, 2016
Gross capitalized cost	$ 8,716	$ 7,252
Accumulated amortization	(4,913)	(3,509)
Capitalized software development costs, net	$ 3,803	$ 3,743

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Amount capitalized	$ 527	$ 452	$ 1,464	$ 1,298
Amortization expense	484	450	1,404	1,319

	Released Products	Unreleased Products
Gross capitalized amount at September 30, 2017	$ 7,866	$ 850
Accumulated amortization	(4,913)	-
Net	$ 2,953	$ 850
Future amortization expense:		
Three months ending December 31, 2017	465	
Year ending December 31,		
2018	1,421	
2019	781	
2020	286	
Total	$ 2,953	

The future amortization expense of the gross capitalized software development costs related to unreleased products will be determinable at a future date when those products are ready for general release to the public.

7. Deferred Revenue

As described in Note 5 regarding accounts receivable, when our customers agree to purchase or renew M&S services, we bill and invoice our customers at that time which could be before the date we begin delivering those services. In that event, we exclude from deferred revenue (and from the related accounts receivable) the invoices we have issued for which the M&S services commencement date is in the future and which have not been paid by the customer as of the date of our financial statements. Accordingly, we determine our deferred revenue as follows ($ in thousands):

	September 30, 2017	December 31, 2016
Total invoiced for M&S contracts for which revenue will be recognized in future periods	$ 16,277	$ 17,826
Less: Unpaid invoices relating to M&S contracts with a start date subsequent to the balance sheet date	(358)	(381)
Total deferred revenue	$ 15,919	$ 17,445
Deferred revenue, current portion	$ 12,012	$ 13,655
Deferred revenue, non-current portion	3,907	3,790
Total deferred revenue	$ 15,919	$ 17,445

8. Stock Options, Restricted Stock and Share-Based Compensation

We have stock-based compensation plans under which we have granted, and may grant in the future, incentive stock options, non-qualified stock options, and restricted stock to employees and non-employee members of the Board of Directors. Our share-based compensation expense was as follows ($ in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Share-based compensation expense	$ 381	$ 231	$ 1,053	$ 753

Stock Options

We have granted stock options to our officers and employees under long-term equity incentive plans that originated in 2000, 2010 and 2016. During the 2017 quarter and nine months, we granted stock options only under the 2016 plan.

Provisions and characteristics of the options granted to our officers and employees under our long-term equity incentive plans include the following:

The exercise price, term and other conditions applicable to each stock option or stock award granted 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 at market close on that date.
Stock options we issue generally become exercisable ratably over a three-year period, expire ten years from the date of grant, and are exercisable for a period of ninety days after the end of employment.
Upon exercise of a stock option, we issue new shares from the shares of common stock we are authorized to issue.

We currently issue stock-based awards to our officers and employees only under the 2016 plan which authorizes the issuance of up to 5,000,000 shares of common stock for stock-based incentives including stock options and restricted stock awards. As of September 30, 2017, stock-based incentives for up to 4,187,000 shares remained available for issuance in the future under this plan.

We have not previously issued any restricted stock under any of these plans.

Our stock option activity has been as follows:

	Number of Shares	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Term in Years	Aggregate Intrinsic Value (000's)
Outstanding at December 31, 2016	2,407,005	$ 3.00	7.19	$ 2,574
Granted	935,000	$ 3.98		
Forfeited	(394,990)	$ 3.73		
Exercised	(195,800)	$ 2.41		
Outstanding at September 30, 2017	2,751,215	$ 3.27	6.60	$ 1,756
Exercisable at September 30, 2017	1,197,204	$ 2.65	3.64	$ 1,445

Additional information about our stock options is as follows:

	Three Months Ended September 30, 2017	Three Months Ended September 30, 2016	Nine Months Ended September 30, 2017	Nine Months Ended September 30, 2016
Weighted average fair value of options granted	$ 1.94	$ 1.59	$ 1.67	$ 1.65
Intrinsic value of options exercised	$ 9,284	$ 78,607	$ 351,893	$ 261,061
Cash received from stock options exercised	$ 13,440	$ 70,320	$ 471,789	$ 333,329
Number of options that vested	28,570	42,390	430,724	308,736
Fair value of options that vested	$ 44,843	$ 48,374	$ 698,442	$ 469,423
Unrecognized compensation expense related to non-vested options at end of period	$ 1,994,289	$ 1,671,434	$ 1,994,289	$ 1,671,434
Weighted average years over which non-vested option expense will be recognized	2.11	2.27	2.11	2.27

As of September 30, 2017

Range of Exercise Prices	Underlying Shares Outstanding	Options Outstanding: Weighted Average Remaining Contractual Life	Options Outstanding: Weighted Average Exercise Price	Options Exercisable: Number of Underlying Shares	Options Exercisable: Weighted Average Exercise Price
$ 0.85 - $1.43	74,100	2.00	$ 1.09	74,100	$ 1.09
$ 1.47 - $2.32	450,245	2.17	$ 1.83	448,885	$ 1.83
$ 2.34 - $3.52	936,580	6.68	$ 3.27	466,999	$ 3.13
$ 3.53 - $5.30	1,283,290	8.35	$ 3.90	207,220	$ 3.92
$ 5.44 - $5.44	7,000	9.80	$ 5.44	-	$ -
Total options	2,751,215			1,197,204	

We used the following assumptions to determine compensation expense for our stock options using the Black-Scholes option-pricing model:

	Three Months Ended September 30, 2017	Three Months Ended September 30, 2016	Nine Months Ended September 30, 2017	Nine Months Ended September 30, 2016
Expected volatility	50%	53%	49%	56%
Expected annual dividend yield	1.50%	1.50%	1.50%	1.50%
Risk free rate of return	1.95%	1.18%	1.94%	1.46%
Expected option term (years)	6.00	6.00	6.00	6.00

Restricted Stock Awards

Our 2015 Non-Employee Directors Long-Term Equity Incentive Plan ("2015 Directors Plan") provides for the issuance of either stock options or restricted stock awards for up to 500,000 shares of our common stock. Provisions and characteristics of this plan include the following:

- The exercise price, term and other conditions applicable to each stock option or stock award granted are determined by the Compensation Committee of the Board of Directors.
- Restricted stock awards are initially issued as restricted shares with a legend restricting transferability of the shares until the recipient satisfies the vesting provision of the award, which is generally continuing service for one year subsequent to the date of the award, after which time the restrictive legend is removed from the shares.
- Restricted shares participate in dividend payments and may be voted.
- As of September 30, 2017, stock based incentives for up to 260,000 shares remained available for issuance in the future under this plan.

Our restricted stock awards activity has been as follows:

	Number of Shares	Grant Date Fair Value Per Share	Total Fair Value of Shares That Vested
Restricted shares outstanding at December 31, 2016	80,000	$ 3.31	
Shares granted with restrictions	80,000	$ 4.24	
Shares vested and restrictions removed	(80,000)	$ 3.31	$ 320,000
Restricted shares outstanding at September 30, 2017	80,000	$ 4.24	
Unrecognized compensation expense for non-vested shares as of September 30, 2017			
Expense to be recognized in future periods	$ 205,744		
Weighted average number of months over which expense is expected to be recognized	7.3		

9. Income Taxes

The components of our income tax expense (benefit) are as follows ($ in thousands):

	Three months ended September 30,						Nine months ended September 30,					
	2017			2016			2017			2016		
	Current	Deferred	Total	Current	Deferred	Total	Current	Deferred	Total	Current	Deferred	Total
Federal	$ 29	$ 146	$ 175	$ 715	$ (78)	$ 637	$ 733	$ 33	$ 766	$ 1,300	$ (21)	$ 1,279
State	10	9	19	72	(4)	68	109	(5)	104	133	(15)	$ 118
Total	$ 39	$ 155	$ 194	$ 787	$ (82)	$ 705	$ 842	$ 28	$ 870	$ 1,433	$ (36)	$ 1,397

Deferred income taxes on our balance sheet reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of our deferred tax assets and liabilities are as follows ($ in thousands):

	September 30 2017	December 31, 2016
Deferred tax assets:		
Deferred revenue	$ 1,094	$ 1,229
Capital loss carryforward	1,099	1,099
Share-based compensation	619	578
Compensation and benefits	284	278
Texas franchise tax R&D credit	168	153
Allowance for doubtful accounts	94	114
Net operating loss carryforward	47	91
Prepaid expenses not deductible	136	-
Accrued expenses not deductible	64	56
Less Valuation Allowances:		
Capital loss carryforward	(1,099)	(1,099)
Texas franchise tax R&D credit	(168)	(153)
Total deferred tax assets	2,338	2,346
Deferred tax liabilities:		
Intangible assets	1,310	1,289
Depreciation	6	7
Total gross deferred tax liabilities	1,316	1,296
Net deferred tax assets	$ 1,022	$ 1,050

In assessing the realizability of deferred tax assets, we consider whether it is more-likely-than-not that a deferred tax asset will not be realized. Our assessment of the likelihood of having sufficient taxable income in the future to support deduction or utilization of the items giving rise to our deferred tax assets indicates it is more-likely-than-not that we will realize the deferred tax assets listed in the table above.

As of September 30, 2017, we had federal income tax net operating loss carryforwards of $137,000 available to offset future federal taxable income, if any. These carryforwards became available through our acquisition of TappIn, Inc. in 2011. These carryforwards expire in 2030 and 2031.

As of September 30, 2017, we have a federal income tax capital loss carryforward of $3,231,000 which resulted from the reduction of our investments in and notes receivable from CoreTrace Corporation in 2012. We can realize this carryforward to the extent we have capital gains in future periods against which this capital loss can be deducted. We believe it uncertain that we will have sufficient capital gains in the future to support this deduction and accordingly have provided a valuation allowance for the full amount of this carryforward. This carryforward expires in 2017.

As of September 30, 2017, we had Texas R&D tax credit carryforwards of $168,000. We can realize Texas R&D tax credit carryforwards to the extent we have sufficient Texas Franchise Tax in future years. We believe it is uncertain that we will have sufficient Texas Franchise Tax in the future to support utilization of these credits and, accordingly, have provided a valuation allowance for the full amount of these carryforwards. These carryforwards expire in 2034 through 2038.

We claim research and experimentation tax credits, or R&D tax credits, on certain of our tax returns and have included the effect of those credits in our provision for income taxes. A routine examination of our 2008, 2009 and 2010 federal income tax returns conducted and completed by the Internal Revenue Service resulted in the amount of the R&D tax credits allowed for those years being less than the amounts we claimed on those federal income tax returns. If the Internal Revenue Service examines our federal income tax returns for 2011 and later years, we believe they may apply their same criteria to the R&D tax credits we claimed on those tax returns. Accordingly, we believed it more-likely-than-not that the R&D tax credit allowed for those years may be less than the amounts we have claimed. As a result, we maintain a reserve for an uncertain tax position for this matter in the amount of $153,000 as of September 30, 2017.

