

Edgar Filing: Wayside Technology Group, Inc. - Form 10-Q

Wayside Technology Group, Inc.

Form 10-Q

November 07, 2018

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 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 No. 000-26408

Wayside Technology Group, Inc.

(Exact name of registrant as specified in its charter)

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Delaware 13-3136104  
(State or other jurisdiction of (I.R.S. Employer Identification No.)  
incorporation or organization)

4 Industrial Way West, Suite 300, Eatontown, New Jersey 07724

(Address of principal executive offices)

(732) 389-8950

Registrant's Telephone Number

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 and 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

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
	Smaller Reporting Company
Non-Accelerated Filer	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

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There were 4,496,494 outstanding shares of common stock, par value \$.01 per share (“Common Stock”) as of November 6, 2018, not including 788,006 shares classified as treasury stock.

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Wayside Technology Group, Inc. and Subsidiaries

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## PART I — FINANCIAL INFORMATION

## Item 1. FINANCIAL STATEMENTS

## Wayside Technology Group, Inc. and Subsidiaries

## Condensed Consolidated Balance Sheets

(Unaudited)

(Amounts in thousands, except share and per share amounts)

	September 30, 2018	December 31, 2017
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 6,464	\$ 5,530
Accounts receivable, net of allowances of \$2,449 and \$2,102, respectively	83,762	76,937
Inventory, net	1,760	2,794
Vendor prepayments	3,970	6,837
Prepaid expenses and other current assets	525	553
Total current assets	96,481	92,651
Equipment and leasehold improvements, net	1,682	1,828
Accounts receivable-long-term, net	4,535	7,437
Other assets	281	231
Deferred income taxes	131	138
	\$ 103,110	\$ 102,285
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable and accrued expenses	\$ 62,675	\$ 62,792
Total current liabilities	62,675	62,792
Deferred rent and tenant allowances	729	781
Total liabilities	63,404	63,573
Stockholders' equity:		
	53	53

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Common Stock, \$.01 par value; 10,000,000 shares authorized; 5,284,500 shares issued; 4,498,223 and 4,454,829 shares outstanding, respectively

Additional paid-in capital	32,241	31,257
Treasury stock, at cost, 786,277 and 829,671 shares, respectively	(13,426)	(14,207)
Retained earnings	22,020	22,522
Accumulated other comprehensive loss	(1,182)	(913)
Total stockholders' equity	39,706	38,712
	\$ 103,110	\$ 102,285

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

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Wayside Technology Group, Inc. and Subsidiaries

Condensed Consolidated Statements of Income

(Unaudited)

(Amounts in thousands, except per share data)

	Nine months ended September 30,		Three months ended September 30,	
	2018	2017	2018	2017
Net sales	\$ 132,389	\$ 116,130	\$ 47,923	\$ 39,018
Cost of sales	112,693	96,555	41,620	32,775
Gross profit	19,696	19,575	6,303	6,243
Selling, general, and administrative expenses	15,248	14,261	4,903	4,451
Separation expenses	2,446	—	—	—
Income from operations	2,002	5,314	1,400	1,792
Other income (expense):				
Interest, net	744	466	296	145
Foreign currency transaction gains	40	22	42	73
Income before provision for income taxes	2,786	5,802	1,738	2,010
Provision for income taxes	987	1,867	420	669
Net income	\$ 1,799	\$ 3,935	\$ 1,318	\$ 1,341
Income per common share-Basic	\$ 0.40	\$ 0.87	\$ 0.29	\$ 0.30
Income per common share-Diluted	\$ 0.40	\$ 0.87	\$ 0.29	\$ 0.30
Weighted average common shares outstanding — Basic	4,344	4,303	4,386	4,283
Weighted average common shares outstanding — Diluted	4,344	4,303	4,386	4,283

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Dividends paid per common share	\$ 0.51	\$ 0.51	\$ 0.17	\$ 0.17
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The accompanying notes are an integral part of these condensed consolidated financial statements.

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Wayside Technology Group, Inc. and Subsidiaries

Condensed Consolidated Statements of Comprehensive Income (Loss)

(Unaudited)

(Amounts in thousands)

	Nine months ended September 30,		Three months ended September 30,	
	2018	2017	2018	2017
Net income	\$ 1,799	\$ 3,935	\$ 1,318	\$ 1,341
Other comprehensive (loss) income:				
Foreign currency translation adjustments	(269)	661	58	274
Other comprehensive (loss) income	(269)	661	58	274
Comprehensive income	\$ 1,530	\$ 4,596	\$ 1,376	\$ 1,615

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

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Wayside Technology Group, Inc. and Subsidiaries

Condensed Consolidated Statement of Stockholders' Equity

(Unaudited)

(Amounts in thousands, except share amounts)

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Treasury Shares	Amount	Retained Earnings	Accumulated Other Comprehensive (loss)	Total
Balance at January 1, 2018	5,284,500	\$ 53	\$ 31,257	829,671	\$ (14,207)	\$ 22,522	\$ (913)	\$ 38,712
Net income	—	—	—	—	—	1,799	—	1,799
Translation adjustment	—	—	—	—	—	—	(269)	(269)
Dividends paid	—	—	—	—	—	(2,301)	—	(2,301)
Share-based compensation expense	—	—	2,618	—	—	—	—	2,618
Restricted stock grants (net of forfeitures) and adjustments	—	—	(1,634)	(115,824)	1,799	—	—	165
Treasury shares repurchased	—	—	—	72,430	(1,018)	—	—	(1,018)
Balance at September 30, 2018	5,284,500	\$ 53	\$ 32,241	786,277	\$ (13,426)	\$ 22,020	\$ (1,182)	\$ 39,706

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

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Wayside Technology Group, Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(Unaudited)

(Amounts in thousands)

	Nine months ended September 30,	
	2018	2017
Cash flows from operating activities		
Net income	\$ 1,799	\$ 3,935
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization expense	358	359
(Benefit) for doubtful accounts receivable	—	(95)
Deferred income tax expense	7	181
Share-based compensation expense	2,618	1,026
Loss on disposal of fixed assets	22	—
Changes in operating assets and liabilities:		
Accounts receivable	(4,147)	21,101
Inventory	1,029	(69)
Prepaid expenses and other current assets	24	169
Vendor prepayments	2,867	(7,471)
Accounts payable and accrued expenses	163	(25,405)
Other assets and liabilities	(109)	(96)
Net cash provided by (used in) operating activities	4,631	(6,365)
Cash flows used in investing activities		
Purchase of equipment and leasehold improvements	(243)	(339)
Net cash used in investing activities	(243)	(339)
Cash flows used in financing activities		
Purchase of treasury stock	(1,018)	(2,841)
Borrowings under revolving credit facility	10,000	2,000
Repayments of borrowings under revolving credit facility	(10,000)	—
Dividends paid	(2,301)	(2,298)
Net cash used in financing activities	(3,319)	(3,139)
Effect of foreign exchange rate on cash	(135)	384
Net increase (decrease) in cash and cash equivalents	934	(9,459)
Cash and cash equivalents at beginning of period	5,530	13,524
Cash and cash equivalents at end of period	\$ 6,464	\$ 4,065

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Supplementary disclosure of cash flow information:

Income taxes paid	\$ 1,779	\$ 1,944
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The accompanying notes are an integral part of these condensed consolidated financial statements.

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Wayside Technology Group, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

September 30, 2018

(Unaudited)

(Amounts in tables in thousands, except share and per share amounts)

1. Basis of Presentation:

The accompanying unaudited condensed consolidated financial statements of Wayside Technology Group, Inc. and its subsidiaries (collectively, the “Company”), have been prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) for interim financial information and with the instructions to Form 10-Q and Rule 8-03 of Regulation S-X. Accordingly, the financial statements do not include all of the information and footnotes required by U.S. GAAP for complete audited financial statements.

The preparation of these condensed consolidated financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets and liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, the Company evaluates its estimates, including those related to product returns, bad debts, inventories, intangible assets, income taxes, stock-based compensation, evaluation of performance obligations and allocation of revenue to distinct items, contingencies and litigation. The Company bases its estimates on its historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. In the opinion of the Company’s management, all adjustments that are of a normal recurring nature, considered necessary for fair presentation, have been included in the accompanying condensed consolidated financial statements. The Company’s actual results may differ from these estimates under different assumptions or conditions. The unaudited condensed consolidated statements of income for the interim periods are not necessarily indicative of results for the full year. For further information, refer to the consolidated financial statements and notes thereto included in the Company’s annual report on Form 10-K filed with the Securities Exchange Commission for the year ended December 31, 2017.

Effective January 1, 2018 we adopted the requirements of Accounting Standards Update, or ASU, No. 2014-09 Revenue from Contracts with customers, or Accounting Standard Codification (“ASC”) 606 using the full retrospective method, as discussed in detail in Note 5. All amounts and disclosures set forth in this Quarterly Report on Form 10-Q have been updated to comply with ASC 606 as discussed in Note 5.

## Reclassifications

Certain reclassifications and immaterial revisions have been made to the prior period financial statements to conform to the current-year presentation.

### 2. Recently issued accounting standards:

In May 2014, the Financial Accounting Standards Board (“FASB”) issued ASU 2014-09, Revenue from Contracts with Customers, superseding the previous revenue recognition requirements, along with most existing industry-specific guidance. In March, April, May and December 2016, the FASB issued additional updates to the new accounting standard which provide supplemental adoption guidance and clarifications. The guidance requires an entity to review contracts in five steps: 1) identify the contract, 2) identify performance obligations, 3) determine the transaction price, 4) allocate the transaction price, and 5) recognize revenue in order to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The new standard also requires enhanced disclosures regarding the nature, amount, timing and uncertainty of revenue arising from contracts with customers. The Company adopted the new standard on January 1, 2018, using the full retrospective method which required us to restate our historical financial information to reflect the adoption as of the earliest reporting period presented. The most significant impact of adopting the standard relates to the determination of whether the Company is acting as a principal or an agent in the sale of third party security software and software that is highly interdependent with support, as well as maintenance, support or other services. See Footnote 5 (Revenue Recognition).

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In February 2016, the FASB issued ASU 2016-02, Leases ("ASU 2016-02"). ASU 2016-02 supersedes the lease guidance under FASB ASC Topic 840, Leases, resulting in the creation of FASB ASC Topic 842, Leases. ASU 2016-02 requires a lessee to recognize in the statement of financial position a liability to make lease payments and a right-of-use asset representing its right to use the underlying asset for the lease term. Leases will be classified as either finance or operating leases with classification affecting the pattern of expense recognition in the statement of earnings. This ASU is effective for fiscal years, and interim periods within those years, beginning after December 15, 2018. Early adoption is permitted. The Company is currently assessing the potential impact of adopting ASU 2016-02 on its consolidated financial statements. It is expected that assets and liabilities will increase as a result of the adoption of this standard.

