

TSS, Inc.  
Form 10-Q  
August 15, 2016

**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 June 30, 2016

or

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

Commission file number: 001-33627

**TSS, INC.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**20-2027651**

(I.R.S. Employer Identification No.)

**110 E. Old Settlers Blvd**

**Austin, Texas**

(Address of principal executive offices) (Zip Code)

**78664**

**(512) 310-1000**

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the past 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 each registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large accelerated filer

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

Accelerated filer

Smaller reporting company

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

Edgar Filing: TSS, Inc. - Form 10-Q

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

<b>Number of shares of common stock outstanding as of August 15, 2016</b>	<b>15,665,824</b>
---	-------------------

TSS, INC.

**QUARTERLY REPORT ON FORM 10Q**

**For the Quarterly Period Ended June 30, 2016**

<u>“SAFE HARBOR” STATEMENT</u>	ii
<u>PART I–FINANCIAL INFORMATION</u>	1
<u>Item 1. Financial Statements</u>	1
<u>Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	12
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	16
<u>Item 4. Controls and Procedures</u>	16
<u>PART II–OTHER INFORMATION</u>	17
<u>Item 1. Legal Proceedings</u>	17
<u>Item 1.A. Risk Factors</u>	17
<u>Item 6. Exhibits</u>	18

**“SAFE HARBOR” STATEMENT**

**UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995**

From time to time, we make oral and written statements that may constitute “forward looking statements” (rather than historical facts) as defined in the Private Securities Litigation Reform Act of 1995 or by the Securities and Exchange Commission (the “SEC”) in its rules, regulations and releases, including Section 27A of the Securities Act of 1933, as amended (the “Securities Act”) and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). We desire to take advantage of the “safe harbor” provisions in the Private Securities Litigation Reform Act of 1995 for forward looking statements made from time to time, including, but not limited to, the forward looking statements made in this Quarterly Report on Form 10-Q (the “Form 10-Q”), as well as those made in other filings with the SEC.

Forward looking statements can be identified by our use of forward looking terminology such as “may,” “will,” “expect,” “anticipate,” “estimate,” “believe,” “continue,” “forecast,” “foresee” or other similar words. Such forward looking statements are based on management’s current plans and expectations and are subject to risks, uncertainties and changes in plans that could cause actual results to differ materially from those described in the forward looking statements. Important factors that could cause actual results to differ materially from those anticipated in our forward looking statements include, but are not limited to, those described under *Risk Factors* set forth in Part I, Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2015.

We expressly disclaim any obligation to release publicly any updates or any changes in our expectations or any changes in events, conditions or circumstances on which any forward looking statement is based.

As used herein, except as otherwise indicated by the context, the terms “TSS,” “Company,” “we”, “our” and “us” are used to refer to TSS, Inc. and its subsidiaries.

**PART I - FINANCIAL INFORMATION****Item 1. Financial Statements****TSS, Inc.****Consolidated Balance Sheets****(in thousands except par values)**

	June 30, 2016 (unaudited)	December 31, 2015
<b>Current Assets:</b>		
Cash and cash equivalents	\$ 540	\$ 1,132
Contract and other receivables, net	2,486	6,997
Costs and estimated earnings in excess of billings on uncompleted contracts	694	1,084
Inventories, net	63	66
Prepaid expenses and other current assets	425	235
Total current assets	4,208	9,514
Property and equipment, net	663	702
Goodwill	1,907	1,907
Intangible assets, net	773	841
Other assets	30	30
Total assets	\$ 7,581	\$ 12,994
<b>Current Liabilities:</b>		
Long-term borrowings, current portion, net	\$ 293	\$ 287
Borrowings under line of credit	-	2,150
Borrowings under receivable financing agreement	337	-
Accounts payable and accrued expenses	6,177	7,608
Billings in excess of costs and estimated earnings on uncompleted contracts	1,611	2,476
Total current liabilities	8,418	12,521
Long-term borrowings, less current portion	924	1,036
Other liabilities	41	37
Total liabilities	9,383	13,594
Commitments and Contingencies	-	-
Stockholders' Equity (Deficit):	-	-

Edgar Filing: TSS, Inc. - Form 10-Q

Preferred stock, \$.0001 par value; 1,000 shares authorized at June 30, 2016 and December 31, 2015; none issued		
Common stock, \$.0001 par value; 49,000 shares authorized at June 30, 2016 and December 31, 2015; 16,390 and 16,366 issued at June 30, 2016 and December 31, 2015, respectively	2	2
Additional paid-in capital	68,463	68,329
Treasury stock 724 shares at cost at June 30, 2016 and December 31, 2015	(1,531 )	(1,531 )
Accumulated deficit	(68,736 )	(67,400 )
Total stockholders' equity (deficit)	(1,802 )	(600 )
Total liabilities and stockholders' equity (deficit)	\$ 7,581	\$ 12,994

See accompanying notes to the consolidated financial statements.

**TSS, Inc.****Consolidated Statements of Operations****(in thousands, except per-share amounts; unaudited)**

	Three Months Ended		Six Months Ended	
	June 30		June 30	
	2016	2015	2016	2015
Revenue	\$ 7,029	\$ 5,847	\$ 14,704	\$ 13,119
Cost of revenue	4,861	4,405	11,231	9,273
Gross profit	2,168	1,442	3,473	3,846
Selling, general and administrative expenses	2,077	2,425	4,329	5,029
Depreciation and amortization	151	148	298	278
Total operating costs	2,228	2,573	4,627	5,307
Loss from operations	(60 )	(1,131 )	(1,154 )	(1,461 )
Other income (expense):				
Interest expense, net	(111 )	(87 )	(191 )	(159 )
Other income(expense), net	2	-	9	-
Loss from operations before income taxes	(169 )	(1,218 )	(1,336 )	(1,620 )
Income tax provision	-	-	-	-
Net loss	\$(169 )	\$(1,218 )	\$(1,336 )	\$(1,620 )
Basic and diluted loss per share:				
Loss per common share	\$(0.01 )	\$(0.08 )	\$(0.09 )	\$(0.10 )
Weighted average common shares outstanding	15,666	15,665	15,662	15,474

See accompanying notes to the consolidated financial statements.



**TSS, Inc.****Consolidated Statements of Changes in Stockholders' Equity (Deficit)****For the Six Months Ended June 30, 2016****(in thousands, except share amounts, unaudited)**

	<b>Common Stock</b>		<b>Additional</b>	<b>Treasury Stock</b>		<b>Accumulated</b>	<b>Total</b>
	<b>Shares</b>	<b>Amount</b>	<b>Paid-in</b>	<b>Shares</b>	<b>Amount</b>	<b>Deficit</b>	<b>Shareholders'</b>
			<b>Capital</b>				<b>Equity</b>
							<b>(Deficit)</b>
Balance January 1, 2016	16,366	\$ 2	\$ 68,329	724	\$(1,531 )	\$ (67,400 )	\$ (600 )
Restricted stock issuance	84	-	-	-	-	-	-
Stock-based compensation	-	-	134	-	-	-	134
Cancellation of restricted stock	(60 )	-	-	-	-	-	-
Net loss	-	-	-	-	-	(1,336 )	(1,336 )
Balance at June 30, 2016	16,390	\$ 2	\$ 68,463	724	\$(1,531 )	\$ (68,736 )	\$ (1,802 )

See accompanying notes to the consolidated financial statements.

