

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

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2019

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to _____
Commission File Number 001-33169



Creative Realities, Inc.

(Exact Name of Registrant as Specified in its Charter)

Minnesota

41-1967918

State or Other Jurisdiction of
Incorporation or Organization

I.R.S. Employer
Identification No.

13100 Magisterial Drive, Suite 100, Louisville KY

40223

Address of Principal Executive Offices

Zip Code

(502) 791-8800

Registrant's Telephone Number, Including Area Code

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the 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.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Emerging growth company

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

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

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

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

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

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock, par value \$0.001 per share	CREX	The Nasdaq Stock Market LLC
Warrants to purchase Common Stock	CREXW	The Nasdaq Stock Market LLC

APPLICABLE ONLY TO CORPORATE ISSUERS

As of May 8, 2019, the registrant had 9,724,826 shares of common stock outstanding.

PART 1. FINANCIAL INFORMATION

Item 1. Financial Statements

CREATIVE REALITIES, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except per share amounts)

	March 31, 2019 (unaudited)	December 31, 2018
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 2,248	\$ 2,718
Accounts receivable, net of allowance of \$651 and \$583, respectively	8,024	6,479
Unbilled receivables	145	1,202
Work-in-process and inventories, net of reserve of \$196 and \$207, respectively	665	379
Prepaid expenses and other current assets	958	1,581
Total current assets	<u>12,040</u>	<u>12,359</u>
Operating lease right-of-use assets	2,122	-
Property and equipment, net	1,329	1,230
Intangibles, net	4,904	5,060
Goodwill	18,900	18,900
Other assets	170	179
TOTAL ASSETS	<u>\$ 39,465</u>	<u>\$ 37,728</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	2,390	1,995
Accrued expenses	5,266	3,847
Deferred revenues	5,430	6,454
Customer deposits	1,491	2,687
Short-term seller note payable	2,303	-
Current maturities of operating leases	662	-
Current maturities of finance leases	31	-
Warrant liability	22	21
Total current liabilities	<u>17,595</u>	<u>15,004</u>
Long-term related party loans payable, net of \$875 and \$1,031 discount, respectively	3,389	3,233
Long-term seller note payable	-	2,303
Long-term obligations under operating leases	1,466	-
Long-term obligations under finance leases	16	-
Deferred tax liabilities	147	128
Other long-term liabilities	3	239
TOTAL LIABILITIES	<u>22,616</u>	<u>20,907</u>
SHAREHOLDERS' EQUITY		
Common stock, \$.01 par value, 200,000 shares authorized; 9,725 and 9,725 shares issued and outstanding, respectively	97	97
Additional paid-in capital	53,616	53,575
Accumulated deficit	(36,864)	(36,851)
Total shareholders' equity	<u>16,849</u>	<u>16,821</u>
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	<u>\$ 39,465</u>	<u>\$ 37,728</u>

See accompanying notes to condensed consolidated financial statements

CREATIVE REALITIES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share amounts)
(Unaudited)

	For the Three Months Ended March 31,	
	2019	2018
Sales		
Hardware	\$ 1,641	\$ 1,231
Services and other	7,843	2,835
Total sales	<u>9,484</u>	<u>4,066</u>
Cost of sales		
Hardware	1,405	1,100
Services and other	4,398	1,457
Total cost of sales	<u>5,803</u>	<u>2,557</u>
Gross profit	3,681	1,509
Operating expenses:		
Sales and marketing expenses	697	503
Research and development expenses	373	321
General and administrative expenses	2,290	1,703
Depreciation and amortization expense	286	327
Lease termination expense	-	474
Total operating expenses	<u>3,646</u>	<u>3,328</u>
Operating income/(loss)	35	(1,819)
Other income (expenses):		
Interest expense	(204)	(574)
Change in fair value of warrant liability	(1)	197
Gain on settlement of obligations	7	-
Other income/(expense)	-	4
Total other income/(expense)	<u>(198)</u>	<u>(373)</u>
Income/(loss) before income taxes	(163)	(2,192)
Provision for income taxes	(21)	(46)
Net income/(loss)	(184)	(2,238)
Dividends on preferred stock	-	(111)
Net income/(loss) attributable to common shareholders	<u>\$ (184)</u>	<u>\$ (2,349)</u>
Basic earnings/(loss) per common share	<u>\$ (0.02)</u>	<u>\$ (0.81)</u>
Diluted earnings/(loss) per common share	<u>\$ (0.02)</u>	<u>\$ (0.85)</u>
Weighted average shares outstanding - basic	<u>9,725</u>	<u>2,753</u>
Weighted average shares outstanding - diluted	<u>9,725</u>	<u>2,753</u>

See accompanying notes to condensed consolidated financial statements.