In June 2016, the FASB issued Accounting Standards Update No. 2016-13, Financial Instruments - Credit Losses (Topic 326) ("ASU No. 2016-13"). ASU No. 2016-13 revises the methodology for measuring credit losses on financial instruments and the timing of when such losses are recorded. ASU No. 2016-13 is effective for the Company in the first quarter of 2020, with early adoption permitted, and is to be applied using a modified retrospective approach. The Company is currently evaluating the potential effects of adopting the provisions of ASU No. 2016-13 on its consolidated financial statements, particularly its recognition of allowances for accounts receivable.

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows ("ASU 2016-15") which reduces diversity in practice in how certain transactions are classified in the statement of cash flows. The new standard is effective for the Company beginning with the first quarter of 2018. The adoption of this guidance did not have a material impact on the Company's consolidated financial statements.

In October 2016, the FASB issued ASU 2016-16, "Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory." This amendment is intended to improve accounting for the income tax consequences of intra-entity transfers of assets other than inventory. In accordance with this guidance, an entity should recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. The ASU is effective for the Company beginning in fiscal 2019. Early adoption is permitted in fiscal 2018 with modified retrospective application. The Company is continuing to evaluate the impact of the adoption of this guidance on its consolidated financial statements.

In May 2017, the FASB issued ASU No. 2017-09, "Scope of Modification Accounting", to reduce diversity in practice and provide clarity regarding existing guidance in ASC 718, "Stock Compensation". The amendments in this updated guidance clarify that an entity should apply modification accounting in response to a change in the terms and conditions of an entity's share-based payment awards unless three newly specified criteria are met. This guidance is effective for fiscal years beginning after December 15, 2017, including interim periods within that reporting period. The new guidance was effective for the Company on a prospective basis beginning on January 1, 2018 and did not impact the Company's Consolidated Financial Statements as it is not the Company's practice to change either the terms or conditions of stock-based payment awards once they are granted.

In August 2017, the FASB issued ASU No. 2017-12, Derivatives and Hedging (Topic 815) – Targeted Improvements to Accounting for Hedging Activities, which improves the financial reporting of hedging relationships to better portray the economic results of an entity's risk management activities in its financial statements. The amendments in this update also make certain targeted improvements to simplify the application of the hedge accounting guidance in

current U.S. GAAP. ASU No. 2017-12 is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years; the ASU allows for early adoption in any interim period after issuance of the update. The Company is currently assessing the impact this ASU will have on its consolidated financial statements.

In February 2018, the FASB issued ASU 2018-02, "Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income" ("ASU 2018-02"), which permits the reclassification of stranded tax effects resulting from the Tax Cuts and Jobs Act (the "TCJA" or "U.S. tax reform") from Accumulated other comprehensive income (loss) to Retained earnings. This new guidance is effective for the Company beginning on January 1, 2019 with early adoption permitted and must be applied either in the period of adoption or retrospectively to periods in which the effects of the TCJA are recognized. The Company is continuing to evaluate the impact of the adoption of this guidance on its consolidated financial statements.

In March 2018, the FASB issued ASU 2018-05, "Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 118 (SEC Update), Income Taxes (Topic 740)". ASU 2018-05 provides guidance regarding the recording of tax impacts where uncertainty exists, in the period of adoption of the 2017 U.S. Tax Cuts and Jobs Act (the "2017 Tax Act"), which allowed companies to reflect provisional amounts for those specific income tax effects of the 2017 Tax Act for which the accounting under ASC Topic 740 is incomplete but for which a reasonable estimate could be



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determined. The Company completed its Federal and State income tax filings for 2017 with no material change to amounts previously reported.

In June 2018, the FASB issued Accounting Standards Update (“ASU”) No. 2018-07, “Compensation — Stock Compensation (Topic 718), Improvements to Nonemployee Share-Based Payment Accounting,” which aligns the measurement and classification guidance for share-based payments to nonemployees with that for employees, with certain exceptions. It expands the scope of ASC 718 to include share-based payments granted to nonemployees in exchange for goods or services used or consumed in the entity’s own operations and supersedes the guidance in ASC 505-50. The ASU retains the existing cost attribution guidance, which requires entities to recognize compensation cost for nonemployee awards in the same period and in the same manner (i.e., capitalize or expense) they would if they paid cash for the goods or services, but it moves the guidance to ASC 718. The guidance also allows nonpublic entities to account for nonemployee awards using certain practical expedients that are already available for employee awards, but the same accounting policies must be used for awards to both employees and nonemployees. ASU 2018-07 is effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted. The Company is currently evaluating the impact of adopting this guidance.

In July 2018, the FASB issued ASU 2018-09 – Codification Improvements, which facilitates amendments to a variety of topics to clarify, correct errors in, or make minor improvements to the accounting standards codification. The effective date of the standard is dependent on the facts and circumstances of each amendment. Some amendments do not require transition guidance and will be effective upon the issuance of this standard. A majority of the amendments in ASU 2018-09 will be effective in annual periods beginning after December 15, 2018. We will be required to adopt this standard in the first quarter of fiscal 2019. This standard is not expected to have a material impact on our consolidated financial statements and related disclosures.

3. Foreign Currency Translation:

Assets and liabilities of the Company’s foreign subsidiaries have been translated using the end of the reporting period exchange rates, and related revenues and expenses have been translated at average rates of exchange in effect during the period. Foreign currency transaction gains and losses are recorded as income or expenses as amounts are settled. The net sales from our foreign operations for the first nine months of 2018 were \$13.9 million as compared to \$14.1 million in the first nine months of 2017. The net sales from our foreign operations for the third quarter of 2018 were \$4.0 million as compared to \$4.6 million in the third quarter of 2017.

4. Comprehensive Income:

Cumulative translation adjustments have been classified within accumulated other comprehensive loss, which is a separate component of stockholders' equity in accordance with FASB ASC Topic 220, "Comprehensive Income."

5. Revenue Recognition:

Effective January 1, 2018, we adopted ASC 606 using the full retrospective method, which requires us to restate our historical financial information to reflect the adoption as of the earliest reporting period presented. There was no adjustment to equity as a result of the adoption. The most significant impact of adopting the standard relates to the determination of whether the Company is acting as a principal or an agent in the sale of third party security software and software that is highly interdependent with support, as well as maintenance, support and other services. Historically, under the transfer of risk and rewards model of revenue recognition, the Company has accounted for primarily all of its sales on a gross basis. The new guidance requires the Company to identify performance obligations and assess transfer of control. While assessing its performance obligations for sales of security software and software subscriptions that are highly interdependent with support, the Company determined that the vendor has ongoing performance obligations with the end customer that are not separately identifiable from the software itself. The Company also determined that the vendor has ongoing performance obligation for sales of certain third-party maintenance, support and service contracts. In these instances, the Company has determined that it does not have control and is acting as an agent in the sale. When acting as an agent in a transaction, the Company accounts for sales on a net basis, with the vendor cost associated with the sale recognized as a reduction of revenue.

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## ASC 606 Adoption Impact to Previously Reported Results

The tables below present historical information adjusted as if the standard had been adopted on January 1, 2017 for all periods presented.

	Nine months ended September 30, 2017			Three months ended September 30, 2017		
	As Reported	Impact of Adoption	As Adjusted	As Reported	Impact of Adoption	As Adjusted
Total						
Net sales	\$ 322,423	\$ (206,293)	\$ 116,130	\$ 106,646	\$ (67,628)	\$ 39,018
Cost of sales	302,848	(206,293)	96,555	100,403	(67,628)	32,775
Gross profit	\$ 19,575	\$ —	\$ 19,575	\$ 6,243	\$ —	\$ 6,243

	Nine months ended September 30, 2017			Three months ended September 30, 2017		
	As Reported	Impact of Adoption	As Adjusted	As Reported	Impact of Adoption	As Adjusted
Lifeboat Distribution Segment:						
Net sales	\$ 300,344	\$ (196,459)	\$ 103,885	\$ 100,188	\$ (65,479)	\$ 34,709
Cost of sales	283,471	(196,459)	87,012	94,771	(65,479)	29,292
Gross profit	\$ 16,873	\$ —	\$ 16,873	\$ 5,417	\$ —	\$ 5,417
TechXtend Segment:						
Net sales	\$ 22,079	\$ (9,834)	\$ 12,245	\$ 6,458	\$ (2,149)	\$ 4,309
Cost of sales	19,377	(9,834)	9,543	5,632	(2,149)	3,483
Gross profit	\$ 2,702	\$ —	\$ 2,702	\$ 826	\$ —	\$ 826

The core principle of ASC 606 is to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration the entity expects to be entitled in exchange for those goods or services. This principle is achieved through applying the following five-step approach:

Identification of the contract, or contracts, with a customer — A contract with a customer exists when (i) we enter into an enforceable contract with a customer that defines each party's rights regarding the goods or services to be transferred and identifies the payment terms related to these goods or services, (ii) the contract has commercial substance and, (iii) we determine that collection of substantially all consideration for goods or services that are transferred is probable based on the customer's intent and ability to pay the promised consideration. We apply judgment in determining the customer's ability and intention to pay, which is based on a variety of factors including the customer's historical payment experience or, in the case of a new customer, published credit and financial information pertaining to the customer. The Company considers customer purchase orders, which in some cases are governed by master agreements or general terms and conditions of sale, to be contracts with customers. All revenue is generated from contracts with customers.

Identification of the performance obligations in the contract — Performance obligations promised in a contract are identified based on the goods or services that will be transferred to the customer that are capable of being distinct, whereby the customer can benefit from the goods or service either on its own or together with other resources that are readily available from third parties or from us, and are distinct in the context of the contract, whereby the transfer of the goods or services is separately identifiable from other promises in the contract. To the extent a contract includes multiple promised goods or services, we apply judgment to determine whether promised goods or services are capable of being distinct in the context of the contract. If these criteria are not met the promised goods or services are accounted for as a combined performance obligation.

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Determination of the transaction price — The transaction price is determined based on the consideration to which we will be entitled in exchange for transferring goods or services to the customer. Net sales are recorded net of estimated discounts, rebates, and returns. Vendor rebates and price protection are recorded when earned as a reduction to cost of sales or merchandise inventory, as applicable. Cooperative reimbursements from vendors, which are earned and available, are recorded in the period the related advertising expenditure is incurred. Cooperative reimbursements are recorded as a reduction of cost of sales.

Allocation of the transaction price to the performance obligations in the contract — If the contract contains a single performance obligation, the entire transaction price is allocated to the single performance obligation. Contracts that contain multiple performance obligations require an allocation of the transaction price to each performance obligation based on a relative standalone selling price, or SSP, basis. We determine standalone SSP based on the price at which the performance obligation is sold separately. If the standalone selling price is not observable through established standard prices, we use judgement and estimate the standalone selling price taking into account available information such as market pricing and pricing related to similar products. Contracts with a significant financing component are discounted to their present value at contract inception and accreted up to the expected payment amounts. These contracts generally offer customers extended payment terms of up to three years.