**TSS, Inc.****Consolidated Statements of Cash Flows****(in thousands; unaudited)**

	Six Months Ended June 30,	
	2016	2015
Cash Flows from Operating Activities:		
Net loss	\$ (1,336 )	\$ (1,620 )
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	298	278
Amortization of discount on notes payable	41	40
Stock-based compensation	134	251
Provision (recoveries) for doubtful accounts	(5 )	(11 )
Changes in operating assets and liabilities:		
Contract and other receivables	4,516	756
Costs and estimated earnings in excess of billings on uncompleted contracts	390	7
Inventories, net	3	74
Prepaid expenses and other current assets	(190 )	(441 )
Accounts payable and accrued expenses	(1,443 )	(355 )
Billings in excess of costs and estimated earnings on uncompleted contracts	(865 )	(42 )
Other liabilities	4	(11 )
Net cash provided by (used in) operating activities	1,547	(1,074 )
Cash Flows from Investing Activities:		
Capital expenditures	(176 )	(199 )
Net cash used in investing activities	(176 )	(199 )
Cash Flows from Financing Activities:		
Payment on long-term borrowings	(150 )	(150 )
Proceeds from (payments on) line of credit	(2,150 )	16
Proceeds from receivables financing agreement	337	-
Proceeds from issuance of debt	-	945
Net cash provided by (used in) financing activities	(1,963 )	811
Net decrease in cash and cash equivalents	(592 )	(462 )
Cash and cash equivalents at beginning of period	1,132	1,378
Cash and cash equivalents at end of period	\$ 540	\$ 916
Supplemental disclosure of cash flow information:		
Cash paid for interest	\$ 145	\$ 79
Cash paid for taxes	\$ 31	\$ 67
Supplemental non-cash financing information:		
Issuance of warrants in connection with debt	\$ -	\$ 168

See accompanying notes to the consolidated financial statements.



**TSS, Inc.**

**Notes to Consolidated Statements**

**June 30, 2016**

**(unaudited)**

**Note 1 – Significant Accounting Policies**

*Description of Business*

TSS, Inc. (“TSS”, the “Company”, “we”, “us” or “our”) provides comprehensive services for the planning, design, construction and maintenance of mission-critical facilities and information infrastructure as well as systems integration services related to this infrastructure. We provide a single source solution for highly technical mission-critical facilities such as data centers, operations centers, network facilities, server rooms, security operations centers, communications facilities and the infrastructure systems that are critical to their function. Our services consist of technology consulting, design and engineering, construction management, facilities management and systems integration. Our corporate offices are in Round Rock, Texas, and we also have facilities in Dulles, Virginia, Columbia, Maryland and Los Altos, California.

The accompanying consolidated balance sheet as of December 31, 2015, which has been derived from audited consolidated financial statements, and the unaudited interim consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (“US GAAP”) for interim financial statements and pursuant to the rules and regulations of the SEC for interim reporting, and include the accounts of the Company and its consolidated subsidiaries. In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments (consisting only of normal recurring items) necessary to present fairly the consolidated financial position of the Company and its consolidated results of operations and cash flows. These interim financial statements should be read in conjunction with the consolidated financial statements and accompanying notes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2015.

The accompanying consolidated financial statements have also been prepared on the basis that the Company will continue to operate as a going concern. Accordingly, assets and liabilities are recorded on the basis that the Company will be able to realize its assets and discharge its liabilities in the normal course of business. Our history of operating losses, declining current ratio, and stockholders’ deficit may, in themselves, cause uncertainty about our ability to continue to operate our business as a going concern and meet our obligations as they come due. In December 2015, we restructured the repayment terms of our notes payable held by Mr. Gallagher, a director and our Chief Technical

Officer, to defer repayment of a large portion of this obligation to 2017, further reducing short term liquidity requirements on our business. During 2014 and 2015, we also adjusted our overhead structure to reduce our level of overhead as business conditions and our revenue mix changed. We believe that there are further adjustments that could be made to our business if we are required to do so.

Our business plans and our assumptions around the adequacy of our liquidity are based on estimates regarding expected revenues and future costs and our ability to secure additional sources of funding if needed. However, our revenue may not meet our expectations or our costs may exceed our estimates. Further, our estimates may change and future events or developments may also affect our estimates. Any of these factors may change our expectation of cash usage or significantly affect our level of liquidity, which may require us to take measures to reduce our operating costs or obtain funding in order to continue operating. Any action to reduce operating costs may negatively affect our range of products and services that we offer or our ability to deliver such products and services, which could materially impact our financial results depending on the level of cost reductions taken. These consolidated financial statements do not include any adjustments that might result from the Company not being able to continue as a going concern

#### *Revenue Recognition*

We recognize revenue when pervasive evidence of an arrangement exists, the contract price is fixed or determinable, services have been rendered or goods delivered, and collectability is reasonably assured. Our revenue is derived from fixed-price contracts, time-and-materials contracts, cost-plus-fee contracts (including guaranteed maximum price contracts), facility service and maintenance contracts, and product shipments.

Revenue from fixed price contracts is recognized on the percentage of completion method. We apply Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) 605-35, *Construction-Type and Production-Type Contracts*, recognizing revenue on the percentage-of-completion method using costs incurred in relation to total estimated project costs. This method is used because management considers costs incurred and estimated costs to complete to be the best available measure of progress in the contracts. Contract costs include all direct materials, subcontract and labor costs and those indirect costs related to contract performance, such as indirect labor, payroll taxes, employee benefits and supplies.

Revenue on cost-plus-fee contracts is recognized to the extent of costs incurred, plus an estimate of the applicable fees earned. Fixed fees under cost-plus-fee contracts are recorded as earned in proportion to the allowable costs incurred in performance of the contract.

Billings in excess of costs and estimated earnings on uncompleted contracts are classified as current liabilities. Costs and estimated earnings in excess of billings, or work in process, are classified as current assets for the majority of our projects. Work in process on contracts is based on work performed but not yet billed to customers as per individual contract terms.

Certain of our contracts involve the delivery of multiple elements including design management, system installation and facilities maintenance. Revenues from contracts with multiple element arrangements are recognized as each element is earned based on the relative selling price of each element provided the delivered elements have value to customers on a standalone basis. Amounts allocated to each element are based on its objectively determined fair value, such as the sales price for the service when it is sold separately or competitor prices for similar services.

Revenue and related costs for master and other service agreements billed on a time and materials basis are recognized as the services are rendered based on actual labor hours performed at contracted billable rates, and costs incurred on behalf of the customer. Services are also performed under master and other service agreements billed on a fixed fee basis. Under fixed fee master service and similar type service agreements for facilities and equipment, we furnish various unspecified units of service for a fixed price. These services agreements are recognized on the proportional performance method or ratably over the course of the service period and costs are recorded as incurred in performance.

