TSS, Inc.
Form 10-Q
November 14, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 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	**20-2027651**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
110 E. Old Settlers Blvd Austin, Texas	**78664**
(Address of principal executive offices)	(Zip Code)

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

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

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

Number of shares of common stock outstanding as of November 11, 2016 15,645,824

TSS, INC.

QUARTERLY REPORT ON FORM 10Q

For the Quarterly Period Ended September 30, 2016

“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 a 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)

	September 30, 2016 (unaudited)	December 31, 2015
Current Assets:		
Cash and cash equivalents	$ 978	$ 1,132
Contract and other receivables, net	2,996	6,997
Costs and estimated earnings in excess of billings on uncompleted contracts	265	1,084
Inventories, net	66	66
Escrow receivable	190	-
Prepaid expenses and other current assets	291	235
Total current assets	4,786	9,514
Property and equipment, net	603	702
Goodwill	1,907	1,907
Intangible assets, net	739	841
Other assets	29	30
Total assets	$ 8,064	$ 12,994
Current Liabilities:		
Long-term borrowings, current portion	$ 320	$ 287
Borrowings under line of credit	-	2,150
Borrowings under receivable financing agreement	605	-
Accounts payable and accrued expenses	5,887	7,608
Billings in excess of costs and estimated earnings on uncompleted contracts	1,983	2,476
Total current liabilities	8,795	12,521
Long-term borrowings, less current portion	833	1,036
Other liabilities	40	37
Total liabilities	9,668	13,594
Commitments and Contingencies	-	-

Stockholders' Equity (Deficit):						
Preferred stock, $.0001 par value; 1,000 shares authorized at September 30, 2016 and December 31, 2015; none issued		-			-	
Common stock, $.0001 par value; 49,000 shares authorized at September 30, 2016 and December 31, 2015; 16,370 and 16,366 issued at September 30, 2016 and December 31, 2015, respectively		2			2	
Additional paid-in capital		68,496			68,329	
Treasury stock, 724 shares at cost at September 30, 2016 and December 31, 2015		(1,531	)		(1,531	)
Accumulated deficit		(68,571	)		(67,400	)
Total stockholders' equity (deficit)		(1,604	)		(600	)
Total liabilities and stockholders' equity (deficit)	$	8,064		$	12,994	

See accompanying notes to the consolidated financial statements.

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TSS, Inc.

Consolidated Statements of Operations

(in thousands, except per-share amounts; unaudited)

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
	2016	2015	2016	2015
Revenue	$ 5,416	$ 6,292	$ 20,120	$ 19,411
Cost of revenue	3,955	4,292	15,186	13,565
Gross profit	1,461	2,000	4,934	5,846
Selling, general and administrative expenses	1,970	2,383	6,299	7,412
Depreciation and amortization	161	144	459	422
Gain on sale of business component	(910)	-	(910)	-
Total operating costs	1,221	2,527	5,848	7,834
Income (loss) from operations	240	(527)	(914)	(1,988)
Other income (expense):				
Interest expense, net	(72)	(74)	(263)	(233)
Other income(expense), net	(3)	-	6	-
Income (loss) from operations before income taxes	165	(601)	(1,171)	(2,221)
Income tax provision	-	-	-	-
Net income (loss)	$ 165	$ (601)	$ (1,171)	$ (2,221)
Basic and diluted loss per share:				
Income (loss) per common share	$ 0.01	$ (0.04)	$ (0.07)	$ (0.14)

See accompanying notes to the consolidated financial statements.

TSS, Inc.

Consolidated Statements of Changes in Stockholders’ Equity (Deficit)

For the Nine Months Ended September 30, 2016

(in thousands, unaudited)

	Common Stock		Additional Paid-in	Treasury Stock		Accumulated	Total Stockholders' Equity
	Shares	Amount	Capital	Shares	Amount	Deficit	(Deficit)
Balance January 1, 2016	16,366	$ 2	$ 68,329	724	$ (1,531)	$ (67,400)	$ (600)
Restricted stock issuance	84	-	-	-	-	-	-
Stock-based compensation	-	-	167	-	-	-	167
Cancellation of restricted stock	(80)	-	-	-	-	-	-
Net loss	-	-	-	-	-	(1,171)	(1,171)
Balance at September 30, 2016	16,370	$ 2	$ 68,496	724	$ (1,531)	$ (68,571)	$ (1,604)

See accompanying notes to the consolidated financial statements.