Recognition of revenue when, or as, we satisfy a performance obligation — The Company recognizes revenue when its performance obligations are complete, and control of the specified goods or services pass to the customer. The Company considers the following indicators in determining when control passes to the customer: (i) the Company has a right to payment for the product or service (ii) the customer has legal title to the product, (iii) the Company has transferred physical possession of the product (iv) the Customer has the significant risk and rewards of ownership of the product and (v) the customer has accepted the product. Substantially all our performance obligations are satisfied at a point in time, as our obligation is to deliver a product or fulfill an order for a third party to deliver ongoing services, maintenance or support.

## Disaggregation of Revenue

We generate revenue from the re-sale of third party software licenses, subscriptions, hardware, and related service contracts. Finance fees related to sales are classified as interest income. The following table depicts the disaggregation of revenue according to revenue type and is consistent with how we evaluate our financial performance:

Net sales	(Unaudited)		Nine months ended		Three months ended
	months ended	September 30,	months ended	September 30,	
	September 30,	September 30,	September 30,	September 30,	
	2018	2017	2018	2017	
Hardware and software product	\$ 120,073	\$ 104,417	\$ 44,100	\$ 35,556	
Software - security & highly interdependent with support	5,029	4,357	1,433	1,343	
Maintenance, support & other services	7,287	7,356	2,390	2,119	
Net sales	\$ 132,389	\$ 116,130	\$ 47,923	\$ 39,018	

Hardware and software product - Hardware product consists of sales of hardware manufactured by third parties. Hardware product is delivered from our warehouse or drop shipped directly from the vendor. Revenue from our hardware products is recognized on a gross basis, with the selling price to the customer as net sales, and the cost of the related product as cost of sales, upon transfer of control to the customer, as the Company is acting a principal in the transaction. Control is generally deemed to have passed to the customer upon transfer of title and risk of ownership.

Software product consists of sales of perpetual and term software licenses for products developed by third party vendors, which are distinct from related maintenance and support. Software licenses are delivered via electronic license keys provided by the vendor to the end user. Revenue from the sale of software products is recognized on a gross basis, with the selling price to the customer as net sales, and the cost of the related product as cost of sales, upon transfer of control to our customers as the Company is a principal in the transaction. Control is deemed to have passed to the customer when they acquire the right to use or copy the software under license as substantially all product functionality is available to the customer at the time of sale.

Software maintenance and support, commonly known as software assurance or post contract support, consists of software updates and technical support provided by the software vendor to the licensor over a period of time. In cases where the software maintenance is distinct from the related software license, software maintenance is accounted for as a

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separate performance obligation. In cases where the software maintenance is not distinct from the related software license, it is accounted for as a single performance obligation with the related license. We utilize judgement in determining whether the maintenance is distinct from the software itself. This involves considering if the software provides its original intended functionality without the updates, or is dependent on frequent, or continuous updates to maintain its functionality. See Allocation of the transaction price to the performance obligations in the contract for a discussion of the allocation of maintenance and support costs when they are distinct from the related software licenses and Software - security and highly interdependent with support for a discussion of maintenance and support costs when they are not distinct from the related software license.

Software - security and highly interdependent with support - Software - security software and software highly interdependent with support consists of sales of security subscriptions and other licensed software products whose functionality is highly interdependent with, and therefore not distinct from, related software maintenance. Delivery of the software license and related support over time is considered a single performance obligation of the third-party vendor for these products. The Company is an agent in these transactions, with revenue being recorded on a net basis when its performance obligation of processing a valid order between the supplier and customer contracting for the services is complete.

Maintenance, support and other services revenue - Maintenance, support and other services revenue consists of third-party post-contract support that is not critical or essential to the core functionality of the related licensed software, and, to a lesser extent, from third-party professional services, software as a service, and cloud subscriptions. Revenue from maintenance, support and other service revenues is recognized on a net basis, upon fulfillment of an order to the customer, as the Company is an agent in the transaction, and its performance obligations are complete at the time a valid order between the parties is processed.

Costs to obtain and fulfill a contract - We pay commissions and related payroll taxes to sales personnel when customers are invoiced. These costs are recorded as selling general and administrative expenses in the period earned as all of our performance obligations are complete within a short window of processing the order.

Contract balances -Accounts receivable is recorded at the invoiced amount, net of an allowance for doubtful accounts and returns. A receivable is recognized in the period we deliver goods or provide services or when our right to consideration is unconditional. Payment terms on invoiced amounts are typically 30-75 days. The balance of accounts receivable, net of allowance for doubtful accounts and returns, as of December 31, 2017 and September 30, 2018 is presented in the accompanying condensed consolidated balance sheets. Accounts receivable-long-term result from product sales with extended payment terms that are discounted to their present values at the Company's estimates of prevailing market rates at the time of the sale. The Company has determined that these amounts do not represent variable consideration as the amount earned is fixed. In subsequent periods, the accounts receivable is increased to the amounts due and payable by the customers through the accretion of interest income on the unpaid accounts receivable due in future years. The amounts due under these long-term accounts receivable due within one year are reclassified to the current portion of accounts receivable and are shown net of reserves. As our revenues are generally recognized at a point in time in the same period as they are billed, we have no deferred revenue balances. Provisions for doubtful accounts including long-term accounts receivable and returns are estimated based on historical write offs, sales returns and credit memo analysis which are adjusted to actual on a periodic basis.

Principal versus agent considerations – The Company determines whether it is acting as a principal or agent in a transaction by assessing whether it controls a good or service prior to it being transferred to a customer, with control being defined as having the ability to direct the use of and obtain the benefits from the asset. The Company considers the following indicators, among others, in making the determination: 1) the Company is primarily responsible for fulfilling the promise to provide the promised good or service, 2) the Company has inventory risk, before or after the specified good or service has been transferred to the customer, 3) the Company has discretion in establishing price for the specified good or service. Generally, we conclude that we are a principal in transactions where software or hardware products containing their core functionality are delivered to the customer at the time of sale and are agents in transactions where we are arranging for the provision of future performance obligations by a third party. As we enter into distribution agreements with third-party service providers, we evaluate whether we are acting as a principal or agent for each product sold under the agreement based on the nature of the product or service, and our performance obligations. Products for which there are significant ongoing third-party performance obligations include software maintenance, which includes periodic software updates and support, security software that is highly interdependent with maintenance, software as a service, cloud and third party professional services. Sales of hardware and software products where we are a principal are recorded on a gross



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basis with the selling price to the customer recorded as sales and the cost of the product or software recorded as cost of sales. Sales where we are acting as an agent are recognized on a net basis at the date our performance obligations are complete. Under net revenue recognition, the cost paid to the vendor or third-party service provider is recorded as a reduction to sales, resulting in revenue being equal to the gross profit on the transaction.

## 6. Fair Value:

The carrying amounts of financial instruments, including cash and cash equivalents, short-term accounts receivable and accounts payable approximated fair value at September 30, 2018 and December 31, 2017 because of the relative short maturity of these instruments. The Company's accounts receivable long-term is discounted to their present value at estimated prevailing market rates at the date of sale which approximates current rates.

## 7. Balance Sheet Detail:

Accounts Receivable – From time to time, we sell accounts receivable to a financial institution on a non-recourse basis. The financial institution is responsible for all servicing of the receivables purchased. At September 30, 2018, accounts receivable includes \$6.5 million of accounts receivable which have been sold to a financial institution with payment due to the Company on November 12, 2018. The receivables are recorded at their discounted fair value at September 30, 2018.

Equipment and leasehold improvements consist of the following:

	September 30, (Unaudited) 2018	December 31, 2017
Equipment	\$ 2,121	\$ 1,988
Leasehold improvements	1,334	1,335
	3,455	3,323
Less accumulated depreciation and amortization	(1,773)	(1,495)
	\$ 1,682	\$ 1,828

For the nine months ended September 30, 2018 and 2017, the Company recorded depreciation and amortization expense of \$0.4 million and \$0.4 million respectively, which is included in general and administrative expense.

Accounts receivable – long term, net consist of the following:

	September 30, (Unaudited) 2018	December 31, 2017
Total amount due from customer	\$ 14,388	\$ 20,886
Less discount	(545)	(912)
Less current portion included in accounts receivable	(9,308)	(12,537)
	\$ 4,535	\$ 7,437

Accounts payable and accrued expenses consist of the following:

	September 30, (Unaudited) 2018	December 31, 2017
Trade accounts payable	\$ 60,035	\$ 58,910
Accrued expenses	2,640	3,882
	\$ 62,675	\$ 62,792

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8. Credit Facility:

On November 15, 2017, the Company entered into a \$20,000 revolving credit facility (the “Credit Facility”) with Citibank, N.A. (“Citibank”) pursuant to a Second Amended and Restated Revolving Credit Loan Agreement (the “Loan Agreement”), Second Amended and Restated Revolving Credit Loan Note (the “Note”), Second Amended and Restated Security Agreement (the “Security Agreement”) and Second Amended and Restated Pledge and Security Agreement (the “Pledge Agreement”). The Credit Facility, which will be used for working capital and general corporate purposes, matures on August 31, 2020, at which time the Company must pay all outstanding principal of all outstanding loans plus all accrued and unpaid interest, and any, fees, costs and expenses. In addition, the Company will pay regular monthly payments of all accrued and unpaid interest. The interest rate for any borrowings under the Credit Facility is subject to change from time to time based on the changes in the LIBOR Rate, as defined in the Loan Agreement (the “Index”). The Index was 2.26% at September 30, 2018. Interest on the unpaid principal balance of the Note will be calculated using a rate of 1.50 percentage points over the Index. If the Index becomes unavailable during the term of the Credit Facility, interest will be based upon the Prime Rate (as defined in the Loan Agreement) after notifying the Company. The Credit Facility is secured by the assets of the Company.

Among other affirmative covenants set forth in the Loan Agreement, the Company must maintain (i) a minimum Debt Service Coverage Ratio (as defined in the Loan Agreement) of not less than 2.0 to 1.0, (ii) a maximum Leverage Ratio (as defined in the Loan Agreement) of at least 2.5 to 1.0, and (iii) a minimum Collateral Coverage Ratio (as defined in the Loan Agreement) of not less than 1.5 to 1.0. Additionally, the Loan Agreement contains negative covenants prohibiting, among other things, the creation of certain liens, the alteration of the nature or character of the Company’s business, and transactions with the Company’s shareholders, directors, officers, subsidiaries and/or affiliates other than with respect to (i) the repurchase of the issued and outstanding capital stock of the Company from the stockholders of the Company or (ii) the declaration and payment of dividends to the stockholders of the Company.

At September 30, 2018 and December 31, 2017, the Company had no borrowings outstanding under the Credit Facility.

9. Earnings Per Share:

Our basic and diluted earnings per share are computed using the two-class method. The two-class method is an earnings allocation that determines net income per share for each class of common stock and participating securities according to their participation rights in dividends and undistributed earnings or losses. Non-vested restricted stock

awards that include non-forfeitable rights to dividends are considered participating securities. Per share amounts are computed by dividing net income available to common shareholders by the weighted average shares outstanding during each period. Diluted and basic earnings per share are the same because the restricted shares are the only potentially dilutive security.

