TSS, Inc.
Form 10-K
March 21, 2019

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2018

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from __________ to __________

Commission file number: **001-33627**

TSS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**20-2027651**
(State or other jurisdiction	*(I.R.S. Employer Identification No.)*

of incorporation or organization)

110 E. Old Settlers Road **78664**
Round Rock, TX *(Zip Code)*
(Address of principal executive offices)

Registrant's telephone number, including area code

(512)-310-1000

Securities registered pursuant to Section 12(b) of the Exchange Act: None

Securities registered pursuant to Section 12(g) of the Exchange Act:

Common Stock, $.0001 par value

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes No

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes No

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Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer Accelerated filer Non-accelerated filer
Smaller reporting company
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of June 30, 2018, the aggregate market value of the registrant's voting and non-voting Common Stock held by non-affiliates of the registrant was approximately $5,142,712. Such aggregate market value was computed by reference to the closing sale price of the Common Stock as reported on the OTCQB tier of OTC Markets Group, Inc., a centralized quotation service that collects and publishes market maker quotes for over-the-counter securities, on such date. For purposes of making this calculation only, the registrant has defined "affiliates" as including all directors, executive officers and stockholders owning more than 10% of the registrant's common stock, but excluding any institutional stockholders owning 10% or more of the registrant's common stock.

Number of shares of Common Stock outstanding as of March 21, 2019: 17,217,919

DOCUMENTS INCORPORATED BY REFERENCE

Certain portions of the registrant's Definitive Proxy Statement, relating to our 2019 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission not later than 120 days after the end of the 2018 fiscal year are incorporated by reference into Part III of this Annual Report on Form 10-K.

TSS, INC.

ANNUAL REPORT ON FORM 10-K

For the Fiscal Year Ended December 31, 2018

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“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 Annual Report on Form 10-K (this “Annual Report”), as well as those made in other filings with the SEC.

Forward-looking statements can be identified by the use of forward-looking terminology such as “believes,” “estimates,” “anticipates,” “expects,” “may,” “will,” “continue,” “forecast,” “foresee” or other similar words. Such forward-looking stateme based on our 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 Item 1A of this Annual Report.

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

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

PART I.

Item 1. Business

Company Overview

TSS, Inc. is a provider of comprehensive services for the planning, design, deployment, maintenance, and refurbishment of end-user and enterprise systems, including the mission-critical facilities they are housed in. We provide a single-source solution for enabling technologies in 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 consist of technology consulting, design and engineering, project management, systems integration, system installations and facilities management.

We were incorporated in Delaware in December 2004. Our headquarters and integration facility are located in Round Rock, Texas.

Our business is concentrated on the data center infrastructure and services market. While this market continues to be highly competitive as commerce moves to cloud-based solutions and as data storage and compute requirements continue to escalate exponentially driven by video, mobility, edge computing and big data requirements. These underlying macroeconomic trends are driving demand for more information technology equipment, and more efficient data center design and operations, resulting in continued overall growth in this market. We compete in large growing market segments, often against larger competitors who have greater resources. We have been successful with several large customers in winning contracts and providing business to us under “Master Service Agreements”, and the loss of any such customers could have a material negative effect on our results.

Since mid-2016 we have changed our business strategy to pivot the business focus from large, one-off, low-margin data center design and build projects, towards providing services that generate higher margins and provide recurring revenue streams from ongoing services, such as our facilities maintenance offering and our systems integrations services. This shift was intended to reduce quarterly fluctuations in revenues and margins, and to transition us towards higher margin service lines to improve the overall profitability of the Company. In 2016 we sold a portion of our facilities management business in Maryland that was not geared towards the modular data center market, and we made the decision to outsource multiple services including consulting engineering and project management that we had previously provided directly. We can still provide these services to customers when required and will do so when it will lead to additional higher margin service offerings that we provide. We will provide these former services through

use of third-party contractors or internal resources. In January 2017, we sold a customer contract that was a part of our project management business. Collectively these actions generated $1.3 million in proceeds, resulted in staffing and overhead cost reductions, and allowed us to close our facility in Maryland. In December of 2018 we completed this strategic transition by selling our business in Virginia that was a reseller and installer of electrical and cooling systems, and this sale generated a further $2.5 million in proceeds. As we have undergone this transition, these actions had reduced our level of operating expenses and allowed us to significantly improve our gross profit and to achieve operating profitability on a quarterly and annual basis in both 2017 and 2018 in addition to substantially strengthening our balance sheet.

Service Offerings

We have developed a unique set of solution offerings whereby we provide a range of services that enable our customers and partners to more efficiently plan, develop, deploy and maintain data centers and their related assets along with end user systems. These solutions begin with strategies for the care of information technology assets that are being housed in the facility or modular data centers, including power, cooling and heat rejection, as well as disaster recovery backup systems. Our operating expenses are not exclusively aligned to each service offering, as shared resources such as sales, marketing and general and administrative expenses support all services. Our solutions involve all aspects of the life cycle of both traditional and modular data centers and are described in more detail below.

Facilities Services:

Consulting:

During the initial phase of a data center project, we provide project development-related services that typically include establishing project goals and a preliminary budget and schedules, setting technical parameters and requirements, and determining project team members and the overall requirements of the team.

Design and engineering consulting services typically include critical power and mechanical load calculations, mechanical design and engineering, high and medium voltage electrical design and engineering, communications and security systems design and engineering, physical vulnerability assessments, force protection design and bomb blast analyses, fire protection system design and engineering, facility systems equipment selection and facility commissioning and testing. These offerings also include post commissioning support of on-going operations.

Our strategy is intended to increase the amount of recurring revenues we generate from our existing customers, IT equipment partners, and major systems integrators. Our mission critical facilities experience and skills position us as a trusted advisor to our customers and allow us to work on new opportunities as our customers grow and partners introduce us to new client opportunities.

Deployment:

In connection with the deployment of a customer’s data center or related equipment requirements, our capabilities include project management, value engineering and design management, bid negotiation support, subcontractor pre-qualification and selection, long-lead equipment procurement, issuance of equipment and construction contracts, and refinement and management of project budgets and schedules. Our project managers mobilize the required expertise for the project, utilizing project superintendents, quality control and safety professionals, as well as qualified subcontractors and support personnel. Project managers supervise work by project team members, including subcontracted parties, including all aspects of the following: architecture and construction, electric power systems, heat rejection and cooling, energy management and controls, cooling tower systems, security systems, voice, data and network cabling, fire and life safety systems, and process piping and plumbing systems. The project manager remains responsible for managing all aspects of the project until project completion and customer delivery.

In addition, this installation portion of a project has the largest number of outside influences that can impact project goals and objectives, such as weather, non-performance of subcontractors, equipment deliveries, unexpected project

changes from the owner, and influence from local authorities and utility providers. Therefore, management experience, skill and mission focus are critical during the project installation period.

Management:

We provide a comprehensive maintenance and service offering designed to ensure that the multiple systems critical to sustaining on-line applications in technologically intensive facilities and modular data centers remain operational and functional. Typical facilities management services include overall management of the post-construction facility maintenance program, and on-site staffing of technical engineering positions (*e.g.,* electricians, HVAC mechanics, control technicians and voice/data technicians). Increasingly, data centers are being constructed in a modular format, whereby information technology, power and other related assets are deployed in pre-integrated solutions. Modular data centers may have lower overall cost of delivery, lower energy consumption and shorter deployment schedules compared to traditional data centers. Our on-site maintenance services provide additional project revenue for us and position us for involvement in any new facility planning, design and construction initiatives that the customer undertakes.

In addition, we provide 24X7 Network Operations support from our Round Rock, Texas facility that has the capability of remotely monitoring our data center service contract customers' facilities for systems operations and emergency events that could lead to outages. Temperature levels, humidity, electrical connectivity, power usage and fire alarm conditions are among the items monitored. The system maintains all site documentation for repairs and maintenance performed on each critical piece of equipment covered under our services. The information is useful to our customers in assessing operational efficiency and causes of failure and enables them to make critical decisions on repair or replacement strategies based on the operating history of the monitored systems.

Our facilities maintenance service contracts are typically one to four years in duration with cancellation clauses for nonperformance and are typically billed annually in advance. Our service contracts take different forms including fixed-price equipment maintenance with optional comprehensive warranty to fix failures in key components such as uninterruptible power supplies or batteries, ticket-based service provided at contracted rates in a master service agreement, comprehensive facility services agreements that include on site staffing, scheduled equipment maintenance and nontechnical facility services, and direct job-specific contracts for additional moves, add and change work within a facility.

As computer density increased and data centers evolved into the use of modular form factors, we found that we could leverage our facilities maintenance experience and infrastructure by offering maintenance service of modules being deployed into new data centers. The number of modular units under our service contracts has continued to expand. Our design services continue to evolve to support changing data center requirements including installation and maintenance of systems deployed on the edge. Ultimately, we started working with IT vendors to help them in the design and integration of their IT equipment into modular data centers, which typically leads to ongoing maintenance contracts as these modular systems deploy.

Systems Integration Services:

To assist our customers with IT-equipment deployment in their data centers we provide what we call “systems integration” services. We provide integrated technology services and software tools designed to accelerate the delivery of complex information technology solutions. These services include custom configuration of a broad scope of information technology products including client products, enterprise products, clusters and modular containers. The integration of this equipment at both a rack-level or modular data center level is performed to our customer specifications and test criteria. We are generally not responsible for the performance of the related equipment in the field. In addition, we provide warehousing of high value equipment such as servers, switches and other information technology hardware that are generally provided on a consignment basis. Occasionally, we will procure and resell the information technology hardware for our customers.

Customers

Our customers include IT equipment, technology and service companies, and private sector businesses that in some cases are the end users of the facility or in other cases are providing a facility to a government or commercial end user.

Three customers comprised 80% and 82% of our total revenue for the years ended December 31, 2018 and 2017, respectively.

Sales and Marketing

Our marketing approach emphasizes expertise in information technology hardware systems, energy consumption, real estate matters and facilities planning and operation. This marketing approach allows the customer to contract for comprehensive facilities services or to contract separately for each individual project phase. Our marketing program seeks to capitalize on our industry standing, including our existing relationships and our reputation based upon our performance on completed projects. We also seek to enhance our name recognition through the use of trade shows, technical seminars, direct mailings and the media. A key part of our selling strategy is entering into master service agreements with multiple partners and co-selling our range of services to the end-user customers of our partners, leveraging their customer relationships and broadening the scope of potential customers for us.

Our headcount in sales and marketing has fluctuated as we have worked to align the skill sets with our evolving service offering, leverage partner relationships and increase the consultative capability of our sales organization.

Maintaining key alliances is also crucial to sales development and growth and often provides us with introductions to the customers of our alliance partners. These alliances reside with various information technology consulting firms, specialty mission-critical engineering firms, application service providers and internet service providers. Key alliance opportunities also reside in other firms within the market sector such as equipment manufacturers, product suppliers, property management firms, developers, information technology system integrators and firmware providers. We have key strategic alliances with large information technology corporations to provide engineering, design, construction management services, systems integration, modular solutions and facility management services.

Competition

The mission-critical information technology solutions market is large, fragmented and highly competitive. We compete for contracts based on the strength of our customer relationships, successful past performance record, significant technical expertise, specialized knowledge and broad service offerings. We often compete against divisions of large information technology service and equipment providers of various sizes. Some of these competitors are large, well-established companies that have broader geographic scope and greater financial and other resources than us. In some cases, because of diverse requirements, we frequently collaborate with these and other competitors for large projects. We expect competition in the information technology services sector to continue to increase in the future.

Because of the breadth of services that we provide, we face many different competitors some of which are our customers or vendors. An example of some of our competitors include the following:

Modular data center design and configuration – IO, Schneider, Skanska, Vertiv
Data center rack and modular IT integration – Quanta, Jabil, Avnet, Supermicro, Hyve
Modular deployment – McKinstry
Data center facilities and modular maintenance – Brookfield GIS, JLL, CBRE

We believe that, while we face large and small competitors across the spectrum of our service offerings, we are uniquely positioned to provide services to IT and facilities across both modular and traditional data center markets. We believe by providing a single source solution focused in the data center market we provide meeting our customer’s requirements cost effectively.

Employees

At December 31, 2018, we had 67 full-time employees. Our future success will depend significantly on our ability to attract, retain and motivate qualified personnel. We are not a party to any collective bargaining agreement and we have not experienced any strikes or work stoppages. We consider our relationship with our employees to be satisfactory.

Available Information

We file annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and proxy statements relating to our annual stockholders' meeting with the Securities and Exchange Commission ("SEC"). Copies of these filings, including amendments to such filings are available, free of charge, on our website, www.totalsitesolutions.com, as soon as reasonably practicable after such material is electronically filed with, or furnished to, the SEC. Information contained on our website is not and should not be deemed to be a part of this Annual Report or a part of any other report or filing with the SEC. All reports that we file with the SEC are available to read and copy at the SEC's Public Reference Room at 100 F Street, NE, Washington, DC 20549, on official business days during the hours of 10:00 am to 3:00 pm. You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an internet site at www.sec.gov that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC.

Item 1A. RISK FACTORS

Our business involves a number of risks, some of which are beyond our control. The risks and uncertainties described below are not the only ones we face. Such factors could have a significant impact on our business, operating results and financial condition. We believe the most significant of these risks and uncertainties are as follows:

We derive a significant portion of our revenues from a limited number of customers.

We derive and believe that we will continue to derive in the near term a significant portion of our revenues from a limited number of customers. To the extent that any significant customer uses less of our services or terminates its relationship with us, our revenues could decline significantly, which could have a material adverse effect on our financial condition and results of operations. After the sale of certain components of our business in 2018 and 2017, our customer concentration increased and revenue from our largest customer comprised 66% and 67% of our total revenues for the years ended December 31, 2018 and 2017, respectively. Our three largest customers comprised 80% and 82% of total revenues for the years ended December 31, 2018 and 2017, respectively.

We recently sold a profitable business unit. Unless we increase revenues and profits from our remaining business offerings or acquire another line of business, our level of profitability may decrease.

In December 2018 we sold the assets of our electrical and cooling equipment and installation business for $2.5 million. This business contributed $1,239,000 towards our 2018 operating income. Unless we are able to increase the revenues and profitability of our existing facilities and systems integration businesses, or acquire another business to replace the profit contribution of the sold business unit, our overall level of profitability will decrease. Although we achieved positive net income in 2017 and 2018, we have a history of recurring annual net losses in prior years, and any failure to maintain or grow our revenue would adversely affect our business, financial condition, and operating results.

In recent prior years (including 2017 and 2016), our independent registered public accounting firm's report contained an explanatory paragraph that expresses substantial doubt about our ability to continue as a "going concern"

In its audit reports on our financial statements included in our prior annual reports (including our 2017 and 2016 annual reports), our independent registered public accounting firm noted that we had a history of operating losses and a net capital deficiency. As a result, those audit reports contained an explanatory paragraph that raises substantial

doubt about our ability to continue as a going concern.

Our quarterly operating results have shown improved results during 2018 and 2017. During this period, our quarterly revenues have fluctuated between $4.2 and $7.3 million. Our gross profit margin has ranged from 33% to 42%, and our operating results have allowed us to achieve operating profits in each quarter of 2018 and 2017. This level of profitability allowed us to eliminate the deficiency in our stockholder's equity and to eliminate the working capital deficit during 2018. In December 2018, we entered a 2-year, $1.5 million, receivables-based revolving line of credit facility with Texas Capital Bank, NA to provide us additional liquidity and financial flexibility for managing our working capital and business. Although our overall liquidity position significantly improved during 2018, we have a history of negative working capital, stockholder's deficit, and net operating losses that may cause uncertainty about our ability to operate our business as a going concern.