TSS, Inc.

Consolidated Statements of Cash Flows

(in thousands; unaudited)

	Nine Months Ended September 30, 2016	2015
Cash Flows from Operating Activities:		
Net loss	$ (1,171)	$ (2,221)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	459	422
Amortization of discount on notes payable	49	42
Stock-based compensation	167	381
Provision (recoveries) for doubtful accounts	(5)	(11)
Gain on sale of business component	(910)	-
Changes in operating assets and liabilities:		
Contract and other receivables	3,828	723
Costs and estimated earnings in excess of billings on uncompleted contracts	577	142
Inventories, net	-	80
Prepaid expenses and other current assets	(65)	(282)
Accounts payable and accrued expenses	(1,583)	(777)
Billings in excess of costs and estimated earnings on uncompleted contracts	(37)	420
Other liabilities	3	(13)
Net cash provided by (used in) operating activities	1,312	(1,094)
Cash Flows from Investing Activities:		
Capital expenditures	(242)	(282)
Proceeds from sale of business component	546	-
Net cash provided by (used in) investing activities	304	(282)
Cash Flows from Financing Activities:		
Payment on long term borrowings	(225)	(175)
Proceeds from (payments on) line of credit	(2,150)	221
Proceeds from receivables financing agreement	605	-
Proceeds from issuance of debt	-	945
Net cash provided by (used in) financing activities	(1,770)	991
Net decrease in cash and cash equivalents	(154)	(385)
Cash and cash equivalents at beginning of period	1,132	1,378
Cash and cash equivalents at end of period	$ 978	$ 993
Supplemental disclosure of cash flow information:		
Cash paid for interest	$ 210	$ 176
Cash paid for taxes	$ 44	$ 76
Supplemental non-cash investing and financing information:		
Issuance of warrants in connection with debt	$ -	$ 168

Escrow receivable	$ 190	$ -

See accompanying notes to the consolidated financial statements.

TSS, Inc.

Notes to Consolidated Statements

September 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, constr 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 September 2016 we sold a portion of our facilities maintenance business component for a purchase price of $950,000. This transaction, along with other cost reductions we made, provided additional capital for our business, lowered our total operating costs, and allowed us to focus our business activities on system integration and modular data center build and maintenance activities. 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 September 30,				Nine Months Ended September 30,			
	2016		2015		2016		2015	
US-based IT OEM	37	%	37	%	35	%	44	%
US based data center company	-		5	%	18	%	8	%
US-based retail company	6	%	20	%	24	%	12	%
US-based technology company	20	%	11	%	12	%	4	%

No other customers represented more than 10% of our revenues for any periods presented. Our US-based IT OEM customer represented 22% and 6% of our accounts receivable at September 30, 2016 and December 31, 2015, respectively. A US-based retail customer represented 18% and 13% of our accounts receivable at September 30, 2016 and December 31, 2015, respectively. A US-based IT services company represented 34% of our accounts receivable at September 30, 2016. A US-based staffing and services company represented 11% of our accounts receivable at September 30, 2016. A US-based data center company represented 47% of our accounts receivable at December 31, 2015. No other customer represented more than 10% of our accounts receivable at September 30, 2016 or at December 31, 2015.

Recent Accounting Guidance

Recently adopted Accounting Guidance

In April 2014, the FASB issued ASU No. 2014-08, *Presentation of Financial Statements (Topic 205) and Property, Plant and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity* (“ASU 2014-08”). ASU 2014-08 requires that a disposal representing a strategic shift that has (or will have) a major effect on an entity’s financial results or a business activity classified as held for sale shall be reported as discontinued operations. ASU 2014-08 also expands the disclosure requirements for discontinued operations and adds new disclosures for individually significant dispositions that do not qualify as discontinued operations. ASU 2014-08 was effective for us for our fiscal year beginning January 1, 2015. ASU 2014-08 was considered in regards to the sale of a portion of our facility maintenance component in September 2016 (see Note 5 – Sale of Business Component).

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):

	September 30, 2016	December 31, 2015
Contract and other receivables	$ 2,999	$ 7,016
Allowance for doubtful accounts	(3)	(19)
	$ 2,996	$ 6,997

Inventories

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

	September 30, 2016	December 31, 2015
Raw materials	$ 68	$ 68
less: Reserve	(2)	(2)
Inventories, net	$ 66	$ 66

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Goodwill and Intangible Assets

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