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A reconciliation of the numerators and denominators of the basic and diluted per share computations follows:

	(Unaudited ) Nine months ended September 30,		(Unaudited ) Three months ended September 30,	
	2018	2017	2018	2017
Numerator:				
Net income	\$ 1,799	\$ 3,935	\$ 1,318	\$ 1,341
Less distributed and undistributed income allocated to participating securities	71	179	31	57
Net Income Attributable to Common Shareholders	1,728	3,756	1,287	1,284
Denominator:				
Weighted average common shares (Basic)	4,344	4,303	4,386	4,283
Weighted average common shares including assumed conversions (Diluted)	4,344	4,303	4,386	4,283
Basic net income per share	\$ 0.40	\$ 0.87	\$ 0.29	\$ 0.30
Diluted net income per share	\$ 0.40	\$ 0.87	\$ 0.29	\$ 0.30

10. Major Customers and Vendors:

The Company had two major vendors that accounted for 25.1% and 14.8%, respectively, of total purchases during the nine months ended September 30, 2018 and 22.6% and 15.2% of total purchases for the three months ended September 30, 2018. The Company had two major vendors that accounted for 27.0% and 14.1%, respectively, of total purchases during the nine months ended September 30, 2017, and 27.9% and 14.1% of total purchases for the three months ended September 30, 2017. The Company had two major customers that accounted for 27.5% and 16.5%, respectively, of its net sales during the nine months ended September 30, 2018, and 37.3%, and 15.6% of total net sales for the three months ended September 30, 2018. These same customers accounted for 40.6% and 8.8% respectively, of total net accounts receivable as of September 30, 2018. Two customers accounted for 28.6% and 15.1% of total net accounts receivable as of December 31, 2017. The Company had two major customers that accounted for 20.3% and 17.9%, respectively, of its total net sales during the nine months ended September 30, 2017, and 20.8%, and 17.2% of total net sales for the three months ended September 30, 2017.

11. Income Taxes:

The Company has analyzed filing positions in all of the federal and state jurisdictions where it is required to file income tax returns, as well as all open tax years in these jurisdictions. The Company has recorded an accrual of \$0.6 million, net of federal tax benefit, for potential liabilities for state income taxes in states which have enacted economic nexus statutes and the Company has not filed income tax returns. The Company's policy is to recognize interest related to unrecognized tax benefits as interest expense and penalties as operating expenses. The Company believes that it has appropriate support for the income tax positions it takes and expects to take on its tax returns, and that its accruals for tax liabilities are adequate for all open years based on an assessment of many factors including past experience and interpretations of tax law applied to the facts of each matter.

The TCJA was enacted on December 22, 2017 and introduced significant changes to the U.S. income tax law. Effective in 2018, the TCJA reduces U.S. statutory tax rates from 34% to 21%. Accordingly, we remeasured our deferred taxes as of December 31, 2017 to reflect the reduced rate that will apply in future periods when these deferred taxes are settled or realized.

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Due to the timing of the enactment and the complexity involved in applying the provisions of the TCJA we have made reasonable estimates of the effects and recorded provisional amounts in our financial statements as of September 30, 2018. As we collect and prepare necessary data and interpret the TCJA and any additional guidance issued by the Internal Revenue Service, and other standard-setting bodies, we may make adjustments to the provisional amounts. Those adjustments may materially impact our provision for income taxes and effective tax rate in the period in which adjustments are made. The accounting for the tax effects of the TCJA will be completed in 2018.

The effective tax rate for the nine and three months ended September 30, 2018 was 35.4% and 24.2%, compared to 32.2% and 33.3%, for the same periods last year. The company's effective tax rate for the nine months ended September 30, 2018 was impacted by limitations on the deductibility of executive compensation resulting from section 162(m) of the Internal Revenue Code, and adjustments to the accrual for state income taxes in states which have enacted economic nexus statutes. The Company recorded a \$0.4 million tax benefit related to separation expenses during the nine months ended September 30, 2018 which were accounted for as a discrete item, resulting in a 18% effective tax benefit rate on that item. The Company also recorded an adjustment to its accrual for potential liabilities for state income taxes in states which have enacted economic nexus statutes of \$0.2 during the nine months ended September 30, 2018. The effective tax rate for ordinary income was 24.2% for the three and nine month ended September 30, 2018.

12. Stockholders' Equity and Stock Based Compensation:

The 2012 Stock-Based Compensation Plan (the "2012 Plan") authorizes the grant of Stock Options, Stock Units, Stock Appreciation Rights, Restricted Stock, Stock Bonuses and other equity-based awards. The total number of shares of Common Stock initially available for award under the 2012 Plan was 600,000 which was increased to 1,000,000 shares by shareholder approval at the Company's 2018 Annual Meeting in June 2018. As of September 30, 2018, the number of shares of Common stock available for future award grants to employees, officers and directors under the 2012 Plan is 530,022.

During 2017, the Company granted a total of 87,076 shares of Restricted Stock to officers and employees. These shares of Restricted Stock vest between twelve and twenty equal quarterly installments. In 2017, a total of 22,694 shares of Restricted Stock were forfeited as a result of officers and employees terminating employment with the Company.

During 2018, the Company granted a total of 123,000 shares of Restricted Stock to officers, employees and directors. In 2018, a total of 7,176 shares of Restricted Stock were forfeited. These shares of Restricted Stock vest between one and twenty equal quarterly installments.



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A summary of nonvested shares of Restricted Stock awards outstanding under the Company's the 2012 Plan as of September 30, 2018, and changes during the nine months then ended is as follows:

	Shares	Weighted Average Grant Date Fair Value
Nonvested shares at January 1, 2018	161,818	\$ 17.26
Granted in 2018	123,000	14.97
Vested in 2018	(171,679)	16.65
Forfeited in 2018	(7,176)	15.40
Nonvested shares at September 30, 2018	105,963	\$ 15.70

As of September 30, 2018, there is approximately \$1.6 million of total unrecognized compensation costs related to nonvested share-based compensation arrangements. The unrecognized compensation cost is expected to be recognized over a weighted-average period of 3.2 years.

For the nine months ended September 30, 2018 and 2017, the Company recognized share-based compensation cost of \$2.6 million and \$1.0 million respectively. During the nine months ended September 30, 2018, \$1.7 million of stock compensation expense, related to accelerated vesting of shares upon the resignation of the Company's former Chief Executive Officer, was included in separation expense. All other share-based compensation is included in selling, general and administrative expenses.

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## 13. Segment Information:

FASB ASC Topic 280, “Segment Reporting,” requires that public companies report profits and losses and certain other information on their “reportable operating segments” in their annual and interim financial statements. The internal organization used by the public company’s Chief Operating Decision Maker (CODM) to assess performance and allocate resources determines the basis for reportable operating segments. The Company’s CODM is the President, and Chief Executive Officer.

The Company is organized into two reportable operating segments. The “Lifeboat Distribution” segment distributes technical software to corporate resellers, value added resellers (VARs), consultants and systems integrators worldwide. The “TechXtend” segment is a value-added reseller of software, hardware and services for corporations, government organizations and academic institutions in the United States and Canada.

As permitted by FASB ASC Topic 280, the Company has utilized the aggregation criteria in combining its operations in Canada with the domestic segments as the Canadian operations provide the same products and services to similar clients and are considered together when the Company’s CODM decides how to allocate resources.

Segment income is based on segment revenue less the respective segment’s cost of revenues as well as segment direct costs (including such items as payroll costs and payroll related costs, such as profit sharing, incentive awards and insurance) and excluding general and administrative expenses not attributed to an individual segment business unit. The Company only identifies accounts receivable and inventory by segment as shown below as “Selected Assets” by segment; it does not allocate its other assets, including capital expenditures by segment. The following segment reporting information of the Company is provided:

	(Unaudited) months ended 2018	September 30, 2017	Nine (Unaudited) months ended 30, 2018	September 2017	Three
Revenue:					
Lifeboat Distribution	\$ 119,308	\$ 103,885	\$ 44,145	\$ 34,709	
TechXtend	13,081	12,245	3,778	4,309	
	132,389	116,130	47,923	39,018	
Gross Profit:					
Lifeboat Distribution	17,099	16,873	5,639	5,417	

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TechXtend	2,597	2,702	664	826
	19,696	19,575	6,303	6,243
Direct Costs:				
Lifeboat Distribution	6,517	6,142	2,295	1,866
TechXtend	1,257	1,362	362	473
	7,774	7,504	2,657	2,339
Segment Income Before Taxes: (1)				
Lifeboat Distribution	10,582	10,731	3,344	3,551
TechXtend	1,340	1,340	302	353
Segment Income Before Taxes	11,922	12,071	3,646	3,904
General and administrative	7,474	6,757	2,246	2,112
Separation expense	2,446	—	—	—
Interest, net	744	466	296	145
Foreign currency translation	40	22	42	73
Income before taxes	\$ 2,786	\$ 5,802	\$ 1,738	\$ 2,010

(1) Excludes general corporate expenses including separation, interest, and foreign currency translation expenses.

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	(Unaudited)	
	As of September 30, 2018	As of December 31, 2017
Selected Assets by Segment:		
Lifeboat Distribution	\$ 72,570	\$ 72,806
TechXtend	21,456	21,200
Segment Select Assets	94,026	94,006
Corporate Assets	9,084	8,279
Total Assets	\$ 103,110	\$ 102,285

Disaggregation of revenue	(Unaudited)		(Unaudited)		Three
	months ended September 30, 2018	September 30, 2017	months ended September 30, 2018	September 30, 2017	Months
Lifeboat Distribution					
Hardware and software product	\$ 108,213	\$ 93,437	\$ 40,617	\$ 31,559	
Software - security & highly interdependent with support	4,607	3,914	1,358	1,215	
Maintenance, support & other services	6,488	6,534	2,170	1,935	
Net Sales	\$ 119,308	\$ 103,885	\$ 44,145	\$ 34,709	
TechXtend					
Hardware and software product	\$ 11,860	\$ 10,980	\$ 3,483	\$ 3,997	
Software - security & highly interdependent with support	422	443	75	128	
Maintenance, support & other services	799	822	220	184	
Net Sales	\$ 13,081	\$ 12,245	\$ 3,778	\$ 4,309	

14. Separation charges:

On May 11, 2018, the Company entered into a Separation and Release Agreement (the “Separation Agreement”) with Simon Nynens upon his resignation from the Company. The Separation Agreement supersedes and replaces the Employment Agreement, dated January 12, 2006, between Mr. Nynens and the Company.

Mr. Nynens is entitled to receive (a) a cash payment of \$0.7 million, payable in 12 consecutive, equal monthly installments on the fifteenth day of each month, commencing June 15, 2018; provided that the monthly payments will be delayed until the earlier to occur of Mr. Nynens’ death or November 19, 2018 (the “Delay Period”), and upon the expiration of the Delay Period, all payments that were delayed will be paid in a lump sum, (b) a one-time, lump sum cash payment of \$0.03 million (Mr. Nynens current monthly salary) payable within 30 days after the Separation Date so long as Mr. Nynens performs certain transition services to the extent reasonably requested by the Company; and (c) payment of accrued vacation equal to \$0.04 million, (ii) all stock options and stock awards issued to Mr. Nynens, consisting solely of 109,084 shares of restricted common stock issued under the 2012 Stock-Based Compensation Plan, will fully vest and become immediately exercisable and remain exercisable through their original terms.