As the age of modular data centers increases and customers look to shut or replace such units, our level or recurring maintenance revenues could be negatively impacted, and this could adversely affect our operating results.

Modular Data Centers (MDC's) typically have an expected useful life between 5-8 years unless refreshed with new IT equipment. As they approach the end of their expected life, we would expect customers to terminate the annual maintenance contracts for those MDC's. This would cause the level of maintenance revenues and our profitability to be negatively impacted unless the units are immediately replaced. Our history suggests that customers will replace MDC's with new modules that will also be subject to an annual maintenance contract, however the time period between these two events could result in an overall decrease in our level of maintenance revenues.

We have substantial amounts of goodwill and other intangibles, and changes in future business conditions could cause these assets to become impaired, requiring substantial write-downs that would adversely affect our operating results.

We have substantial amounts of goodwill and other intangibles resulting from prior acquisitions of businesses. Under generally accepted accounting principles, we do not amortize goodwill and intangible assets acquired in a purchase business combination that are determined to have indefinite useful lives, but instead review them annually (or more frequently if impairment indicators arise) for impairment. We are amortizing certain other intangibles over their useful lives. To the extent we determine that such assets have been impaired, we will write-down their carrying value on our consolidated balance sheet and book an impairment charge in our consolidated statement of operations. During each of the years ended December 31, 2018 and 2017, we conducted such analyses that resulted in no impairment. During 2018 we wrote off $1.1 million of goodwill and $0.1 million of other finite-lived intangible assets that were attributable to the business component that we sold. After these write-offs, the net carrying value of goodwill and other indefinite lived intangibles totaled $0.8 and $1.9 million at December 31, 2018 and 2017, respectively, and the net carrying value of finite lived intangible assets totaled $0.4 million and $0.6 million at December 31, 2018 and 2017.

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We may be unable to raise additional capital if and when needed.

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 bank credit facility. 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 sources of funding when 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 2019 and beyond or significantly affect our level of liquidity. We may also require additional capital if we seek to acquire additional businesses as a way to increase the scale of our operations. Failure to raise capital when needed, on acceptable terms, could have a material adverse effect on our business, prospects, financial condition, and results of operations.

Most of our contracts may be canceled on short notice, so our revenue and potential profits are not guaranteed.

Most of our contracts are cancelable on short notice by the customer either at its convenience or upon our default. If one of our customers terminates a contract at its convenience, then we typically are able to recover only costs incurred or committed, settlement expenses and profit on work completed prior to termination, which could prevent us from recognizing all of our potential revenue and profit from that contract. If one of our customers terminates the contract due to our default, we could be liable for excess costs incurred by the customer in re-procuring services from another source, as well as other costs. Many of our contracts, including our service agreements, are periodically open to bid. We may not be the successful bidder on our existing contracts that are re-bid. We also provide a portion of our services on a non-recurring, project-by-project basis. We could experience a reduction in our revenue, profitability and liquidity if our customers cancel a significant number of contracts, we fail to win a significant number of our existing contracts upon re-bid or we complete the required work under a significant number of our non-recurring projects and cannot replace them with similar projects. In addition, we provide services under certain master service agreements. If these agreements are terminated, we would be unable to provide on-going services to those customers.

We submit change orders to our customers for work we perform beyond the scope of some of our contracts. If our customers do not approve these change orders, our results of operations could be adversely impacted.

We typically submit change orders under some of our contracts for payment of work performed beyond the initial contractual requirements. The applicable customers may not approve or may contest these change orders and we cannot assure you that these claims will be approved in whole, in part or at all. If these claims are not approved, our net income and results of operations could be adversely impacted.

We may not accurately estimate the costs associated with services provided under fixed-price contracts, which could impair our financial performance.

Approximately 85% 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.

We warrant customer equipment against failure in some of our fixed price contracts, and a major equipment failure could have a material impact on our financial performance.

Under some of our maintenance contracts we provide limited warranties for the continued performance of equipment, including batteries and actuators used in modular data centers. We estimate the anticipated failure or replacement rate of this equipment, but if a customer location experienced a failure rate of equipment greater than we anticipated, we would incur higher equipment replacement costs and incur a loss on that maintenance contract, and potentially this could have a material negative impact on our profitability and liquidity.

We may choose, or be required, to pay our subcontractors even if our customers do not pay or delay paying us for the related services.

We use subcontractors to perform many portions of our services and to manage work flow. In some cases, we pay our subcontractors before our customers pay us for the related services. If we choose, or are required, to pay our subcontractors for work performed for customers who fail to pay, or delay paying us for the related work, we could experience a decrease in profitability and liquidity.

We operate in a highly competitive industry, which could reduce our growth opportunities, revenue and operating results.

The mission-critical information technology industry in which we operate is highly competitive and continues to become more competitive. We often compete against divisions of large information technology consulting and integration companies, including several that are large domestic companies that may have financial, technical and marketing resources that exceed our own. These larger competitors have an infrastructure and support greater than ours, and accordingly, we continue to experience some price pressure as some companies are willing to take on projects at lower margins. Our competitors may develop the expertise, experience and resources to provide services that are equal or superior in both price and quality to our services, and we may not be able to maintain or enhance our competitive position. Our size often prevents us from bidding on larger, more profitable projects, which significantly reduces our growth opportunities. Although our customers currently outsource a significant portion of these services to us and our competitors, we can offer no assurance that our existing or prospective customers will continue to outsource specialty contracting services to us in the future.

The industries we serve have experienced and may continue to experience rapid technological, structural and competitive changes that could reduce the need for our services and adversely affect our revenues.

The mission-critical information technology industry is characterized by rapid technological change, intense competition and changing consumer and data center needs. We generate a significant portion of our revenues from customers in the mission-critical information technology industry. New technologies, or upgrades to existing technologies by customers, could reduce the need for our services and adversely affect our revenues and profitability. Improvements in existing technology may allow companies to improve their networks without physically upgrading them. Reduced demand for our services or a loss of a significant customer could adversely affect our results of operations, cash flows and liquidity.

We may be unable to hire and retain sufficient qualified personnel and the loss of any of our key executive officers may adversely affect our business.

We believe that our future success will depend in large part on our ability to attract and retain highly skilled, knowledgeable, sophisticated and qualified managerial, professional and technical personnel. Our business involves the development of tailored solutions for customers, a process that relies heavily upon the expertise and services of employees. Accordingly, our employees are one of our most valuable resources. Competition for skilled personnel is intense in our industry. Recruiting and training these personnel require substantial resources. Our failure to attract and retain qualified personnel could increase our costs of performing our contractual obligations, reduce our ability to efficiently satisfy our customers’ needs, limit our ability to win new business and constrain our future growth.

If we are unable to engage appropriate subcontractors or if our subcontractors fail to perform their contractual obligations, our performance as a prime contractor and ability to obtain future business could be materially and adversely impacted.

Our contract performance may involve subcontracts with other companies upon which we rely to perform all or a portion of the work we are obligated to deliver to our customers. Our inability to find and engage appropriate subcontractors or a failure by one or more of our subcontractors to satisfactorily deliver on a timely basis the agreed-upon supplies and/or perform the agreed-upon services may materially and adversely affect our ability to perform our obligations as a prime contractor.

In extreme cases, a subcontractor's performance deficiency could result in the customer terminating the contract for default with us. A default termination could expose us to liability for excess costs of procurement by the customer and have a material adverse effect on our ability to compete for future contracts and task orders.

Security breaches and attacks on our computer systems could lead to significant costs and disruptions that could harm our business, financial results and reputation.

We are reliant upon a number of third party and internally-developed software programs to operate our business. We store and transmit our own as well as customer information and data, including individual data of and about their end-user customers. Maintaining the security and availability of our services, network and internal IT systems and the security of information we hold is a critical issue or us and our customers. Any software failure or corruption, including cyber-based attacks or network security breaches, could lead to the dissemination of proprietary information or sensitive, personal or confidential data about us, our employees, customers and end-user customers, could threaten our ability to provide services to our customers, generate negative publicity about us, result in litigation and increased legal liability or costs or lead to government inquiry or oversight. The occurrence of any of these events could harm our business or damage our brand and reputation, lead to loss of customers, higher expenses and possibly imped our present and future success in retaining and attracting new customers.

A successful assault on our infrastructure would be damaging to our reputation and could adversely affect our financial condition. Similar security risks exist with respect to our business partners and the third-party vendors we rely on for aspects of our information technology infrastructure, support services and administrative functions. As a result, we are subject to the risk that the activities of our business partners and third-party vendors may adversely affect our business even if an attack or breach does not directly impact our systems.

Because we do not currently intend to pay dividends on our common stock, stockholders will benefit from an investment in our common stock only if it appreciates in value.

We have never declared or paid any cash dividends on our common stock. We currently intend to retain all future earnings, if any, for use in the operations and expansion of our business. As a result, we do not anticipate paying cash dividends in the foreseeable future. Any future determination as to the declaration and payment of cash dividends will be at the discretion of our board of directors and will depend on factors our board of directors deems relevant, including, among others, our results of operations, financial condition and cash requirements, business prospects, and the terms of our credit facility and other financing arrangements. Accordingly, realization of a gain on stockholders' investments will depend on the appreciation of the price of our common stock. There is no guarantee that our common stock will appreciate in value or even maintain the price at which stockholders purchased their shares.

Our insiders beneficially own a significant portion of our outstanding common stock. Future sales of common stock by these insiders may have an adverse effect on the market price of our common stock.

Our officers, directors or their affiliates beneficially own approximately 8.0 million shares of common stock or approximately 38.65% of our outstanding common shares as of March 21, 2019. Stock sales by our directors and officers are subject to compliance with our Code of Conduct and preapproval process from the Chief Financial Officer. Sales of a substantial number of these shares in the public market could decrease the market price of our common stock. In addition, the perception that such sales might occur may cause the market price of our common stock to decline. Future issuances or sales of our common stock could have an adverse effect on the market price of our common stock.

Our shares are thinly traded and may not be readily marketable.

Our shares are not widely traded, and daily trading volume is generally very low compared with most publicly traded companies. As a result, you may not be able to readily sell your shares in the company.

Our common stock may be characterized as a "penny stock" under applicable SEC regulations.

Our common stock may be characterized as "penny stock" under SEC regulations. As such, broker-dealers dealing in our common stock may be subject to the disclosure rules for transactions involving penny stocks, which generally require that, prior to a purchase, the broker-dealer determine if purchasing the common stock is suitable for the applicable purchaser. The broker-dealer must also obtain the written consent of the applicable purchasers to purchase the common stock and disclose the best bid and offer prices available for the common stock and the price at which the broker-dealer last purchased or sold the common stock. These additional burdens imposed upon broker-dealers may discourage them from effecting transactions in our common stock, which could make it difficult for an investor to sell his, her or its shares at any given time

Item 1B. Unresolved Staff Comments.

Not applicable.

Item 2. Properties.

We lease a production facility, warehouse and office space in Round Rock, Texas. We also lease a warehouse and office facility in Virginia which is now fully subleased. We believe that our current facilities are adequate for our operations and additional or replacement facilities would be available if necessary.

Item 3. Legal Proceedings

We are not a party to any material litigation in any court, and we are 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 believe that any potential 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 4. Mine Safety Disclosures

Not applicable.

PART II

Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

The market for our common stock is limited due to the relatively low trading volume of our common stock and lack of analyst coverage. Our common stock is currently quoted on the OTCQB tier of OTC Markets Group, Inc. under the symbol “TSSI.” The OTCQB is a centralized quotation service that collects and publishes market maker quotes for over-the-counter securities in real time. Over-the-counter market quotations, like those on the OTCQB, reflect inter-dealer prices, without retail mark-up, mark-down or commission and may not necessarily represent actual

transactions.

The following table sets forth the high and low bid prices for our common stock for each of the quarters of 2018 and 2017 as reported by the OTC Markets Group:

	2018		**2017**	
	Low	**High**	**Low**	**High**
First Quarter	$0.31	$0.65	$0.04	$0.22
Second Quarter	0.37	0.53	0.13	0.25
Third Quarter	0.41	0.85	0.15	0.30
Fourth Quarter	0.54	1.09	0.24	0.48

As of March 21, 2019, there were 56 stockholders of record of our common stock, although we believe there is a larger number of beneficial owners.

We did not pay dividends on our outstanding stock during the years ended December 31, 2018 and 2017. We currently intend to retain all future earnings, if any, for use in the operations and expansion of our business. As a result, we do not anticipate paying cash dividends in the foreseeable future. Any future determination as to the declaration and payment of cash dividends will be at the discretion of our board of directors and will depend on factors our board of directors deems relevant, including, among others, our results of operations, financial condition and cash requirements, business prospects and the terms of our credit facilities and other financing arrangements.

The following table provides information as of December 31, 2018 with respect to shares of our common stock that may be issued under equity compensation plans:

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans
Equity compensation plans approved by security holders	3,399,000	$0.18	2,028,208
Equity compensation plans not approved by security holders	-	-	None
Total	3,399,000	$0.18	2,028,208

The following table provides information with respect to shares of our common stock that was acquired by the Company during the fourth quarter of 2018.

Monthly Period During the Quarter Ended December 31, 2018	Total Shares Purchased	Average Price paid per Share	Total Shares Purchased as Part of Publically Announced Plans	Approximate Dollar Amount of Shares Yet To Be Purchased Under Plans
Oct. 1, 2018 - Oct. 31, 2018	-	$ -	-	-
Nov.1, 2018 – Nov. 30, 2018	-	$ -		
Dec. 1, 2018 – Dec. 31, 2018	4,762	$ 0.84	-	-

Total	4,762	$ 0.84

(a) All of these shares were acquired from associates to satisfy tax withholding or purchase price requirements upon the exercise of stock option grants.

Item 6. Selected Financial Data and Supplementary Financial Information

The information called for by this item is not required as we are a smaller reporting company.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion contains statements that are forward-looking. These statements are based on expectations and assumptions that are subject to risks and uncertainties. Actual results could differ materially because of, among other reasons, factors discussed in Item 1A – Risk Factors and elsewhere in this Annual Report. The commentary should be read in conjunction with the consolidated financial statements and related notes and other statistical information included in this Annual Report.

Overview

TSS, Inc. ("TSS", the "Company", "we", "us" or "our") provides comprehensive services for the planning, design, deployment maintenance, and refurbishment of end-user and enterprise systems, including the mission-critical facilities they are housed in. We provide a single source solution for enabling technologies in 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, project management, systems integration, system installations and facilities management. Our headquarters and integration facility are located in Round Rock, Texas

Our business is concentrated on the data center infrastructure and services market. This market continues to be highly 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 more information technology equipment, more efficient data center design and operation, resulting in continued overall growth 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 could have a material negative effect on our results.

In 2016 we made the decision to focus our business on the modular data center area and to concentrate our activities around our systems integration and facilities maintenance businesses. We also developed and expanded our rack integration services to increase the utilization of our systems integration facility and to insulate us from the variable timing of modular data center orders. During 2016 and 2017 we phased out of our remaining businesses and sold or discontinued those operations. In December 2018 we completed this transition when we sold the assets of our critical power and cooling solutions business that was based in Virginia. Collectively our efforts to transform the business have generated $3.8 million in cash, and allowed us to significantly reduce our staff levels, overhead expenses and to close our facilities in Maryland and Virginia.