CREATIVE REALITIES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Three Months Ended	
	March 31,	
	2019	2018
Operating Activities:		
Net income/(loss)	\$ (184)	\$ (2,238)
Adjustments to reconcile net income/(loss) to net cash in operating activities		
Depreciation and amortization	277	327
Amortization of debt discount	156	345
Stock-based compensation	41	64
Change in warrant liability	1	(197)
Deferred tax provision	19	40
Allowance for doubtful accounts	68	19
Increase in notes due to in-kind interest	-	22
Charge for lease termination	-	474
Gain on settlement of obligations	(7)	-
Changes to operating assets and liabilities:		
Accounts receivable and unbilled receivables	(556)	596
Inventories	(286)	81
Prepaid expenses and other current assets	623	(285)
Operating lease right-of-use assets, net	141	-
Other assets	9	23
Accounts payable	402	(489)
Deferred revenue	(1,024)	(114)
Accrued expenses	1,419	227
Deposits	(1,196)	29
Other non-current liabilities	(135)	(36)
Net cash provided by/(used) in operating activities	<u>(232)</u>	<u>(1,112)</u>
Investing activities		
Purchases of property and equipment	(230)	(149)
Net cash used in investing activities	<u>(230)</u>	<u>(149)</u>
Financing activities		
Proceeds from related party loans	-	1,000
Principal payments on finance leases	(8)	-
Net cash provided by/(used in) financing activities	<u>(8)</u>	<u>1,000</u>
Increase/(decrease) in Cash and Cash Equivalents	<u>(470)</u>	<u>(261)</u>
Cash and Cash Equivalents, beginning of period	<u>2,718</u>	<u>1,003</u>
Cash and Cash Equivalents, end of period	<u>\$ 2,248</u>	<u>\$ 742</u>

See accompanying notes to condensed consolidated financial statements.

CREATIVE REALITIES, INC.
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(in thousands, except shares)

	Common Stock		Additional paid in capital	Accumulated (Deficit)	Total
	Shares	Amount			
Balance as of December 31, 2018	9,724,826	\$ 97	\$ 53,575	\$ (36,851)	\$ 16,821
Adoption of ASU 2016-02	-	-	-	171	171
Stock-based compensation	-	-	41	-	41
Net loss	-	-	-	(184)	(184)
Balance as of March 31, 2019	<u>9,724,826</u>	<u>\$ 97</u>	<u>\$ 53,616</u>	<u>\$ (36,864)</u>	<u>\$ 16,849</u>

	Common Stock		Additional paid in capital	Accumulated (Deficit)	Total
	Shares	Amount			
Balance as of December 31, 2017	2,752,742	\$ 28	\$ 30,555	\$ (26,231)	\$ 4,352
Stock-based compensation	-	-	64	-	64
Issuance of warrants with debt extension	-	-	266	-	266
Net loss	-	-	-	(2,238)	(2,238)
Balance as of March 31, 2018	<u>2,752,742</u>	<u>\$ 28</u>	<u>\$ 30,885</u>	<u>\$ (28,469)</u>	<u>\$ 2,444</u>

See accompanying notes to condensed consolidated financial statements.

CREATIVE REALITIES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(all currency in thousands, except per share amounts)
(unaudited)

NOTE 1: NATURE OF ORGANIZATION AND OPERATIONS

Unless the context otherwise indicates, references in these Notes to the accompanying condensed consolidated financial statements to “we,” “us,” “our” and “the Company” refer to Creative Realities, Inc. and its subsidiaries.