The Company recorded expenses of \$2.4 million during the nine months ended September 30, 2018 related to the Separation Agreement consisting of \$1.7 million for accelerated vesting of restricted stock grants and \$0.8 million in other cash payments to be made over during the next twelve months. The compensation is subject to certain limitations on deductibility for income tax purposes under section 162(m) of the Internal Revenue Code (see note 11).

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

The following Management's Discussion and Analysis of Financial Condition and Results of Operations contains, in addition to historical information, forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of risk and uncertainties, including those set forth under the heading "Forward Looking Statements" and elsewhere in this report and those set forth in "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2017, filed with the Securities and Exchange Commission on March 15, 2018. The following discussion should be read in conjunction with the accompanying unaudited condensed consolidated financial statements and related notes included in this report and the consolidated financial statements and related notes included in our 2017 Annual Report on Form 10-K.

Overview

Wayside Technology Group, Inc. (the "Company," "we," "our," or "us") distributes software and hardware developed by others through resellers indirectly to customers worldwide. We also resell computer software and hardware developed by others to customers in the United States and Canada. In addition, we operate a sales branch in Europe to serve our customers in this region of the world. We offer an extensive line of products from leading publishers of software and tools for virtualization/cloud computing, security, networking, storage and infrastructure management, application lifecycle management and other technically sophisticated domains as well as computer hardware. We market these products through creative marketing communications, including our web sites, local and on-line seminars, webinars, social media, direct e-mail, and printed materials.

The Company is organized into two reportable operating segments. The "Lifeboat Distribution" segment distributes technical software to corporate resellers, value added resellers (VARs), consultants and systems integrators worldwide. The "TechXtend" segment is a value-added reseller of software, hardware and services for corporations, government organizations and academic institutions in the USA and Canada.

Factors Influencing Our Financial Results

We derive the majority of our net sales through the sale of third party software licenses, maintenance and service agreements. In our Lifeboat distribution segment, sales are impacted by the number of product lines we distribute, and sales penetration of those products into the reseller channel. In our TechXtend segment sales are generally driven by sales force effectiveness and success in providing superior customer service, competitive pricing, and flexible payment solutions to our customers. Our sales are also impacted by external factors such as levels of IT spending and customer demand for products we distribute.

We sell in a competitive environment where gross product margins have historically declined due to competition and changes in product mix towards products where no delivery of a physical product is required. To date, we have been able to implement cost efficiencies such as the use of drop shipments, electronic ordering (“EDI”) and other capabilities to be able to operate our business profitably as gross margins have declined.

Selling general and administrative expenses are comprised mainly of employee salaries, commissions and other employee related expenses, facility costs, costs to maintain our IT infrastructure, public company compliance costs and professional fees. We monitor our level of accounts payable, inventory turnover and accounts receivable turnover which are measures of how efficiently we utilize capital in our business.

The Company’s sales, gross profit and results of operations have fluctuated and are expected to continue to fluctuate on a quarterly basis as a result of a number of factors, including but not limited to: the condition of the software industry in general, shifts in demand for software products, pricing, level of extended payment terms sales transactions, industry shipments of new software products or upgrades, fluctuations in merchandise returns, adverse weather conditions that affect response, distribution or shipping, shifts in the timing of holidays and changes in the Company’s product offerings. The Company’s operating expenditures are based on sales forecasts. If sales do not meet expectations in any given quarter, operating results may be materially adversely affected.

Dividend Policy and Share Repurchase Program. Historically we have sought to return value to investors through the payment of quarterly dividends and share repurchases. Total dividends paid and shares repurchased were \$0.8 million and \$0.02 million for the quarter ended September 30, 2018, respectively, and \$0.8 million and \$0.1 million for the quarter

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ended September 30, 2017, respectively. The payment of future dividends and share repurchases is at the discretion of our Board of Directors and dependent on results of operations, projected capital requirements and other factors the Board of Directors may find relevant.

**Stock Volatility.** The technology sector of the United States stock markets is subject to substantial volatility. Numerous conditions which impact the technology sector or the stock market in general or the Company in particular, whether or not such events relate to or reflect upon the Company's operating performance, could adversely affect the market price of the Company's Common Stock. Furthermore, fluctuations in the Company's operating results, announcements regarding litigation, the loss of a significant vendor or customer, increased competition, reduced vendor incentives and trade credit, higher operating expenses, and other developments, could have a significant impact on the market price of our Common Stock.

We adopted ASC 606 Revenue from Contracts with Customers on retrospective basis effective January 1, 2018. Under ASC 606 net sales for certain maintenance, service and security products we sell are recorded net of the related cost of sales. We refer to these items as being recorded on a "net basis" in the discussion below. Software and hardware products for which sales and cost of sales are reported on separate line items are referred to as being recorded on a gross basis.

Forward Looking Statements

This report includes "forward-looking statements" within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Statements in this report regarding future events or conditions, including but not limited to statements regarding industry prospects and the Company's expected financial position, results of operations, business and financing plans, are forward-looking statements. These statements can be identified by forward-looking words such as "may," "will," "expect," "intend," "anticipate," "believe," "estimate," and "continue," or similar

Although the Company believes that the expectations reflected in such forward-looking statements are reasonable, it can give no assurance that such expectations will prove to have been correct. Substantial risks and uncertainties unknown at this time could cause actual results to differ materially from those indicated by such forward-looking statements, including, but not limited to, the continued acceptance of the Company's distribution channel by vendors and customers, the timely availability and acceptance of new products, product mix, market conditions, competitive pricing pressures, contribution of key vendor relationships and support programs, including vendor rebates and discounts, as well as factors that affect the software industry in general and other factors generally. We strongly urge current and prospective investors to carefully consider the cautionary statements and risk factors contained in this report and our annual report on Form 10-K for the year ended December 31, 2017 filed with the Securities and Exchange Commission on March 15, 2018.



The Company operates in a rapidly changing business, and new risk factors emerge from time to time. Management cannot predict every risk factor, nor can it assess the impact, if any, of all such risk factors on the Company's business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those projected in any forward-looking statements.

Accordingly, forward-looking statements should not be relied upon as a prediction of actual results and readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of their dates. The Company undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

The statements concerning future sales, future gross profit margin and future selling and administrative expenses are forward looking statements involving certain risks and uncertainties such as availability of products, product mix, pricing pressures, market conditions and other factors, which could result in a fluctuation of sales below recent experience.

#### Financial Overview

Net sales increased 23%, or \$8.9 million, to \$47.9 million for the quarter ended September 30, 2018, compared to \$39.0 million for the same period in 2017. Gross profit was \$6.3 million for the quarter ended September 30, 2018, compared to \$6.2 million in the prior year. Selling, general and administrative ("SG&A") expenses increased 10%, or \$0.4 million, to \$4.9 million for the quarter ended September 30, 2018, compared to \$4.5 million for the same period last year.

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The Company reported net income of \$1.3 million for each of the quarters ended September 30, 2018 and 2017. Diluted income per share for the quarter ended September 30, 2018 was \$0.29, compared to diluted income per share of \$0.30 for the same period in 2017.

### Critical Accounting Policies and Estimates

Management's discussion and analysis of the Company's financial condition and results of operations are based upon the Company's consolidated financial statements that have been prepared in accordance with US GAAP. The preparation of these financial statements requires the Company 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 on-going basis, the Company evaluates its estimates, including those related to product returns, bad debts, inventories, intangible assets, income taxes, stock-based compensation, contingencies and litigation.

The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The Company believes the following critical accounting policies used in the preparation of its consolidated financial statements affect its more significant judgments and estimates.

### Revenue

The Company adopted ASC 606 Revenue from Contracts with customers using the full retrospective method effective January 1, 2018. See Note 5 to the accompanying financial statements for further information. The Company makes estimates regarding performance obligations inherent in the products and services it sells including, whether ongoing maintenance obligations performed by third party vendors are distinct from the related software licenses, and allocation of sales prices among distinct performance obligations. These estimates require significant judgement to determine whether the software's functionality is dependent on ongoing maintenance or if substantially all functionality is available in the original software download. We also use judgement in the allocation of sales proceeds among performance obligations, utilizing observable data such as stand-alone selling prices, or market pricing for similar products and services.

#### Allowance for Accounts Receivable

The Company maintains allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. Management determines the estimate of the allowance for uncollectible accounts receivable by considering a number of factors, including: historical experience, aging of the accounts receivable, and specific information obtained by the Company on the financial condition and the current creditworthiness of its customers. If the financial condition of the Company's customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required. At the time of sale, we record an estimate for sales returns based on historical experience. If actual sales returns are greater than estimated by management, additional expense may be incurred.

#### Accounts Receivable – Long Term

The Company's accounts receivable long-term are discounted to their present value at prevailing market rates at the time of sale based on prevailing rates. In doing so, the Company considers competitive market rates and other factors. At times the Company sells receivables to a financial institution on a non-recourse basis. The net proceeds from such sales are included in the operating section of the statement of cash flows as changes in accounts receivable.

#### Inventory Allowances

The Company writes down its inventory for estimated obsolescence or unmarketable inventory equal to the difference between the cost of inventory and the estimated market value based upon assumptions about future demand and market conditions. If actual market conditions are less favorable than those projected by management, additional inventory write-offs may be required.

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### Income Taxes

The Company has considered future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for the valuation allowance related to deferred tax assets. In the event the Company were to determine that it would not be able to realize all or part of its net deferred tax assets in the future, an adjustment to the deferred tax assets would be charged to income in the period such determination was made.

### Share-Based Payments

Under the fair value recognition provision, stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense on a straight-line basis over the requisite service period. We record the impact of forfeitures when they occur. We review our valuation assumptions periodically and, as a result, we may change our valuation assumptions used to value stock-based awards granted in future periods. Such changes may lead to a significant change in the expense we recognize in connection with share-based payments.

### Recently Issued Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued ASU 2014-09, Revenue from Contracts with Customers, superseding the previous revenue recognition requirements for contracts, along with most existing industry-specific guidance. In March, April, May and December 2016, the FASB issued additional updates to the new accounting standard which provide supplemental adoption guidance and clarifications. The guidance requires an entity to review contracts in five steps: 1) identify the contract, 2) identify performance obligations, 3) determine the transaction price, 4) allocate the transaction price, and 5) recognize revenue in order to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The new standard also requires enhanced disclosures regarding the nature, amount, timing and uncertainty of revenue arising from contracts with customers. The Company adopted the new standard on January 1, 2018, using the full retrospective method which required us to restate our historical financial information to reflect the adoption as of the earliest reporting period presented. The most significant impact of adopting the standard relates to the determination of whether the Company is acting as a principal or an agent in the sale of third party security software or software that is highly interdependent with support, as well as maintenance, support or other services. See Footnote 5 (Revenue Recognition).