This simplification of our business and the focus towards the modular data center market will increase our customer concentration in the short-term and concentrate the markets in which we compete. However, our business is now focused on providing a life-cycle of activities in support of the use of modular data centers and rack integration including assembly, deployment and maintenance of these modules. We believe we can be a smaller, more profitable enterprise by narrowing our market focus. The winding down of our less profitable revenue streams decreased the liquidity requirements of the business, and the reduction of overhead and staffing costs lowered the break-even point for our business and contributed significantly towards our improved operating performance during 2018.

Our total revenue in 2018 of $22.3 million was a $4 million or 22% increase from our 2017 revenue of $18.3 million. We experienced growth in both of our operating segments during 2018, with our systems integration revenues increasing by $1.1 million or 18% from 2017, and our facilities services revenues increasing by $2.9 million or 24% from 2017. Increases in modular data center integration and deployment was the primary driver behind the growth in revenue in 2018.

Our gross profits increased by $0.8 million or 10% in 2018, reflecting a decrease in our gross profit margins from 42% in 2017 to 38% in 2018. The decrease in margin was attributable to fluctuating volumes in our systems integration facility that prevent us from optimizing the utilization of the facility throughout the year, and from lower margins on deployment projects during 2018.

Our operating expenses were 1% lower than in 2017. Combined with our higher gross profits and a $1.1 million gain from the sale of our critical power and cooling solutions business, we were able to generate an operating profit of $2.9 million in 2018. This was a $1.8 million, or 159% increase in operating profits compared to 2017.

The improved operating results from our refined business focus combined with the proceeds from the sale of a business unit saw us increase our cash and equivalents by $3.9 million during 2018, and we ended the year with $6.2 million in cash on hand. We have eliminated our negative working capital and our deficiency of stockholder’s equity as of December 31, 2018 and now are in a much-improved liquidity position. We also entered a new $1.5 million bank revolving line of credit facility in December 2018 to provide more financial flexibility to us as we manage our working capital requirements and to ensure that we have the necessary financial resources to execute on our business strategy.

Critical Accounting Policies and Estimates

We consider an accounting policy to be critical if:

- the accounting estimate requires us to make assumptions about matters that are highly uncertain or require the use of judgment at the time we make that estimate; and
- changes in the estimate that are reasonably likely to occur from period to period or use of different estimates that we could have reasonably used instead in the current period, would have a material impact on our financial condition or results of operations.

Management has reviewed the development and selection of these critical accounting estimates with the Audit Committee of our Board of Directors, and the Audit Committee has reviewed these disclosures. In addition, there are other items within our financial statements that require estimation but are not deemed critical as defined above. Changes in these and other items could still have a material impact upon our financial statements.

Revenue Recognition

We recognize revenues when control of the promised goods or services is transferred to our customers in an amount that reflects the consideration we expect to be entitled to in exchange for those goods or services.

Maintenance services

We generate maintenance services revenues from fees that provide our customers with as-needed maintenance and repair services on modular data centers during the contract term. Our contracts are typically one year in duration, are billed annually in advance, and are non-cancellable. As a result, we record deferred revenue (a contract liability) and recognize revenue from these services on a ratable basis over the contract term. We can mitigate our exposure to credit losses by discontinuing services in the event of non-payment, however our history of non-payments and bad debt expense has been insignificant.

Integration services

We generate integration services revenues from fees that provide our customers with customized system and rack-level integration services. We recognize revenue upon shipment to the customer of the completed systems as this is when we have completed our services and when the customer obtains control of the promised goods. We typically extend credit terms to our integration customers based on their credit worthiness and generally do not receive advance payments. As such, we record accounts receivable at the time of shipment, when our right to the consideration becomes unconditional. Accounts receivable from our integration customers are typically due within 30-105 days of invoicing. An allowance for doubtful accounts is provided based on a periodic analysis of individual account balances, including an evaluation of days outstanding, payment history, recent payment trends, and our assessment of our customers' credit worthiness. As of December 31, 2018 and 2017, our allowance for doubtful accounts was $8,000.

Equipment sales

We generate revenues under fixed price contracts from the sale of data center and related ancillary equipment to customers in the United States. We recognize revenue when the product is shipped to the customer as that is when the customer obtains control of the promised goods. Typically, we do not receive advance payments for equipment sales, however if we do, we record the advance payment as deferred revenue. Normally we record accounts receivable at the time of shipment, when our right to the consideration has become unconditional. Accounts receivable from our equipment sales are typically due within 30-60 days of invoicing.

Deployment and Other services

We generate revenues from fees we charge our customers for other services, including repairs or other services not covered under maintenance contracts, installation and servicing of equipment including modular data centers that we sold, and other fixed-price services including repair, design and project management services. In some cases, we arrange for a third party to perform warranty and servicing of equipment, and in these instances, we recognize revenue as the amount of any fees or commissions that we expect to be entitled to. Other services are typically invoiced upon completion of services or completion of milestones. We record accounts receivable at the time of completion when our right to consideration becomes unconditional.

Some of our contracts with customers contain multiple performance obligations. For these contracts, we account for individual performance obligations separately if they are distinct. The transaction price is allocated to the separate performance obligations based on relative standalone selling prices.

Judgments

We consider several factors in determining that control transfers to the customer upon shipment of equipment or upon completion of our services. These factors include that legal title transfers to the customer, we have a present right to payment, and the customer has assumed the risks and rewards of ownership at the time of shipment or completion of the services.

Sales taxes

Sales (and similar) taxes that are imposed on our sales and collected from customers are excluded from revenues.

Shipping and handling costs

Costs for shipping and handling activities, including those activities that occur subsequent to transfer of control to the customer, are recorded as cost of sales and are expensed as incurred. We accrue costs for shipping and handling activities that occur after control of the promised good or service has transferred to the customer.

The following table shows our revenues disaggregated by reportable segment and by product or service type (in $’000):

	Year ended December 31,	
	2018	**2017**
FACILITIES:		
Maintenance revenues	$4,851	$4,638
Equipment sales	2,860	2,608
Deployment and other services	7,475	5,008
	$15,186	$12,254
SYSTEMS INTEGRATION:		
Integration services	$7,149	$6.062
TOTAL REVENUES	$22,335	$18,316

Remaining Performance Obligations

As part of our adoption of ASU 2014-09, we have elected to use a practical expedient to exclude disclosure of transaction prices allocated to remaining performance obligations, and when we expect to recognize such revenue, for all periods prior to the date of initial application of the standard.

As of December 31, 2018, deferred revenue of $2,181,000 represents our remaining performance obligations for our maintenance contracts, all of which are expected to be recognized within one year. The remaining $112,000 of deferred revenue is our remaining performance obligations for other services, all of which is expected to be recognized between one and three years.

Intangible Assets

We recorded goodwill and intangibles with definite lives, including customer relationships and acquired software, in conjunction with the acquisition of various businesses. These intangible assets are amortized based on their estimated economic lives. Goodwill represents the excess of the purchase price over the fair value of net identified tangible and intangible assets acquired and liabilities assumed, and it is not amortized.

We 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 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 also review intangible assets with definite lives for impairment whenever events or circumstances indicate that the carrying amount may not be recoverable. If the sum of the expected undiscounted cash flows is less than the carrying value of the related asset, a loss is recognized for the difference between the fair value and carrying value of the intangible asset.

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. 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.

Stock Based Compensation

We account for stock-based compensation using a fair-value based recognition method. Stock-based compensation cost is estimated at the grant date based on the fair value of the award and is recognized ratably over the requisite service period of the award. Determining the appropriate fair-value model and calculating the fair value of stock-based awards at the grant date requires considerable judgment, including estimating stock price volatility, expected option life and forfeiture rates. We develop our estimates based on historical data and market information that can change significantly over time. A small change in estimates used can have a relatively large change in the estimated valuation.

We use the Black-Scholes option valuation model to value employee stock awards that are not performance based awards. We estimate stock price volatility based upon our historical volatility. Estimated option life and forfeiture rate assumptions are derived from historical data. For stock-based compensation awards with graded vesting, we recognize compensation expense using the straight-line amortization method. For performance-based stock awards we use third-party valuation specialists and a Monte-Carlo simulation model to ascertain the fair value of the award at grant date.

Results of Operations

Comparison of 2018 to 2017

Revenue

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

We contract with our customers under five primary contract types: fixed-price service and maintenance contracts, time and material contracts, cost-plus-fee, guaranteed maximum price and fixed-price 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. Certain of our service and maintenance contracts provide comprehensive coverage of all of the customers equipment (generally excluding IT equipment) at a facility during the contract period. Where customer requirements are clear, we prefer to enter into comprehensive fixed-price arrangements or time-and-materials 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 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 design and project-management 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 higher levels of working capital and generated lower margins than our maintenance and integration services. We re-focused our design and project-management services towards smaller scaled jobs typically connected with addition/move/retrofit activities rather than new construction - to obtain better margins. We have also focused on providing maintenance services for modular data center applications as this market continues to expand. We continue to focus on increasing our systems integration revenues through more consistent revenue streams that will better utilize our assets in that business.

Our total revenue in 2018 of $22.3 million was a $4 million or 22% increase from our 2017 revenue of $18.3 million. We experienced growth in both of our operating segments during 2018, with our systems integration revenues increasing by $1.1 million or 18% from 2017, and our facilities services revenues increasing by $2.9 million or 24% from 2017. Increases in modular data center integration and deployment of modules was the primary driver behind the growth in revenue in 2018.

Our changed business model will result in quarterly and annual revenue levels lower than historical levels. We anticipate less fluctuation in our quarterly revenues due to the absence of larger project management and design projects, but higher customer concentration levels with our OEM channel partner, until such time as we can diversify and grow our customer base. Elimination of large one-off projects will also reduce the variability in our working capital, which we believe will also help us manage our liquidity, and contribute to improved and sustained profitability,

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, excluding 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 62% for the year ended December 31, 2018 compared to 58% for 2017. This increase in costs from 2017 reflects lower profit margins in our systems integration activities during 2018 because of fluctuating production volumes that decreased the efficiency of our production facility, and from lower margins on our modular deployment activities compared to the prior year.

Since we earn higher profits on our own direct labor services than when we use subcontractors or third-party services, we expect gross margins to improve when our labor service mix increases relative to the use of subcontracted or third-party labor. 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 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. 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 ability to outsource these activities without carrying a higher level of fixed overhead allows us to 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

Our gross profit margin for the year ended December 31, 2018 was 38% compared to a gross profit margin of 42% in 2017. This decrease in margin compared to 2017 was primarily attributable to lower profitability in our systems integration business compared to 2017. With higher revenue compared to 2017, the lower margin resulted in our gross profit being $8.5 million for 2018, up $0.8 million or 10% from the $7.7 million in gross profit we achieved in 2017.

Our ability to maintain and to further improve gross margins will depend, in part, upon our ability to continue increasing 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 consist 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 year ended December 31, 2018, our selling, general and administrative expenses of $6.4 million decreased by $0.2

million, or 1%, compared to 2017. This decrease was due to lower headcount-related costs, and lower professional fees.

Gain on sale of Business Component

In December 2018, we completed the sale of certain identified assets and liabilities connected with our Virginia-based critical power and cooling equipment business. We sold this business component for gross proceeds of $2.5 million. The buyer assumed net assets of $3,000 and $175,000 of the proceeds are being held in escrow for a six-month period, resulting in net cash proceeds of $2.325 million. We wrote off goodwill and identifiable intangible assets of $1.176 million that were directly attributable to the business component sold. Additionally, we incurred approximately $184,000 in legal and other direct costs that would not have been incurred otherwise. As a result, we recorded a gain of approximately $1.14 million from the sale of these assets during our fourth quarter of 2018.

In January 2017, we completed the sale of certain identified assets and liabilities connected with a specific customer contract from our project management business for $350,000. The buyer assumed net liabilities of $7,000 resulting in cash proceeds of $343,000. Additionally, we incurred approximately $29,000 in legal, escrow and other costs that would not have been incurred otherwise. As a result, we recorded a net gain of approximately $321,000 from the sale of these assets during the first quarter of 2017.

Income tax expense

Due to consolidated operating losses, we have not recorded any income tax expenses, other than minimum or statutory costs. As of December 31, 2018, our accumulated net operating loss carry forward was $35.1 million. We anticipate that these loss carry-forwards may offset future taxable income that we may achieve and future tax liabilities. However, because of uncertainty regarding our ability to use these carry forwards and the potential limitations due to ownership changes, we have established a valuation allowance for the full amount of our net deferred tax assets.

Operating income

For the year ended December 31, 2018 we had an operating income of $2.9 million. This was a $1.8 million or 159% increase from the operating income of $1.1 million that we recorded in 2017. This increase includes the $1.1 million gain from the sale of a portion of our business in the fourth quarter of 2018. With higher revenues and lower overhead from the businesses that we sold or discontinued, we have been able to achieve consistent quarterly and annual operating profit, driving the improvement in our financial results compared to 2017.

Net income

After income taxes, we recorded net income of $2.4 million, or $0.15 per share, for the year ended December 31, 2018. This was an increase of $1.7 million or 218% from the net income of $0.8 million, or $0.05 per share we recorded for the year ended December 31, 2017.

Comparison of 2017 to 2016

Revenue

Our total revenue of $18.3 million in 2017 was a $9.1 million or 33% decrease from our 2016 revenue of $27.4 million. Our 2016 revenue included $13.6 million from business activities that we either sold or discontinued, which was the primary reason that our annual revenues decreased. Our facilities services revenues decreased by $9.5 million or 44% from 2016 levels. The portions of the facility services businesses that we retained actually grew by $4.1 million or 50% from 2016. Our systems integration revenues increased by $0.4 million or 8% from 2016 reflecting higher demand from our largest channel partner during 2017.

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, excluding 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 58% for the year ended December 31, 2017 compared to 74% for 2016. This decrease from 2016 is because of a lower level of equipment procurement costs and subcontractor expense in 2017 due to the elimination of design, build and large project management activities as we existed these business activities, and because of higher utilization of our systems integration facility in 2017 compared to 2016 as revenues from this business unit increased. We had higher costs and lower margins from project management activities including equipment procurement, and the decrease in this type of revenue in absolute value and as a percentage of our total revenues compared to the prior year, resulted in a lower cost of revenue.

Gross Profit

Our gross profit margin for the year ended December 31, 2017 was 42% compared to a gross profit margin of 26% in 2016. This improvement reflects our efforts to concentrate on higher-margin service offerings such as our systems integration business and our modular facility services. The discontinuation of design, construction management and equipment procurement activities allowed us to reduce the associated overhead from these businesses, further contributing to our improved margins. As a result of this improved margin, our gross profit for 2017 was $7.7 million, up $0.5 million or 7% from 2016 despite our revenues being $9.1 million lower than in 2016.

Selling, General and Administrative Expenses

Selling, general and administrative expenses primarily consist 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 year ended December 31, 2017, our selling, general and administrative expenses decreased by $1.7 million or 21% compared to 2016. This decrease was due to lower headcount-related costs following the discontinuation of directly providing project management and design services, and due to the closure of our Maryland facility in late 2016. We also had lower professional fees and lower levels of stock-based compensation expense in 2017..