The aggregate changes in the balance of our gross unrecognized tax benefits were as follows ($ in thousands):

	Nine Months Ended September,	
	2017	**2016**
Balance at beginning of period	$ 121	$ 90
Increases for tax positions related to the current year	16	9
Increases for tax positions related to prior years	16	11
Balance at end of period	$ 153	$ 110

We believe it reasonably possible that we will not recognize any of our unrecognized tax benefits at least through September 30, 2017. If we realized and recognized any of our gross unrecognized tax benefits, such benefits would reduce our effective tax rate in the year of recognition.

We are subject to taxation in the United States and in multiple state jurisdictions. Our federal income tax returns for 2016, 2015, 2014 and 2013 are subject to examination by the Internal Revenue Service. Our amended federal income tax returns for 2012 and 2011 are subject to examination with the amount of any claim for payment of additional taxes limited to the amount by which the tax due on those amended returns was less than the tax due on the returns for those years as originally filed. Our state tax returns are subject to examination for varying periods of time by numerous state taxing authorities. Currently, none of our federal or state income tax returns are under examination.

To the extent they arise, we record interest and penalty expenses related to income taxes as components of other expense in our statement of operations. We incurred no such expenses in the 2017 quarter or the 2016 quarter.

We file state tax returns in various states. The taxes resulting from these filings are included in income tax expense.

Our income tax expense (benefit) reconciles to an income tax expense resulting from applying an assumed statutory federal income rate of 34% to income before income taxes as follows ($ in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2017	**2016**	**2017**	**2016**
Income tax expense (benefit) at federal statutory rate	$ 160	$ 693	$ 828	$ 1,345
Increase (decrease) in taxes resulting from:				
State taxes, net of federal benefit	16	52	67	97
Stock based compensation	37	25	121	60
Other	7	5	19	37
R&D tax credit uncertain tax position (net)	6	10	32	20
Research and development credit	(30)	(55)	(177)	(119)
Domestic production activities deduction	(2)	(25)	(20)	(43)
Income tax expense (benefit) per the statements of operations	$ 194	$ 705	$ 870	$ 1,397

10. Earnings per Common Share

Earnings per share for the periods indicated were as follows ($ in thousands, except per share amounts):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Numerators				
Numerator for basic and diluted earnings per share:				
Net income	$ 276	$ 1,334	$ 1,564	$ 2,558
Denominators				
Denominators for basic and diluted earnings per share:				
Weighted average shares outstanding - basic	21,792	21,122	21,672	21,061
Dilutive potential common shares				
Stock options and awards	455	552	473	579
Denominator for diluted earnings per share	22,247	21,674	22,145	21,640
Net income per common share - basic	$ 0.01	$ 0.06	$ 0.07	$ 0.12
Net income per common share – diluted	$ 0.01	$ 0.06	$ 0.07	$ 0.12

As a result of our implementation of *ASU 2016-09, Improvements to Employee Share-Based Payment Accounting (issued March 2016)*, the estimated proceeds resulting from equity compensation deductible for federal income tax purposes being greater than the associated share-based compensation expense are no longer considered as part of the treasury stock method used in computing diluted earnings per share. This change had no material effect on our earnings per share computations.

11. Dividends

We paid dividends as follows:

	Three Months Ended March 31, 2017	Three Months Ended March 31, 2016	Three Months Ended June 30, 2017	Three Months Ended June 30, 2016	Three Months Ended September 30, 2017	Three Months Ended September 30, 2016
Dividend per share of common stock	$ 0.015	$ 0.015	$ 0.015	$ 0.015	$ 0.015	$ 0.015
Dividend record date	February 23, 2017	February 23, 2016	May 23, 2017	May 23, 2016	August 23, 2017	August 23, 2016
Dividend payment date	March 8, 2017	March 8, 2016	June 8, 2017	June 8, 2016	September 8, 2017	September 8, 2016

12. Commitments and Contingencies

Severance Payments

We have agreements with key personnel that provide for severance payments to them in the event of a change in control of the Company, as defined in those agreements, and their employment is terminated in connection with that change in control. In such event, our aggregate severance payments to those employees would be $2.0 million.

Contractual Obligations

We have an obligation under a contract with a third party to prepay future minimum royalty payments in the amount of $800,000 in September 2018 and $1.2 million in November 2019.

Legal and Regulatory Matters

As previously disclosed in the Company's Current Report on Form 8-K filed on November 15, 2017, on August 9, 2017, a securities class action complaint, Anthony Giovagnoli v. GlobalSCAPE, Inc., et. al., Case No. 5:17-cv-00753, was filed against the Company in the United States District Court for the Western District of Texas. The complaint names as defendants the Company, Matthew Goulet, and James Albrecht for allegedly making materially false and misleading statements regarding, *inter alia*, the Company's previously reported financial statements. The complaint alleges violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and Rule 10b-5 promulgated thereunder. The complaint seeks unspecified damages, costs, attorneys' fees, and equitable relief. On November 6, 2017, the Court appointed a lead plaintiff, who has agreed to file an amended complaint following the completion of the previously disclosed restatement of certain of our financial statements (the "Restatement"). Management intends to vigorously defend against this action. At this time, the Company cannot predict how the courts will rule on the merits of the claims and/or the scope of the potential loss in the event of an adverse outcome. Should the Company ultimately be found liable, the resulting damages could have a material adverse effect on its financial position, liquidity, or results of operations.

On October 20, 2017, the Company received a demand letter from a stockholder seeking the inspection of books and records of the Company pursuant to Section 220 of the Delaware General Corporation Law (the "Section 220 Demand"). This stockholder's stated purpose for the demand is, *inter alia*, to investigate whether the Company's Board of Directors and officers engaged in an illegal scheme to misrepresent the Company's performance by falsely reporting accounts receivable, license revenue, total current assets and total assets, total stockholders' equity, and total liabilities for the year ended December 31, 2016, as well as the Board's independence to consider a stockholder derivative demand. The Company intends to fully respond to the Section 220 Demand to the extent required under Delaware law.

The Board has established a special litigation committee ("Special Litigation Committee") consisting of Dr. Thomas Hicks and Frank Morgan to analyze and investigate claims that could potentially be asserted in stockholder derivative litigation related to facts connected to the claims and allegations asserted in the litigation related to the Restatement and the Section 220 Demand (the "Potential Derivative Litigation"). The Special Litigation Committee will determine what actions are appropriate and in the best interests of the Company, and decide whether it is in the best interests of the Company to pursue, dismiss, or consensually resolve any claims that may be asserted in the Potential Derivative Litigation. The Board determined that each member of the Special Litigation Committee is disinterested and independent with respect to the Potential Derivative Litigation. Among other things, the Special Litigation Committee has the power to retain counsel and advisors, as appropriate, to assist it in the investigation, to gather and review relevant documents relating to the claims, to interview persons who may have knowledge of the relevant information, to prepare a report setting forth its conclusions and recommended course of action with respect to the Potential Derivative Litigation, and to take any actions, including, without limitation, directing the filing and prosecution of litigation on behalf of the Company, as the Special Litigation Committee in its sole discretion deems to be in the best interests of the Company in connection with the Potential Derivative Litigation. The Special Litigation Committee's findings and determinations shall be final and not subject to review by the Board and in all respects shall be binding upon the Company.

As disclosed in a Current Report on Form 8-K filed on March 16, 2018, the Fort Worth, Texas Regional Office of the SEC has opened a formal investigation of issues relating to the Restatement, with which the Company is cooperating fully. At this time, the Company is unable to predict the duration, scope, result or related costs associated with the SEC's investigation. The Company is also unable to predict what, if any, action may be taken by the SEC, or what penalties or remedial actions the SEC may seek. Any determination by the SEC that the Company's activities were not in compliance with existing laws or regulations, however, could result in the imposition of fines, penalties, disgorgement, equitable relief, or other losses, which could have a material adverse effect on the Company's financial position, liquidity, or results of operations.

On May 31, 2018, the Company was served with a subpoena issued by a grand jury sitting in the United States District Court for the Western District of Texas (the "Grand Jury Subpoena"). The Grand Jury Subpoena requests all documents and emails relating to the Company's investigation of the potential improper recognition of software license revenue. The Company intends to fully cooperate with the Grand Jury Subpoena and related investigation being conducted by the United States Attorney's Office for the Western District of Texas (the "U.S. Attorney's Investigation"). At this time, the Company is unable to predict the duration, scope, result or related costs of the U.S. Attorney's Investigation. The Company is also unable to predict what, if any, further action may be taken in connection with the Grand Jury Subpoena and the U.S. Attorney's Investigation, or what, if any, penalties, sanctions or remedial actions may be sought. Any determination by the U.S. Attorney's office that the Company's activities were not in compliance with existing laws or regulations, however, could result in the imposition of fines, penalties, disgorgement, equitable relief, or other losses, which could have a material adverse effect on the Company's consolidated financial position, liquidity, or results of operations.

13. Concentration of Business Volume and Credit Risk

In order to leverage the resources of third parties, we make our products available for purchase by end users through third-party channel distributors even though those end users can also purchase those products directly from us. In the 2017 quarter and 2016 quarter, we earned approximately 14% and 17%, respectively, of our revenue from such sales through our largest, third-party channel distributor. During the 2017 nine months and 2016 nine months, we earned approximately 14% of our revenue from such sales through our largest, third-party channel distributor. As of September 30, 2017, approximately 15% of our accounts receivable were due from this channel distributor with payment for substantially all such amounts having been received subsequent to that date.

14. Segment and Geographic Disclosures

In accordance with FASB ASC Topic 280, Segment Reporting, we view our operations and manage our business as principally one segment. As a result, the financial information disclosed herein represents all of the material financial information related to our principal operating segment.

Revenues derived from customers and partners located outside the United States accounted for approximately 30% and 17% of our total revenues in the 2017 and 2016 quarters, respectively, and 26% and 22% for the 2017 nine months and 2016 nine months respectively. Revenue derived from customers and partners in the United Kingdom were 13% of our revenue during the 2017 quarter. For the 2017 nine months, the 2016 nine months and the 2016 quarter, no individual foreign country accounted for 10% or more of total revenues. We attribute revenues to countries based on the country in which the customer or partner is located. None of our property and equipment was located in a foreign country as of September 30, 2017.

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

This Quarterly Report on Form 10-Q and any documents incorporated by reference herein contain "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 are not of historical fact but describe management's beliefs and expectations. We have identified many of the forward-looking statements in this Quarterly Report by using words such as "anticipate," "believe," "could," "estimate," "may," "expect," "potentially" 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 2016 Form 10-K/A and other documents filed with the Securities and Exchange Commission. Therefore, GlobalSCAPE's actual results of operations and financial condition in the future could differ materially from those discussed in this Quarterly Report.

In the following discussion, our references to the 2017 quarter and the 2016 quarter refer to the three months ended September 30, 2017 and 2016, respectively. Our references to the 2017 nine months and the 2016 nine months refer to the nine months ended September 30, 2017 and 2016, respectively.