Nature of the Company’s Business

Creative Realities, Inc. is a Minnesota corporation that provides innovative digital marketing technology and solutions to retail companies, individual retail brands, enterprises and organizations throughout the United States and in certain international markets. The Company has expertise in a broad range of existing and emerging digital marketing technologies, as well as the related media management and distribution software platforms and networks, device management, product management, customized software service layers, systems, experiences, workflows, and integrated solutions. Our technology and solutions include: digital merchandising systems and omni-channel customer engagement systems, interactive digital shopping assistants, advisors and kiosks, and other interactive marketing technologies such as mobile, social media, point-of-sale transactions, beaconing and web-based media that enable our customers to transform how they engage with consumers. We have expertise in a broad range of existing and emerging digital marketing technologies, as well as the following related aspects of our business: content, network management, and connected device software and firmware platforms; customized software service layers; hardware platforms; digital media workflows; and proprietary processes and automation tools. We believe we are one of the world’s leading interactive marketing technology companies that focuses on the retail shopper experience by helping retailers and brands use the latest technologies to create better shopping experiences.

On November 20, 2018, we closed on our acquisition of Allure Global Solutions, Inc. (the “Allure Acquisition”). While the Allure Acquisition expanded our operations, geographical footprint and customer base and also enhanced our current product offerings, the core business of Allure is consistent with the operations of Creative Realities, Inc. and we are not adding different operating activities to our business.

Our main operations are conducted directly through Creative Realities, Inc., and under our wholly owned subsidiaries Allure Global Solutions, Inc., Creative Realities Canada, Inc., and ConeXus World Global, LLC, a Kentucky limited liability company. Our other wholly owned subsidiary Creative Realities, LLC, a Delaware limited liability company, has been effectively dormant since October 2015, the date of the merger with ConeXus World Global, LLC.

Liquidity and Financial Condition

The accompanying Condensed Consolidated Financial Statements have been prepared on the basis of the realization of assets and the satisfaction of liabilities and commitments in the normal course of business and do not include any adjustments to the recoverability and classifications of recorded assets and liabilities as a result of uncertainties.

We have incurred net losses for the years ended December 31, 2018 and 2017 and have negative cash flows from operating activities as of December 31, 2018. For the three months ended March 31, 2019 and 2018 we have incurred net losses of \$184 and \$2,238, respectively. As of March 31, 2019, we had cash and cash equivalents of \$2,248 and working capital deficit of \$5,555, which includes \$662 representing current maturities of operating leases brought onto the consolidated balance sheet January 1, 2019 upon adoption of Accounting Standards Update (“ASU”) 2016-02.

On November 9, 2018, Slipstream Communications, LLC, (“Slipstream”) a related party (see Note 9), extended the maturity date of our term loan and revolving loan to August 16, 2020. Our intent is to refinance our term loan and revolving loan with an unrelated third party in the first half of 2019. In conjunction with the extension of the maturity date of our term loan, we agreed that the cash portion of the interest rate would conditionally increase from 8.0% per annum to 10.0% per annum effective July 1, 2019 if we have not successfully completed such refinancing activity by June 30, 2019.

Management believes that, based on (i) the extension of the maturity date on our term loan and revolving loans, (ii) our operational forecast through 2020, and (iii) the execution of our planned capital raise, we can continue as a going concern through at least May 15, 2020. However, given our net losses, cash used in operating activities and working capital deficit, we obtained a continued support letter from Slipstream through May 15, 2020. We can provide no assurance that our ongoing operational efforts will be successful which could have a material adverse effect on our results of operations and cash flows.

See Note 9 to the Condensed Consolidated Financial Statements for a discussion of the Company’s debt obligations.

Acquisitions

Acquisition of Allure Global Solutions, Inc.

On September 20, 2018, we entered into a Stock Purchase Agreement (the “Purchase Agreement”) with Christie Digital Systems, Inc. (“Seller”) to acquire the capital stock of Allure, a wholly owned subsidiary of the Seller (the “Allure Acquisition”). Allure is an enterprise software development company providing software solutions, a suite of complementary services, and ongoing support for an array of digital media and POS solutions. Allure provides a wide range of products for the theatre, restaurant, convenience store, theme park, and retail spaces and works to create, develop, deploy, and maintain enterprise software solutions including those designed specifically to integrate, manage, and power ambient client-owned networks. Those networks manage data and marketing content that has been designed and proven to influence consumer purchase behavior. The Allure Acquisition closed on November 20, 2018.