In February 2016, the FASB issued ASU 2016-02, Leases ("ASU 2016-02"). ASU 2016-02 supersedes the lease guidance under FASB ASC Topic 840, Leases, resulting in the creation of FASB ASC Topic 842, Leases. ASU 2016-02 requires a lessee to recognize in the statement of financial position a liability to make lease payments and a

right-of-use asset representing its right to use the underlying asset for the lease term. Leases will be classified as either finance or operating leases with classification affecting the pattern of expense recognition in the statement of earnings. This ASU is effective for fiscal years, and interim periods within those years, beginning after December 15, 2018. Early adoption is permitted. The Company is currently assessing the potential impact of adopting ASU 2016-02 on its consolidated financial statements. It is expected that assets and liabilities will increase as a result of the adoption of this standard.

In June 2016, the FASB issued Accounting Standards Update No. 2016-13, Financial Instruments - Credit Losses (Topic 326) ("ASU No. 2016-13"). ASU No. 2016-13 revises the methodology for measuring credit losses on financial instruments and the timing of when such losses are recorded. ASU No. 2016-13 is effective for the Company in the first quarter of 2020, with early adoption permitted, and is to be applied using a modified retrospective approach. The Company is currently evaluating the potential effects of adopting the provisions of ASU No. 2016-13 on its consolidated financial statements, particularly its recognition for accounts receivable.

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows ("ASU 2016-15") which reduces diversity in practice in how certain transactions are classified in the statement of cash flows. The new standard is effective for the Company beginning with the first quarter of 2018. The adoption of this guidance did not have a material impact on the Company's consolidated financial statements.

In October 2016, the FASB issued ASU 2016-16, "Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory." This amendment is intended to improve accounting for the income tax consequences of intra-entity transfers of assets other than inventory. In accordance with this guidance, an entity should recognize the income tax

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consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. The ASU is effective for the Company beginning in fiscal 2019. Early adoption is permitted in fiscal 2018 with modified retrospective application. The Company is continuing to evaluate the impact of the adoption of this guidance on its consolidated financial statements.

In May 2017, the FASB issued ASU No. 2017-09, “Scope of Modification Accounting”, to reduce diversity in practice and provide clarity regarding existing guidance in ASC 718, “Stock Compensation”. The amendments in this updated guidance clarify that an entity should apply modification accounting in response to a change in the terms and conditions of an entity’s share-based payment awards unless three newly specified criteria are met. This guidance is effective for fiscal years beginning after December 15, 2017, including interim periods within that reporting period. The new guidance was effective for the Company on a prospective basis beginning on January 1, 2018 and did not impact the Company’s Consolidated Financial Statements as it is not the Company’s practice to change either the terms or conditions of stock-based payment awards once they are granted.

In August 2017, the FASB issued ASU No. 2017-12, Derivatives and Hedging (Topic 815) – Targeted Improvements to Accounting for Hedging Activities, which improves the financial reporting of hedging relationships to better portray the economic results of an entity’s risk management activities in its financial statements. The amendments in this update also make certain targeted improvements to simplify the application of the hedge accounting guidance in current U.S. GAAP. ASU No. 2017-12 is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years; the ASU allows for early adoption in any interim period after issuance of the update. The Company is currently assessing the impact this ASU will have on its consolidated financial statements.

In February 2018, the FASB issued ASU 2018-02, “Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income” (“ASU 2018-02”), which permits the reclassification of stranded tax effects resulting from the Tax Cuts and Jobs Act (the “TCJA” or “U.S. tax reform”) from Accumulated other comprehensive income (loss) to Retained earnings. This new guidance is effective for the Company beginning on January 1, 2019 with early adoption permitted and must be applied either in the period of adoption or retrospectively to periods in which the effects of the TCJA are recognized. The Company is continuing to evaluate the impact of the adoption of this guidance on its consolidated financial statements.

In March 2018, the FASB issued ASU 2018-05, Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 118 (SEC Update), Income Taxes (Topic 740). ASU 2018-05 provides guidance regarding the recording of tax impacts where uncertainty exists, in the period of adoption of the 2017 U.S. Tax Cuts and Jobs Act (the “2017 Tax Act”), which allowed companies to reflect provisional amounts for those specific income tax effects of the 2017 Tax Act for which the accounting under ASC Topic 740 is incomplete but for which a reasonable estimate could be determined. The Company completed its Federal and State income tax filings for 2017 with no material change to amounts previously reported.

In June 2018, the FASB issued Accounting Standards Update (“ASU”) No. 2018-07, “Compensation — Stock Compensation (Topic 718), Improvements to Nonemployee Share-Based Payment Accounting,” which aligns the measurement and classification guidance for share-based payments to nonemployees with that for employees, with

certain exceptions. It expands the scope of ASC 718 to include share-based payments granted to nonemployees in exchange for goods or services used or consumed in the entity's own operations and supersedes the guidance in ASC 505-50. The ASU retains the existing cost attribution guidance, which requires entities to recognize compensation cost for nonemployee awards in the same period and in the same manner (i.e., capitalize or expense) they would if they paid cash for the goods or services, but it moves the guidance to ASC 718. The guidance also allows nonpublic entities to account for nonemployee awards using certain practical expedients that are already available for employee awards, but the same accounting policies must be used for awards to both employees and nonemployees. ASU 2018-07 is effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted. The Company is currently evaluating the impact of adopting this guidance.

In July 2018, the FASB issued ASU 2018-09 – Codification Improvements, which facilitates amendments to a variety of topics to clarify, correct errors in, or make minor improvements to the accounting standards codification. The effective date of the standard is dependent on the facts and circumstances of each amendment. Some amendments do not require transition guidance and will be effective upon the issuance of this standard. A majority of the amendments in ASU 2018-09 will be effective in annual periods beginning after December 15, 2018. We will be required to adopt this standard in the first quarter of fiscal 2019. This standard is not expected to have a material impact on our consolidated financial statements and related disclosures.

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## Results of Operations

The following table sets forth for the periods indicated certain financial information derived from the Company's unaudited condensed consolidated statements of income expressed as a percentage of net sales. This comparison of financial results is not necessarily indicative of future results:

	Nine months ended				Three months ended			
	September 30, 2018		September 30, 2017		September 30, 2018		September 30, 2017	
Net sales	100.0	%	100.0	%	100.0	%	100.0	%
Cost of sales	85.1		83.1		86.8		84.0	
Gross profit	14.9		16.9		13.2		16.0	
Selling, general and administrative expenses	11.5		12.3		10.2		11.4	
Separation expenses	1.8		—		—		—	
Income from operations	1.5		4.6		2.9		4.6	
Other income	0.6		0.4		0.7		0.6	
Income before income taxes	2.1		5.0		3.6		5.2	
Income tax provision	0.7		1.6		0.9		1.7	
Net income	1.4	%	3.4	%	2.8	%	3.4	%

## Non-GAAP Financial Measures

Our management monitors a number of financial and non-financial measures and ratios on a regular basis in order to track the progress of our business. We believe that the most important of these measures and ratios include net sales, gross margin, adjusted gross billings, gross profit as a percentage of gross billings, net income as a percentage of net sales, net income as a percentage of gross billings, and net income excluding separation expenses, net of taxes. We use a variety of operating and other information to evaluate the operating performance of our business, develop financial forecasts, make strategic decisions, and prepare and approve annual budgets. These key indicators include financial information that is prepared in accordance with U.S. GAAP and presented in our consolidated financial statements as well as non-GAAP performance measurement tools.

	Nine months ended		Three months ended	
	September 30, 2018	September 30, 2017	September 30, 2018	September 30, 2017
Net sales	\$ 132,389	\$ 116,130	\$ 47,923	\$ 39,018
Adjusted gross billings (Non-GAAP)	\$ 375,615	\$ 322,423	\$ 133,977	\$ 106,646
Adjusted gross billings - Lifeboat Distribution (Non-GAAP)	\$ 343,010	\$ 300,344	\$ 121,972	\$ 100,188
Adjusted gross billings - TechXtend (Non-GAAP)	\$ 32,605	\$ 22,079	\$ 12,005	\$ 6,458



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Gross profit	\$ 19,696	\$ 19,575	\$ 6,303	\$ 6,243
Net income excluding Separation expense (Non-GAAP)	\$ 3,807	\$ 3,935	\$ 1,318	\$ 1,341
Gross margin % - Net sales	14.9%	16.9%	13.2%	16.0%
Gross margin % - Adjusted gross billings (Non-GAAP)	5.2%	6.1%	4.7%	5.9%
Net income - % of Net sales	1.4%	3.4%	2.8%	3.4%
Net income - % of Adjusted gross billings (Non-GAAP)	0.5%	1.2%	1.0%	1.3%
Net income excluding Separation expense % - Net sales (Non-GAAP)	2.9%	3.4%	2.8%	3.4%

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Reconciliation of net sales to adjusted gross billings:	Nine months ended		Three months ended	
	September 30, 2018	September 30, 2017	September 30, 2018	September 30, 2017
Net sales	\$ 132,389	\$ 116,130	\$ 47,923	\$ 39,018
Costs of sales related to Software – security or highly interdependent with support and maintenance, support or other services	243,226	206,293	86,054	67,628
Adjusted gross billings (Non-GAAP)	\$ 375,615	\$ 322,423	\$ 133,977	\$ 106,646

We define adjusted gross billings as net sales in accordance with U.S. GAAP, adjusted for the cost of sales related to Software – security or highly interdependent with support and maintenance, support or other services. We provided a reconciliation of adjusted gross billings to net sales, which is the most directly comparable U.S. GAAP measure. We use adjusted gross billings of product and services as a supplemental measure of our performance to gain insight into the volume of business generated by our business, and to analyze the changes to our accounts receivable and accounts payable. Our use of adjusted gross billings of product and services as analytical tools has limitations, and you should not consider it in isolation or as substitutes for analysis of our financial results as reported under U.S. GAAP. In addition, other companies, including companies in our industry, might calculate Adjusted gross billings of product and services or similarly titled measures differently, which may reduce their usefulness as comparative measures.

Reconciliation of net income to net income excluding separation expenses, net of tax	Nine months ended		Three months ended	
	September 30, 2018	September 30, 2017	September 30, 2018	September 30, 2017
Net income	\$ 1,799	\$ 3,935	\$ 1,318	\$ 1,341
Separation expenses (Non-GAAP)	2,446	-	-	-
Income tax benefits related to separation expenses	(438)	-	-	-
Net income excluding separation expenses, net of taxes	\$ 3,807	\$ 3,935	\$ 1,318	\$ 1,341

We use net income excluding separation payments as a supplemental measure of our performance to gain insight into comparison of our businesses profitability when compared to the prior year. Our use of net income excluding separation expenses, net of tax has limitations, and you should not consider it in isolation or as substitutes for analysis of our financial results as reported under U.S. GAAP. In addition, other companies, including companies in our industry, might calculate separation expenses net of tax, or similarly titled measures differently, which may reduce their usefulness as comparative measures.