Overview

We develop and sell computer software that provides secure information exchange, data transfer and sharing capabilities for enterprises and consumers. We have been in business for more than twenty years having sold our products to thousands of enterprises and more than one million individual consumers globally.

Our primary business is selling and supporting managed file transfer, or MFT, software for enterprises. The brand name of our MFT product platform is Enhanced File Transfer, or EFT. MFT software facilitates the transfer of data from one location to another across a computer network within a single enterprise or between multiple computer networks in multiple enterprises.

We earn most of our revenue from the sale of EFT and products that are part of our EFT platform. We earn revenue from the sale of perpetual software licenses, providing products under SaaS subscriptions, providing maintenance and support services, or M&S, and offering professional services for product implementation, integration and training.

We also sell other products that are synergistic to EFT including Mail Express, WAFS, and CuteFTP. Collectively, these products constitute less than 10% of our total revenue.

We focus on selling our EFT platform products in a business-to-business environment. The majority of the resources we will expend in the future for product research, development, marketing and sales will focus on our EFT platform products. We expect to expend minimal resources developing and selling our other products. We believe our EFT platform products and business capabilities are well-positioned to compete effectively in the market for these products. For a more comprehensive discussion of the products we sell and the services we offer, see *Software Products and Services* below.

As a corporation, we have won multiple awards for performance and reputation, including:

In 2017:

- Named to the CRN 2017 Cloud Partner Program Guide which recognizes partner programs with distinguished margins, sales support and cloud resources
- Received three awards from the 2017 Golden Bridge Awards for distinguished technology achievements which included:
  - § Cloud/SaaS Innovations (Gold Winner) – EFT on Amazon Web Services or Microsoft Azure
  - § Managed File Transfer Innovations (Gold Winner) – The EFT Accelerate module
  - § Governance, Risk and Compliance Innovations (Bronze Winner) – EFT platform
- Received two awards from the Network Product Guide 2017 IT World Awards for achievements in product excellence that included:
  - Governance, Risk and Compliance (Gold Winner) – EFT.
  - Cloud Security (Silver Winner) – EFT Cloud Services.
- Recognized as a Best Place to Work in IT by Computerworld for the fourth consecutive year and sixth time overall.

- Recognized for three Info Security Products Guide 2017 Global Excellence Awards for distinguished achievements in product innovation in categories that included:
  - Innovation in Compliance (Gold Winner) – Enhanced File Transfer.
  - Cloud/SaaS Solutions (Gold Winner) – EFT Cloud Services.
  - BYOD Security (Bronze Winner) – EFT Workspaces.
- Honored as a Best Company to Work for in Texas by Best Companies Group (BCG), Texas Monthly, the Texas Association of Businesses (TAB), and Texas SHRM.
- Received a 5-Star rating in The Channel Company's CRN 2017 Partner Program Guide for the third year in a row.
- Honored with the 2017 Total Rewards & Benefits Excellence Award by the HRO Today Services and Technology Association.
- Selected as a finalist in the 2017 Cybersecurity Product Awards Secure File Transfer: EFT Enterprise.

In 2016:

- Recognized as a 2016 Top Workplace by San Antonio Express-News, marking our sixth recognition as a Top Workplace in San Antonio.
- Earned awards from the Golden Bridge Awards for several categories, including:
  - Enhanced File Transfer (EFT) – Gold Winner in Access Compliance and Risk Management.
  - EFT Cloud Services – Gold Winner in Managed File Transfer.
- Selected for awards from Network Products Guide for the 2016 IT World Awards in several categories, including:
  - EFT Workspaces module, a part of Enhanced File Transfer - Gold Winner in BYOD Security
  - Enhanced File Transfer (EFT) - Bronze Winner in Compliance
  - Mail Express - Bronze Winner in Email Security and Management
- Named as Leader in Secure Information Exchange Services 2016 – Texas by the Corp America 2016 Small Cap Awards.
- Earned awards from *Info Security Guide* in several categories, including:
  - EFT Workspaces – Gold Winner in BYOD Security.
  - Enhanced File Transfer – Silver Winner in Compliance.
  - EFT Cloud Services – Bronze Winner in Cloud Security.
  - Mail Express – Bronze Winner in Email Security and Management.
- Received a 5-Star rating in The Channel Company's CRN 2016 Partner Program Guide for the second year in a row.
- Named by *Texas Monthly* magazine as one of the best companies to work for in Texas for the sixth year in a row with a ranking of #16 in the medium size category.
- Honored as the HR Employer of the Year and Excellence in Engagement Strategy in North America by the HRO Today Services and Technology Association.
- Recognized by the *San Antonio Business Journal* as a 2016 Best Place to Work, making this the fifth time GlobalSCAPE has received this honor.
- Named by *Computerworld* as one of the best companies to work for in IT for the third consecutive year with a ranking of #3 in the small company category.

Key Business Metrics

We review a number of key business metrics on an ongoing basis to help us monitor our performance and to identify material trends which may affect our business. The significant metrics we review are described below.

Revenue Growth

We believe annual revenue growth is a key metric for monitoring our continued success in developing our business in future periods. Given our diverse solution portfolio, we regularly review our revenue mix and changes in revenue across all solutions to identify emerging trends. We believe our revenue growth is primarily dependent upon executing our business strategies which include:

Ongoing innovation of our EFT platform to address the expanding needs of our existing customers and to enhance our products' appeal to new customers.

Licensing, developing and/or acquiring technologies with features and functions that are complementary to and synergistic with our EFT platform so as to expand the breadth of our products offerings.

Enhancing our sales and marketing programs to improve identification of potential demand for our products and to increase the rate at which we are successful in selling our products.

To support product innovation, we continue to enhance our software engineering group and our focus on optimizing the manner in which we assess the development of new technologies, our approach to managing those projects, and the timelines over which we do that work.

We remain alert for attractive opportunities to collaborate with others or perhaps combine other revenue-producing technologies with ours to expand our product offerings and reach. To that end, we continually assess products and services offered by others that might be synergistic with our existing products. We may elect to take advantage of those opportunities through cooperative marketing agreements or licensing arrangements or by acquiring an ownership position in the enterprise offering the opportunity.

In continuing to develop our demand generation activities, we have made and continue to make ongoing changes in sales and marketing including:

Increasing sales staff capacity as needed to address our markets.
Aligning our sales group to enhance its industry and geographic focus.
Implementing new sales and marketing campaigns.
Using third-party digital marketing experts with search engine optimization expertise to enhance our efforts in this area.
Evolving our lead generation programs to increase our sales staff's exposure to potential purchasers.
Enhancing our support of channel partners and engaging them to sell our products through training, orientation and marketing programs.

As part of growing revenue in total, we are focused on increasing license revenue both in terms of absolute dollars and as a percent of total revenue. When we sell our licensed products, we also typically create a recurring revenue stream from M&S since almost all purchasers of our licensed enterprise products also purchase an M&S contract. Most of our M&S contracts are for one year although we also sell multi-year contracts. The customer pays us the M&S fee for the entire term of the agreement at the time the contract begins. We recognize that amount as revenue ratably in future periods over the term of the contract.

We typically experience a high renewal rate for M&S services for our enterprise products so long as a customer continues using the licensed product they purchased from us. As a result, growing license revenue not only contributes to increasing revenue growth at the time the license is sold but also provides a foundation for future recurring revenue as the purchasers of our licensed products renew M&S contracts to support their ongoing product support needs. This pattern of activity can create a cumulative effect for M&S renewals as a result of the cumulative number of licensed software installations sold over multiple years that create M&S renewals in any single year predictably (and in line with our expectations) exceeding the number of new software licenses we sell in a single year. We expect this cumulative effect to continue to grow if we continue to increase enterprise software license revenue in future periods. For these reasons, we expect M&S revenue will remain a substantial part of our total revenue.

See *Comparison of the Consolidated Statement of Operations for the Three Months Ended September 30, 2017 and 2016* and *Comparison of the Consolidated Statement of Operations for the Nine Months Ended September 30, 2017 and 2016* for a discussion of trends in our revenue growth that we monitor using this metric.

In the past, we reported bookings and potential future revenue as key business metrics. With the refinement of our revenue growth key business metric discussed above, we no longer rely on bookings or potential future revenue as key business metrics since we have determined that our revenue growth metric is the primary metric upon which we rely to measure the success of sales and marketing programs and our outlook for revenue in the future.

Adjusted EBITDA (Non-GAAP Measurement)

We utilize Adjusted EBITDA (Earnings Before Interest, Taxes, Total Other Income/Expense, Depreciation, Amortization, other than amortization of capitalized software development costs, and Share-Based Compensation Expense) to provide us a view of income and expenses that is supplemental and secondary to our primary assessment of net income as presented in our condensed consolidated statement of operations and comprehensive income. We use Adjusted EBITDA to provide another perspective for measuring profitability that does not include the effects of the following items:

Expenses that typically do not require us to pay them in cash in the current period (such as depreciation, amortization and share-based compensation);
The cost of financing our business;
The effects of income taxes.

We monitor Adjusted EBITDA to assess our performance relative to our intended strategies, expected patterns of action, and budgets. We use the results of that assessment to adjust our future activities to the extent we deem necessary.

Adjusted EBITDA is not a measure of financial performance under GAAP. It should not be considered as a substitute for net income presented on our condensed consolidated statement of operations and comprehensive income. Adjusted EBITDA has limitations as an analytical tool and when assessing our operating performance. Adjusted EBITDA should not be considered in isolation or without a simultaneous reading and consideration of our consolidated financial statements prepared in accordance with GAAP.

We compute Adjusted EBITDA as follows ($ in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	**2016**	**2017**	**2016**
Net Income	$ 276	$ 1,334	$ 1,564	$ 2,558
Add (subtract) items to determine Adjusted EBITDA:				
Income tax expense	194	705	870	1,397
Interest (income) expense, net	(75)	(28)	(221)	(88)
Depreciation and amortization:				
Total depreciation and amortization	547	513	1,604	1,522
Amortization of capitalized software development costs	(484)	(450)	(1,404)	(1,319)
Stock-based compensation expense	381	231	1,053	753
Adjusted EBITDA	$ 839	$ 2,305	$ 3,466	$ 4,823

See *Comparison of the Consolidated Statement of Operations for the Three Months Ended September 30, 2017 and 2016* and *Comparison of the Consolidated Statement of Operations for the Nine Months Ended September 30, 2017 and 2016* for discussion of the variances between periods in the components comprising Adjusted EBITDA.

Software Products and Services

We develop and sell computer software that provides secure information exchange, file transfer, and file sharing for enterprises and consumers. We have been in business for more than twenty years having sold our products to thousands of enterprises and more than one million individual consumers globally.