Subject to the terms and conditions of the Purchase Agreement, upon the closing of the Allure Acquisition, we acquired ownership of all of Allure’s issued and outstanding capital shares in consideration for a total purchase price of approximately \$8,450, subject to a post-closing working capital adjustment. Of this purchase price amount, we paid \$6,300 in cash. Of the remaining purchase price amount, approximately \$1,250 is to be paid to former management of Allure, and approximately \$900 due from Allure to the Seller, under an existing Seller Note which was amended and restated for this reduced amount. That debt is represented by our issuance to the Seller of a promissory note accruing interest at 3.5% per annum. The promissory note will require us to make quarterly payments of interest only through February 19, 2020, on which date the promissory note will mature and all remaining amounts owing thereunder will be due. We are able to prepay in whole or in part amounts owing under the promissory note, without penalty, at our option, at any time and from time to time.

The promissory note is convertible into shares of Creative Realities common stock, at the Seller’s option on or after May 19, 2019, at an initial conversion price of \$8.40 per share, subject to customary equitable adjustments. Conversion of all amounts owing under the promissory note will be mandatory if the 30-day volume-weighted average price of our common stock exceeds 200% of the common stock trading price at the closing of the Allure Acquisition. We will grant the Seller customary registration rights for the shares of our common stock issuable upon conversion of the promissory note.

The Purchase Agreement contemplates additional consideration of \$2,000 to be paid by us to Seller in the event that Allure’s revenue exceeds \$13,000, wherein revenues from one specifically-named customer add only 70% of their gross value to the total, for any of (i) the 12-month period ending December 31, 2019, or (ii) any of the next following trailing 12-month periods ending on each of March 31, June 30, September 30 and December 31, 2020.

See Note 5 to the Condensed Consolidated Financial Statements for further discussion of the Company’s Allure Acquisition.

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. Basis of Presentation

The accompanying unaudited Condensed Consolidated Financial Statements have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X and include all of the information and disclosures required by generally accepted accounting principles in the United States of America (“GAAP”) for interim financial reporting. These unaudited Condensed Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements of the Company and related footnotes for the year ended December 31, 2018, included in the Company’s Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 28, 2019.

The results of operations for the interim periods are not necessarily indicative of results of operations for a full year. It is the opinion of management that all necessary adjustments for a fair presentation of the results of operations for the interim periods have been made and are of a recurring nature unless otherwise disclosed herein.

2. Revenue Recognition

We recognize revenue in accordance with Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) 606, *Revenue from Contracts with Customers*, which we adopted effective January 1, 2018, using the modified retrospective method. See further discussion of the impact of adoption and our revenue recognition policy in Note 4.

3. Inventories

Inventories are stated at the lower of cost or market (net realizable value), determined by the first-in, first-out (FIFO) method, and consist of the following:

	March 31, 2019	December 31, 2018
Raw materials, net of reserve of \$196 and \$207, respectively	\$ 241	\$ 220
Work-in-process	424	159
Total inventories	<u>\$ 665</u>	<u>\$ 379</u>

4. Impairment of Long-Lived Assets

We review the carrying value of all long-lived assets, including property and equipment, for impairment in accordance with ASC 360, *Accounting for the Impairment or Disposal of Long-Lived Assets*. Under ASC 360, impairment losses are recorded whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable.

If the impairment tests indicate that the carrying value of the asset is greater than the expected undiscounted cash flows to be generated by such asset, an impairment loss would be recognized. The impairment loss is determined as the amount by which the carrying value of such asset exceeds its fair value. We generally measure fair value by considering sale prices for similar assets or by discounting estimated future cash flows from such assets using an appropriate discount rate. Assets to be disposed of are carried at the lower of their carrying value or fair value less costs to sell. Considerable management judgment is necessary to estimate the fair value of assets, and accordingly, actual results could vary significantly from such estimates.

5. Basic and Diluted Income/(Loss) per Common Share

Basic and diluted income/(loss) per common share for all periods presented is computed using the weighted average number of common shares outstanding. Basic weighted average shares outstanding includes only outstanding common shares. Diluted weighted average shares outstanding includes outstanding common shares and potential dilutive common shares outstanding in accordance with the treasury stock method. Shares reserved for outstanding stock options and warrants totaling approximately 5,320,162 and 1,615,976 at March 31, 2019 and 2018, respectively, were excluded from the computation of loss per share as they are anti-dilutive. Net loss attributable to common shareholders for the three months ended March 31, 2019 and 2018 is after dividends on convertible preferred stock of \$0 and \$111, respectively.