Three Months Ended September 30, 2018 Compared to Three Months Ended September 30, 2017

Net Sales

Net sales for the quarter ended September 30, 2018 increased 23%, or \$8.9 million, to \$47.9 million, compared to \$39.0 million for the same period in 2017. Adjusted gross billings for the quarter ended September 30, 2018 increased 26%, or \$27.3 million, to \$134.0 million, compared to \$106.6 million for the same period in 2017.

Lifeboat Distribution segment net sales for the quarter ended September 30, 2018 increased \$9.4 million, or 27% to \$44.1 million, compared to \$34.7 million for the same period a year earlier. The increase was due primarily to growth in sales penetration for several of our more significant product lines, as well as the addition of several new product lines. The increases were partially offset by turnover in some vendor and customer accounts, including the termination of one of our vendor distribution agreements that accounted for less than 10% of net sales. While the tenure of our vendor relationships is generally for multiple years, the contractual terms of the distribution agreements themselves are short term in nature and vendors consolidate or change their relationships for various reasons. We operate in a competitive market in which vendor distribution and sales agreements are subject to turnover due to competitive bidding processes and other factors. Adjusted gross billings for the Lifeboat Distribution segment increased \$21.8 million or 22% to \$122.0 million for the quarter ended

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September 30, 2018. Net sales increased at a higher rate than adjusted gross billings due to the impact of reporting certain products on a net basis.

TechXtend segment net sales decreased \$0.5 million or 12% to \$3.8 million for the quarter ended September 30, 2018, compared to \$4.3 million for the prior year. Sales in our TechXtend segment may vary significantly from quarter to quarter based on the timing of IT spending decisions by our larger customers and internal capital allocation decisions regarding capital we allocate to the extended payment program. Adjusted gross billings for the TechXtend segment increased \$5.5 million or 86% to \$12.0 million for the quarter ended September 30, 2018.

During the quarter ended September 30, 2018, we relied on two key customers for a total of 52.9% of our net sales. One of these customers accounted for 37.3% and the other for 15.6% of our total net sales during the three months ended September 30, 2018. These same customers accounted for 40.6% and 8.8% of total net accounts receivable as of September 30, 2018.

Gross Profit

Gross profit for the quarter ended September 30, 2018 increased slightly to \$6.3 million, compared to \$6.2 million for the same period in 2017. Lifeboat Distribution segment gross profit increased 4% or \$0.2 million to \$5.6 million for the quarter ended September 30, 2018 compared \$5.4 million for the same period in 2017 due to the impact of the higher net sales discussed above, partially offset by lower gross profit margin. TechXtend segment gross profit decreased 20% to \$0.7 million for the quarter ended September 30, 2018 compared to \$0.8 million for the same period in the prior year due to the lower net sales discussed above.

Gross profit margin (gross profit as a percentage of net sales) for the quarter ended September 30, 2018 was 13.2% compared to 16.0% in 2017. Lifeboat Distribution segment gross profit margin was 12.8% for the quarter ended September 30, 2018, compared to 15.6% in 2017. TechXtend segment gross profit margin for the quarter ended September 30, 2018 was 17.6%, compared to 19.2% in 2017. The decrease in gross profit margin was primarily caused by lower gross profit margins as a percent of net sales for hardware and software product sales which are reported on a gross basis and a change in the percentage mix of our products which are recorded net of the related cost of sales. During the three months ended September 30, 2018 approximately 8.0% of our net sales was attributable to security, maintenance and third-party service products which are recorded on a net basis, or an effective 100% gross profit margin, compared to 8.9% in 2017. This shift in product mix had the effect of reducing gross profit as a percent of net sales by 100 basis points. The remainder of the decline was caused by lower gross profit margin on software and hardware products recorded on a gross basis, as growth in these products was primarily from high volume lines which are sold at lower gross profit margin than our average gross profit. We operate in a competitive environment where the trend has been and may continue to be for gross profit margins as a percentage of adjusted gross billings to decline.

## Selling, General and Administrative Expenses

SG&A expenses for the quarter ended September 30, 2018 increased \$0.4 million, or 10%, to \$4.9 million when compared to \$4.5 million for prior year. The increase is primarily due to higher business development and field sales personnel expenses, professional, and public company related costs. SG&A expenses were 10.2% of net sales for the quarter ended September 30, 2018, compared to 11.4% for the same period in 2017.

The Company expects that its SG&A expenses, as a percentage of net sales, may vary depending on changes in sales volume, as well as the levels of continuing investments in key growth initiatives. We plan to continue to expand our investment in information technology and marketing, while monitoring SG&A expenses closely.

## Income Taxes

For the three months ended September 30, 2018, the Company recorded a provision for income taxes of \$0.4 million, compared to \$0.7 million for the same period in 2017. The effective tax rate for ordinary income was 24.2% for the three months ending September 30, 2018, compared to 33.3% during the same period in the prior year.

Due to the timing of the enactment and the complexity involved in applying the provisions of the TCJA we have made reasonable estimates of the effects and recorded provisional amounts in our financial statements as of September 30, 2018. As we collect and prepare necessary data and interpret the TCJA and any additional guidance issued by the Internal

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Revenue Service, and other standard-setting bodies, we may make adjustments to the provisional amounts. Those adjustments may materially impact our provision for income taxes and effective tax rate in the period in which adjustments are made. The accounting for the tax effects of the TCJA will be completed in 2018.

Nine Months Ended September 30, 2018 Compared to Nine Months Ended September 30, 2017

Net Sales

Net sales for the nine months ended September 30, 2018 increased 14%, or \$16.2 million, to \$132.4 million, compared to \$116.1 million for the same period in 2017. Adjusted gross billings for the nine months ended September 30, 2018 increased 16%, or \$53.2 million, to \$375.6 million, compared to \$322.4 million for the same period in 2017.

Lifeboat Distribution segment net sales for the nine months ended September 30, 2018 increased \$15.4 million, or 15% to \$119.3 million, compared to \$103.9 million for the same period a year earlier. The increase was due primarily to growth in sales penetration for several of our more significant product lines, the addition of several new product lines, as well as product mix resulting in an increased percent of our sales being reported on a gross basis. The increases were partially offset by turnover in some vendor and customer accounts, including the termination of one of our vendor distribution agreements that accounted for less than 10% of net sales. While the tenure of our vendor relationships is generally for multiple years, the contractual terms of the distribution agreements themselves are short term in nature and vendors consolidate or change their relationships for various reasons. We operate in a competitive market in which vendor distribution and sales agreements are subject to turnover due to competitive bidding processes and other factors. Approximately 9.3% of our net sales were recorded on a net basis compared to 10.1% in the same period of the prior year. Adjusted gross billings for the Lifeboat Distribution segment increased \$42.7 million or 14% to \$343.0 million for the nine months ended September 30, 2018. Adjusted gross billings increased at a lower rate than net sales due to the impact of recording sales for certain products net of the related cost of sales.

TechXtend segment net sales increased \$0.8 million or 7% to \$13.1 million for the nine months ended September 30, 2018, compared to \$12.3 million for the prior year. Sales in our TechXtend segment may vary significantly from quarter to quarter based on the timing of IT spending decisions by our larger customers and internal capital allocation decisions regarding capital we allocate to the extended payment program. Adjusted gross billings for the TechXtend segment increased \$10.5 million or 48% to \$32.6 million for the nine months ended September 30, 2018.

During the nine months ended September 30, 2018, we relied on two key customers for a total of 44.0% of our net sales. One major customer accounted for 27.5% and the other for 16.5%, of our total net sales during the nine months ended September 30, 2018. These same customers accounted for 40.6% and 8.8% of total net accounts receivable as

of September 30, 2018.

### Gross Profit

Gross profit for the nine months ended September 30, 2018 increased slightly to \$19.7 million, compared to \$19.6 million for the same period in 2017. Lifeboat Distribution segment gross profit increased 1% or \$0.2 million to \$17.1 million for the nine months ended September 30, 2018 compared \$16.9 million for the same period in 2017 due to higher net sales which were partially offset by the impact of lower gross margin as a percentage of net sales (discussed below). TechXtend segment gross profit decreased 4% to \$2.6 million for the nine months ended September 30, 2018 compared to \$2.7 million for the same period in the prior year due to the decreased net sales discussed above.

Gross profit margin (gross profit as a percentage of net sales) for the nine months ended September 30, 2018 was 14.9% compared to 16.9% in 2017. Lifeboat Distribution segment gross profit margin was 14.3% for the nine months ended September 30, 2018, compared to 16.2% in 2017. TechXtend segment gross profit margin for the nine months ended September 30, 2018 was 19.9%, compared to 22.1% in 2017. The decrease in gross profit margin was primarily caused by lower gross profit margins on hardware and software products and a change in the percentage mix of our products which are recorded net of the related cost of sales. During the nine months ended September 30, 2018 approximately 9.3% of our net sales was attributable to security, maintenance and third-party service products which are recorded on a net basis, or an effective 100% gross profit margin, compared to 10.1% in 2017. This shift in product mix had the effect of reducing gross profit as a percent of net sales by 80 basis points. The remainder of the decline was caused by lower gross profit margin on software and hardware products recorded on a gross basis, as growth in these products was primarily from high volume

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lines which are sold at lower gross profit margin than our average gross profit. We operate in a competitive environment where the trend has been and may continue to be for gross profit margins as a percentage of adjusted gross billings to decline.

### Selling, General and Administrative Expenses

SG&A expenses for the nine months ended September 30, 2018 increased \$0.9 million, or 7%, to \$15.2 million compared to \$14.3 million for the prior year. The increase is primarily due to higher business development and field sales personnel expenses, professional, and public company related costs, accounting, legal and public company costs. SG&A expenses were 11.5% of net sales for the nine months ended September 30, 2018, compared to 12.3% for the same period in 2017.

The Company expects that its SG&A expenses, as a percentage of net sales, may vary depending on changes in sales volume, as well as the levels of continuing investments in key growth initiatives. We plan to continue to expand our investment in information technology and marketing, while monitoring SG&A expenses closely.

### Separation Expense

Separation expense for the nine months ended September 30, 2018 was \$2.4 million compared to no expense in the same period in 2017. The increase is due to \$2.4 million in separation expenses related to the resignation of our former Chairman and Chief Executive Officer on May 11, 2018, consisting of a \$1.7 million charge for accelerated vesting of restricted stock and \$0.8 million in accrued payments to be made over the next twelve months.

### Income Taxes

For the nine months ended September 30, 2018, the Company recorded a provision for income taxes of \$1.0 million, compared to \$1.9 million for the same period in 2017. The company's effective tax rate for the nine months ended September 30, 2018 was impacted by limitations on the deductibility of executive compensation resulting from section 162(m) of the Internal Revenue Code, and adjustments to the accrual for state income taxes in states which have enacted economic nexus statutes. The Company recorded a \$0.4 million tax benefit related to separation expenses during the nine months ended September 30, 2018 which were accounted for as a discrete item, resulting in a 18% effective tax benefit rate on that expense. We also adjusted our provision for state income taxes in states with economic nexus statutes by \$0.2. The effective tax rate for ordinary income was 24.2% for the nine months ending September 30, 2018, compared to 32.2% during the same period in the prior year.