Our primary business is selling and supporting MFT software for enterprises. MFT software facilitates the transfer of data from one location to another across a computer network within a single enterprise or between multiple computer networks in multiple enterprises. These transfers may be ongoing, repetitive activities executed by automated software routines that occur without human intervention, or they may be transfers that people create and complete in the absence of automated routines or as a result of ad-hoc, special situations that arise from time-to-time. Examples of enterprise-level activities that rely on MFT software include:

Transfer of transactional information within an enterprise on a repetitive basis from one geographic location to another, such as a transfer of deposit and withdrawal information throughout the day from a branch of a bank to a central data processing center at another location.

Movement of accumulated information within an enterprise from one data processing application to another on a periodic basis, such as a transfer of bi-weekly payroll information from a payroll system that is used to pay employees to a job cost system that is used to manage the cost of a project.
Exchange of information between enterprises to facilitate the completion of one or more business transactions, such as a retailer transmitting inventory purchasing requirements produced by its material requirements planning system to an order entry system at a supplying vendor.

We have multiple revenue streams from our EFT Platform products that include:

Perpetual software licenses under which customers pay us a one-time fee for the right to install our products in their information systems environment on computers they manage and either own or otherwise procure from a cloud services provider, including deploying our products at a cloud services provider in a bring-your-own-license, or BYOL, environment.
Cloud-based, SaaS solutions that we sell on an ongoing subscription basis resulting in our earning a recurring, monthly subscription fee to access the service.
M&S.
Professional services for product installation, integration and training.

In June 2017, we introduced a data integration product that we planned to sell under the brand name Kenetix. We licensed the technology for this product from a third-party. We have experienced issues with the third-party technology and have determined to suspend marketing of the product as we evaluate options and determine whether the licensor can effectively address the issues.

We focus on selling our EFT platform products in a business-to-business environment. The majority of the resources we will expend in the future for product research, development, marketing and sales will focus on our EFT platform. We believe the EFT product platform and its business capabilities are well-positioned to compete effectively in the market for MFT products. For a more comprehensive discussion of the products we sell and the services we offer, see below.

We also sell products that can be synergistic to our EFT platform. These products have capabilities that:

Support information sharing and exchange capabilities using traditional email systems.
Enable enterprise file synchronization and sharing.
Enhance the ability to replicate, share and backup files within a wide area network or local area network, thereby allowing users to access their data at higher speeds than possible with most alternate approaches.
Support file transfers by individuals and small businesses.

We earn most of our revenue from the sale of our EFT Platform products that support business-to-business activities and are strategically focused on selling products in that environment.

We intend to expend the majority of our resources in the future for product research and development, marketing, and sales in a manner that concentrates on the business-to-business market. We believe our products and business capabilities are well-positioned to compete effectively in that market.

Some of our products support consumer-oriented file transfers and file sharing. Even though these products are profitable on an overall basis, we anticipate the future resources we will expend related to products sold to consumers and the associated revenue we earn from those products will continue to be a minor part of our business.

The following discussion presents a summary description of our specific products and solutions.

Managed File Transfer – Enhanced File Transfer Platform

Enhanced File Transfer, or EFT, is the brand name of our core MFT product platform. Our EFT platform products received multiple industry awards in compliance categories in 2017 including the 2017 Golden Bridge awards, the Network Product Guide’s 2017 IT World Awards, and the 2017 Info Security Products Guide Global Excellence Awards.

The EFT platform provides users the ability to securely transmit data from one location to another using any number of files of any size or configuration. It facilitates management, monitoring, and reporting on file transfers and delivers advanced data transfer workflow capabilities to move data and information into, out of, and throughout an enterprise. Notable features and capabilities of the EFT platform include:

- State-of-the-art, enterprise-level security when transferring information within or between computer networks as well as for collaboration with business partners, customers, and employees. EFT provides automation that supports effective integration of back-end systems. It has built-in regulatory compliance, governance, and visibility controls to provide a means of safely maintaining information. EFT offers a high level of performance and scalability to support operational efficiency and maintain business continuity. Administrative tools are provided at various levels of granularity to allow for complete control and monitoring of file transfer activities.
- Transmission of critical information such as financial data, medical records, customer files, vendor files, personnel files, transaction activity, and other similar documents between diverse and geographically separated network infrastructures while supporting a range of information protection approaches to meet privacy and other security requirements. In addition to enabling the secure, flexible transmission of critical information using servers, desktop, and notebook computers and a wide range of network-enabled mobile devices, our products also provide customers with the ability to monitor and audit file transfer activities.
- Compliance with government regulations and industry standards relating to the protection of information while allowing users to reduce information systems and technologies costs, increase efficiency, track and audit transactions, and automate processes. Our solutions also provide data replication, acceleration of file transfer, sharing/collaboration, and continuous data backup and recovery.

The EFT platform provides a common, scalable MFT environment that accommodates a broad family of accompanying modules to provide enterprises with increased security, automation, and performance when compared to traditional FTP-based and e-mail delivery systems. Various optional modules allow users to select the solution configuration most applicable to their requirements for auditing and reporting, encryption, ad hoc and web-based file transfers, operability in or through a DMZ network, and integration with back-end business processes, including workflow automation capabilities.

Since 2015, we have released new versions of our EFT platform and new modules which added several enhancements and capabilities including:

- Advanced Authentication Module (AAM) that increases the interoperability of EFT with multiple authentication methods. AAM provides a single source of authentication across a customer’s infrastructure.
- EFT Workspaces, which is a file-sharing module that allows employees to create their own groups and assign permissions for those groups, much like a virtual data room, to provide access to files for which they themselves have access on the EFT server. This functionality is accomplished without compromising the security, control, and governance of those files.
- An EFT Workspaces Microsoft® Outlook plugin that provides secure ad hoc file transfers via email, providing customers with the reporting features in EFT and combining them with the simplicity and security of sending files with Mail Express. The integration of these two products takes the best features in Mail Express and incorporates them into EFT.
- Accelerate, which is an accelerated file transfer module that boosts the speed and efficiency of secure data transfers and allows for the fast transfer of large files over disparate geographic distances.
- Improved facilitation of PCI DSS version 3.0 compliance with updates to data security protocols.
- Enhanced and expanded event rule functionality which improves the ability to integrate our products with client business processes and backend systems.
- Support for active-active high availability in Amazon Web Services to accommodate for bursts or dips in network traffic, and provide improved resiliency, scalability and flexibility.
- Enhanced security features supporting improved compliance with Health Insurance Portability and Accountability Act of 1996 (or HIPAA) guidelines.
- EFT Insight, which is a new reporting platform that provides enhanced intelligence and analytics regarding file transfer activity that occurs within EFT.

We expect to continue to enhance the EFT platform with capabilities that improve its speed and responsiveness of performance, provide additional administration flexibility supporting cross-platform implementation with our DMZ Gateway solution, offer more robust reporting capabilities, and provide additional language support.

Most EFT customers choose to purchase a perpetual software license for a one-time fee paid at the time of purchase and under which they install the software on equipment they own and/or manage. In almost all cases, they also purchase ongoing M&S for which they pay us a recurring, annual amount that typically is 20% to 30% of the price of the software license.

If a customer prefers to use the capabilities of EFT in a SaaS fashion, we offer EFT Cloud Services for a monthly subscription fee. The EFT platform delivered in this manner has the same features and functionality as our EFT platform installed at a customer site. EFT Cloud Services allows users to reduce their upfront cost and achieve other recognized benefits of cloud-based managed file transfer subscription solutions including strong service level agreements for information technologies infrastructure reliability and performance. EFT can also be deployed for customers, on a BYOL basis, in their infrastructures running through Amazon Web Services or Microsoft Azure. We have also initiated offering EFT Enterprise direct to buyers on a pre-deployed basis in the Amazon Web Services and Microsoft Azure Marketplaces.

Subscription revenue from EFT Cloud Services or EFT on AWS or Azure, which is on a BYOL basis or pre-deployed within either infrastructure provider’s marketplace, is increasing but is not yet a material portion of the total revenue from our EFT platform.

Secure Information Sharing and Exchange Solution – Mail Express

Mail Express is a solution that provides secure information sharing and exchange capabilities leveraging traditional email workflow. It is a stand-alone product installed in a client-server environment that allows users to send and receive secure, encrypted e-mail and attachments of virtually unlimited size. Mail Express was a Bronze Winner in Email Security and Management by Network Products Guide’s 2016 IT World Awards.

To broaden the appeal and capabilities of Mail Express, we continue to develop and add functionality that integrates the features of Mail Express into the EFT platform through the Workspaces Microsoft® Outlook Plugin. This integration takes the superior control, visibility and monitoring capabilities of the EFT platform and makes them available to administrators and users in an email environment. The Workspaces Microsoft® Outlook Plugin combines the technology and features available in Mail Express with the functionality of Workspaces and integrates them directly into EFT Enterprise.

Wide Area File Services Solution - WAFS

Our WAFS software product uses data synchronization to further enhance the ability to replicate, share and backup files within a wide area network or local area network thereby allowing users to access their data at higher speeds than possible with most alternate approaches. The software uses byte-level differencing technology to update changes to files with minimal impact on network bandwidth while also ensuring that files are never overwritten, even if opened by other remote users. Other key features of WAFS include native file locking, replication to multiple locations simultaneously, adherence to access control list file permissions, and full UTF-8 support.

We will continue to offer WAFS as a stand-alone product and provide M&S services to customers who purchased WAFS in the past and who purchase it in the future. We do not expect to expend significant resources in the future expanding the features and capabilities of WAFS.

File Transfer Solution for Consumers - CuteFTP

CuteFTP is our original product introduced in 1996. It is a file transfer program generally used by individuals and small businesses. It remains popular today and generates incremental revenue for us at a relatively low cost.

CuteFTP continues to have significant brand recognition in the market. Our current CuteFTP Version 9 introduced several notable new features including:

- Support for Unicode (UTF-8) characters that allows greater international use.
- Web Distributed Authoring and Versioning (WebDAV) support to facilitate collaboration between users in editing and managing documents and files stored on World Wide Web servers.

Version 9 simplified our CuteFTP product line by consolidating all the features of our previous multi-product CuteFTP product line for Windows operating systems into this single version. We continue to offer CuteFTP Version 3.1 software for Mac platforms. We believe current versions of CuteFTP appeal to users wanting features more robust than offered in free alternatives such that it will be a product competitive in the marketplace for the foreseeable future.

We will continue selling CuteFTP as a stand-alone product and providing M&S services to customers who purchased CuteFTP in the past and who purchase it in the future but we will not invest significantly in marketing the product. We do not expect to expend significant resources in the future expanding the features and capabilities of CuteFTP.

Professional Services

We offer a range of professional services to complement our on-premises and SaaS solutions. These professional services include system integration, solution "quickstart" implementations, business process and workflow, policy development, education and training, and solution health checks. In addition, we may provide longer-term engineering services, including supporting multi-year contracts, if necessary, to support certain solution implementations and integrations.