We recognize revenue from assembled products when the finished product is shipped and collection of the resulting receivable is reasonably assured. In arrangements where a formal acceptance of products or services is required by the customer, revenue is recognized upon meeting such acceptance criteria.

#### *Allowance for Doubtful Accounts*

We estimate an allowance for doubtful accounts based on factors related to the specific credit risk of each customer. Historically our credit losses have been minimal. We perform credit evaluations of new customers and may require prepayments or use of bank instruments such as trade letters of credit to mitigate credit risk. As we expand our product offerings and customer base, our risk of credit loss has increased. We monitor outstanding amounts to limit our credit exposure to individual accounts. We continue to pursue collection even if we have fully provided for an account balance.

*Concentration of Credit Risk*

We are currently economically dependent upon our relationship with a large US-based IT Original Equipment Manufacturer (OEM). If this relationship is unsuccessful or discontinues, our business and revenue would suffer. The loss of or a significant reduction in orders from this customer or the failure to provide adequate products or services to them would significantly reduce our revenue. We also periodically perform large construction projects which may comprise a significant portion of our revenues during the construction phase, and which may cause large fluctuations in our quarterly revenues.

The following customers accounted for a significant percentage of our revenues for the periods shown:

	Three months ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
US-based IT OEM	49%	40 %	35%	47 %
US-based data center company	6 %	20 %	24%	9 %

No other customers represented more than 10% of our revenues for any periods presented. A US-based IT OEM customer represented 18% and 6% of our accounts receivable at June 30, 2016 and December 31, 2015, respectively. A US-based retail customer represented 6% and 13% of our accounts receivable at June 30, 2016 and December 31, 2015, respectively. A US-based IT services company represented 15% of our accounts receivable at June 30, 2016. No other customer represented more than 10% of our accounts receivable at June 30, 2016 or at December 31, 2015.

*Recently Issued Accounting Pronouncements*

In April 2015, the FASB issued ASU No. 2015-03, Interest – *Imputation of Interest (Subtopic 835-30): Simplifying The Presentation of Debt Issuance Costs* (“ASU 2015-03”). This ASU requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct reduction from the carrying amount of that debt liability, consistent with debt discounts. ASU 2-15-03 is effective for financial statements issued for fiscal years beginning after December 15, 2015 and interim periods within those fiscal years. This ASU was effective for us for our fiscal year beginning January 1, 2016. The adoption of ASU 2015-03 did not have a material impact on our consolidated financial statements but did require us to reclassify certain balances in our December 31, 2015 consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, “*Leases (Topic 842)*” (“ASU 2016-02”). Under ASU 2016-02, an entity will be required to recognize right-of-use assets and lease liabilities on its balance sheet and disclose key information about leasing arrangements. ASU 2016-02 offers specific accounting guidance for a lessee, a lessor and sale and leaseback transactions. Lessees and lessors are required to disclose qualitative and quantitative information about leasing arrangements to enable a user of the financial statements to assess the amount, timing and uncertainty of cash flows arising from leases. For public companies, ASU 2016-02 is effective for annual reporting periods beginning after December 15, 2018, including interim periods within that reporting period, and requires a modified retrospective adoption, with early adoption permitted. We are currently evaluating the future impact of ASU2016-02 on our consolidated financial statements.

**Note 2 – Supplemental Balance Sheet Information***Receivables*

Contract and other receivables consist of the following (in ‘000’s):

	June 30, 2016	December 31, 2015
Contract and other receivables	\$2,493	\$ 7,016
Allowance for doubtful accounts	(7 )	(19 )
	\$2,486	\$ 6,997



*Inventory*

We state inventories at the lower of cost or market, using the first-in-first-out-method (in '000's):

	June 30, 2016	December 31, 2015
Raw materials	\$ 65	\$ 68
less: Reserve	(2 )	(2 )
Inventories, net	\$ 63	\$ 66

*Goodwill and Intangible Assets*

Goodwill and Intangible Assets consist of the following (in '000's):

	June 30, 2016		December 31, 2015	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Intangible assets not subject to amortization:				
Goodwill	\$1,907	-	\$ 1,907	-
Trade name	\$60	-	\$ 60	-
Intangible assets subject to amortization:				
Customer relationships	\$906	\$ (282 )	\$ 906	\$ (237 )
Acquired software	\$234	\$ (145 )	\$ 234	\$ (122 )

We recognized amortization expense related to intangibles of approximately \$34,000 in each of the three-month periods ended June 30, 2016 and 2015, respectively. We recognized amortization expense related to intangibles of approximately \$69,000 and \$70,000 for the six-month periods ended June 30, 2016 and 2015, respectively.

US GAAP requires us to perform an impairment test of goodwill on an annual basis or whenever events or circumstances make it more likely than not that impairment of goodwill may have occurred. As part of the annual impairment test, we first have the option to make a qualitative assessment of goodwill for impairment. If we are able to determine, through the qualitative assessment, that the fair value of a reporting unit more likely than not exceeds its carrying value, no further evaluation is necessary. For those reporting units for which the qualitative assessment is either not performed or indicates that further testing may be necessary, we may then assess goodwill for impairment using a two-step process. The first step requires comparing the fair value of the reporting unit with its carrying amount, including goodwill. If that fair value exceeds the carrying amount, the second step of the process is not required to be performed, and no impairment charge is required to be recorded. If that fair value does not exceed that carrying amount, we must perform the second step, which requires an allocation of the fair value of the reporting unit to all assets and liabilities of that unit as if the reporting unit had been acquired in a purchase business combination and the fair value of the reporting unit was the purchase price. The goodwill resulting from that purchase price allocation is then compared to the carrying amount with any excess recorded as an impairment charge.

We have elected to use December 31 as our annual date to test goodwill and intangibles for impairment. As circumstances change that could affect the recoverability of the carrying amount of the assets during an interim period, the Company will evaluate its indefinite lived intangible assets for impairment. We performed a quantitative analysis of our goodwill and intangibles at December 31, 2015 as part of our annual testing for impairment. We used a combination of valuation methodologies including income and market-based valuation methods, with increased weighting on the income-based approaches and subject company stock-price methods as we felt these options more accurately captured the operations of our reporting units. Although there were events and circumstances in existence at December 31, 2015 that suggest substantial doubt about our ability to continue as a going concern, the valuation results indicated that the fair value of our reporting units was substantially greater than the carrying value, including goodwill, for each of our reporting units. Thus we concluded that there was no impairment at December 31, 2015 for our goodwill and other long-lived intangible assets. There were no identified triggering events or circumstances that occurred during the three or six-month periods ended June 30, 2016 that would have required an interim impairment analysis of our goodwill and other long-lived intangible assets.