Gain on sale of Business Component

In January 2017, we completed the sale of certain identified assets and liabilities connected with a specific customer contract from our project management business for $350,000. The buyer assumed net liabilities of $7,000 resulting in cash proceeds of $343,000. Additionally, we incurred approximately $29,000 in legal, escrow and other costs that would not have been incurred otherwise. As a result, we recorded a net gain of approximately $321,000 from the sale of these assets during the first quarter of 2017.

Income tax expense

Due to operating losses, we have not recorded any income tax expenses, other than minimum or statutory costs. As of December 31, 2017, our accumulated net operating loss carry forward was $37.7 million. We anticipate that these loss carry-forwards may offset future taxable income that we may achieve and future tax liabilities. However, because of uncertainty regarding our ability to use these carry forwards and the potential limitations due to ownership changes, we have established a valuation allowance for the full amount of our net deferred tax assets.

Operating income (loss)

For the year ended December 31, 2017 we had operating income of $1.1 million. This was a $1.7 million or 270% improvement from our $0.6 million operating loss in 2016. Included in our 2016 operating losses was the $0.9 million gain from the sale of the Maryland-based portion of our facilities maintenance business. With improved margins and lower overhead from the businesses that we sold or discontinued, we have been able to achieve consistent quarterly and annual operating profit, driving the improvement in our financial results compared to 2016.

LIQUIDITY AND CAPITAL RESOURCES

Our primary sources of liquidity at December 31, 2018 are our cash and cash equivalents on hand, funds available under our bank credit facility and projected cash flows from operating activities.

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 2019 and beyond or significantly affect our level of liquidity, which may limit our opportunities to grow our business.

Our quarterly operating results have shown improved results during 2018 and 2017. During this period our quarterly revenues have fluctuated between $4.2 and $7.3 million. Our gross profit margin has ranged from 33% to 42%, and our operating results have allowed us to achieve operating profits in each quarter of 2018 and 2017. This level of profitability allowed us to eliminate the deficiency in our stockholder's equity and to eliminate the working capital deficit during 2018 as our overall liquidity position continued to improve. In December 2018 we entered a 2-year, $1.5 million, receivables-based revolving line of credit facility with Texas Capital Bank, NA to provide us additional liquidity and financial flexibility for managing our working capital and business. We remain open to further funding to finance growth in our business, to finance potential acquisitions or to further improve our liquidity position, however there can be no guarantee that such financing will be available to us or that we will complete any such financing.

As of December 31, 2018, and 2017, we had cash and cash equivalents of $6.2 million and $2.3 million, respectively.

Significant uses of cash

Operating activities:

Cash provided by operating activities was $1.9 million for the year ended December 31, 2018 compared to cash used in operating activities of $45,000 for the year ended December 31, 2017. The improvement in corporate profitability and the sale of a business component were the primary reason for this improvement. The amount of funds used in working -capital has decreased significantly from 2017. As we exited our design and project management activities in late 2016 and early 2017, we reduced our overall level of receivables and payables from these businesses, and this drove a decrease in working capital as we collected those receivables and paid those vendors as we exited these businesses. We now operate the business with significantly lower levels of both receivables and payables and have less fluctuation in our level of working capital as we have a more consistent and stable revenue stream.

Investing activities:

Cash provided by investing activities was $1.9 million for the year ended December 31, 2018 compared to cash provided by investing activities of $0.1 million in 2017. In 2018 we received cash proceeds of approximately $2.1million in connection with the sale of our critical power and cooling business in Virginia, offset by purchases of property and equipment of $0.2 million. In 2017 we received cash proceeds of approximately $0.3 million in connection with the sale of a portion of our project management business, offset by purchases of property and equipment of $0.2 million.

Finance activities:

Cash provided by financing activities was $0.1 million during both 2018 and 2017. In 2018 we received proceeds of $0.1 million from the exercise of warrants by holders of our promissory notes. During 2017 we borrowed $1.05 million in new promissory notes, which was offset by the repayment of $250,000 of promissory notes and the repayment of $737,000 against our accounts receivable factoring facility.

Future uses of cash

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 sources of funding when 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 2019 and beyond or significantly affect our level of liquidity, which may require us to 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.

Our primary liquidity and capital requirements are to fund working capital from 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 bank credit facility. 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. However, the timing and effect of these steps may not completely alleviate a material effect on liquidity. We may also require additional capital if we seek to acquire additional businesses as a way to increase the scale of our operations.

Off-Balance Sheet Arrangements

During the years ended December 31, 2018 and 2017, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow limited purposes.

New Accounting Pronouncements

Recently Adopted Accounting Guidance

On January 1, 2018, we adopted Accounting Standards Update 2014-09, *Revenue from Contracts with Customers* (ASU 2014-09), using the modified retrospective method. ASU 2014-09 requires entities to recognize revenue in a way that depicts the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services. Adoption of ASU 2014-09 did not have a material impact on our consolidated financial position or results of operations.

On January 1, 2018 we also adopted Accounting Standards Update 2016-08, *Revenue from Contracts with Customers, Principal versus Agent Considerations (Reporting Revenue Gross versus Net)*, (ASU 2016-08), using the modified retrospective method. ASU 2016-08 clarified the implementation guidance on principal versus agent consideration from ASU 2014-09. Specifically an entity is required to determine whether the nature of a promise is to provide the specified good or service itself (that is, the entity is a principal) or to arrange for the good or service to be provided to the customer by the other party (that is, the entity is an agent). The determination influences the timing and amount of revenue recognition. Adoption of ASU 2016-08 did not have a material impact on our consolidated financial position or results of operations.

Recently Issued Accounting Pronouncements

In February 2016, the FASB issued ASU No. 2016-02, *"Leases (Topic 842)"*. 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 adopted ASU 2016-02 on January 1, 2019 and recorded lease-related assets and lease liabilities of approximately $2 million on our consolidated balance sheet upon adoption of the pronouncement. We do not anticipate ASU 2016-02 having a material impact on our future results of operations.

In May 2017, the FASB issued ASU No. 2017-09, which amends the scope of modification accounting for share-based payment arrangements. The AU provides guidance on the types of changes to the terms or conditions of share-based payment awards to which an entity would be required to apply modification accounting under ASC 718. Specifically, an entity would not apply modification accounting if the fair value, vesting conditions, and classification of the awards are the same immediately before and after the modification. ASU 2017-09 will be applied prospectively to awards modified on or after the adoption date. The guidance is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. Adoption of this new guidance did not have a material impact on our consolidated financial statements.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk.

The information called for by this item is not required as we are a smaller reporting company.

Item 8. Financial Statements and Supplementary Data.

a) Audited Financial Statements

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders

TSS, Inc.

Round Rock, TX

Opinion on the Consolidated Financial Statements

We have audited the accompanying consolidated balance sheets of TSS, Inc. and Subsidiaries (the Company) as of December 31, 2018 and 2017, the related consolidated statements of operations, changes in stockholders' equity (deficiency), and cash flows for each of the two years in the period ended December 31, 2018, and the related notes (collectively referred to as the consolidated financial statements). In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Company as of December 31, 2018 and 2017, and the results of its operations and its cash flows for each of the two years in the period ended December 31, 2018, in conformity with accounting principles generally accepted in the United States of America.

Basis for Opinion

These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's consolidated financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of

material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion of the effectiveness of the Company’s internal control over financial reporting. Accordingly, we express no such opinion.

Our audits include performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

Emphasis of Matter

As discussed in Note 1 to the consolidated financial statements the Company had one customer which accounted for 66% and 67%, respectively, of total revenue for the years ended December 31, 2018 and 2017. Our opinion is not modified with respect to this matter.

/s/ WEAVER AND TIDWELL, L.L.P.

We have served as the Company's auditor since 2015.

Austin, Texas

March 21, 2019

TSS, Inc.

Consolidated Balance Sheets

(in '000 except per-share amounts)

	December 31,	
	2018	**2017**
Current Assets:		
Cash and cash equivalents	$6,178	$2,268
Contract and other receivables, net	727	990
Costs and estimated earnings in excess of billings on uncompleted contracts	154	223
Inventories, net	108	134
Prepaid expenses and other current assets	266	114
Total current assets	7,433	3,729
Property and equipment, net	390	418
Goodwill	780	1,907
Other intangible assets, net	398	561
Other assets	109	112
Total assets	$9,110	$6,727
Current Liabilities:		
Accounts payable and accrued expenses	$2,390	$2,841
Deferred revenues	2,181	2,494
Total current liabilities	4,571	5,335
Long-term borrowings	1,838	1,656
Deferred revenues – noncurrent portion	112	-
Other liabilities	108	41
Total liabilities	6,629	7,032
Commitments and Contingencies	-	-
Stockholders' Equity (Deficiency):		
Preferred stock, $.0001 par value, 1,000 shares authorized; none issued	-	-
Common stock, $.0001 par value, 49,000 shares authorized; 17,520 and 16,316 issued; 16,743 and 15,547 outstanding at December 31, 2018 and 2017, respectively	2	2
Additional paid-in capital	69,241	68,886
Treasury stock 777 and 769 shares at cost at December 31, 2018 and, 2017, respectively	(1,542)	(1,536)
Accumulated deficit	(65,220)	(67,657)
Total stockholders' equity (deficiency)	2,481	(305)
Total liabilities and stockholders' equity (deficiency)	$9,110	$6,727

See accompanying notes to consolidated financial statements.

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TSS, Inc.

Consolidated Statements of Operations

(in ’000 except per-share amounts)

	Year Ended December 31, 2018	2017
Revenue	$22,335	$18,316
Cost of revenue excluding depreciation and amortization	13,852	10,591
Gross profit	8,483	7,725
Selling, general and administrative expenses	6,372	6,459
Depreciation and amortization	385	481
Gain on sale of business component	(1,140)	(321)
Operating income	2,866	1,106
Interest expense, net	(403)	(328)
Other income (expense), net	-	(3)
Income before income tax provision	2,463	775
Income tax provision	26	9
Net income	$2,437	$766
Basic income per share	$0.16	$0.05
Diluted income per share	$0.13	$0.05

See accompanying notes to consolidated financial statements.

TSS, Inc.

Consolidated Statements of Changes in Stockholders' Equity (Deficiency)

(in '000)

	Common Stock		Additional Paid-in Capital	Treasury Stock		Accumulated Deficit	Total Stockholders' Equity (Deficiency)
	Shares	Amount		Shares	Amount		
Balance at January 1, 2017	16,370	$ 2	$ 68,522	748	$ (1,532)	$ (68,423)	$ (1,431)
Cancellation of restricted stock	(54)	-	-	-	-	-	-
Treasury stock repurchased	-	-	-	21	(4)	-	(4)
Warrants issued for debt	-	-	296	-	-	-	296
Stock-based compensation	-	-	68	-	--	-	68
Net income for the year	-	-	-	-	-	766	766
Balance December 31, 2017	16,316	$ 2	$ 68,886	769	$ (1,536)	$ (67,657)	$ (305)
Cancellation of restricted stock	(30)	-	-	-	-	-	--
Treasure stock repurchased	-	-	-	8	(6)	-	(6)
Issuance of shares on option exercise	90		9				9
Issuance of shares on warrant exercise	1,144	-	105	-	-	-	105
Stock-based compensation	-	-	241	-	-	-	241
Net income for the year	-	-	-	-	-	2,437	2,437
Balance December 31, 2018	17,520	$ 2	$ 69,241	777	$ (1,542)	$ (65,220)	$ 2,481

See accompanying notes to consolidated financial statements.

TSS, Inc.

Consolidated Statements of Cash Flows

(in '000)

	Year Ended December 31, 2018			2017		
Cash Flows from Operating Activities:						
Net income	$	2,437		$	766	
Adjustments to reconcile net income to net cash provided by (used in) operating activities:						
Depreciation and amortization		385			481	
Provision for doubtful accounts		-			(2	)
Stock-based compensation		241			68	
Gain on sale of business component		(1,140	)		(321	)
Amortization of discount on note payable		81			34	
Non-cash interest		101			47	
Changes in operating assets and liabilities:						
Contracts and other receivables		(478	)		1,401	
Costs and estimated earnings in excess of billings on uncompleted contracts		(84	)		316	
Inventories, net		26			(75	)
Prepaid expenses and other current assets		21			59	
Accounts payable and accrued expenses		369			(2,474	)
Billings in excess of costs and estimated earnings on uncompleted contracts		(126	)		(324	)
Other liabilities		67			(21	)
		1,900			(45	)

Net cash provided by (used in) operating activities				
Cash Flows from Investing Activities:				
Capital expenditures		(242)		(212)
Proceeds from sale of business component		2,144		314
Net cash provided by investing activities		1,902		102
Cash Flows from Financing Activities:				
Payments on convertible notes and seller notes		-		(250)
Proceeds from issuance of debt		-		1,050
Repurchase of treasury stock		(6)		(4)
Borrowing (repayment) of receivables financing facility		-		(737)
Proceeds from issuance of stock		114		-
Net cash provided by financing activities		108		59
Net increase in cash		3,910		116
Cash, beginning of period		2,268		2,152
Cash, end of period	$	6,178	$	2,268
Supplemental disclosure of cash flow information:				
Cash paid for interest	$	223	$	273
Cash paid for taxes		57		43

See accompanying notes to consolidated financial statements.

Note 1 Significant Accounting Policies

Description of Business

TSS, Inc. ("TSS", the "Company", "we", "us" or "our") provides comprehensive services for the planning, design, deployment maintenance, refresh and take-back of end-user and enterprise systems, including the mission-critical facilities they are housed in. We provide a single source solution for enabling technologies in 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, project management, systems integration, systems installation and facilities management. Our corporate offices and integration facility are located in Round Rock, Texas.

The preparation of financial statements in accordance with the accounting principles generally accepted in the United States of America ("GAAP") requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates which are based on historical experience and on various other assumptions that we believe are reasonable under the circumstances, the results of which form a basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions; however, we believe that our estimates are reasonable and that the actual results will not vary significantly from the estimated amounts.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation.

Financial Instruments

The Company's financial instruments primarily consist of cash and cash equivalents, accounts receivable, accounts payable and long-term debt. The fair value of the long-term debt is disclosed in *Note 3– Long Term Borrowings.* The carrying amounts of the other financial instruments approximate their fair value at December 31, 2018 and 2017, due to the short-term nature of these items. See *Note 8 – Fair Value Measurements.*

Accounting for Business Combinations

We allocate the purchase price of an acquired business to its identifiable assets and liabilities based on estimated fair values. The excess of the purchase price over the fair value of the assets acquired and liabilities assumed, if any, is recorded as goodwill.

We use all available information to estimate fair values. We typically engage outside appraisal firms to assist in the fair value determination of identifiable intangible assets such as customer contracts, leases and any other significant assets or liabilities and contingent consideration. Preliminary purchase price allocation is adjusted, as necessary, up to one year after the acquisition closing date if management obtains more information regarding asset valuations and liabilities assumed.

Revenue Recognition

On January 1, 2018, we adopted Accounting Standards Update 2014-09*, Revenue from Contracts with Customers* (ASU 2014-09), using the modified retrospective method. Adoption of ASU 2014-09 did not have a material impact on our consolidated financial position or results of operations.

We recognize revenues when control of the promised goods or services is transferred to our customers in an amount that reflects the consideration we expect to be entitled to in exchange for those goods or services.