6. Income Taxes

Deferred income taxes are recognized in the financial statements for the tax consequences in future years of differences between the tax basis of assets and liabilities and their financial reporting amounts based on enacted tax laws and statutory tax rates. Temporary differences arise from net operating losses, differences in basis of intangibles, stock-based compensation, reserves for uncollectible accounts receivable and inventory, differences in depreciation methods, and accrued expenses. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized. The Company accounts for uncertain tax positions utilizing an established recognition threshold and measurement attributes for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. We had no uncertain tax positions as of March 31, 2019 and December 31, 2018.

7. Goodwill and Definite-Lived Intangible Assets

We follow the provisions of ASC 350, Goodwill and Other Intangible Assets. Pursuant to ASC 350, goodwill acquired in a purchase business combination is not amortized, but instead tested for impairment at least annually. The Company uses a measurement date of September 30. There was no impairment loss recognized on goodwill or definite-lived intangible assets during the three months ended March 31, 2019 and 2018 (see Note 8).

8. Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Our significant estimates include: the allowance for doubtful accounts, recognition of revenue, right-of-use assets and related lease liabilities, deferred taxes, deferred revenue, the fair value of acquired assets and liabilities, valuation of warrants and other stock-based compensation and other assumptions and estimates used to evaluate the recoverability of long-lived assets, goodwill and other intangible assets and the related amortization methods and periods. Actual results could differ from those estimates.

9. Reverse Stock Split

On October 17, 2018, the Company effectuated a 1-for-30 reverse stock split of its outstanding common stock. The accompanying financial statements and notes to the financial statements give effect to the reverse stock split for all periods presented. The shares of common stock retained a par value of \$0.01 per share. Accordingly, the stockholders' equity for the three-months ended March 31, 2018 reflects the reverse stock split by reclassifying from "common stock" to "additional paid-in capital" an amount equal to the par value of the decreased shares resulting from the reverse stock split.

10. Business Combinations

Accounting for acquisitions requires us to recognize separately from goodwill the assets acquired and the liabilities assumed at their acquisition date fair values. Goodwill as of the acquisition date is measured as the excess of consideration transferred over the net acquisition date fair values of the assets acquired and the liabilities assumed. While we use our best estimates and assumptions to accurately value assets acquired and liabilities assumed at the acquisition date as well as contingent consideration, where applicable, our estimates are inherently uncertain and subject to refinement. As a result, during the measurement period, which may be up to one year from the acquisition date, we may record adjustments to the assets acquired and liabilities assumed with the corresponding offset to goodwill. Upon the conclusion of the measurement period or final determination of the values of assets acquired or liabilities assumed, whichever comes first, any subsequent adjustments are recorded to our consolidated statements of operations. Refer to Note 5, "Business Combination" for a discussion of the accounting for the Allure Acquisition.

11. Leases

On January 1, 2019, we adopted ASU No. 2016-02, *Leases* (Topic 842), as amended, which supersedes the lease accounting guidance under ASC 840, and generally requires lessees to recognize operating and financing lease liabilities and corresponding right-of-use (“ROU”) assets on the balance sheet and to provide enhanced disclosures surrounding the amount, timing and uncertainty of cash flows arising from leasing arrangements. We adopted the new guidance using the modified retrospective transition approach by applying the new standard to all leases existing at the date of initial application and not restating comparative periods. The most significant impact was the recognition of ROU assets and lease liabilities for operating leases, while our accounting for finance leases remained substantially unchanged. For information regarding the impact of Topic 842 adoption, see Note 17— Leases.

Lease accounting results and disclosure requirements for reporting periods beginning after January 1, 2019 are presented under Topic 842, while prior period amounts have not been adjusted and continue to be reported in accordance with our historical accounting under Topic 840.

We elected the package of practical expedients permitted under the transition guidance, which allowed us to carryforward our historical lease classification, our assessment on whether a contract was or contains a lease, and our initial direct costs for any leases that existed prior to January 1, 2019. We also elected to combine our lease and non-lease components. We have no leases with an initial term of 12 months or less.

Upon adoption, we recognized total ROU assets of \$2,319, with corresponding liabilities of \$2,319 on the condensed consolidated balance sheets. This included \$54 of pre-existing finance lease ROU assets previously reported in computer equipment within property and equipment, net. The ROU assets include adjustments for prepayments and accrued lease payments. The net effect of the adoption resulted in an insignificant cumulative effect adjustment to retained earnings on January 1, 2019 but did not impact our prior year consolidated statements of income, statements of cash flows, or statements of shareholders’ equity.