#### *Accounts Payable and Accrued Expenses*

Accounts payable and accrued expenses consisted of the following (in \$'000):

Edgar Filing: TSS, Inc. - Form 10-Q

	June 30, 2016	December 31, 2015
Accounts payable	\$4,011	\$ 5,202
Accounts payable retainage	316	264
Accrued expenses	1,217	1,560
Compensation, benefits & related taxes	575	473
Other accrued expenses	58	109
Total accounts payable and accrued expenses	\$6,177	\$ 7,608

**Note 3 – Long term borrowings**

Long-term borrowings consisted of the following (in \$'000)

	June 30, 2016	December 31, 2015
Convertible notes payable	\$ 400	\$ 550
Less unamortized discount	(7 )	(11 )
Notes Payable due Feb. 2020	945	945
Less unamortized discount and debt issuance costs	(121 )	(161 )
	1,217	1,323
Current portion of long-term borrowing	(293 )	(287 )
Non-current portion of long-term borrowing	\$ 924	\$ 1,036

We currently have outstanding convertible notes payable to Gerard J. Gallagher, a director and Chief Technical Officer of the Company. As of June 30, 2016 there was an aggregate principal balance outstanding under the note of \$400,000.

In December 2015, we amended the terms of the notes payable to revise the future payment schedule and to extend the maturity date of the promissory note from January 1, 2016 to July 1, 2017. Under the amended payment schedule, the Company will make monthly principal payments of \$25,000 to Mr. Gallagher for a fourteen-month period beginning January 1, 2016 and ending on February 1, 2017. The Company will also make an additional principal payment of \$100,000 on or before March 1, 2017. The remaining outstanding balance is due on July 1, 2017. The Company will continue to make monthly interest payments. The interest rate was also increased to an annual rate of 5% per annum effective January 1, 2016.

In connection with the amendment to the note payable to Mr. Gallagher in December 2015, the Company and Mr. Gallagher entered into a warrant granting Mr. Gallagher the right to purchase up to 100,000 shares of the Company's common stock. The warrant is exercisable for a period of up to five years from December 21, 2016 with an exercise price of \$0.15 per share. The exercise price and number of shares of common stock issuable upon exercise of the warrant will be subject to adjustment in the event of any stock split, reverse stock split, recapitalization, reorganization or similar transactions. The fair value of the warrant has been recorded as a discount against the balance of the note payable, and will be amortized to interest expense over the remaining term of the notes payable.

In February 2015 we entered into a multiple advance term loan agreement and related agreements with MHW SPV II, LLC ('MHW'), an entity affiliated with the Chairman of our Board of Directors, for a loan in the maximum amount of \$2 million. We borrowed \$945,000 under the terms of this loan agreement on February 3, 2015 and executed a promissory note to evidence this loan and the terms of repayment.

The loan requires interest-only payments made monthly, beginning March 1, 2015, and bears annual interest at a fixed rate of 12%. The loan has a maturity date of February 3, 2020. We are able to prepay the loan at any time, subject to a prepayment fee of (a) 4% of the amount prepaid if the prepayment is made prior to February 3, 2016, (b) 2% of the amount prepaid if the prepayment is made between February 4, 2016 and February 3, 2017, and (c) 1% of the amount prepaid if the prepayment is made between February 4, 2017 and February 3, 2018.

The obligations under the loan are secured by substantially all of our assets pursuant to the terms of a security agreement. In connection with the receivables financing agreement described below, MHW executed a subordination agreement to evidence their agreement that their security interest is subordinated to the security interest of RTS Financial Services, Inc. in all of the Company's present and future accounts receivable and all proceeds thereof.

In conjunction with entering into the loan agreement, the Company and MHW also entered into a warrant granting MHW the right to purchase up to 1,115,827 shares of the Company's common stock. The warrant is exercisable for a period of five years from February 3, 2015 at an exercise price of \$0.50 for the first 472,500 shares, \$1.00 for the next 425,250 shares and \$1.30 for the final 218,077 shares. The exercise price and number of shares of common stock issuable on exercise of the warrant will be subject to adjustment in the event of any stock split, reverse stock split,

recapitalization, reorganization or similar transaction. The fair value of the warrant was approximately \$204,000. Using the relative-fair value allocation method, the debt proceeds were allocated between the debt value and the fair value of the warrant, resulting in a recognition of a discount on the loan of approximately \$168,000 and a corresponding increase to additional paid in capital. This discount will be amortized using the effective interest rate method over the term of the loan. \$8,000 was amortized in each of the three-month periods ended June 30, 2016 and 2015, respectively, and \$17,000 was amortized during each of the six-month periods ended June 30, 2016 and 2015, respectively.

Peter H. Woodward, the Chairman of our Board of Directors, is a principal of MHW Capital Management LLC, which is the investment manager of MHW. MHW Capital Management LLC is entitled to a performance-related fee equal to 10% of any appreciation in the valuation of the common stock in excess of the applicable strike price under the warrant issued to MHW.

#### **Note 4 - Receivables Financing Liability**

In May 2016 we entered into a receivables factoring agreement with RTS Financial Service, Inc. (“RTS”). Under the terms of this agreement, we may offer for sale, and RTS in its sole discretion may purchase our eligible receivables (the “Purchased Accounts”). Upon purchase RTS becomes the absolute owner of the Purchased Accounts, which are payable directly to RTS, subject to certain repurchase obligations by us.

RTS's fee for each Purchased Account is computed on a daily basis until the amount of the Purchased Account is paid to RTS, and such fee equals the amount of the Purchased Account multiplied by the sum of the prime rate then in effect plus 7%, divided by 360. RTS will pay us 80% of the amount of the Purchased Accounts upon purchase and the balance (less fees) is paid to us upon collection of the Purchased Account by RTS.

Our obligations under the factoring agreement are secured by all present and future accounts receivable (provided, however that accounts for one customer are excluded) and all chattel paper, instruments, general intangibles, securities, contract rights, insurance, proceeds, property rights and interests associated therewith, as well as all equipment, inventory and deposit accounts of the Company.

RTS may require us to repurchase a Purchased Account if we breach any warranty or otherwise violate or default on any of our obligations under the factoring agreement or if the Purchased Account is not paid in full on or before the payment due date of such Purchased Account or within 120 days after the invoice date of such Purchased Account.

The agreement has an initial term of 12 months and automatically renews for successive 12-month renewal periods unless terminated pursuant to the terms of the agreement. We may terminate the agreement at the end of the initial term upon 60 days' notice and payment of an early termination fee to RTS in the amount of \$10,000. We may also terminate the agreement at any time during the first 24 months upon 30 days' notice and payment of an early termination fee based on the average monthly amount purchased during the term of the agreement. RTS may terminate the agreement upon 90 days' notice to us or immediately upon the occurrence of certain events.

In connection with entering into the factoring agreement with RTS, we terminated our Business Financing Agreement with Bridge Bank. We received an initial funding amount of \$668,000 under the factoring agreement which was used to repay our outstanding obligations to Bridge Bank. No early termination or prepayment penalties were incurred by us in connection with the termination of the Bridge Bank facility.