Maintenance services

We generate maintenance services revenues from fees that provide our customers with as-needed maintenance and repair services on modular data centers during the contract term. We recognize revenue from these services on a ratable basis over the contract term. Our contracts are typically one year in duration, are billed annually in advance, and are non-cancellable. As a result, we record deferred revenue (a contract liability) and accounts receivable for any amounts for which we have a right to invoice but for which services have not been provided. We can mitigate our exposure to credit losses by discontinuing services in the event of non-payment, however our history of non-payments and bad debt expense has been insignificant.

Integration services

We generate integration services revenues from fees that provide our customers with customized system and rack-level integration services. We recognize revenue upon shipment to the customer of the completed systems as this is when we have completed our services and when the customer obtains control of the promised goods. We typically extend credit terms to our integration customers based on their credit worthiness and generally do not receive advance payments. As such, we record accounts receivable at the time of shipment, when our right to the consideration becomes unconditional. Accounts receivable from our integration customers are typically due within 30-105 days of invoicing. An allowance for doubtful accounts is provided based on a periodic analysis of individual account balances, including an evaluation of days outstanding, payment history, recent payment trends, and our assessment of our customers' credit worthiness. As of December 31 2018 and 2017, our allowance for doubtful accounts was $8,000.

Equipment sales

We generate revenues under fixed price contracts from the sale of data center and related ancillary equipment to customers in the United States. We recognize revenue when the product is shipped to the customer as that is when the customer obtains control of the promised goods. Typically, we do not receive advance payments for equipment sales, however if we do, we record the advance payment as deferred revenue. Normally we record accounts receivable at the time of shipment, when our right to the consideration has become unconditional. Accounts receivable from our equipment sales are typically due within 30-60 days of invoicing.

Deployment and Other services

We generate revenues from fees we charge our customers for other services, including repairs or other services not covered under maintenance contracts, installation and servicing of equipment including modular data centers that we sold, and other fixed-price services including repair, design and project management services. In some cases, we arrange for a third party to perform warranty and servicing of equipment, and in these instances, we recognize revenue as the amount of any fees or commissions that we expect to be entitled to. Other services are typically invoiced upon completion of services or completion of milestones. We record accounts receivable at the time of completion when our right to consideration becomes unconditional.

Some of our contracts with customers contain multiple performance obligations. For these contracts, we account for individual performance obligations separately if they are distinct. The transaction price is allocated to the separate performance obligations based on relative standalone selling prices.

Judgments

We consider several factors in determining that control transfers to the customer upon shipment of equipment or upon completion of our services. These factors include that legal title transfers to the customer, we have a present right to payment, and the customer has assumed the risks and rewards of ownership at the time of shipment or completion of the services.

Sales taxes

Sales (and similar) taxes that are imposed on our sales and collected from customers are excluded from revenues.

Shipping and handling costs

Costs for shipping and handling activities, including those activities that occur subsequent to transfer of control to the customer, are recorded as cost of sales and are expensed as incurred. We accrue costs for shipping and handling activities that occur after control of the promised good or service has transferred to the customer.

The following table shows our revenues disaggregated by reportable segment and by product or service type (in $’000):

	Years ended December 31,	
	2018	**2017**
FACILITIES:		
Maintenance revenues	$4,851	$4,638
Equipment sales	2,860	2,608
Deployment and other services	7,475	5,008
	$15,186	$12,254
SYSTEMS INTEGRATION:		
Integration services	$7,149	$6,062
TOTAL REVENUES	$22,335	$18,316

Remaining Performance Obligations

As part of our adoption of ASU 2014-09, we have elected to use a practical expedient to exclude disclosure of transaction prices allocated to remaining performance obligations, and when we expect to recognize such revenue, for all periods prior to the date of initial application of the standard.

As of December 31, 2018, deferred revenue of $2,181,000 represents our remaining performance obligations for our maintenance contracts, all of which are expected to be recognized within one year. The remaining $112,000 of deferred revenue is our remaining performance obligations for other services, all of which is expected to be recognized between one and three years.

Stock-Based Compensation

Stock-based compensation is measured at the grant date based on the fair value of the award and is recognized as expense ratably over the requisite service period, net of estimated forfeitures. We award shares of restricted stock and stock options to employees, managers, executive officers and directors.

During the years ended December 31, 2018 and 2017, we incurred approximately $0.2 and $0.1 million, respectively in non-cash compensation expense which was included in *Selling, general and administrative expenses.*

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 will suffer. The loss of or a significant reduction in orders from this customer or the failure to provide adequate products or services to them could significantly reduce our revenue.

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

	2018	2017
US-based IT OEM	66%	67%

No other customers represented more than 10% of our revenues for any periods presented. Our US based IT OEM customer represented 75% and 26% of our trade accounts receivable at December 31, 2018 and 2017, respectively. A US-based UPS manufacturer represented 22% of our accounts receivable at December 31, 2017. A US-based technology consulting company represented 23% of our accounts receivable at December 31, 2017. No other customer represented more than 10% of our accounts receivable at December 31, 2018 or at December 31, 2017.

Cash and cash equivalents

Cash and cash equivalents are comprised of cash in banks and highly liquid instruments with original maturities of three months or less, primarily consisting of bank time deposits. At December 31, 2018 and 2017 we did not have cash invested in interest bearing accounts. At December 31, 2018, we had unrestricted cash of $5.9 million in excess of FDIC insured limits.

Contract and Other Receivables

Accounts receivable are recorded at the invoiced amount and may bear interest in the event of late payment under certain contracts. Included in accounts receivable is retainage, which represents the amount of payment contractually withheld by customers until completion of a particular project.

Under certain construction management contracts, the Company is obligated to obtain performance bonds with various financial institutions, which typically require a security interest in the corresponding receivable. At December 31, 2018 and 2017, bonds outstanding totaled $7.3 million and $7.3 million, respectively, and the sureties were indemnified in the event of a loss by related project receivables of $0.01 million and $0.02 million, respectively.

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. 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.

The following table summarizes the changes in our allowance for doubtful accounts (in $'000)

	Year Ended December 31,	
	2018	2017
Balance at beginning of year	$ 8	$ 4
Additions charged to expense	-	4
Recovery of amounts previously reserved	-	-
Amounts written off	-	-
Balance at end of year	$ 8	$ 8

Inventories

Inventories are stated at the lower of cost or market. Cost is determined using the first-in, first-out method for all purchased inventory. We write down obsolete inventory or inventory in excess of our estimated usage to its estimated market value less cost to sell, if less than its cost. Inherent in our estimates of market value in determining inventory valuation are estimates related to future demand and technological obsolescence of our products. Any significant unanticipated changes in demand or technological developments could have a significant impact on the value of our inventories and our results of operations and financial position could be materially affected.

Property and Equipment

Property and equipment are recorded at cost. We provide for depreciation using the straight-line method over the estimated useful lives of the assets. Additions and major replacements or improvements are capitalized, while minor replacements and maintenance costs are charged to expense as incurred. Depreciation expense is included in operating expenses in the statement of operations. The cost and accumulated depreciation of assets sold or retired are removed from the accounts and any gain or loss is included in the results of operations for the period of the transaction.

Goodwill and Intangible Assets

We have recorded goodwill and intangibles with definite lives, including customer relationships and acquired software, in conjunction with the acquisition of various businesses. These intangible assets are amortized based on their estimated economic lives. Goodwill represents the excess of the purchase price over the fair value of net identified tangible and intangible assets acquired and liabilities assumed, and it is not amortized. The recorded goodwill is allocated to the reporting unit to which the underlying transaction relates.

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 also review intangible assets with definite lives for impairment whenever events or circumstances indicate that the carrying amount may not be recoverable. If the sum of the expected undiscounted cash flows is less than the carrying value of the related asset, a loss is recognized for the difference between the fair value and carrying value of the intangible asset.

We have elected to use December 31 as our impairment date. As circumstances change that could affect the recoverability of the carrying amount of the assets during an interim period, we will evaluate our indefinite lived intangible assets for impairment. The Company performed a quantitative analysis of our indefinite lived intangible assets at December 31, 2018 and 2017 and concluded there was no additional impairment. The valuation results indicated that the fair value of our reporting units was greater than the carrying value, including goodwill, for each of our reporting units. Thus, we concluded that there was no impairment at December 31, 2018 or 2017 for our goodwill and other long-lived intangible assets. During the year ended December 31, 2018 we wrote-off goodwill of $1.1 million attributable to the sale of a subsidiary business (see Note 5). At December 31, 2018 and 2017, the residual carrying value of goodwill was $0.8 million and $1.9 million, respectively.

Income Taxes

Deferred income taxes are provided for the temporary differences between the financial reporting and tax basis of the Company's assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. The U.S. net operating losses generated prior to 2018 and not utilized can be carried forward for 20 years to offset future taxable income. A full valuation allowance has been recorded against our net deferred tax assets, because we have concluded that under relevant accounting standards it is more likely than not that deferred tax assets will not be realizable. We recognize interest and penalty expense associated with uncertain tax positions as a component of income tax expense in the consolidated statements of operations.

Earnings Per-Common Share

Basic and diluted income 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 income 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.

Treasury Stock

We account for treasury shares using the cost method. Purchases of shares of common stock are recorded at cost and results in a reduction of stockholders' equity. We hold repurchased shares in treasury for general corporate purposes, including issuances under various employee compensation plans. When treasury shares are issued, we use a weighted average cost method. Purchase costs in excess of reissue price are treated as a reduction of retained earnings. Reissue price in excess of purchase costs is treated as additional paid-in-capital.

Recent Accounting Guidance

Recently Adopted Accounting Guidance

On January 1, 2018, we adopted Accounting Standards Update 2014-09, *Revenue from Contracts with Customers* (ASU 2014-09), using the modified retrospective method. ASU 2014-09 requires entities to recognize revenue in a way that depicts the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services. Adoption of ASU 2014-09 did not have a material impact on our consolidated financial position or results of operations.

On January 1, 2018 we also adopted Accounting Standards Update 2016-08, *Revenue from Contracts with Customers, Principal versus Agent Considerations (Reporting Revenue Gross versus Net)*, (ASU 2016-08), using the modified retrospective method. ASU 2016-08 clarified the implementation guidance on principal versus agent consideration from ASU 2014-09. Specifically, an entity is required to determine whether the nature of a promise is to provide the specified good or service itself (that is, the entity is a principal) or to arrange for the good or service to be provided to the customer by the other party (that is, the entity is an agent). The determination influences the timing and amount of revenue recognition. Adoption of ASU 2016-08 did not have a material impact on our consolidated financial position or results of operations.

Recently Issued Accounting Pronouncements

In February 2016, the FASB issued ASU No. 2016-02, *"Leases (Topic 842)"*. 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 ASU 2016-02 on our consolidated financial statements and while we do not anticipate this having a material impact on our results of operations, we anticipate recording lease-related assets and liabilities of approximately $2 million on our consolidated balance sheet upon adoption of the pronouncement in January 2019.

In May 2017, the FASB issued ASU No. 2017-09, which amends the scope of modification accounting for share-based payment arrangements. The AU provides guidance on the types of changes to the terms or conditions of share-based payment awards to which an entity would be required to apply modification accounting under ASC 718. Specifically, an entity would not apply modification accounting if the fair value, vesting conditions, and classification of the awards are the same immediately before and after the modification. ASU 2017-09 will be applied prospectively to awards modified on or after the adoption date. The guidance is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. Adoption of this new guidance did not have a material impact on our consolidated financial statements.

Note 2 Supplemental Balance-sheet Information

Receivables

Contract and other receivables consisted of the following (in '000's):

	December 31,	**December 31,**

	2018	2017
Contract and other receivables	$ 735	$ 998
Allowance for doubtful accounts	(8)	(8)
	$ 727	$ 990

32

Inventories

We state inventories at the lower of cost or net realizable value, using the first-in-first-out-method (in '000's) as follows:

	December 31, 2018	December 31, 2017
Raw materials	110	136
Less: Reserve	(2)	(2)
Inventories, net	$ 108	$ 134

Goodwill and Intangible Assets

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

	December 31, 2018		December 31, 2017	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Intangible assets not subject to amortization:				
Goodwill	$780	-	$1,907	-
Intangible assets subject to amortization:				
Customer relationships	$906	$ (508)	$906	$ (418)
Acquired software	$234	$ (234)	$234	$ (216)
Trade name	$-	$ -	$60	(5)

We recognized amortization expense related to intangibles of approximately $115,000 and $143,000 for the years ended December 31, 2018 and 2017, respectively.

Annual amortization expense for the customer relationships is expected to be approximately $91,000 during each year through 2022 and approximately $35,000 in 2023.

Property and equipment

Property and equipment consisted of the following (in $’000):

	Estimated Useful Lives (in years)	December 31,	
		2018	2017
Vehicles	5	$-	$32
Trade equipment	5	102	162
Leasehold improvements	2 – 5	250	378
Furniture and fixtures	7	16	18
Computer equipment and software	3	1,599	1,448
		1,967	2,038
Less accumulated depreciation		(1,577)	(1,620)
Property and equipment, net		$390	$418

Depreciation of property and equipment and amortization of leasehold improvements and software totaled $0.3 and $0.3 million for the years ended December 31, 2018 and 2017, respectively.

Accounts Payable and Accrued Expenses

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

	December 31,	
	2018	**2017**
Accounts payable	$944	$1,413
Accrued expenses	566	847
Compensation, benefits and related taxes	856	567
Other accrued expenses	24	14
Total accounts payable and accrued expenses	$2,390	$2,841

Note 3 Long-term Borrowings

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

	December 31,	
	2018	**2017**
Notes Payable due July, 2022	$1,995	$1,995
Accrued interest – long term	148	47
Less unamortized discount and debt issuance costs	(305)	(386)
	1,838	1,656
Current portion of long-term borrowing	-	-
Non-current portion of long-term borrowing	$1,838	$1,656

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.

In July 2017, we amended and restated the terms of this multiple advance term loan agreement whereby we increased the maximum principal amount of loans to $2.5 million for up to sixty days, and $2 million thereafter. The term of the loan was modified to be five years from the date of modification, thereby extending the term of the $945,000 loan to

July 19, 2022. As part of this modification, the interest rate on the $945,000 loan remains at a fixed annual rate of 12%, however it was changed so that 6% is paid in cash monthly in arrears, and 6% is payable in kind, to be evidenced by additional promissory notes having an aggregate principal amount equal to the accrued but unpaid interest. We can prepay the loan at any time, subject to a prepayment fee of (a) 2% if the prepayment is made between July 20, 2018 and July 19, 2019, and (b) 1% if the prepayment is made between July 20, 2019 and July 19, 2020.

In conjunction with entering into the loan agreement with MHW, the Company and MHW also entered into a warrant agreement granting MHW the right to purchase up to 1,115,827 shares of the Company's common stock. As part of the July 2017 modification, we also modified the warrant to change the exercise price of the shares and to extend the term of the warrant to July 19, 2022. The warrant is now exercisable for a period of five years from July 19, 2017 at an exercise price of $0.10 for the first 390,539 shares, $0.20 for the next 390,539 shares and $0.30 for the final 334,749 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 modified warrant was determined to be approximately $167,000 and the incremental value of the warrant compared to the original warrant was approximately $6,000. This amount was added to the remaining unamortized value of the original warrant such that approximately $93,000 will be amortized using the straight-line method (which approximates the effective interest rate method) over the term of the loan. Amortization expense of $19,000 and $26,000 was recorded during the years ended December 31, 2018 and 2017, respectively, for this warrant.