Maintenance and Support

We offer M&S contracts to licensees of all of our software products. These M&S contracts entitle the licensee to software upgrades and technical support services in accordance with the terms of our M&S contract. Standard technical support services are provided via email and telephone during our regular business hours. For certain of our products, we offer a Platinum M&S contract which provides access to emergency technical assistance 24 hours per day, 7 days a week.

Most of our M&S contracts are for one year although we also sell multi-year contracts. M&S is purchased by substantially all buyers of our EFT platform as well as by many customers who purchase our other products. Customers with M&S pay us a recurring, annual amount that is typically 20% to 30% of the software license price. A majority of our customers with M&S contracts renew them each year.

Employees

Our number of employees is as follows:

	September 30,	
Department	**2017**	**2016**
Sales and Marketing	56	44
Engineering	30	28
Professional Services	6	12
Customer Support	23	22
Management and Administration	19	20
Total	134	126

Solution Perspective and Trends

The components of our revenue are as follows ($ in thousands):

	Three Months Ended September 30, 2017		2016		Nine Months Ended September 30, 2017		2016	
	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
Revenue By Type								
License	2,488	30.3%	3,322	38.4%	7,768	30.9%	8,381	34.7%
M&S	5,360	65.2%	4,637	53.5%	15,702	62.5%	13,635	56.5%
Professional Services	368	4.5%	702	8.1%	1,652	6.6%	2,107	8.7%
Total Revenue	$ 8,216	100.0%	$ 8,661	100.0%	$ 25,122	100.0%	$ 24,123	100.0%
Revenue by Product Line								
License								
EFT Platform	$ 2,388	96.0%	$ 3,060	92.1%	$ 7,338	94.5%	$ 7,579	90.4%
Other	100	4.0%	262	7.9%	430	5.5%	802	9.6%
Total License Revenue	2,488	100.0%	3,322	100.0%	7,768	100.0%	8,381	100.0%
M&S								
EFT Platform	5,100	95.1%	4,329	93.4%	14,893	94.8%	12,695	93.1%
Other	260	4.9%	308	6.6%	809	5.2%	940	6.9%
Total M&S Revenue	5,360	100.0%	4,637	100.0%	15,702	100.0%	13,635	100.0%
Professional Services (all EFT Platform)	368	100.0%	702	100.0%	1,652	100.0%	2,107	100.0%
Total Revenue								
EFT Platform	7,856	95.6%	8,091	93.4%	23,883	95.1%	22,381	92.8%
Other	360	4.4%	570	6.6%	1,239	4.9%	1,742	7.2%
Total Revenue	$ 8,216	100.0%	$ 8,661	100.0%	$ 25,122	100.0%	$ 24,123	100.0%

Our total revenue decreased 5.1% for the 2017 quarter and increased 4.1% for the 2017 nine months. Revenue from our EFT platform products decreased 2.9% for the 2017 quarter and increased 6.7% for the 2017 nine months. Revenue from our other product lines decreased for both the 2017 quarter and the 2017 nine months, which is consistent with our expectations as discussed below. For a more detailed discussion of these revenue trends, see *Comparison of the Consolidated Statement of Operations for the Three Months Ended September 30, 2017 and 2016* and *Comparison of the Consolidated Statement of Operations for the Nine Months Ended September 30, 2017 and 2016.*

We earn revenue primarily from the following activities:

- License revenue from sales of our EFT platform products that we deliver as either perpetually-licensed software installed at the customer's premises, for which we earn the full amount of the license revenue at the time the license is delivered, or as a cloud-based service under our EFT Cloud Services brand delivered using a SaaS model, for which we earn monthly subscription revenue as these services are delivered.
- License revenue from sales of our Mail Express, WAFS and CuteFTP products that are installed at the customer's premises under a perpetual license for which we earn the full amount of the license revenue at the time the license is delivered.
- M&S revenue under contracts to provide ongoing product support and software updates to our customers who have purchased license software which we recognize ratably over the contractual period, which is typically one year, but can be up to three years.
- Professional services revenue from a variety of implementation and integration services, as well as delivery of education and training associated with our solutions, which we recognize as the services are performed and accepted by the client.

We earn most of our revenue from the sale of our EFT platform products and the associated M&S and professional services related to those products. With our core competency being in products that address the MFT market, we believe our EFT platform products provide the best opportunity for our future growth. Accordingly, expansion of the capabilities of the EFT platform will be our primary focus in the future. While we will continue to sell and support our other products for the foreseeable future, they will not be an area of emphasis for us going forward.

We believe that continuing to offer licensed products installed on-premises for which we recognize revenue up-front and that carry with them a recurring M&S revenue stream is important to our future success. At the same time, we recognize that a migration of capabilities to a SaaS platform is attractive to a growing number of customers. We have, and have had for quite some time, the capabilities in place to deliver our EFT platform in that manner through our EFT Cloud products. While our SaaS revenue is not yet a material component of our total revenue, a migration by our customers to our EFT Cloud products could create some near-term decreases in the growth rate of license revenue, and may result in similar decreases in future periods, because it typically takes approximately 24 to 36 months of SaaS revenue to yield total revenue equivalent to that realized up-front from the sale of a license for an on-premise installation.

In mid-2016, we reviewed the allocation of our product research and development resources across all of our products. As a result of that review, we decided to adjust that allocation to focus most of our engineering resources involved in product research and development on our EFT platform products in order to expand their capabilities and to remain positioned to be responsive to the evolving needs of our customers.

We have developed and offered individual product lines throughout our history that include EFT, Mail Express, WAFS, and CuteFTP. Each of these product lines addresses distinct needs in the marketplace. While some customers purchase products from more than one of these product lines, for the most part, customers in a particular market or vertical have needs that are addressed by only one of these products and, therefore, purchase only that product. While we will continue to offer Mail Express as a stand-alone product for the time being, the engineering resources we allocate to this technology will focus on migrating it to becoming an integrated component of our EFT platform. We do not expect to expend significant resources in the future on expanding the features and capabilities of WAFS and CuteFTP although we will continue to sell those products and support them.

To support product innovation, we continue to enhance our software engineering group and our focus on optimizing the manner in which we assess the development of new technologies, our approach to managing those projects, and the timelines over which we do that work. In continuing to develop our demand generation activities, we have made and continue to make ongoing changes in sales and marketing including:

- Increasing sales staffing and capabilities as needed to address our markets.
- Aligning our sales group to enhance its industry and geographic focus.
- Implementing new sales and marketing campaigns.
- Evolving our lead generation programs to increase our sales staff’s exposure to potential purchasers.
- Enhancing our support of channel partners and engaging them to sell our products through training, orientation and marketing programs.

Liquidity and Capital Resources

Our total cash, cash equivalents, certificates of deposit and working capital positions were as follows ($ in thousands):

	September 30, 2017	December 31, 2016
Cash and cash equivalents	$ 11,447	$ 8,895
Short term certificates of deposit	2,768	2,754
Long term certificates of deposit	12,960	12,779
Total cash, cash equivalents and certificates of deposit	$ 27,175	$ 24,428
Current assets	$ 20,109	$ 18,760
Current liabilities	(15,397)	(16,188)
Working capital	$ 4,712	$ 2,572

At September 30, 2017, our certificates of deposit in current assets mature on various dates through October 2017. Our long term certificates of deposit mature after June 30, 2018, on various dates through December 2021.

When assessing our liquidity and capital resources, we consider the following factors:

- We may access and monetize our certificates of deposit at any time without risk of loss of the original amounts invested. If we were to redeem these certificates of deposit prior to their maturity, we may incur a penalty and forfeit certain amounts of accrued interest, but we view such amounts as not material.
- Deferred revenue, unlike the other liability components of our working capital, is an obligation we will satisfy by providing services in the future to our customers as part of our ongoing operating activities from which we have historically generated cash flow. Our deferred revenue does not involve a disbursement of cash as a direct payment of that liability although we will incur operating expenses in the future as we deliver those M&S services.

Our capital requirements principally relate to our need to fund our ongoing operating expenditures, which are primarily related to employee salaries and benefits. We make these expenditures to enhance our existing products, develop new products, sell those products in the marketplace and support our customers after the sale.

We rely on cash and cash equivalents on hand and cash flows from operations to fund our operating activities and believe those items will be our principal sources of capital for the foreseeable future. If our revenue declines and/or our expenses increase, our cash flow from operations and cash on hand could decline.

We plan to expend significant resources in the future for research and development of our products and expansion and enhancement of our sales and marketing activities. If sales decline or if our liquidity is otherwise under duress, we could substantially reduce personnel and personnel-related costs, reduce or substantially eliminate capital expenditures and/or reduce or substantially eliminate certain research and development and sales and marketing expenditures. We may also sell equity or debt securities or enter into credit arrangements in order to finance future acquisitions or licensing activities, to the extent available.

Cash provided or used by our various activities consisted of the following ($ in thousands):

	Cash Provided (Used) During the Nine Months Ended September 30,	
	2017	**2016**
Operating activities	$ 4,773	$ 3,624
Investing activities	(1,713)	(1,466)
Financing activities	(508)	(622)

Our cash provided by operating activities increased during the 2017 nine months compared to the 2016 nine months primarily due to the following factors:

- Accounts receivable decreased $1.8 million in the 2017 nine months compared to increasing $2.2 million in the 2016 nine months due in part to a large M&S renewal that was still outstanding at the end of the 2016 nine months with no similar transaction in the 2017 nine months.
- Normal variations in our payments to vendors that contributed to our accounts payable increasing $448,000 in the 2017 nine months compared to decreasing $237,000 in the 2016 nine months.
- Normal variations in the timing of our payroll payment dates relative to the date of the condensed consolidated balance sheet presented as a part of our condensed consolidated financial statements that contributed to accrued expenses increasing $404,000 in the 2017 nine months compared to a decreasing $197,000 in the 2016 nine months.

Offset by:

A decision by the U.S. Army to consolidate certain of their operations resulting in the non-renewal of their M&S contract combined with our transition during 2017 to emphasizing selling one-year instead of multi-year M&S contracts primarily due to our desire to reduce the effects of discounts that customers expect from a multi-year contract. Since our customers pay us for the full M&S term at the beginning of the contract, the up-front cash we receive at the time we sell a single-year contract is less than the up-front cash we receive when we sell a multi-year contract. At the same time, we potentially enhance our future M&S revenue due to less discounting. These factors contributed to our deferred revenue decreasing $1.5 million in the 2017 nine months compared to increasing $770,000 in the 2016 nine months.

Higher payments for federal income taxes in the 2017 nine months as compared to the 2016 nine months. During the 2016 nine months, we did not make any federal income tax payments due to our application of overpayments from the 2015 tax year to 2016 tax year. We did not have overpayments in the 2016 tax year to apply to the 2017 tax year. As a result, we made federal income tax payments during the 2017 nine months for which there were no similar payments during the 2016 nine months. These factors contributed to our federal income taxes payable decreasing $759,000 during the 2017 nine months as compared to increasing $600,000 during the 2016 nine months.