#### **Note 5 – Net Loss Per-Share**

Basic and diluted (loss) earnings per share are based on the weighted average number of shares of common stock and potential common stock outstanding during the period. Potential common stock, for the purposes of determining diluted earnings per share, includes the effects of dilutive unvested restricted stock, options to purchase common stock and convertible securities. The effect of such potential common stock is computed using the treasury stock method or the if-converted method, as applicable.

Edgar Filing: TSS, Inc. - Form 10-Q

The following table presents a reconciliation of the numerators and denominators of the basic and diluted earnings per share computations for income from continuing operations. The table below represents the numerator and shares represent the denominator (in thousands except per share amounts).

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Numerator:				
Net loss	\$ (169 )	\$ (1,218 )	\$ (1,336 )	\$ (1,620 )
Denominator:				
Weighted-average shares of common stock outstanding	15,665	15,665	15,662	15,474
Dilutive effect of employee stock options and restricted stock awards	-	-	-	-
Weighted-average shares for diluted net loss per share	15,665	15,665	15,662	15,474
Basic & diluted net loss per share	\$ (0.01 )	\$ (0.08 )	\$ (0.09 )	\$ (0.10 )

For the three-month periods ended June 30, 2016 and 2015, potentially dilutive shares of 3,496,000 and 4,421,000 were excluded from the calculation of dilutive shares because their effect would have been anti-dilutive due to the net loss reported in each period. For the six-month periods ended June 30, 2016 and 2015, potentially dilutive shares of 3,496,000 and 4,421,000 were excluded from the calculation of dilutive shares because their effect would have been anti-dilutive due to the net loss reported in each period

**Note 6 – Related Party Transactions**

We lease our facility in Columbia, Maryland from an entity that is 50% owned by Gerard Gallagher, a director and our Chief Technical Officer. This lease expires on January 31, 2017 and contains two options to extend the lease for an additional six months. Rents paid under this agreement were \$69,000 for each of the three -month periods ended June 30, 2016 and 2015 respectively and \$138,000 for each of the six-month periods ended June 30, 2016 and 2015, respectively.

We have \$400,000 principal outstanding at June 30, 2016 in convertible notes payable to Mr. Gallagher, net of remaining discount of \$7,000. The notes bear interest at 5% per annum and are subordinated to our borrowings to MHW and to RTS under our receivables financing agreement. Per the terms of the notes, we paid interest of \$5,000 and \$7,000 during the three month periods ended June 30, 2016 and 2015, respectively. We repaid principal against the Notes of \$75,000 in each of the three -month periods ended June 30, 2016 and 2015, respectively. For the six-month periods ended June 30, 2016 and 2015, we paid interest of \$12,000 and \$14,000 respectively. We repaid principal against the notes of \$150,000 in each of the six-month periods ended June 30, 2016 and 2015.

We have \$945,000 principal outstanding at June 30, 2016 in promissory notes payable to MHW, net of remaining discount of \$120,000. Per the terms of the notes, we paid interest of \$ 28,000 during each of the three-month periods ended June 30, 2016 and 2015, respectively. We paid interest of \$57,000 and \$46,000 during the six-month periods ended June 30, 2016 and 2015, respectively. Peter H. Woodward, the Chairman of our Board of Directors, is a principal of MHW Capital Management, LLC which is the investment manager of MHW. MHW Capital Management LLC is entitled to a performance-related fee equal to 10% of any appreciation in the valuation of the common stock in excess of the applicable strike price under the warrant issued to MHW.

#### Note 7 - Segment Reporting

Segment information reported in the tables below represents the operating segments of the Company organized in a manner consistent with which separate information is available and for which segment results are evaluated regularly by our Chief Executive Officer, the chief operating decision-maker in assessing performance and allocating resources. Our activities are organized into two major segments: facilities and systems integration. Our facilities unit is involved in the design, project management and maintenance of data center and mission-critical business operations. Our systems integration unit integrates IT equipment for OEM vendors and customers to be used inside data center environments, including modular data centers. All of our revenues are derived from the U.S. market. Segment operating results reflect earnings before stock-based compensation, acquisition related expenses, other expenses, net, and provision for income taxes.

Revenue and operating results by reportable segment reconciled to reportable net loss for the three and six-month periods ended June 30, 2016 and 2015 and other segment-related information is as follows (in thousands):

	Three Month Periods		Six Month Periods	
	ended June 30, 2016	2015	ended June 30, 2016	2015
Revenues:				
Facilities construction and maintenance	\$5,269	\$4,849	\$12,002	\$9,655



Edgar Filing: TSS, Inc. - Form 10-Q

System integration services	1,760	998	2,702	3,464
Total revenues	\$7,029	\$5,847	\$14,704	\$13,119

Income (loss) from operations:

Facilities construction and maintenance	\$1,148	\$812	\$1,806	\$1,806
System integration services	165	(202 )	(63 )	343
Other consolidated activities	(1,373)	(1,741)	(2,897 )	(3,610 )
Consolidated loss from operations	\$(60 )	\$(1,131)	\$(1,154 )	\$(1,461 )

Depreciation expense

System integration services expense	\$91	\$73	\$178	\$138
Other consolidated activities	18	22	37	43
Consolidated depreciation expense	\$109	\$95	\$215	\$181

Interest expense

Facilities construction and maintenance	\$—	\$—	\$—	\$—
System integration services	—	—	—	—
Other consolidated activities	111	87	191	159
Consolidated interest expense	\$111	\$87	\$191	\$159

	June 30, 2016	Dec. 31, 2015
Total Assets		
Facilities	\$4,816	\$9,443
System integration services	1,780	2,222
Other consolidated activities	985	1,329
Total assets	\$7,581	\$12,994

Other consolidated activities relates to operating costs not specifically attributable to each business segment including sales, marketing, executive and administrative support functions including activities such as finance, human resources and IT.

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

*The following discussion should be read in conjunction with, and is qualified in its entirety by reference to, the financial statements and notes thereto included in Item 1 of this Form 10-Q and the financial statements and notes thereto and our Management’s Discussion and Analysis of Financial Condition and Results of Operations for the year ended December 31, 2015 included in our 2015 Annual Report on Form 10-K. This report contains forward-looking statements, within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, that involve risks and uncertainties. Our expectations with respect to future results of operations that may be embodied in oral and written forward-looking statements, including any forward-looking statements that may be included in this report, are subject to risks and uncertainties that must be considered when evaluating the likelihood of our realization of such expectations. Our actual results could differ materially. The words “believe,” “expect,” “intend,” “plan,” “project,” “will” and similar phrases as they relate to us are intended to identify such forward-looking statements. In addition, please see the “Risk Factors” in Part I, Item 1A of our 2015 Annual Report on Form 10-K and in Part II, Item 1A of this Form 10-Q for a discussion of items that may affect our future results.*

### **Overview**

TSS, Inc. (“TSS”, the “Company”, “we”, “us” or “our”) provides comprehensive services for the planning, design, construction and maintenance of mission-critical facilities and information infrastructure as well as systems integration services related to this infrastructure. We provide a single source solution for highly technical mission-critical facilities such as data centers, operation centers, network facilities, server rooms, security operations centers, communications facilities and the infrastructure systems that are critical to their function. Our services include technology consulting, design and engineering, construction project management, systems integration, system installations and facilities management.