On July 19, 2017, we also borrowed an additional $650,000 from MHW Partners, an entity affiliated with MHW. This loan ranks parri-passu with the $945,000 promissory notes held by MHW and is subject to the same loan agreement. Similar to the notes held by MHW, this note issued to MHW Partners bears interest at 12% per annum payable in cash monthly in arrears at a rate of 6% per annum and payable in kind at a fixed rate of 6% per annum and has a maturity date of July 19, 2022. We can prepay the note issued to MHW Partners at any time, subject to a prepayment fee of (a) 2% if the prepayment is made between July 20, 2018 and July 19, 2019, and (b) 1% if the prepayment is made between July 20, 2019 and July 19, 2020.

The obligations under the loans to MHW and MHW Partners are secured by substantially all of the Company's assets pursuant to the terms of a security agreement. At the time we entered into the revolving line of credit described below, MHW and MHW Partners executed a subordination agreement to evidence their agreement that their security interest is subordinated to the security interest of Texas Capital Bank, N.A.

In conjunction with entering into the loan with MHW Partners, we entered into a warrant granting MHW Partners the right to purchase up to 767,500 shares of our common stock. The warrant is exercisable for a period of 5 years from July 19, 2017, at an exercise price of $0.10 for the first 268,625 shares, $0.20 for the next 268,625 shares and $0.30 for the final 230,250 shares. The exercise price and number of shares of common stock issuable upon exercise of this 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 granted was approximately $115,000. Using the relative-fair value allocation method, the debt proceeds were allocated between the debt value and the fair value of the warrants, resulting in a recognition of a discount on the loan of approximately $98,000 and a corresponding increase to additional paid-in capital. This discount will be amortized using the straight-line method (which approximates the effective interest rate method) over the term of the loan. Approximately $20,000 and $10,000 was amortized during the years ended December 31, 2018 and 2017, 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 and MHW Partners. MHW Capital Management LLC is entitled to a performance-related fee tied to any appreciation in the valuation of the common stock in excess of the applicable strike price under the warrants.

On October 6, 2017, we entered into an amendment to our multiple advance term loan agreement and the related security agreement with MHW and MHW Partners, to add new lenders to the loan and security agreements. Upon execution, Mr. Glen Ikeda and Mr. Andrew Berg became new lenders to the Company. In accordance with the terms of the Amendment, Mr. Ikeda then provided a loan in the amount of $300,000 and Mr. Berg provided a loan in the amount of $100,000 (collectively the "New Loans").

The New Loans have a maturity date of July 19, 2022. The New Loans do not bear interest and we are permitted to make optional prepayments at any time without premium or penalty, provided that if we prepay the outstanding

principal amount of a New Loan prior to the second anniversary of the date of the applicable note, then the total amount of such prepayment will not exceed 95% of the total principal amount of the applicable note and any remaining principal amount under the note shall be fully and finally cancelled, extinguished, forgiven and terminated without further action of any party.

The New Loans include customary affirmative covenants for secured transactions of this type, including compliance with laws, maintenance of insurance, maintenance of assets, timely payments of taxes and notice of adverse events. The loan agreement and ancillary documents include customary negative covenants including limitations on liens on assets of the Company.

Concurrent with the New Loans, we entered into a warrant with Mr. Ikeda granting Mr. Ikeda the right to purchase up to 954,231 shares of our common stock. This warrant is exercisable until July 19, 2022, at an exercise price of $0.10 for the first 498,981 shares, $0.20 for the next 273,981 shares and $0.30 for the final 181,269 shares. The exercise price and number of shares of common stock issuable on exercise of this warrant will be subject to adjustment in the event of any stock split, reverse stock split, recapitalization, reorganization or similar transaction. Mr. Ikeda exercised the warrant in December 2018.

Concurrent with the New Loans, we entered into a warrant with Mr. Berg granting Mr. Berg the right to purchase up to 318,077 shares of our common stock. This warrant is exercisable until July 19, 2022, at an exercise price of $0.10 for the first 166,327 shares, $0.20 for the next 91,327 shares and $0.30 for the final 60,423 shares. The exercise price and number of shares of common stock issuable on exercise of this warrant will be subject to adjustment in the event of any stock split, reverse stock split, recapitalization, reorganization or similar transaction. Mr. Berg exercised the warrant in December 2018.

The fair value of the two warrants granted in connection with the New Loans was approximately $367,000. Using the relative fair-value allocation method, the debt proceeds were allocated between the debt value and the fair value of the warrants, resulting in a recognition of a discount on the new loans of approximately $191,000, with a corresponding increase to additional paid-in capital. This discount will be amortized to interest expense over the term of the loan using the straight-line method (which approximates the effective interest rate method). Approximately $40,000 and $10,000 was amortized during the years ended December 31, 2018 and 2017, respectively.

Future principal repayments on the notes payable as at December 31, 2018 are as follows (in $’000):

2019	$-
2020	-
2021	-
2022	1,995
Total	$1,995

Note 4 - Revolving Line of Credit

On December 31, 2018, we entered into a revolving line of credit (the “credit facility”) with Texas Capital Bank, National Association (“Lender”) pursuant to a Business Loan Agreement (Asset Based) (the “Loan Agreement”). The obligations under the credit facility are secured by substantially all our assets. Our wholly-owned subsidiaries, Vortech, L.L.C., VTC, L.L.C., Total Site Solutions Arizona LLC and Alletag Builders, Inc. jointly and severally guaranteed our obligations under the credit facility.

The maximum principal amount of the credit facility is $1,500,000. The credit facility is subject to a borrowing base of 80% of eligible accounts receivables, subject to customary exclusions and limitations. Borrowings under the credit facility will bear interest at LIBOR plus 3% (effective rate of 5.37% at December 31, 2018). Certain accounts receivables subject to a vendor payment program with a customer are excluded from the definition of eligible accounts receivables under the credit facility. In addition to interest payable on the principal amount of indebtedness outstanding from time to time under the credit facility, we will pay a 0.25% unused facility fee, payable quarterly in arrears. The credit facility matures on December 31, 2020.

The credit facility requires that we maintain a minimum liquidity of $500,000 at all times excluding availability under the loan. It also requires us to comply with certain financial covenants including a maximum Total Leverage Ratio of 3.00, a minimum Total Interest Coverage Ratio of 2.50, and a minimum Total Fixed Charge Coverage Ratio of 1.25. The credit facility also limits the amount of new indebtedness to $250,000 per fiscal year without Lender’s prior written approval.

The Loan Agreement and ancillary documents include customary affirmative covenants for secured transactions of this type, including maintaining adequate books and records, periodic financial reporting, compliance with laws, maintenance of insurance, maintenance of assets, timely payment of taxes, and notice of adverse events. The Loan Agreement and ancillary documents include customary negative covenants, including incurrence of other indebtedness, mergers, consolidations and transfers of assets and liens on assets of the Company. The Loan Agreement and ancillary documents include customary events of default, including payment defaults, failure to perform or observe terms, covenants or agreements included in the Loan Agreement and ancillary documents, insolvency and bankruptcy defaults, judgment defaults, material adverse change defaults, and change of ownership defaults.

There were no amounts outstanding under this credit facility at December 31, 2018 and we were in compliance with all financial covenants. The maximum amount we were eligible to borrow at December 31, 2018 was approximately $100,000.

Note 5 – Sale of Business Component

On December 28, 2018, we completed the sale of substantially all of the assets and liabilities used in our Virginia-based, critical data center power and cooling business, operated by our wholly-owned subsidiary Innovative Power Systems, Inc. The business was sold to Innovative Power, LLC (the "Buyer") for total cash consideration of $2.5 million, subject to certain post-closing adjustments relating to working capital and certain customer contracts of the business.

The managing member of Innovative Power, LLC is Peter H. Woodward, Chairman of our Board of Directors. Mr. Woodward is also the General Partner of MHW Partners, LP and the managing member of MHW SPV II, LLC, entities that hold $1.595 million of promissory notes payable by TSS described above. The purchase price was determined through arms-length negotiations between us and Mr. Woodward. The transaction was unanimously approved by our Board of Directors other than Mr. Woodward.

The transaction closed on December 28, 2018. The purchase agreement contains representations, warranties, covenants and indemnification provisions customary for a transaction of this type. Many of the representations made by us are subject to, and qualified by, materiality or similar concepts. Both parties have agreed to indemnify the other party for certain losses arising from the breach of the purchase agreement and for certain other liabilities, subject to specified limitations. In connection with the transaction both parties will provide transition services with respect to the business activities that were sold.

The customer contracts and intellectual property sold had a net book value of $1,176,000. As a result of the sale, the Buyer assumed assets of $3,000, and $175,000 was placed in an escrow account, resulting in $2,325,000 of cash proceeds that was paid to us upon closing. Additionally, we incurred approximately $184,000 in legal, escrow and other expenses that would not have been incurred otherwise. After writing off the carrying value of intangibles associated with the business sold, we recorded a net gain of approximately $1,140,000 in our consolidated statement of operations during the year ended December 31, 2018.

On January 31, 2017, we completed the sale of certain identified assets and liabilities associated with a specific customer contract from our project management business for $350,000 pursuant to an Asset Purchase Agreement ("APA") dated December 12, 2016 with Tech Site Services, LLC, a privately held Maryland company. The sale price was subject to certain post-closing adjustments relating to working capital and obtaining the consent of the customer as a condition of closing. Tech Site Services, LLC also must pay us an earn-out payment equal to 10% of all revenue generated under the customer contract in excess of $2.5 million in each 12-month period during the two-year period after the closing of this transaction. No earn out payments were due in 2017 or 2018.

The managing member of Tech Site Services, LLC is Thomas P. Rosato and the Company leased our Maryland office until December 2016 from an entity that is fifty percent owned by Mr. Rosato.

The transaction closed on January 31, 2017. The APA contains representations, warranties, covenants and indemnification provisions customary for a transaction of this type. Many of the representations made by us are subject to, and qualified by materiality or similar concepts. Both parties have agreed to indemnify the other party for certain losses arising from the breach of the APA and for certain other liabilities, subject to specified limitations. In connection with the transaction both parties will provide transition services with respect to the business activities that were sold.

The customer contract and intellectual property sold had a net book value of $0. As a result of the sale, Tech Site Services LLC assumed liabilities of $7,000, resulting in $343,000 of cash proceeds that was paid to us upon closing. Additionally, we incurred approximately $29,000 in legal, escrow and other expenses that would not have been incurred otherwise. As a result, we recorded a net gain of approximately $321,000 in our consolidated statement of operations during the year ended December 31, 2017.

As noted above, on July 1, 2016 we adopted ASU 2014-08 regarding discontinued operations. As a result, we evaluated both the sale of the specific customer contract and the sale of a portion of our facilities maintenance business component in light of this new standard. We concluded that neither of these transactions were a "material shift" (as defined in ASU 2014-08) for us and therefore, were not considered a discontinued operation. In accordance with ASU 2014-08, the following information is being provided:

	Years Ended December 31,	
	2018	**2017**
Pre-tax profit related to power and cooling business	$1,332	$1,122
Pre-tax profit related to specific customer contract	$-	$93

Pro forma impact of disposition

The following unaudited pro forma combined results of operations are provided for the years ended December 31, 2018 and 2017 as though both of these dispositions occurred on January 1, 2017.

The unaudited pro forma consolidated statement of operations for the years ended December 31, 2018 and 2017 reflect the following adjustments:

(1) Eliminates the revenues and cost of goods sold as if the transaction occurred on January 1, 2017

(2) Eliminates operating expenses including salary and related costs for employees who transferred as if this transaction occurred on January 1, 2017.

The unaudited pro forma consolidated financial information is provided for illustrative purposes only and does not purport to represent what the actual results of operations would have been had the transactions occurred on the respective date assumed, nor is it necessarily indicative of the Company's future operating results. However, the pro forma adjustments reflected in the accompanying unaudited pro forma financial information reflect estimates and assumptions that the Company's management believes to be reasonable.

Pro forma adjustments related to the unaudited pro forma consolidated statement of operations for the years ended December 31, 2018 and 2017 were computed assuming the transactions were consummated on January 1, 2017 and include adjustments which give effect to events that are (i) directly attributable to the transaction, (ii) expected to have a continuing effect on the Company, and (iii) factually supportable.

(unaudited, in thousands)	Years ended December 31, 2018 (Pro forma)	2017 (Pro forma)
Revenue	$17,487	$14,255
Operating income (loss)	$429	$(395)
Net income (loss)	$(35)	$(735)
Basic and diluted net income (loss) per share	$0.00	$(0.05)

Note 6 – Income Taxes

Income taxes are recognized for the amount of taxes payable or refundable for the current year and deferred tax liabilities and assets are established for the future tax consequences of events that have been recognized in our consolidated financial statements or tax returns. The effects of income taxes are measured based on enacted tax laws and rates.

The provision for income taxes from continuing operations consists of the following (in $'000):

	Year Ended December 31,	
	2018	2017
Current:		
Federal	$ -	$ -
State	26	19
Deferred:		
Federal	-	(6)
State	-	(4)
Total provision for income taxes before valuation allowance	$ 26	$ 9
Change in valuation allowance	-	-
Total provision for income taxes	$ 26	$ 9

The significant components of our deferred tax assets and liabilities are as follows (in $'000):

	December 31,	
	2018	**2017**
Deferred tax assets:		
Accrued expenses	$ 139	$ 65
Net operating loss carryover	8,154	8,792
Goodwill and other intangibles	1,205	1,665

Deferred compensation	70	135
Depreciation	-	39
Other carryovers and credits	12	12
Total deferred tax assets	9,580	10,708
Deferred tax liabilities:		
Prepaid expenses	$(7)	$(20)
Depreciation	(12)	-
Deferred revenue	33	-
Total deferred tax liabilities	14	(20)
Valuation Allowance	(9,594)	(10,688)
Net non-current deferred taxes	$-	$-

At December 31, 2018 and 2017, we had net operating losses ("NOL") totaling $35.1 million and $37.7 million, respectively, to be carried forward 20 years to offset future taxable income and any unused NOL will begin to expire in 2027.

We do not believe our net operating loss will be limited under Internal Revenue Code (“IRC”) Section 382 and believe it will also be available for state income tax purposes subject to state carryforward limitations. IRC Section 382 limits the utilization of net operating loss in years subsequent to an owner shift based upon the value of the Company at the date of the owner shift. We have not undertaken a detailed study in connection with IRC Section 382 in order to determine if there is any limitation of the utilization of its net operating loss carryforward. If IRC Section 382 limitation were deemed to apply, our gross deferred tax asset and its corresponding valuation allowance could be reduced. The 2017 Tax Cuts and Jobs Act revised the use of net operating loss carryforwards and limits them to 80% of taxable income each year, but removed the limitation on years carried forward.

Our provision for income taxes reflects the establishment of a full valuation allowance against deferred tax assets as of December 31,2018 and 2017. Accounting Standards Codification Topic 740 *Income Taxes* requires management to evaluate its deferred tax assets on a regular basis to reduce them to an amount that is realizable on a more likely than not basis. During 2018, the valuation allowance decreased by approximately $1.1 million due to continuing operations. In determining our provision/(benefit) for income taxes, net deferred tax assets, liabilities and valuation allowances, we are required to make judgments and estimates related to projections of profitability, the timing and extent of the utilization of net operating loss carryforwards and applicable tax rates. Judgments and estimates related to our projections and assumptions are inherently uncertain; therefore, actual results could differ materially from the projections.