The amount of cash we used for investing activities during the 2017 nine months increased compared to the 2016 nine months due primarily to:

An increase in our work to develop new software products and services which resulted in the amount of software development costs we capitalized being higher during the 2017 nine months than during the 2016 nine months.
An increase in purchases of property and equipment resulting from a reconfiguration of certain of our office space.

Financing activities used less cash during the 2017 nine months than during the 2016 nine months primarily due to an increase in proceeds from stock option exercises as a result of more option holders electing to exercise their options.

Contractual Obligations and Commitments

As of September 30, 2017, our contractual obligations and commitments consisted primarily of the following items:

An obligation to deliver services in the future to satisfy our right to earn our deferred revenue of $15.9 million. Those future services primarily relate to our obligations under M&S contracts. We will recognize this deferred revenue as revenue over the remaining life of those contracts which generally ranges from one to three years. Deferred revenue, unlike the other liability components of our working capital, is an obligation we will satisfy by providing services in the future to our customers as part of our ongoing operating activities from which we have historically generated cash flow. Our deferred revenue does not involve a disbursement of cash as a direct payment of that liability although we will incur operating expenses in the future as we deliver those M&S services.
We have an obligation under a contract with a third party to prepay future minimum royalty payments in the amount of $800,000 in September 2018 and $1.2 million in November 2019.
Trade accounts payable and accrued liabilities which include our contractual obligations to pay software royalties to third parties that vary in amount based on our sales volume of products upon which royalties are payable.
Operating lease for our office space.
Federal and state taxes.

Our non-cancellable, contractual obligations at September 30, 2017 consisted primarily of the following ($ in thousands):

	Amounts Due for the Period				
		Fiscal Years			
	Three Months Ending December 31, 2017	**2018**	**2019**	**Thereafter**	**Total**
Prepaid royalty fees	$ -	$ 800	$ 1,200	$ -	$ 2,000
Operating leases	90	360	120	-	570
Total	$ 90	$ 1,160	$ 1,320	$ -	$ 2,570

As of September 30, 2017, we had no interest-bearing obligations in the form of loans, notes payable or similar debt instruments.

We plan to continue to expend significant resources in the future on product development, sales and marketing which may require that we enter into additional contractual arrangements and use our cash to acquire or license technology, intellectual property, products, services or businesses related to our current business strategy.

Comparison of the Consolidated Statement of Operations for the Three Months Ended September 30, 2017 and 2016

	Three Months Ended September 30, 2017	Three Months Ended September 30, 2016	$ Change
	$ in thousands		
Total revenues	$ 8,216	$ 8,661	$ (445)
Total cost of revenues	1,573	1,617	(44)
Gross profit	6,643	7,044	(401)
Operating expenses			
Sales and marketing	3,079	2,880	199
General and administrative	2,575	1,634	941
Research and development	594	519	75
Total operating expenses	6,248	5,033	1,215
Income from operations	395	2,011	(1,616)
Other income	75	28	47
Income before income taxes	470	2,039	(1,569)
Income tax expense	194	705	(511)
Net income	$ 276	$ 1,334	$ (1,058)

In the discussion below, we refer to the three months ended September 30, 2017, as the "2017 quarter" and the three months ended September 30, 2016, as the "2016 quarter". The percentage changes cited in our discussions are based on the 2017 quarter amounts compared to the 2016 quarter amounts.

Revenue. The components of our revenues were as follows ($ in thousands):

	Three Months Ended September 30, 2017		2016	
	Amount	Percent of Total	Amount	Percent of Total
Revenue By Type				
License	2,488	30.3%	3,322	38.4%
M&S	5,360	65.2%	4,637	53.5%
Professional Services	368	4.5%	702	8.1%
Total Revenue	$ 8,216	100.0%	$ 8,661	100.0%
Revenue by Product Line				
License				
EFT Platform	$ 2,388	96.0%	$ 3,060	92.1%
Other	100	4.0%	262	7.9%
	2,488	100.0%	3,322	100.0%
M&S				
EFT Platform	5,100	95.1%	4,329	93.4%
Other	260	4.9%	308	6.6%
	5,360	100.0%	4,637	100.0%
Professional Services (all EFT Platform)	368	100.0%	702	100.0%
Total Revenue				
EFT Platform	7,856	95.6%	8,091	93.4%
Other	360	4.4%	570	6.6%
	$ 8,216	100.0%	$ 8,661	100.0%

Our total revenue decreased 5.1%. Revenue from our EFT platform products and services decreased 2.9%. Revenue from our other products that consist of Mail Express, WAFS, CuteFTP, and TappIn decreased to comprise 4.4% of our total revenue which is a trend that is in line with our ongoing de-emphasis of those products.

EFT Platform Products

License revenue from our EFT platform products decreased 22%. During the 2017 quarter, we were transitioning to new leadership of our sales team as a result of certain of our personnel being involved in improper arrangements with customers that have been the subject of the investigation by the Audit Committee of the Board of Directors that we first announced in August 2017. This transition caused a temporary loss in sales momentum while this new leadership became familiar with our existing sales programs and began to design and implement new and enhanced initiatives.

To improve our ability to successfully sell existing EFT platform products as well as new products produced by our software engineering team, we continued to make, and will continue to make, ongoing changes in sales and marketing personnel and activities including:

- Increasing sales staffing and capabilities as needed to address our markets.
- Aligning our sales group to enhance its industry and geographic focus.
- Implementing new sales and marketing campaigns.
- Evolving our lead generation programs to increase our sales staff’s exposure to potential purchasers.
- Enhancing our support of channel partners and engaging them to sell our products through training, orientation and marketing programs.

M&S revenue from our EFT platform products increased 18% primarily due to:

- Ongoing license sales since a majority of license sales are accompanied by an M&S contract. The change in M&S revenue typically lags behind the related change in license revenue because license sales are recognized as revenue in full in the period the license is delivered while the related M&S revenue is recognized in future periods as those services are delivered. As a result, growth in M&S revenue is typically tied to the license sales growth we experienced in earlier periods.
- Sustaining high renewal rates of M&S contracts by customers who initially purchased these services in earlier periods. We believe these renewals result from our programs designed to provide high-quality and responsive M&S services to our customers.

Our professional services revenue was $334,000 less for the 2017 quarter compared to the 2016 quarter, which is a decrease of 48%. This decrease was partially related to the decreased license revenue from our EFT platform since there generally is a direct relationship between the licenses our customers purchase and their need for professional services. In addition, subsequent to the 2016 quarter, we had a backlog of professional services engagements that arose from software sales in previous periods. We worked down that backlog during the 2016 quarter which resulted in our professional services revenue being higher than typical for the 2016 quarter relative to software license revenue. During the 2017 quarter, we also began to focus more on selling pre-packaged professional services (as compared to customized services) which, while yielding lower total revenue from professional services, allowed us to deliver professional services more efficiently and without the unpredictability (and related costs) that can arise with customized services.

When we sell our licensed products, we also typically create a recurring revenue stream from M&S since almost all purchasers of our licensed products also purchase an M&S contract. In general, and depending upon the level of M&S a customer purchases, this recurring revenue stream is 20% to 30% per year of the price of the underlying software license to which the M&S relates.

Our M&S contracts are typically for one year, with some customers buying two or three year contracts. The customer pays us the M&S fee for the entire term of the agreement at the time the contract begins. We recognize that amount as revenue ratably in future periods over the term of the contract.

We typically experience a high renewal rate for M&S services for our enterprise products so long as a customer continues using the licensed product they purchased from us. As a result, growing license revenue not only contributes to increasing revenue growth at the time the license is sold but also provides a foundation for future recurring revenue as the purchasers of our licensed products continually renew M&S contracts to support their ongoing product support needs. This pattern of activity can create a cumulative effect for M&S renewals as a result of the cumulative number of licensed software installations sold over multiple years that create M&S renewals in any single year predictably (and in line with our expectations) exceeding the number of new software licenses we sell in a single year. We expect this cumulative effect to continue to grow if we continue to increase enterprise software license revenue in future periods.

Other Products

In mid-2016, we announced that our focus would be on our EFT platform products. At the same time, we announced that while we would continue selling our Mail Express, WAFS, CuteFTP, and TappIn products that collectively constitute less than 10% of our total revenue, in the future we would de-emphasize these stand-alone products that are not part of our EFT platform. Accordingly, during the second half of 2016, we began to curtail our product development and engineering resources for these products and significantly reduced our sales and marketing activities supporting them. As a result, our license and M&S revenue from those products collectively declined 36.8% in the 2017 quarter compared to the 2016 quarter. Our future focus will be on our EFT platform such that we expect to see a continuing decline in revenue from these other products although we do expect them to continue to produce a modest contribution margin that contributes to our future profitability.

Cost of Revenues. These expenses are associated with the production, delivery and support of our products and services. We believe it is most meaningful to view cost of revenues as a percent of the revenues to which those costs relate since many of those costs are variable relative to revenue.

Cost of license revenue consists primarily of:

- Amortization of capitalized software development costs we incur when producing our software products. This amortization begins when a product is ready for general release to the public and generally is an expense that is not directly variable relative to revenue.
- Royalties we pay to use software developed by others for certain features of our products that is generally an expense that is variable relative to revenue.
- Fees we pay to third parties who provide services supporting our SaaS and cloud-based subscription solutions that generally have components that are both variable and not variable relative to revenue.

Cost of M&S revenue and cost of professional services revenue consist primarily of salaries and related costs of our employees and third parties we use to deliver these services.

Cost of software license revenue decreased 16% and as a percent of software license revenue was 29% in the 2017 quarter compared to 26% in the 2016 quarter. These fluctuations were primarily due to:

- A decrease in royalties we pay to third-parties to use their technology for certain components of our products. The amount of royalties we pay relative to our aggregate revenue fluctuates based on the mix of products we sell. During the 2017 quarter, more of the products we sold were not subject to a royalty payment than was the case during the 2016 quarter. This product mix will cause the cost of software license revenue to ebb and flow based upon our customers' unique demands such that we do not view this decrease in royalties as unusual or indicative of a long-term trend.
- A decrease in expense related to two non-recurring engineering projects during the 2016 quarter with no similar transaction in the 2017 quarter.

Cost of M&S revenue as a percent of M&S revenue was substantially unchanged. Cost of revenue for M&S in absolute dollars increased by 23% due to an increase in M&S revenue. The cost of delivering M&S can vary slightly up or down from period-to-period, but we believe such changes are typically not indicative of long term trends or permanent changes in our cost of delivering M&S. Our gross margin on these services generally remains greater than 90% as a result of a consistent application of our customer support delivery protocols and practices.

Cost of professional services revenue exceeded revenue from professional services in the 2017 quarter due mainly to the one-time cost of extending the time allowed to exercise certain stock options to some of our former employees.