Due to the timing of the enactment and the complexity involved in applying the provisions of the TCJA we have made reasonable estimates of the effects and recorded provisional amounts in our financial statements as of September 30, 2018. As we collect and prepare necessary data and interpret the TCJA and any additional guidance issued by the Internal Revenue Service, and other standard-setting bodies, we may make adjustments to the provisional amounts. Those adjustments may materially impact our provision for income taxes and effective tax rate in the period in which adjustments are made. The accounting for the tax effects of the TCJA will be completed in 2018.

## Liquidity and Capital Resources

Our cash and cash equivalents increased by \$1.0 million to \$6.5 million at September 30, 2018 from \$5.5 million at December 31, 2017. The increase in cash was primarily the result of \$4.6 million in cash provided by operating activities offset by \$3.3 million of cash used for dividends and stock repurchases.

Net cash provided by operating activities for the nine months ended September 30, 2018 was \$4.6 million, comprised primarily of net income adjusted for non-cash items of \$4.8 million, offset by changes in operating assets and liabilities of \$0.2 million. Net cash provided by changes in working capital increased slightly as increases in accounts receivables were offset by lower inventory and utilization of vendor prepayments.

In the nine months ended September 30, 2018, net cash used in investing activities was \$0.2 million, compared to \$0.3 million in the prior year.

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Net cash used in financing activities for the nine months ended September 30, 2018 of \$3.3 million was comprised of \$2.3 million of dividend payments on our Common Stock, and \$1.0 million for the stock repurchases.

On November 15, 2017, the Company entered into a \$20,000 revolving credit facility (the “Credit Facility”) with Citibank, N.A. (“Citibank”) pursuant to a Second Amended and Restated Revolving Credit Loan Agreement (the “Loan Agreement”), Second Amended and Restated Revolving Credit Loan Note (the “Note”), Second Amended and Restated Security Agreement (the “Security Agreement”) and Second Amended and Restated Pledge and Security Agreement (the “Pledge Agreement”). The Credit Facility, which will be used for working capital and general corporate purposes, matures on August 31, 2020, at which time the Company must pay all outstanding principal of all outstanding loans plus all accrued and unpaid interest, and any interest, fees, costs and expenses, if any. As of September 30, 2018, no borrowings were outstanding under the Credit Facility.

We anticipate that our working capital needs will increase as we invest in the growth of our business. We believe that the funds held in cash and cash equivalents and our unused borrowings under our credit facility will be sufficient to fund our working capital and cash requirements for at least the next 12 months.

Contractual Obligations as of September 30, 2018 are summarized as follows:

Payment due by Period	Total	Less than 1 year	1-3 years	4-5 years	After 5 years
Operating Leases obligations (1)	\$ 3,886	\$ 505	\$ 1,269	\$ 892	\$ 1,220
Total Contractual Obligations	\$ 3,886	\$ 505	\$ 1,269	\$ 892	\$ 1,220

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(1) Operating leases relate primarily to the leases of the space used for our operations in Eatontown, New Jersey, Mesa Arizona, Mississauga, Canada and Amsterdam, Netherlands. The commitments for operating leases include the minimum rent payments.

As of September 30, 2018, the Company had no borrowings outstanding under our lines of credit and no commitments relating to standby letters of credit, and has no standby repurchase obligations or other commercial commitments (see Note 8 in the Notes to our Condensed Consolidated Financial Statements).

Foreign Exchange

The Company's foreign subsidiaries are subject to changes in demand or pricing resulting from fluctuations in currency exchange rates or other factors. We are subject to fluctuations primarily in the Canadian Dollar and the Euro Dollar to-U.S. Dollar exchange rate.

#### Off-Balance Sheet Arrangements

As of September 30, 2018, we did not have any off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of SEC Regulation S-K.

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

In addition to its activities in the United States, 10.5% of the Company sales during the nine months ended September 30, 2018 were generated by its subsidiaries in Canada and Europe. We are subject to general risks attendant to the conduct of business in Canada and Europe, including economic uncertainties and foreign government regulations. In addition, the Company's international business is subject to changes in demand or pricing resulting from fluctuations in currency exchange rates or other factors. See "Item 2 — Management's Discussion and Analysis of Financial Condition and Results of Operations - Results of Operations - Foreign Exchange."

The Company's cash balance is invested in short-term savings accounts with our primary banks, Citibank, and JPMorgan Chase Bank. As such, we believe that the risk of significant changes in the value of our cash invested is minimal.

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Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures. As required by Rule 13a-15(b) under the Exchange Act, our management carried out an evaluation of the effectiveness of the design and operation of the Company's "disclosure controls and procedures", as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, as of the end of the period covered by this report. This evaluation was carried out under the supervision and with the participation of various members of our management, including our Company's President and Chief Executive Officer (principal executive officer), Vice President and Chief Financial Officer (principal financial officer), and Vice President and Chief Accounting Officer (principal accounting officer). Based upon that evaluation, we have identified a material weakness in our controls over financial reporting that are designed to ensure that information required to be disclosed by the Company in the reports it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and is accumulated and communicated to the Company's management, including the Company's Chief Executive Officer, Chief Financial Officer and Chief Accounting Officer, as appropriate, to allow timely decisions regarding required disclosure.

Based on the material weaknesses described below, the Company's Chief Executive Officer, Chief Financial Officer, and Chief Accounting Officer concluded that the Company's disclosure controls and procedures were not effective as of the end of the period covered by this report. A material weakness is a deficiency or a combination of deficiencies in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of the Company's annual or interim financial statements will not be prevented or detected on a timely basis.

The weaknesses we identified relate to several deficiencies in the design and operating effectiveness of controls over financial reporting that we reported in our annual report on Form 10-K for the year ended December 31, 2017, that in the aggregate constitute a material weakness in our internal controls over financial reporting. Management performed additional procedures to determine the impact of these issues and determined that any errors resulting from the deficiencies above were immaterial individually and in the aggregate, to the Company's current and previously issued financial statements.

Remediation plan: We have been implementing several processes, including those outlined below, to remediate the deficiencies noted above. We currently are assessing and improving the operating effectiveness of these controls to ensure they will operate at an acceptable level of assurance.

- Hire and train appropriate personnel or professionals sufficient to manage the complexity, timing, and ever changing nature of our business and financial reporting requirements.
- Retain and evaluate the qualifications and performance of experts who are engaged to assist in the evaluation and adoption of accounting and tax matters where appropriate. The Company has retained an accounting firm to advise

with state income tax compliance requirements.

- Ensure controls are properly designed and documented to address risks and train key process owners and other relevant personnel to perform timely reconciliations with appropriate documentation and review procedures. The Company has retained outside advisors to assist in the documentation of controls and account reconciliation processes and has implemented enhanced procedures related to the review and documentation of account analysis. The Company is currently testing the performance of these procedures with its outside advisors.

#### Changes in Internal Control Over Financial Reporting

In January 2018, we implemented certain internal controls over financial reporting in connection with our adoption of ASC Topic 606, Revenue from Contracts with Customers. There were no other changes in our internal control over financial reporting identified in connection with the evaluation required by Rules 13a-15(d) and 15d-15(d) of the Exchange Act that occurred during the three months ended September 30, 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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## PART II - OTHER INFORMATION

## Item 2. - Unregistered Sales of Equity Securities and Use of Proceeds

The table below sets forth the repurchase of Common Stock by the Company and its affiliated purchasers during the third quarter of 2018.

## ISSUER PURCHASE OF EQUITY SECURITIES

Period	Total Number of Shares Purchased	Average Price Paid Per Share (2)	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Average Price Paid Per Share (3)	Maximum Number of Shares That May Yet Be Purchased Under the Plans or Programs (4)
July 1, 2018 - July 31, 2018	—	\$ —	—	\$ —	547,488
August 1, 2018 - August 31, 2018	1,888	(1) \$ 12.85	—	\$ —	547,488
September 1, 2018 - September 30, 2018	—	\$ —	—	\$ —	547,488
Total	1,888	\$ 12.85	—	\$ —	547,488

(1) Includes 1,888 shares surrendered to the Company by employees to satisfy individual tax withholding obligations upon vesting of previously issued shares of Restricted Stock. These shares are not included in the Common Stock repurchase program referred to in footnote (4) below.

(2) Average price paid per share reflects the closing price the Company's Common Stock on the business date the shares were surrendered by the employee stockholder to satisfy individual tax withholding obligations upon vesting of Restricted Stock or the price of the Common Stock paid on the open market purchase, as applicable.

(3) Average price paid per share reflects the price of the Company's Common Stock purchased on the open market.

(4)

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On December 3, 2014, the Board of Directors of the Company approved an increase of 500,000 shares of Common Stock to the number of shares of Common Stock available for repurchase under its repurchase plans. On February 2, 2017, the Board of Directors of the Company approved an increase of 500,000 shares of Common Stock to the number of shares of Common Stock available for repurchase under its repurchase plans. The Company expects to purchase shares of its Common Stock from time to time in the market or otherwise subject to market conditions.

The Common Stock repurchase program does not have an expiration date.

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Item 6. Exhibits

(a) Exhibits

- 31.1 Certification pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, of Steve DeWindt, President and Chief Executive Officer (principal executive officer) of the Company.
- 31.2 Certification pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, of Kevin T. Scull, the Vice President and Chief Accounting Officer (principal accounting officer) of the Company.
- 31.3 Certification pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, of Michael Vesey, the Vice President and Chief Financial Officer (principal financial officer) of the Company.
- 32.1 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, of Steve DeWindt, President and Chief Executive Officer (principal executive officer) of the Company.
- 32.2 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, of Kevin T. Scull, the Vice President and Chief Accounting Officer (principal accounting officer) of the Company.
- 32.3 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, of Michael Vesey, the Vice President and Chief Financial Officer (principal financial officer) of the Company.
- 101 The following financial information from Wayside Technology Group, Inc.'s Quarterly Report on Form 10-Q for the quarter ended September 30, 2018, filed with the SEC on November 7, 2018, formatted in XBRL (Extensible Business Reporting Language) includes: (1) Condensed Consolidated Balance Sheets, (2) Condensed Consolidated Statements of Income, (3) Condensed Consolidated Statements of Stockholders' Equity, (4) Condensed Consolidated Statements of Comprehensive Income, (5) Condensed Consolidated Statements of Cash Flows, and (6) the Notes to the Unaudited Condensed Consolidated Financial Statements.



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SIGNATURES

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

WAYSIDE TECHNOLOGY GROUP, INC

11/7/2018 By: /s/ Steve DeWindt  
Date Steve DeWindt, President and Chief Executive Officer (Principal Executive Officer)

11/7/2018 By: /s/ Michael Vesey  
Date Michael Vesey, Vice President and Chief Financial Officer (Principal Financial Officer)

11/7/2018 By: /s/ Kevin T. Scull  
Date Kevin T. Scull, Vice President and Chief Accounting Officer (Principal Accounting Officer)