We have adopted the provisions of the guidance related to accounting for uncertainties in income taxes. We have analyzed our current tax reporting compliance positions for all open years and have determined that it does not have any material unrecognized tax benefits. Accordingly, we have omitted the tabular reconciliation schedule of unrecognized tax benefits. We do not expect a material change in unrecognized tax benefits over the next 12 months. All of our prior federal and state tax filings from the 2015 tax year forward remain open under statutes of limitation. Operating losses generated in years prior to 2015 remain open to adjustment until the statute closes for the tax year in which the net operating losses are utilized.

The Company’s provision for income taxes attributable to continuing operations differs from the expected tax benefit amount computed by applying the statutory federal income tax rate of 34% to income (loss) before taxes for the years ended December 31, 2018 and 2017, primarily as a result of the following:

	Year Ended December 31,	
	2018	**2017**
Federal statutory rate	21.0 %	34.0 %
State tax, net of income tax benefit	2.4 %	4.0 %
Effect of permanent differences	13.9 %	11.0 %
Change in valuation allowance	(36.3)%	(48.0)%
Total	1.0 %	1.0 %

Note 7 – Commitments and Contingencies

We lease premises and equipment under operating leases having terms from month-to-month to 5 years. At December 31, 2018, future minimum lease payments under leases having an initial or remaining non-cancellable lease term in excess of one year including known escalation clauses are as set forth in this table below (in $'000):

Year	
2019	$729
2020	784
2021	807
2022	194
2023	-
Total	$2,514

For both of the years ended December 31, 2018 and 2017, rent expense included in selling, general and administrative expenses for operating leases was approximately $0.3 million. For the years ended December 31, 2018 and 2017, rent expense included in cost of revenue for operating leases was $0.8 million and $0.7 million, respectively.

In the normal course of business, we issue binding purchase orders to subcontractors and equipment suppliers. At December 31, 2018, these open purchase order commitments amount to approximately $1.2 million. The majority of services delivered and equipment received is expected to be satisfied during the first six months of 2019 at which time these commitments will be fulfilled.

From time to time, we are involved in various legal matters and proceedings concerning matters arising in the ordinary course of business. We currently estimate that a material adverse effect on our financial position, results of operations and cash flows from such matters is not reasonably likely.

Note 8 – Fair Value Measurements

GAAP defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. GAAP also established a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. As of December 31, 2018, we did not have any assets measured at fair value on a recurring basis that would require disclosure based on the fair value hierarchy of valuation techniques. In addition, certain non-financial assets and liabilities are to be initially measured at fair value on a non-recurring basis. This includes items such as non-financial assets and liabilities initially measured at fair value in a business combination (but not measured at fair value in subsequent periods) and non-financial, long-lived assets measured at fair value for an impairment assessment. In general, non-financial assets and liabilities including goodwill and property and equipment are measured at fair value using Level 3 inputs, which result in management’s best estimate of fair value from the perspective of a market participant, when there is an indication of impairment and are recorded at fair value only when impairment is recognized.

Note 9 – Share Based Payments

In January 2007, our stockholders approved the Company’s 2006 Omnibus Incentive Compensation Plan, which was designed to attract, retain and motivate key employees. Under this plan, we reserved 5.1 million shares of our common stock for issuance to employees and directors through incentive stock options, non-qualified stock options or restricted stock. In June 2015 our stockholders approved a new 2015 Omnibus Incentive Compensation Plan (the “Plan”) and reserved a further 2.5 million shares of our common stock for issuance to employees and directors through incentive stock options, non-qualified stock options or restricted shares. At December 31, 2018, 1,578,000 shares remain available for issuance.

The Plan is administered by the compensation committee of our Board of Directors. Subject to the express provisions of the Plan, the compensation committee has the Board of Directors' authority to administer and interpret the Plan, including the discretion to determine the form of grant, exercise price, vesting schedule, contractual life and the number of shares to be issued. We have historically issued restricted stock under the Plan; however, as further incentive to key employees, the Company also issued options to purchase shares of our common stock during the years ended December 31, 2018 and 2017.

Stock-based Compensation Expense

For the years ended December 31, 2018 and 2017, we recognized stock-based compensation of $241,000 and $68,000, respectively, which was included in selling, general and administrative expenses.

As of December 31, 2018, the total unrecognized compensation cost related to unvested restricted stock and options to purchase common stock was approximately $314,000 with a weighted average remaining vest life of 0.9 years.

Stock Options

Although we had historically issued restricted stock under the Plan, we also issued options to purchase shares of our common stock during the years ended December 31, 2018 and 2017. The grants have various vesting features but typically involve time-based vesting.

Fair Value Determination –We utilize a Black-Scholes-Merton model to value stock options vesting over time. We will reconsider the use of the Black-Scholes-Merton model if additional information becomes available in the future that indicates another model would be more appropriate or if grants issued in future periods have characteristics that cannot be reasonably estimated under these models.

Volatility -The expected volatility of the options granted was estimated based upon historical volatility of our share price through weekly observations of our trading history corresponding to the expected term for Black-Scholes-Merton model.

Expected Term -Given the lack of historical experience, the expected term of options granted to employees was determined utilizing a plain vanilla approach whereby minimum or median time to vest and the contractual term of 10 years are averaged.

Risk-free Interest Rate -The yield was determined based on U.S. Treasury rates corresponding to the expected term of the underlying grants.

Dividend Yield -The Black-Scholes-Merton valuation model requires an expected dividend yield as an input. We currently do not anticipate paying dividends; therefore, the yield was estimated at zero.

The following table summarizes weighted-average assumptions used in our calculations of fair value for the year ended December 31, 2018:

	Black-Scholes-Merton	
Volatility	174	%
Expected life of options (in years)	5	

Risk-free interest rate	2.50	%
Dividend yield	0	%

During the years ended December 31, 2018 and 2017, we granted stock options to purchase 0.25 and 2.557 million shares, respectively, of common stock at a weighted-average exercise price of $0.49 and $0.10 per share, respectively, which reflects the fair market value of the shares on date of grant. In accordance with the terms of the Plan, the Board of Directors determined that the average of the high and low bid prices for the Common Stock reported daily on the OTCQB marketplace during the 20 trading days following the grant date was the fair market value of the shares. The weighted-average fair value of options granted during the years ended December 31, 2018 and 2017, as determined under the Black-Scholes-Merton valuation model was $0.47 and $0.10, respectively.

The following table includes information with respect to stock option activity and stock options outstanding for the years ended December 31, 2018 and 2017:

	Number Of Shares	**Weighted Average Exercise Price**	**Weighted Average Remaining Contractual Life (years)**	**Aggregate Intrinsic Value***
Shares under option, January 1, 2017	2,220,000	$ 0.48	-	$ -
Options granted	2,557,000	$ 0.10		
Options exercised	-	$ -		
Options cancelled and expired	(2,316,000)	$ (0.41)		
Shares under option, December 31, 2017	2,461,000	$ 0.15	8.66	
Options granted	250,000	$ 0.49		
Options exercised	(90,000)	$ 0.10		
Options cancelled and expired	(49,000)	$ (0.37)		
Shares under option, December 31, 2018	2,572,000	$ 0.18	7.80	$ 1,700

*Aggregate intrinsic value includes only those options with intrinsic value (options where the exercise price is below the market price).

The following table summarizes non-vested stock options for the years ended December 31, 2018 and 2017:

	Number of Shares	Weighted Average Fair Value
Non-vested stock options at January 1, 2017	1,340,000	$ 0.34
Options granted	2,557,000	$ 0.13
Vested during period	-	$ -
Options cancelled	(1,760,000)	$ (0.29)
Non-vested shares under option, December 31, 2017	2,137,000	$ 0.13
Options granted	250,000	$ 0.47
Vested during period	(1,231,000)	$ (0.13)
Options cancelled	(17,500)	$ (0.13)
Non-vested shares under option, December 31, 2018	1,138,500	$ 0.20

The following table includes information concerning stock options exercisable and stock options expected to vest at December 31, 2018:

	Options	Weighted Average Remaining Contractual Life (years)	Weighted Average Exercise Price	Aggregate Intrinsic Value
Stock options exercisable	1,433,500	7.28	$ 0.17	$ 954
Stock options expected to vest	1,138,500	8.45	$ 0.19	$ 745
Options exercisable and expected to vest	2,572,000			

Restricted Stock

We have granted shares of restricted stock under the Plan. A restricted stock award is an issuance of shares that cannot be sold or transferred by the recipient until the vesting period lapses. Restricted shares issued to employees typically vest over two or three years in in equal installments on the anniversaries of the grant date, contingent upon employment with the Company on the vesting dates. The related compensation expense is recognized over the service period and is based on the grant date fair value of the stock and the number of shares expected to vest.

The fair value of restricted stock awarded for the year ended December 31, 2018 was $405,000 and was calculated using the value of TSS' common stock on the grant date. No restricted stock was awarded during the year ended December 31, 2017. The value of awards are amortized over the vesting periods of the awards taking into account the effect of an estimated forfeiture rate of zero associated with termination behavior for the years ended December 31, 2018 and 2017, respectively.

The following table summarizes the restricted stock activity during the years ended December 31, 2018 and 2017:

	Number of Shares	**Weighted Average Grant Date Fair Value**
Unvested January 1, 2017	249,000	$ 0.45
Granted restricted stock	-	$ -
Cancelled restricted stock	(54,000)	(0.08)
Vested restricted stock	(165,000)	$ (0.562)
Unvested December 31, 2017	30,000	$ 0.15
Granted restricted stock	827,000	$ 0.49
Cancelled restricted stock	(30,000)	(0.15)
Vested restricted stock	-	$ -
Unvested December 31, 2018	827,000	$ 0.49

Note 10 – Common Stock Repurchases

During the years ended December 31, 2018 and 2017, we repurchased 7,989 and 20,567 treasury shares, respectively, with an aggregate value of approximately $6,000 and $4,000 respectively, associated with the vesting of restricted stock held by employees. Per terms of the restricted stock agreements, for certain employees we paid the employee’s related taxes associated with the employee’s vested stock and decreased the freely tradable shares issued to the employee by a corresponding value, resulting in a share issuance net of taxes to the employee. The value of the shares netted for employee taxes represents treasury stock repurchased.

Note 11 – Related Party Transactions

We have $945,000 principal outstanding at December 31, 2018 in promissory notes payable to MHW, net of remaining discount of $65,000. Per the terms of the notes, we paid interest of approximately $120,000 and $114,000 during the years ended December 31, 2018 and 2017, respectively. We have $650,000 principal outstanding at December 31, 2018 in promissory notes payable to MHW Partners, net of remaining discount of $68,000. Per the terms of the notes, we paid interest of approximately $82,000 and $36,000 during the years ended December 31, 2018 and 2017, 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 and MHW Partners. MHW Capital Management LLC is entitled to a performance-related fee tied to appreciation in the valuation of the common stock in excess of the applicable strike price under the warrant issued to MHW and MHW Partners.

Note 12 – Net Income Per-Share

Basic and diluted income 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 purpose of determining diluted income 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.

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

	Years Ended December 31,	
	2018	**2017**
Basic net income per share:		
Numerator:		
Net income	$2,437	$766
Denominator:		
Weighted-average shares of common stock outstanding	15,532	15,507
Basic net income per share	$0.16	$0.05
Diluted net income per share:		
Numerator:		
Net income	$2,437	$766
Plus interest expense on convertible debt	-	-
	$2,437	$766
Denominator:		
Weighted-average shares of common stock outstanding	15,532	15,507
Dilutive options and warrants outstanding	3,147	1,013
Effect of conversion of convertible notes	-	4
Number of shares used in diluted per-share computation	18,679	16,524
Diluted net income per share	$0. 13	$0.05

For the year ended December 31, 2017 potentially dilutive shares of 324,000 were excluded from the calculation of dilutive shares because their effect would have been anti-dilutive in that period.

Note 13 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 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 result by reportable segment reconciled to reportable net loss for the years ended December 31, 2018 and 2017 and other segment-related information is as follows (in thousands):

	Year Ended December 31,	
	2018	**2017**
Revenues:		
Facilities	$15,187	$12,254
Systems integration services	7,148	6,062
Total revenues	$22,335	$18,316
Operating income:		
Facilities	$4,317	$2,816
Systems integration services	(1,451)	(1,710)
Operating income	$2,866	$1,106
Depreciation expense:		
Facilities design and maintenance	$32	$64
Systems integration services	231	306
Consolidated depreciation expense	263	$339
Interest expense		
Facilities design and maintenance	$256	$184
Systems integration services	147	144
Consolidated interest expense	$403	$328
Total Assets		
Facilities	$1,063	$2,682
Systems integration services	1,514	1,572
Other consolidated activities	6,533	2,473
Total assets	$9,110	$6,727

Other consolidated activities includes assets not specifically attributable to each business segment including cash, prepaid and other assets that are managed at a corporate level.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.

None.

Item 9A. Controls and Procedures.

(a) Disclosure Controls and Procedures

The Company carried out an evaluation, under the supervision of and with the participation of the Company's Chief Executive Officer and Chief 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 the date of this Annual Report. Based upon that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this Annual Report, 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 required disclosure.

(b) Management's Report on Internal Control Over Financial Reporting

The management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rule 13a-15(f) and 15d-15(f) under the Exchange Act. There are inherent limitations on the effectiveness of any system of internal controls, including the possibility of human error and circumvention or overriding of the controls and procedures. Accordingly, even effective internal controls and procedures provide only reasonable assurance of achieving their objectives.

Management, including the Chief Executive Officer and the Chief Financial Officer, assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2018. 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 December 31, 2018.

(c) Changes in Internal Control Over Financial Reporting

There have been no changes in the Company’s internal control over financial reporting during the three months ended December 31, 2018 that 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.

Item 9B. Other Information

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance.

Information required by this item regarding our directors, executive officers and corporate governance matters may be found under the caption “Management and Corporate Governance” in our Proxy Statement relating to our 2019 Annual Meeting of Stockholders (the “2019 Proxy Statement”) to be filed with the SEC within 120 days of December 31, 2018 and is incorporated herein by reference. Information relating to compliance with Section 16(a) of the Securities and Exchange Act of 1934, as amended, may be found under the caption “Section 16(a) Beneficial Ownership Reporting Compliance” in the 2019 Proxy Statement and is incorporated herein by reference.

Item 11. Executive Compensation.

The information required by this item is included under the captions “Management and Corporate Governance,” and “Executive Officer and Director Compensation” in the 2019 Proxy Statement and incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

The information required by this item is included under the caption “Security Ownership of Certain Beneficial Owners and Management” in the 2019 Proxy Statement and is incorporated herein by reference.

Item 13. Certain Relationships and Related Transactions, and Director Independence.

The information required by this item is included under the captions “Related Person Transactions” and “Management and Corporate Governance” in the 2019 Proxy Statement and is incorporated herein by reference.

Item 14. Principal Accounting Fees and Services.

The information required by this item is included under the caption “Independent Registered Public Accounting Firms” in the 2019 Proxy Statement and is incorporated herein by reference.

PART IV

Item 15. Exhibits, Financial Statement Schedules.

(a) The following documents are filed as part of this Annual Report:

1. Financial Statements:

The following consolidated financial statements of TSS, Inc. for each of the years ended December 31, 2018 and 2017 are submitted in Part II, Item 8. Financial Statements and Supplementary Data of this report:

Description	**Page**
Consolidated Balance Sheets - December 31, 2018 and 2017	23
Consolidated Statements of Operations for the years ended December 31, 2018 and 2017	24
Consolidated Statements of Changes in Stockholders' Equity for the years ended December 31, 2018 and 2017	25
Consolidated Statements of Cash Flows for the years ended December 31, 2018 and 2017	26
Notes to Consolidated Financial Statements	27

2. Financial Statements Schedules:

None.