Sales and Marketing. We believe it most meaningful to view cost of sales and marketing as a percent of revenues since many of those costs, particularly sales commissions, are variable relative to revenue. These expenses were 37% of total revenue for the 2017 quarter compared to 33% of total revenue for the 2016 quarter. In absolute dollars these expenses increased 7%. These variations were primarily due to:

- Increasing the size of our sales, marketing and product strategy teams and increased compensation rates due to competitive demands in the marketplace.
- Increased marketing activities related to competitive intelligence and channel development.
- Increased sales lead generation activities.

General and Administrative. These expenses increased 58% primarily due to:

Increased professional fees and related expenses associated with the previously disclosed internal investigation, the restatement of certain of our financial statements and related litigation.
Increased salaries and share-based compensation expense.

Offset by:

A decrease in severance expense as a result of the 2016 quarter including severance expense related to the resignation of our chief executive officer during the second fiscal quarter of 2016, which is an expense we did not incur in the 2017 quarter.

Research and Development. The overall profile of our research and development, or R&D, activities was as follows ($ in thousands):

	Three Months Ended September 30,	
	2017	2016
R&D expenditures expensed	$ 594	$ 519
R&D expenditures capitalized	527	452
Total R&D expenditures (non-GAAP measurement)	$ 1,121	$ 971

Our R&D expenditures expensed increased 14% and our R&D expenditures capitalized increased 17%. These results were due to our planned, continued increase in our capacity to develop new products as well as maintain our existing products and research technologies available from third-parties. We did this through a combination of increasing our engineering headcount and engaging additional third-party resources on a flexible basis as needed.

Total resources expended for R&D set forth above as total R&D expenditures serves to illustrate our total corporate efforts to improve our existing products and to develop new products regardless of whether or not our expenditures for those efforts were expensed or capitalized. Total resources expended for R&D is not a measure of financial performance under GAAP and should not be considered a substitute for R&D expense (set forth above as R&D expenditures expensed) and capitalized software development costs (set forth above as R&D expenditures capitalized) individually. While we believe the non-GAAP, total resources expended for R&D amount provides useful supplemental information regarding our overall corporate product improvement and new product creation activities, there are limitations associated with the use of this non-GAAP measurement. Total resources expended for R&D is a non-GAAP measure not prepared in accordance with GAAP and may not be comparable to similarly titled measures of other companies since there is no standard for preparing this non-GAAP measure. As a result, this non-GAAP measure of total resources expended for R&D has limitations and should not be considered in isolation from, or as a substitute for, R&D expense and capitalized software development cost individually.

Interest Income (Expense), Net. Interest income (expense), net consists primarily of interest income earned on certificates of deposit. The increase in this amount was due primarily to enhanced investment of our cash beginning in the second half of 2016 to earn a higher rate of interest.

Income Taxes. Our effective tax rate was 41% for the 2017 quarter and 35% for the 2016 quarter. These rates differed from a federal statutory tax rate of 34% primarily due to:

Certain expenses in our consolidated financial statements, such as incentive stock option compensation expense and a portion of meals and entertainment that are not deductible on our federal income tax return.
A reduction in the amount of the domestic production activities deduction due to our estimated taxable income being lower than previously anticipated.
State income taxes included in income tax expense in our consolidated financial statements.

Offset by:

The research and development credit that is a tax incentive that serves to reduce the rate at which we pay federal income taxes in exchange for us conducting certain aspects of our business in a manner promoted the Internal Revenue Code.

Comparison of the Consolidated Statement of Operations for the Nine Months Ended September 30, 2017 and 2016

	Nine Months Ended September 30, 2017	2016	$ Change
	$ in thousands		
Total revenues	$ 25,122	$ 24,123	$ 999
Total cost of revenues	4,637	4,695	(58)
Gross profit	20,485	19,428	1,057
Operating expenses			
Sales and marketing	9,564	8,765	799
General and administrative	6,178	5,046	1,132
Research and development	2,530	1,750	780
Total operating expenses	18,272	15,561	2,711
Income from operations	2,213	3,867	(1,654)
Other income	221	88	133
Income before income taxes	2,434	3,955	(1,521)
Income tax expense	870	1,397	(527)
Net income	$ 1,564	$ 2,558	$ (994)

In the discussion below, we refer to the nine months ended September 30, 2017, as the “2017 nine months” and the nine months ended September 30, 2016, as the “2016 nine months.” The percentage changes cited in our discussions are based on the 2017 nine month amounts compared to the 2016 nine month amounts.

Revenue. The components of our revenues were as follows ($ in thousands):

	Nine Months Ended September 30, 2017 Amount	Percent of Total	2016 Amount	Percent of Total
Revenue By Type				
License	7,768	30.9%	8,381	34.7%
M&S	15,702	62.5%	13,635	56.5%
Professional Services	1,652	6.6%	2,107	8.7%
Total Revenue	$ 25,122	100.0%	$ 24,123	100.0%
Revenue by Product Line				
License				
EFT Platform	$ 7,338	94.5%	$ 7,579	90.4%
Other	430	5.5%	802	9.6%
	7,768	100.0%	8,381	100.0%
M&S				
EFT Platform	14,893	94.8%	12,695	93.1%
Other	809	5.2%	940	6.9%
	15,702	100.0%	13,635	100.0%
Professional Services (all EFT Platform)	1,652	100.0%	2,107	100.0%
Total Revenue				
EFT Platform	23,883	95.1%	22,381	92.8%
Other	1,239	4.9%	1,742	7.2%
	$ 25,122	100.0%	$ 24,123	100.0%

Our total revenue increased 4.1%. Revenue from our EFT platform products and services increased 6.7% but was offset by a decrease in revenue from our other products. Revenue from those other products that consist of Mail Express, WAFS, CuteFTP, and TappIn decreased to comprising 4.9% of our total revenue. These trends were in line with our expectations in light of our announcement in mid-2016 that our focus would be on our EFT platform products. At the same time, we announced that while we would continue selling our other products, we would de-emphasize those products in the future, not expend future significant product development and engineering resources to enhance those products, and not dedicate significant future sales and marketing activities to them. We intend to maintain our focus on our EFT platform for the foreseeable future such that we expect to see a continuing decline in revenue from our products other than those that are part of the EFT platform.

EFT Platform Products

License revenue from our EFT platform products decreased 3.2%. During the latter half of 2017, we were transitioning to new leadership of our sales team as a result of certain of our personnel being involved in improper arrangements with customers that have been the subject of the investigation by the Audit Committee of the Board of Directors that we first announced in August 2017. This transition caused a temporary loss in sales momentum while this new leadership became familiar with our existing sales programs and began to design and implement new and enhanced initiatives.

To improve our ability to successfully sell existing EFT platform products as well as new products produced by our software engineering team, we continued to make and will continue to make ongoing changes in sales and marketing personnel and activities including:

- Increasing sales staffing and capabilities as needed to address our markets.
- Aligning our sales group to enhance its industry and geographic focus.
- Implementing new sales and marketing campaigns.
- Evolving our lead generation programs to increase our sales staff’s exposure to potential purchasers.
- Enhancing our support of channel partners and engaging them to sell our products through training, orientation and marketing programs.

The 17% increase in M&S revenue from our EFT platform products was due to:

- Ongoing license sales since a majority of license sales are accompanied by an M&S contract. The change in M&S revenue typically lags behind the related change in license revenue because license sales are recognized as revenue in full in the period the license is delivered while the related M&S revenue is recognized in future periods as those services are delivered.
- Sustaining high renewal rates of M&S contracts by customers who initially purchased these services in earlier periods. We believe these renewals result from our programs designed to provide high-quality and responsive M&S services to our customers.

Our professional services revenue decreased $455,000 which is a decrease of 22% in that revenue line item and a decrease of less than two percent of our total revenue. This decrease was partially a result of the overall decreased license revenue from our EFT platform since there generally is a direct relationship between the licenses our customers purchase and their need for professional services. In addition, subsequent to the 2016 nine months, we worked down our backlog of professional services which we did not fully replace with the same level of new engagements primarily because we did not complete as many large EFT platform sales during the 2017 nine months which are the type of sales that tend to drive the demand for professional services.

When we sell our licensed products, we also typically create a recurring revenue stream from M&S since almost all purchasers of our licensed products also purchase an M&S contract. In general, and depending upon the level of M&S a customer purchases, this recurring revenue stream is 20% to 30% per year of the price of the underlying software license to which the M&S relates.

Our M&S contracts are typically for one year, with some customers buying two or three year contracts. The customer pays us the M&S fee for the entire term of the agreement at the time the contract begins. We recognize that amount as revenue ratably in future periods over the term of the contract.

We typically experience a high renewal rate for M&S services for our enterprise products so long as a customer continues using the licensed product they purchased from us. As a result, growing license revenue not only contributes to increasing revenue growth at the time the license is sold but also provides a foundation for future recurring revenue as the purchasers of our licensed products continually renew M&S contracts to support their ongoing product support needs. This pattern of activity can create a cumulative effect for M&S renewals as a result of the cumulative number of licensed software installations sold over multiple years that create M&S renewals in any single year predictably (and in line with our expectations) exceeding the number of new software licenses we sell in a single year. We expect this cumulative effect to continue to grow if we continue to increase enterprise software license revenue in future periods.

Other Products

In mid-2016, we announced that our focus would be on our EFT platform products. At the same time, we announced that while we would continue selling our Mail Express, WAFS, CuteFTP, and TappIn products that collectively constitute less than 10% of our total revenue, in the future we would de-emphasize these stand-alone products that are not part of our EFT platform. Accordingly, during the second half of 2016, we curtailed our product development and engineering resources for these products and significantly reduced our sales and marketing activities supporting them. As a result, our license and M&S revenue from those products collectively declined 29% in the 2017 nine months compared to the 2016 nine months. Our future focus will be on our EFT platform such that we expect to see a continuing decline in revenue from these other products although we do expect them to continue to produce a modest contribution margin that contributes to our future profitability.

Cost of Revenues. These expenses are associated with the production, delivery and support of our products and services. We believe it is most meaningful to view cost of revenues as a percent of the revenues to which those costs relate since many of those costs are variable relative to revenue.

Cost of license revenue consists primarily of:

- Amortization of capitalized software development costs we incur when producing our software products. This amortization begins when a product is ready for general release to the public and generally is an expense that is not directly variable relative to revenue.
- Royalties we pay to use software developed by others for certain features of our products that is generally an expense that is variable relative to revenue.
- Fees we pay to third parties who provide services supporting our SaaS and cloud-based subscription solutions that generally have components that are both variable and not variable relative to revenue.

Cost of M&S revenue and cost of professional services revenue consist primarily of salaries and related costs of our employees and third parties we use to deliver these services.

Cost of software license revenue decreased 2% and as a percent of software license revenue was 29% in the 2017 nine months and 27% in the 2016 nine months. These changes were primarily due:

- A decrease in royalties we pay to third-parties to use their technology for certain components of our products. The amount of royalties we pay relative to our aggregate revenue fluctuates based on the mix of products we sell. During the 2017 nine months, more of the products we sold were not subject to a royalty payment than was the case during the 2016 nine months. This product mix will cause the cost of software license revenue to ebb and flow based upon our customers' unique demands such that we do not view this decrease in royalties as unusual or indicative of a long-term trend.
- A decrease in expenses related to two non-recurring engineering projects during the 2016 nine months that were not repeated in the 2017 nine months.