Our headquarters are in Round Rock, Texas, and we have offices in Columbia, Maryland, Dulles, Virginia, and Los Altos, California.

Our business is concentrated on the data center infrastructure and services market. This market is becoming increasingly competitive as commerce moves to cloud-based solutions and as data storage requirements continue to escalate for many industries. These underlying macroeconomic trends are driving demand for increasingly efficient data center design, construction and operation, resulting in increasing capital expenditures in this market. We compete against many larger competitors who have greater resources than we do, which may affect our competitiveness in the market. We rely on several large customers to win contracts and to provide business to us under “Master Service Agreements”, and the loss of such customers would have a negative effect on our results. We have recently added to our direct sales force to help diversify our customer base to reduce this risk.

## RESULTS OF OPERATIONS

### *Revenue*

Revenue consists of fees earned from the planning, design and construction project management for mission-critical facilities and information infrastructures, as well as fees earned from providing equipment and maintenance services for these facilities. We also earn revenue from providing system configuration and integration services to IT equipment vendors. Currently we derive all of our revenue from the U.S. market.

We contract with our customers under five primary contract types: cost-plus-fee, guaranteed maximum price, time-and-materials, fixed-price contracts and fixed price service and maintenance contracts. Cost-plus-fee and guaranteed maximum price contracts are typically lower risk arrangements and thus yield lower profit margins than time-and-materials and fixed-price arrangements which generate higher profit margins generally, relative to their higher risk. Where customer requirements are clear, we prefer to enter into time-and-materials and fixed-price arrangements rather than cost-plus-fee and guaranteed maximum price contracts.

Most of our revenue is generated based on services provided either by our employees or subcontractors. To a lesser degree, the revenue we earn includes reimbursable travel and other costs to support the project. Since we earn higher profits from the labor services that our employees provide compared with use of subcontracted labor and other reimbursable costs, we seek to optimize our labor content on the contracts we are awarded in order to maximize our profitability.

We have been concentrating our sales efforts towards maintenance and integration services where we have traditionally earned higher margins. Historically our construction services were tied to a few, high-value contracts for the construction of new data centers at any point in time. In addition to contributing to large quarterly fluctuations in revenue depending upon project timing, these projects required additional working capital and generated lower margins than our maintenance and integration services. We have re-focused our construction services towards smaller scaled jobs typically connected with addition/move/retrofit activities rather than new construction, where we can obtain better margins. We have also focused on providing maintenance services for modular data center applications as this emerging market expands.

Revenues for the three-month period ended June 30, 2016 increased by \$1.2 million, or 20% compared to the same period in 2015. This increase reflects a \$0.4 million or 9% increase in our facilities services revenues as our project management activities increased due to a large customer project that began in the fourth quarter of 2015 and through the first half of 2016. This increase in revenues also reflects a \$0.8 million or 31% increase in our systems integration business compared to the second quarter of 2015 driven by higher demand for modular data center products from our largest channel partner compared to the prior year. Our revenue of \$7.0 million in the three-month period ended June 30, 2016 was 8% or \$0.7 million lower than the \$7.7 million in revenue we had in the first quarter of 2016, primarily due to lower levels of construction management and equipment procurement services.

Revenues for the six-month period ended June 30, 2016 increased by 12% or \$1.5 million compared to the same period in 2015. This was driven by a \$2.3 million, or 24%, increase in our facilities services revenues as we procured equipment and managed a large data center build project in 2016. This increase was offset by a \$0.8 million or 22% decrease in systems integration revenues, reflecting lower levels of customer demand in modular data center products.

Our facility construction management projects tend to be larger in value than the contracts for our other products and services and from a smaller number of customers. These projects have greater transaction values and can contribute to large quarterly fluctuations in revenue due to the timing of such projects and their fulfillment, as evidenced by comparing our 2016 results to the prior year where 2016 included such a project but the prior year did not. We have historically had such projects with values that exceeded \$10 million annually. A small number of these transactions could lead to a significant increase in revenue but cause greater volatility in our quarterly results depending on the deployment timetable of the projects. These projects also increase our liquidity risk because they tend to be longer in duration and require larger amounts of working capital to fulfill, which we attempt to manage through customer and vendor payment terms, including paid-when-paid terms, as part of our working capital management.

#### *Cost of revenue*

Cost of revenue includes the cost of component parts for our products, labor costs expended in the production and delivery of our services, subcontractor and third-party expense, equipment and other costs associated with our test and

integration facilities, including depreciation of our manufacturing property and equipment, shipping costs, and the costs of support functions such as purchasing, logistics and quality assurance. The cost of revenue as a percentage of revenue was 69% for the three-month period ended June 30, 2016 compared to 75% for the same period in 2015 and 83% in the first quarter of 2016. This decrease is because of a lower level of equipment procurement costs in 2016 and better utilization of our systems integration facility in 2016 compared to the same period in 2015 as revenues from this business unit increased. We have higher costs and lower margins from project management activities including equipment procurement, and this revenue decreased in absolute value and as a percentage of our total revenues during the second quarter of 2016 compared to the second quarter of the prior year, resulting in a lower cost of revenue.

For the six-month period ended June 30, 2016 the cost of revenue as a percentage of revenue was 76%, compared to 71% in the same period of 2015. This increase reflects the higher project management services revenue in 2016 that involved a higher use of subcontractors and higher levels of equipment procurement, increasing the cost of revenues.

Since we earn higher profits on our own labor services, we expect the ratio of cost of services to revenue to decline when our labor services mix increases relative to the use of subcontracted labor or third-party material. Our systems integration activities mainly comprise labor services, so growth in this business will favorably impact the ratio of cost of services to revenue. Conversely, as subcontracted labor or third-party material purchases for customer projects increase relative to our own labor services or overall cost of services, we expect the ratio of cost of services to revenue to increase. Our direct labor costs are relatively fixed in the short-term, and the utilization of direct labor is critical to maximizing our profitability. As we continue to bid and win larger contracts or win contracts that require specialized skills that we do not possess, we would expect to have more third-party subcontracted labor to help us fulfill those contracts, particularly with our construction management services. In addition, we can face hiring challenges in internally staffing larger contracts. While these factors could lead to a higher ratio of cost of services to revenue, the economics of these larger jobs are nonetheless generally favorable because they increase income, broaden our revenue base and have a favorable return on invested capital.

A large portion of our revenue is derived from fixed price contracts. Under these contracts, we set the price of our services and assume the risk that the costs associated with our performance may be greater than we anticipated. Our profitability is therefore dependent upon our ability to estimate accurately the costs associated with our services. These costs may be affected by a variety of factors, such as lower than anticipated productivity, conditions at the work sites differing materially from what was anticipated at the time we bid on the contract, and higher than expected costs of materials and labor. Certain agreements or projects could have lower margins than anticipated or losses if actual costs for contracts exceed our estimates, which could reduce our profitability and liquidity.