3. Exhibits:

2.1	Asset Purchase Agreement, dated September 28, 2016 by and between VTC, L.L.C. d/b/a Total Site Solutions and Tech Site Services, L.L.C. (previously filed with the Commission as Exhibit 2.1 to the Company's Current Report on Form 8-K filed on October 4, 2016, and incorporated herein by reference).
2.2	Asset Purchase Agreement, dated December 28, 2018 by and among Innovative Power Systems, Inc., TSS, Inc. and Innovative Power, L.L.C. (previously filed with the Commission as Exhibit 2.1 to the Company's Current Report on Form 8-k filed on January 3, 2018, and incorporated herein by reference).
3.2	

	Second Amended and Restated Certificate of Incorporation dated January 19, 2007 (previously filed with the Commission as Exhibit 3.1 to the Current Report on Form 8-K filed on January 25, 2007 and incorporated herein by reference)
3.3	Certificate of Amendment to Second Amended and Restated Certificate of Incorporation (previously filed with the Commission as Exhibit A to the Company's Definitive Proxy Statement filed on April 29, 2011 and incorporated herein by reference)
3.4	Certificate of Amendment of Second Amended and Restated Certificate of Incorporation of the Company, dated effective June 6, 2013 (previously filed with the Commission as Exhibit 3.1 to the Company's Current Report on Form 8-K filed on June 7, 2013, and incorporated herein by reference).
3.5	Amended and Restated By-laws (previously filed with the Commission as Exhibit 4.2 to the Company's Registration Statement on Form S-8 No. 333-142906, filed on May 14, 2007 and incorporated herein by reference)

4.1.	Loan Agreement, among TSS, Inc. Innovative Power Systems, Inc., VTC, L.L.C., Vortech, L.L.C., Total Site Solutions Arizona, LLC, Alletag Buildings, Inc. and MHW SPV II, LLC, dated February 3, 2015 (previously filed with the Commission as Exhibit 99.1 to the Company's Current Report on Form 8-K filed on February 3, 2015, and incorporated herein by reference).
4.2	Amended and Restated Loan Agreement, among TSS, Inc., Innovative Power Systems, Inc., VTC, L.L.C., Vortech, L.L.C., Total Site Solutions Arizona, LLC, Alletag Builders, Inc. and MHW SPV II, LLC, dated February 3, 2015 (previously filed with the Commission as Exhibit 99.1 to the Company's Current Report on Form 8-K filed on July 25, 2017, and incorporated herein by reference).
4.3	Promissory Note, made by TSS, Inc. Innovative Power Systems, Inc., VTC, L.L.C., Vortech, L.L.C., Total Site Solutions Arizona, LLC, and Alletag Buildings, Inc. payable to the order of MHW SPV II, LLC, dated February 3, 2015 (previously filed with the Commission as Exhibit 99.2 to the Company's Current Report on Form 8-K filed on February 3, 2015, and incorporated herein by reference).
4.4	Amended and Restated Promissory Note, made by TSS, Inc., Innovative Power Systems, Inc., VTC, L.L.C., Vortech, L.L.C., Total Site Solutions Arizona, LLC and Alletag Builders, Inc. payable to the order of MHW SPV II, LLC, dated July 19, 2017 (previously filed with the Commission as Exhibit 99.2 to the Company's Current Report on Form 8-K filed on July 25, 2017, and incorporated herein by reference).
4.5	Security Agreement, among TSS, Inc., Innovative Power Systems, Inc., VTC, L.L.C., Vortech, L.L.C., Total Site Solutions Arizona, LLC and Alletag Buildings, Inc. in favor of MHW SPV II, LLC, dated February 3, 2015 (previously filed with the Commission as Exhibit 99.3 to the Company's Current Report on Form 8-K filed on February 3, 2015, and incorporated herein by reference).
4.6	Subordination Agreement, among TSS, Inc. Innovative Power Systems, Inc., VTC, L.L.C., Vortech, L.L.C., Total Site Solutions Arizona, LLC, Alletag Buildings, Inc., MHW SPV II LLC and Bridge Bank, National Association, dated February 3, 2015 (previously filed with the Commission as Exhibit 99.4 to the Company's Current Report on Form 8-K filed on February 3, 2015, and incorporated herein by reference).
4.7	Warrant between TSS, Inc. and MHW SPV II, LLC, dated February 3, 2015 (previously filed with the Commission as Exhibit 99.5 to the Company's Current Report on Form 8-K filed on February 3, 2015, and incorporated herein by reference).
4.8	Promissory Note, made by TSS, Inc., Innovative Power Systems, Inc., VTC, L.L.C., Vortech, L.L.C., Total Site Solutions Arizona, LLC. and Alletag Builders, Inc. payable to the order of MHW Partners, LP dated July 19, 2017 (previously filed with the Commission as Exhibit 99.3 to the Company's Current Report on Form 8-K filed on July 25, 2017, and incorporated herein by reference).
4.9	Amended and Restated Security Agreement, among TSS, Inc., Innovative Power Systems, Inc., VTC, L.L.C., Vortech, L.L.C., Total Site Solutions Arizona, LLC and Alletag Builders, Inc. in favor of MHW Partners, LP and MHW SPV II, LLC dated July 19, 2017 (previously filed with the Commission as Exhibit 99.4 to the Company's Current Report on Form 8-K filed on July 25, 2017, and incorporated herein by reference).
4.10	Amended and Restated Warrant between TSS, Inc. and MHW SPV II, LLC dated July 19, 2017 (previously filed with the Commission as Exhibit 99.5 to the Company's Current Report on Form 8-K filed on July 25, 2017, and incorporated herein by reference).

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4.11	Warrant between TSS, Inc. and MHW Partners, LP dated July 19, 2017 (previously filed with the Commission as Exhibit 99.6 to the Company's Current Report on Form 8-K filed on July 25, 2017, and incorporated herein by reference).
4.12	First Amendment among TSS, Inc., Innovative Power Systems, Inc., VTC, LLC, Vortech, LLC, Total Site Solutions Arizona, LLC, Alletag Builders, Inc., MHW Partners, LP, MHW SPV II, LLC, Andrew Berg and Glen Ikeda dated October 6, 2017 (previously filed with the Commission as Exhibit 99.1 to the Company's Current Report on Form 8-K filed on October 13, 2017, and incorporated herein by reference).
4.13	Promissory note made by TSS, Inc., Innovative Power Systems, Inc., VTC, LLC, Vortech, LLC, Total Site Solutions Arizona, LLC and Alletag Builders, Inc. payable to the order of Glen Ikeda, dated October 6, 2017 (previously filed with the Commission as Exhibit 99.2 to the Company's Current Report on Form 8-K filed on October 13, 2017, and incorporated herein by reference).
4.14	Promissory note made by TSS, Inc., Innovative Power Systems, Inc., VTC, LLC, Vortech, LLC, Total Site Solutions Arizona, LLC and Alletag Builders, Inc. payable to the order of Andrew Berg, dated October 10, 2017 (previously filed with the Commission as Exhibit 99.3 to the Company's Current Report on Form 8-K filed on October 13, 2017, and incorporated herein by reference).
4.15	Warrant between TSS, Inc. and Glen Ikeda dated October 6, 2017 (previously filed with the Commission as Exhibit 99.4 to the Company's Current Report on Form 8-K filed on October 13, 2017, and incorporated herein by reference).
4.16	Warrant between TSS, Inc. and Andrew Berg dated October 9, 2017 (previously filed with the Commission as Exhibit 99.5 to the Company's Current Report on Form 8-K filed on October 13, 2017, and incorporated herein by reference).
10.1	Fortress America Acquisition Corporation 2006 Omnibus Incentive Compensation Plan, as amended (previously filed with the Commission as Annex A to the Company's Definitive Proxy Statement filed on April 30, 2012, and incorporated herein by reference).
10.2.‡	Form of Restricted Stock Award Agreement with executive officers relating to the 2006 Omnibus Incentive Compensation Plan (previously filed with the Commission as Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q filed on May 20, 2015, and incorporated herein by reference).
10.3‡	Executive Employment Agreement dated January 19, 2007 by Fortress America Acquisition Corporation and Gerard J. Gallagher (previously filed with the Commission as Exhibit 10.10 to the Company's Current Report on Form 8-K filed on January 25, 2007 and incorporated herein by reference), as amended by Amendment No. 1, dated August 26, 2008 (previously filed with the Commission as Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q filed on November 14, 2008 and incorporated herein by reference)
10.4‡	Amendment to Executive Employment Agreement, effective as of February 28, 2010, between the Company and Gerard J. Gallagher (previously filed with the Commission as Exhibit 99.3 to the Company's Current Report on Form 8-K filed on March 1, 2010, and incorporated herein by reference).
10.5‡	Letter Agreement, dated February 28, 2010, between the Company and Gerard J. Gallagher (previously filed with the Commission as Exhibit 99.1 to the Company's Current Report on Form 8-K filed on March 1, 2010 and incorporated herein by reference).

10.6‡	Amendment to Executive Employment Agreement, dated January 3, 2012, between the Company and Gerard J. Gallagher (previously filed with the Commission as Exhibit 99.5 to the Company's Current Report on Form 8-K filed on January 3, 2012, and incorporated herein by reference).

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10.7‡	Amendment to Executive Employment Agreement, effective as of March 15, 2012, between the Company and Gerard J. Gallagher (previously filed with the Commission as Exhibit 99.2 to the Company’s Current Report on Form 8-K filed on March 19, 2012, and incorporated herein by reference).
10.8‡	Amendment to Executive Employment Agreement, effective as of May 21, 2013, between the Company and Gerard J. Gallagher (previously filed with the Commission as Exhibit 99.2 to the Company’s Current Report on Form 8-K filed on May 24, 2013, and incorporated herein by reference).
10.9‡	Amendment to Executive Employment Agreement, effective as of August 13, 2013, between the Company and Gerard J. Gallagher (previously filed with the Commission as Exhibit 99.2 to the Company’s Current Report on Form 8-K filed on August 14, 2013, and incorporated herein by reference).
10.11	Amendment to Executive Employment Agreement, effective as of April 5, 2017 between the Company and Gerard J. Gallagher (previously filed with the Commission as Exhibit 99.1 to the Company’s Current Report on Form 8-K filed on April 5, 2017, and incorporated herein by reference).
10.12	Second Amendment to Amended and Restated Convertible Promissory Note, dated as of December 21, 2015 between TSS, Inc. and Gerard J. Gallagher (previously filed with the Commission as Exhibit 99.1 to the Company's Current Report on Form 8-K filed on December 22, 2015, and incorporated herein by reference).
10.13	Warrant between TSS, Inc. and Gerard J. Gallagher (previously filed with the Commission as Exhibit 99.2 to the Company’s Current Report on Form 8-K filed on December 22, 2015, and incorporated herein by reference).
10.14‡	Executive Employment Agreement, dated January 3, 2012, between the Company and Anthony Angelini (previously filed with the Commission as Exhibit 99.2 to the Company’s Current Report on Form 8-K filed on January 3, 2012, and incorporated herein by reference).
10.15‡	Amendment No.1 to Executive Employment Agreement, effective as of March 14, 2012, between the Company and Anthony Angelini (previously filed with the Commission as Exhibit 99.1 to the Company’s Current Report on Form 8-K filed on March 19, 2012, and incorporated herein by reference).
10.16‡	Stock Option Agreement, dated as of April 30, 2012, between the Company and Anthony Angelini with respect to options to purchase 250,000 shares of the Company’s common stock (previously filed with the Commission as Exhibit 99.2 to the Company’s Current Report on Form 8-K filed on June 8, 2012, and incorporated herein by reference).
10.17‡	Stock Option Agreement dated as of April 30, 2012 between the Company and Anthony Angelini with respect to options to purchase 500,000 shares of the Company’s common stock (previously filed with the Commission as Exhibit 99.4 to the Company’s Current Report on Form 8-K filed on June 8, 2012 and incorporated herein by reference).
10.18‡	Amendment to Stock Option Agreement, dated as of April 10, 2017 between the Company and Anthony Angelini with respect to options to purchase 250,000 shares of the Company’s Common Stock (previously filed with the Commission as Exhibit 99.2 to the Company’s Current Report on Form 8-K filed on April 11, 2017, and incorporated herein by reference).
10.19‡	Amendment to Stock Option Agreement, dated as of April 10, 2017 between the Company and Anthony Angelini with respect to options to purchase 500,000 shares of the Company’s Common Stock (previously filed

with the Commission as Exhibit 99.3 to the Company's Current Report on Form 8-K filed on April 11, 2017, and incorporated herein by reference).

10.20‡	Employment Agreement, dated August 29, 2014, between TSS, Inc. and John K. Penver (previously filed with the Commission as Exhibit 99.2 to the Company’s Current Report on Form 8-K filed on August 29, 2014, and incorporated herein by reference).
10.21‡	Award Agreement, dated August 29, 2014, between TSS, Inc. and John K. Penver (previously filed with the Commission as Exhibit 99.3 to the Company’s Current Report on Form 8-K filed on August 29, 2014, and incorporated herein by reference).
10.22‡	Amendment to Award Agreement, dated as of April 10, 2017 between the Company and John K. Penver (previously filed with the Commission as Exhibit 99.5 to the Company’s Current Report on Form 8-K filed on April 11, 2017, and incorporated herein by reference).
10.23‡	TSS, Inc. 2015 Omnibus Incentive Compensation Plan (previously filed with the Commission as Annex A to the Company’s Definitive Proxy Statement filed on April 30, 2015 and incorporated herein by reference).
10.24	Business Loan Agreement, dated December 31, 2018, by and between TSS, Inc. and Texas Capital Bank, National Association. (previously filed with the Commission as Exhibit 10.1 to the Company’s Current Report on Form 8-K filed on January 7, 2019, and incorporated herein by reference).
21*	Listing of subsidiaries
23.1*	Consent of Weaver Tidwell LLP regarding TSS, Inc. financial statements for the years ended December 31, 2018 and 2017.
31.1*	Certificate of TSS, Inc. Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2*	Certificate of TSS, Inc. Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1**	Certificate of TSS, Inc. Principal Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2**	Certificate of TSS, Inc. Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

101.INS*	XBRL Instance Document
101.SCM*	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

‡ Management contract or compensatory plan or arrangement.
* Filed herewith.

**Furnished herewith.

Item 16. Form 10-K Summary

None

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

TSS, Inc.

Date:	March 21, 2019	By: /s/ Anthony Angelini Anthony Angelini Chief Executive Officer *(Principal Executive Officer)*
Date:	March 21, 2019	By: /s/ John K. Penver John K. Penver Chief Financial Officer *(Principal Financial Officer)*

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed below by the following persons in the capacities indicated on March 21, 2019.

Signature	**Title**
/s/ Peter H. Woodward Peter H. Woodward	Chairman of the Board
/s/ Anthony Angelini Anthony Angelini	Chief Executive Officer and Director *(Principal Executive Officer)*
/s/ John K. Penver John K. Penver	Chief Financial Officer *(Principal Financial Officer and Accounting Officer)*
/s/ Gerard J. Gallagher Gerard J. Gallagher	Chief Technical Officer and Director
/s/ Daniel J. Phelps Daniel J. Phelps	Director