Offset by:

- An increase in hosting fees paid to third parties to support the delivery of our EFT Cloud SaaS products.
- An increase in the amortization of capitalized software development costs due to the release of new features that are now being amortized.

Cost of M&S revenue as a percent of M&S revenue was substantially unchanged. Cost of revenue for M&S in absolute dollars increased by 23% due to an increase in M&S revenue. The cost of delivering M&S can vary slightly up or down from period-to-period, but we believe such changes are typically not indicative of long term trends or permanent changes in our cost of delivering M&S. Our gross margin on these services generally remains greater than 90% as a result of a consistent application of our customer support delivery protocols and practices.

Cost of professional services revenue as a percent of that revenue was 68% in the 2017 nine months as compared to 60% in the 2016 nine months. This variation resulted from the varying scope and mix of the professional services we deliver that can change from period-to-period in response to the circumstances of the customer environments in which we are working. In addition, during the second half of 2016, we undertook a refinement of our professional services organization and the manner in which we manage and deliver these services which resulted in more efficient processes from which we began to realize the cost benefit in 2017. Also, we incurred a one-time charge in the 2017 nine months related to extending the time allowed to exercise certain stock options to some of our former employees. Because the cost of revenue for professional services is highly variable relative to our revenue from our services, this cost in absolute dollars decreased 12% due to a decrease in our professional services revenue for the reasons discussed above.

Sales and Marketing. We believe it most meaningful to view cost of sales and marketing as a percent of revenues since many of those costs, particularly sales commissions, are variable relative to revenue. These expenses were 38% of total revenue for the 2017 nine months compared to 36% of total revenue for the 2016 nine months. In absolute dollars these expenses increased 9%. These variations were primarily due to:

Increasing the size of our sales, marketing and product strategy teams and increased compensation rates due to competitive demands in the marketplace.
Increased marketing activities related to competitive intelligence and channel development.
Increased sales lead generation activities.

General and Administrative. These expenses increased 22% primarily due to:

Increased professional fees and related expenses associated with the previously disclosed internal investigation, the restatement of certain of our consolidated financial statements and related litigation.
Increased salaries and share-based compensation expense.

Offset by:
A decrease in severance expense as a result of the 2016 nine months including severance expense related to the resignation of our chief executive officer during the second fiscal quarter of 2016, which is an expense we did not incur in the 2017 nine months.
A decrease in bad debt expense as a result of an enhanced review of our accounts receivable during the 2016 nine months resulting in an increased write-off of accounts receivable in that period for which there was not a similar event during the 2017 nine months due to an improvement in our collections of accounts receivable.

Research and Development. The overall profile of our research and development activities was as follows ($ in thousands):

	Nine Months Ended September 30,	
	2017	**2016**
R&D expenditures expensed	$ 2,530	$ 1,750
R&D expenditures capitalized	1,464	1,298
Total R&D expenditures (non-GAAP measurement)	$ 3,994	$ 3,048

Our R&D expenditures expensed increased 45% and our R&D expenditures capitalized increased 13%. These results were due to our planned, continued increase in our capacity to develop new products as well as maintain our existing products and research technologies available from third-parties. We did this through a combination of increasing our engineering headcount and engaging additional third-party resources on a flexible basis as needed.

Total resources expended for R&D (set forth above as total R&D expenditures) serves to illustrate our total corporate efforts to improve our existing products and to develop new products regardless of whether or not our expenditures for those efforts were expensed or capitalized. Total resources expended for R&D is not a measure of financial performance under GAAP and should not be considered a substitute for R&D expense (set forth above as R&D expenditures expensed) and capitalized software development costs (set forth above as R&D expenditures capitalized) individually. While we believe the non-GAAP, total resources expended for R&D amount provides useful supplemental information regarding our overall corporate product improvement and new product creation activities, there are limitations associated with the use of this non-GAAP measurement. Total resources expended for R&D is a non-GAAP measure not prepared in accordance with GAAP and may not be comparable to similarly titled measures of other companies since there is no standard for preparing this non-GAAP measure. As a result, this non-GAAP measure of total resources expended for R&D has limitations and should not be considered in isolation from, or as a substitute for, R&D expense and capitalized software development cost individually.

Other Income. Other income consists primarily of interest income earned on certificates of deposit. The increase in this amount was due primarily to enhanced investment of our cash beginning in the second half of 2016 to earn a higher rate of interest.

Income Taxes. Our effective tax rate was 36% for the 2017 nine months and 35% for the 2016 nine months. These rates differed from a federal statutory tax rate of 34% primarily due to:

The domestic production activities deduction and the research and development credit that are tax credit incentives that serve to reduce the rate at which we pay federal income taxes in exchange for us conducting certain aspects of our business in a manner promoted by the Internal Revenue Code.

Offset by:

Certain expenses in our consolidated financial statements, such as a portion of meals and entertainment expenses, that are not deductible on our federal income tax return.
State income taxes included in income tax expense in our consolidated financial statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

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 2017 and 2016 quarter and the 2017 and 2016 nine months, we earned approximately 14% respectively, of our revenue from a single third-party channel distributor who purchases products from us and resells them to their customers. Approximately 15% of our accounts receivable as of September 30, 2017 were due from this distributor. We have since received payment for substantially all of these accounts receivable.

We earned approximately 30% and 17% of our revenue from customers outside the United States during the 2017 quarter and the 2016 quarter, respectively, and 26% and 22% for the 2017 nine months and 2016 nine months, respectively. We receive all revenue in U.S. dollars, so we have no material exchange rate risk with regard to our sales. We charge Value Added Taxes to our non-business customers in the European Union. We remit these taxes periodically in pound sterling. The impact of this currency translation has not been material to our business.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures designed to ensure that information required to be disclosed in reports filed under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms, and that such information is accumulated and communicated to our management, including our President and Chief Executive Officer and our Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

No system of controls, no matter how well designed and operated, can provide absolute assurance that the objectives of the system of controls are met. No evaluation of controls can provide absolute assurance that the system of controls has operated effectively in all cases. Our disclosure controls and procedures are designed to provide reasonable assurance that the objectives of disclosure controls and procedures are met.

Our management, including our President and Chief Executive Officer and our Interim Chief Financial Officer, evaluated our disclosure controls and procedures and concluded that our disclosure controls and procedures were not effective as of September 30, 2017 to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosures.

Material Weaknesses

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis. In connection with our management's assessment of our internal control over financial reporting, our management has identified the following deficiencies that constituted individually, or in the aggregate, material weaknesses in our internal controls over financial reporting as of September 30, 2017.

We had material weaknesses in our control environment and monitoring:

- We did not implement effective oversight of our finance and accounting processes (including organizational structure and reporting hierarchy), which impacted our ability to make appropriate decisions regarding revenue recognition.
- We did not effectively design and implement appropriate oversight controls over our period-end financial closing and reporting processes, and our review controls were not sufficient to ensure that errors regarding revenue recognition would be detected.
- We did not effectively monitor (review, evaluate and assess) the risks associated with key internal control activities that provide the revenue information contained in our financial statements.

We had material weaknesses related to internal control monitoring and activities to support the financial reporting process:

- We did not maintain effective controls over the invoicing process to ensure that proper supporting documentation was received prior to preparing invoices.
- We did not maintain effective controls over the revenue recognition process to ensure revenue was only recognized when all four criteria of our revenue recognition policy were met.

Changes in Internal Control Over Financial Reporting

With the exception of the remediation efforts described below, there has been no change in our internal control over financial reporting that occurred during the quarterly period covered by this report and during the subsequent time period through the filing of this Form 10-Q that materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

We designed a remediation plan to strengthen our internal control over financial reporting and haven taken, and will continue to take, remediation steps to address the material weaknesses described above. We also continue to take meaningful steps to enhance our disclosure controls and procedures and our internal controls over financial reporting.

Our remediation plan includes the following:

- Clearly defining and communicating the management-approved, standard terms and conditions that may be offered to customers during the sales process and requiring appropriate management approval of requested deviations from these standard terms and conditions before a sale is consummated with a customer and a sales invoice is created.
- Creating and implementing a policy clearly stating that all terms and conditions of agreements with customers are to be recorded in writing, communicated to finance and accounting personnel, and recorded in our permanent records prior to the creation of a sales invoice.
- Conducting periodic training sessions and briefings to communicate our policies and procedures regarding our standard terms and conditions that we offer to customers and how we document and communicate approved deviations from those standard terms and conditions.
- Enhancing the breadth and depth of the review by finance and accounting personnel of sales invoices and underlying supporting documentation to ensure that unusual items are identified and considered when determining revenue recognition.
- Establishing a total invoice dollar amount threshold over which finance and accounting personnel must examine all actual invoices and supporting documentation to confirm the purchase by the customer and the appropriate revenue recognition profile.
- Publishing guidelines that personnel can reference which set forth the requirements to be met for revenue to be recognized from a sale transaction and conducting periodic meetings with personnel to educate and remind them of these guidelines.

Our management is implementing and monitoring the effectiveness of these and other processes, procedures and controls and will make any further changes deemed appropriate. Our management believes the foregoing remedial efforts will effectively remediate the material weaknesses. As the Company continues to evaluate and work to improve its internal control over financial reporting, our management may determine to take additional measures to address control deficiencies or determine to modify the remediation plan described above. If not remediated, these control deficiencies could result in further material misstatements to the Company’s consolidated financial statements.

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Part II. Other Information

Item 1. Legal Proceedings

The information set forth under "Note 12 – Commitments and Contingencies – Legal and Regulatory Matters" to the condensed consolidated financial statements included in Part I, Item 1 of this Form 10-Q is incorporated herein by reference.

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 2016 Form 10-K/A filed with the Securities and Exchange Commission on June 14, 2018. These risk factors could materially affect our business, financial condition or future results, but they 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 Interim Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101	Interactive Data File.

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.

June 14, 2018	By: /s/ Karen J. Young
Date	Karen J. Young
	Interim Chief Financial Officer

EXHIBIT 31.1

CERTIFICATIONS

I, Matthew C. Goulet, 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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) 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

d) 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: June 14, 2018

/s/ Matthew C. Goulet
Matthew C. Goulet
President and Chief Executive Officer

EXHIBIT 31.2

CERTIFICATIONS

I, Karen J. Young, 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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) 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

d) 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: June 14, 2018

/s/ Karen J. Young

Karen J. Young
Interim Chief Financial Officer

EXHIBIT 32.1

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, 2017, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned, Matthew C. Goulet, Chief Executive Officer and Karen J. Young, Interim 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.

June 14, 2018

/s/ Matthew C. Goulet
Matthew C. Goulet
President and Chief Executive Officer

/s/ Karen J. Young
Karen J. Young
Interim Chief Financial Officer