### *Gross Profit*

For the three-month period ended June 30, 2016 our gross profit was 31% of revenue, compared to a gross profit margin of 25% in the second quarter of 2015 and a gross profit margin of 17% in the first quarter of 2016. This increase resulted in our gross profit of \$2.2 million for the quarter, compared to a gross profit of \$1.4 million on lower revenue in the second quarter of 2015. This comparison highlights the differences in profit margins for our different service offerings. Our revenue mix in this current quarter was significantly more favorable from a profit perspective as our revenue growth was from our higher margin activities including systems integration and modular data center deployment activities. For the six-month period ended June 30, 2016 our gross profit was 24% of revenue compared to 29% in the same period of 2015. This decrease resulted in our gross profit of \$3.5 million being \$0.4 million or 10% lower than the 2015 gross profit of \$3.8 million, despite the higher revenue. The year to date results reflects the higher equipment purchases and project management activities compared to the first half of 2015 that generate lower gross profits for our business.

Our goal is to offer a broad range of data-center related service offerings but to focus our business on the higher-margin activities such as systems integration and facility maintenance services. Our ability to further improve gross margins will depend, in part, upon our ability to further increase sales of our higher-margin services including maintenance and integration services, improve our service margins through further pricing and operating efficiency including utilization of our direct labor, and increasing our total revenues to a level that will allow us to increase the utilization of our integration and service operations.

### *Selling, General and Administrative Expenses*

Selling, general and administrative expenses primarily consists of compensation and related expenses, including variable sales compensation, for our executive, administrative and sales and marketing personnel, as well as related travel, selling and marketing expenses, professional fees, facility costs, insurances and other corporate costs. For the three-month period ended June 30, 2016 our selling, general and administrative expenses decreased by \$348,000 or 14% compared to the same period of 2015. This decrease was due to lower headcount related costs and lower professional fees, including accounting and legal fees. For the six-month period ended June 30, 2016 our selling, general and administrative expenses decreased by \$700,000 or 14% compared to the same period of 2015. This decrease was also due to lower headcount and lower professional fees in 2016.

### *Operating income (loss)*

For the three-month period ended June 30, 2016 our operating loss was \$60,000. This was a 95% reduction from the \$1.1 million operating loss that we had in the second quarter of 2015. This improvement was driven by improved gross profits from an improved revenue-mix, and lower operating expenses. For the six-month period ended June 30, 2016 our operating loss of \$1.15 million was a 21% decrease from the \$1.5 million loss that we had in the first half of 2015. This decrease was driven by lower operating expenses, primarily headcount and professional fees.

## **LIQUIDITY AND CAPITAL RESOURCES**

Our primary sources of liquidity at June 30, 2016 are our cash and cash equivalents on hand, funds available under our receivable factoring agreement and projected cash flows from operating activities. In December 2015, we restructured the repayment terms of our notes payable held by Mr. Gallagher, a director and our Chief Technical Officer, to defer repayment of a large portion of this obligation to 2017, further reducing short term liquidity requirements on our business.

If we continue to meet the cash flow projections in our current business plan, we expect that we will have adequate capital resources necessary to continue operating our business for at least the next twelve months. Our business plan and our assumptions around the adequacy of our liquidity are based on estimates regarding expected revenues and future costs. However, there are potential risks, including that our revenues may not meet our projections, our costs may exceed our estimates, or our working capital needs may be greater than anticipated. Further, our estimates may change and future events or developments may also affect our estimates. Any of these factors may change our expectation of cash usage in the remainder of 2016 and beyond or significantly affect our level of liquidity, which may limit our opportunities to grow our business.

In May 2016, we entered into a full-recourse receivables factoring agreement with RTS Financial Service, Inc. (RTS) whereby RTS may purchase eligible accounts receivable from us. RTS will advance 80% of the face value of our receivables and the balance (less fees) is paid to us after our customer remits funds to RTS. Advances are subject to a financing cost of prime plus 7% per annum. Advances under this agreement are at the discretion of RTS and there is no maximum or committed facility amount such as existed under our bank-based revolving credit facility. We have not yet determined what impact, if any, that this different type of financing facility will have on our liquidity and working capital management, or if it will be adequate for our needs. Upon entering this facility with RTS we repaid all outstanding amounts due under our revolving credit facility with Bridge Bank.

Our quarterly operating results have shown mixed results over the last year with large quarterly fluctuations in revenue and operating results. Our quarterly revenues have fluctuated between \$5.8 million to \$10.1 million. Our gross profit margin has ranged from 17% to 33%, and our operating results have varied from an operating loss of \$1.1 million to an operating profit of \$0.1 million in the fourth quarter of 2015. As a result of these fluctuations, we continue to look at alternative sources of funding to strengthen our balance sheet and to further improve our liquidity. We are currently evaluating both debt and equity financing alternatives. There can be no guarantee that such financing will be available to or that we will complete any such financing.

As of June 30, 2016 and December 31, 2015, we had cash and cash equivalents of \$0.5 million and \$1.1 million, respectively.

#### *Significant uses of cash*

#### *Operating activities:*

Cash provided by operating activities for the six-month period ended June 30, 2016 was \$1.5 million compared to cash used in operating activities for the six-month period ended June 30, 2015 of \$1.1 million. This increase was primarily driven by reductions in our accounts receivables and overall working capital requirements, and by reduction of our net losses of approximately \$300,000 compared to the first half of 2015.

Changes in our working capital are driven by changes in the timing of product orders and delivery of products and services. We derive revenue from different products and services and some of these, in particular our project management services, can be large in value, exceeding \$10 million in certain cases. As we or our subcontractors perform work on these large contracts, we have significant fluctuations in the level of our receivables and payables, especially on a quarterly basis. We had one large construction management project commence in the fourth quarter of 2015 and continue into the first half of 2016, but did not have such a project in progress at the end of the first quarter of 2015. The timing and completion of this project contributed to a \$4.5 million decrease in our accounts receivable since December 31, 2015 offset by a \$1.4 million decrease in our accounts payable since December 31, 2015 for this one project.

#### *Investing activities:*



Cash used in investing activities in 2016 consists of purchases of property and equipment. Our capital expenditures were approximately \$176,000 as we invested in additional equipment and testing infrastructure in our systems integration facility, and invested in sales management and time management software.

*Financing activities:*

Cash used in financing activities was \$2 million for the six-month period ended June 30, 2016 compared to cash provided by financing activities of \$811,000 for the same period in 2015. The primary use of cash in 2016 was the repayment of \$2.15 million to Bridge Bank upon expiration of our revolving credit facility. We replaced this revolving credit facility with a receivables factoring agreement in the second quarter of 2016 and received proceeds of \$1,754,000 under this agreement. \$1.4 million of cash was subsequently collected and applied against this borrowing. In 2015 we borrowed \$945,000 from new long-term debt and repaid \$150,000 against our notes payable to Mr. Gallagher. In 2016 we also repaid \$150,000 against our notes payables to Mr. Gallagher.

*Future uses of cash*

Our history of operating losses, declining current ratio, and our stockholders' deficit may, in themselves, cause uncertainty about our ability to continue to operate our business as a going concern. In December 2015, we restructured the repayment terms of our notes payable held by Mr. Gallagher, a director and our Chief Technical Officer, to defer payments of a large portion of this obligation to 2017, further reducing short term liquidity requirements on our business. In the first half of 2016 we repaid \$2.15 million against our bank-based revolving credit facility. In May 2016 we entered into a new financing agreement to factor our receivables to replace the bank credit facility upon its expiration. During 2015, we also adjusted our overhead structure to reduce our level of overhead as business conditions and our revenue mix changed. We believe that there are further adjustments that could be made to our business if we were required to do so.

Our business plans and our assumptions around the adequacy of our liquidity are based on estimates regarding estimated revenues and future costs and our ability to secure these sources of funding if needed. However, our revenue may not meet our expectations or our costs may exceed our estimates. Further, our estimates may change and future events or developments may also affect our estimates. Any of these factors may change our expectation of cash usage during 2016 and beyond or significantly affect our level of liquidity, which may require us to seek additional financing or take other measures to reduce our operating costs in order to continue operating. Any action to reduce operating costs may negatively affect our range of products and services that we offer or our ability to deliver such products and services, which could materially impact our financial results depending on the level of cost reductions taken. The consolidated financial statements included in this filing do not include any adjustments that might result from the Company not being able to continue as a going concern.

If we have to raise additional funds through the issuance of convertible debt or equity securities, the ownership of our existing stockholders could be significantly diluted. If we obtain additional debt financing, a substantial portion of our operating cash flow may be dedicated to the payment of principal and interest on such indebtedness, and the terms of the debt securities issued could impose significant restrictions on our operations. We do not know whether we will be able to secure additional funding, or funding on terms acceptable to us, to continue our operations as planned. If financing is not available, we may be required to reduce, delay or eliminate certain business activities or to sell all or parts of our operations.

Our primary liquidity and capital requirements are to fund working capital for current operations. Our primary sources of funds to meet our liquidity and capital requirements include cash on hand, funds generated from operations including the funds from our customer financing programs, and borrowings under our receivables factoring agreement. We believe that if future results do not meet expectations, we can implement reductions in selling, general and administrative expenses to better achieve profitability and therefore improve cash flows, or that we could take further steps such as the issuance of new equity or debt or the sale of part or all of our operations. However, the timing and effect of these steps may not completely alleviate a material effect on liquidity.

#### *Off-Balance Sheet Arrangements*

As of June 30, 2016 and December 31, 2015, we had no off balance sheet arrangements.

#### *Critical Accounting Policies and Pronouncements*

There have been no material changes to our critical accounting policies and estimates as set forth in the Annual Report for the year ended December 31, 2015. See also Item 1. Financial Statements *Note 1 – Significant Accounting Policies* regarding Recent Accounting Pronouncements.

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

Not applicable.

#### **Item 4. Controls and Procedures.**

Our management performed an evaluation under the supervision and with the participation of our Chief Executive Officer (principal executive officer) and our Chief Financial Officer (principal financial officer) of the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) or 15d-15(e) of the Securities Exchange Act of 1934, as amended) as of June 30, 2016. Based upon that evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that, as of June 30, 2016, the Company's disclosure controls and procedures were effective such that information relating to the Company (including its combined subsidiaries) required to be disclosed in the Company's SEC reports (1) is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and (2) is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding financial disclosures.

Management, including the Chief Executive Officer and the Chief Financial Officer, assesses the effectiveness of the Company's internal control over financial reporting as of June 30, 2016. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations ("COSO") of the Treadway Commission's 2013 Internal Control-Integrated Framework. Management has determined that the Company's internal controls over financial reporting were effective as of June 30, 2016.

#### **Changes in Internal Control over Financial Reporting**

There were no changes in the Company's internal control over financial reporting for the three months ended June 30, 2016 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting as such term is defined in Rule 13a-15 and 15d-15 of the Exchange Act of 1934, as amended.

## **PART II - OTHER INFORMATION**

### **Item 1. Legal Proceedings.**

Currently, we are not a party to any material litigation in any court, and management is not aware of any contemplated proceeding by any governmental authority against us. From time to time, we are involved in various legal matters and proceedings concerning matters arising in the ordinary course of business. We currently believe that any ultimate liability arising out of these matters and proceedings will not have a material adverse effect on our financial position, results of operations or cash flows.

### **Item 1A. Risk Factors.**

*If we are unable to raise additional capital as needed, we may not be able to satisfy our obligations as they become due.*

Our primary sources of funds to meet our liquidity and capital requirements include cash on hand, funds generated from operations including the funds from our customer financing programs, and borrowings under our receivables factoring agreement. In May 2016 we entered into a receivables factoring agreement with RTS. Under the terms of this agreement, we may offer for sale, and RTS in its sole discretion may purchase eligible receivables of the Company (the "Purchased Accounts"). Upon purchase, RTS becomes the absolute owner of the Purchased Accounts, which are payable directly to RTS, subject to certain repurchase obligations of the Company. The willingness of RTS to make advances to us by purchasing eligible accounts receivable is subject to customary conditions for financings of this nature. If we are unable to satisfy those conditions, RTS could refrain from providing financing to us, and we might not have sufficient cash on hand to fund our ongoing operations.

As a result, we would need to raise additional capital or obtain additional credit to fund our operations in the future. The failure to raise capital, or obtain credit when needed, on acceptable terms, could have a material adverse effect on our business, prospects, financial condition and results of operations, and we may not be able to continue our business as currently contemplated or may be required to seek protection under United States federal bankruptcy law.

**Item 6. Exhibits.**

- 31.1\* Certification of TSS, Inc. Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2\* Certification of TSS, Inc. Interim Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1\*\* Certification of TSS, Inc. Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2\*\* Certification of TSS, Inc. Interim Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

- 101.INS\* XBRL Instance Document
- 101.SCH\* XBRL Taxonomy Extension Schema
- 101.CAL\* XBRL Taxonomy Extension Calculation Linkbase
- 101.DEF\* XBRL Taxonomy Extension Definition Linkbase
- 101.LAB\* XBRL Taxonomy Extension Label Linkbase
- 101.PRE\* XBRL Taxonomy Extension Presentation Linkbase

\* Filed herewith.

\*\*Furnished herewith.

**SIGNATURES**

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

**TSS, INC.**

Date: August 15, 2016 By: /s/ Anthony Angelini  
Anthony Angelini  
President and Chief Executive Officer  
(Principal Executive Officer)

By: /s/ John K. Penver  
John K. Penver  
Chief Financial Officer  
(Principal Financial Officer)