Under Topic 842, we determine if an arrangement is a lease at inception. ROU assets and liabilities are recognized at commencement date based on the present value of remaining lease payments over the lease term. For this purpose, we consider only payments that are fixed and determinable at the time of commencement. As most of our leases do not provide an implicit rate, we use our incremental borrowing rate based on the information available at commencement date in determining the present value of lease payments. Our incremental borrowing rate is a hypothetical rate based on our understanding of what our credit rating would be. The ROU asset also includes any lease payments made prior to commencement and is recorded net of any lease incentives received. Our lease terms may include options to extend or terminate the lease when it is reasonably certain that we will exercise such options.

Operating leases are included in operating lease right-of-use assets, current maturities of operating leases, and long-term obligations under operating leases on our condensed consolidated balance sheets. Finance leases are included in property and equipment, net, current maturities of financing leases, and long-term obligations under financing leases on our condensed consolidated balance sheets

NOTE 3: RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

Recently adopted

On January 1, 2019, we adopted ASU No. 2016-02, *Leases* (Topic 842), as amended. For information regarding the impact of Topic 842 adoption, see Note 2 – Summary of Significant Accounting Policies and Note 17— Leases.

In October 2018, the FASB issued ASU No. 2018-16 (“ASU 2018-16”), *Derivatives and Hedging*. ASU 2018-16 expands the permissible benchmark interest rates to include the Secured Overnight Financing Rate (SOFR) to be eligible as a U.S. benchmark interest rate for purposes of applying hedge accounting under Topic 815, *Derivatives and Hedging*. The Company adopted this ASU effective January 1, 2019 on a prospective basis for qualifying or redesignated hedging relationships entered on or after the date of adoption. As we previously adopted the amendments in Update 2017-12, and as the benchmark rate on our term loan debt does not utilize the SOFR, the adoption of this amendment had no effect on the Company’s results of operations, financial position and cash flows.

On January 1, 2019, we adopted the final rule under SEC Release No. 33-10532, *Disclosure Update and Simplification*, which amended certain disclosure requirements that were redundant, duplicative, overlapping, outdated or superseded. In addition, the amendments expanded the disclosure requirements on the analysis of stockholders’ equity for interim financial statements. Under the amendments, an analysis of changes in each caption of stockholders’ equity presented in the balance sheet must be provided in a note or separate statement. We have updated our Condensed Consolidated Financial Statements to include a reconciliation of the beginning balance to the ending balance of stockholders’ equity for each period for which a statement of comprehensive income is filed.

On January 1, 2019, we adopted ASU 2017-04, *Intangibles—Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment* which aimed to address concerns over the cost and complexity of the two-step goodwill impairment test by removing the second step of the test. Prior to adoption, an entity was required to perform a two-step test to determine the amount, if any, of goodwill impairment. In Step 1, an entity compared the fair value of a reporting unit with its carrying amount, including goodwill. If the carrying amount of the reporting unit exceeds its fair value, the entity performed Step 2 by comparing the implied fair value of goodwill with the carrying amount of that goodwill for that reporting unit. An impairment charge equal to the amount by which the carrying amount of goodwill for the reporting unit exceeds the implied fair value of that goodwill is recorded, limited to the amount of goodwill allocated to that reporting unit. As a result of adoption, in completing our annual impairment testing of goodwill as of September 30, 2019, we will apply a one-step quantitative test and record the amount of goodwill impairment, if any, as the excess of a reporting unit’s carrying amount over its fair value, not to exceed the total amount of goodwill allocated to the reporting unit. There was no impact on our condensed consolidated financial statements as the result of adoption.

Not yet adopted

In August 2018, the FASB issued ASU 2018-15 *Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That is a Service Contract*. The amendments in this update provide guidance on evaluating the accounting for fees paid by a customer in a cloud computing arrangement (hosting arrangement) by providing guidance for determining when the arrangement includes a software license. The amendments in this ASU are effective for public business entities for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. Early adoption of the amendments in this ASU is permitted, including adoption in any interim period, for all entities. We are currently evaluating the impact of adopting this guidance on our consolidated financial statements.

In August 2018, the FASB issued ASU 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement*. This standard modifies the disclosure requirements for fair value measurements by removing the requirements to disclose: (i) amount of and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy; (ii) timing of recognizing transfers between levels within the fair value hierarchy; and (iii) valuation processes used for Level 3 fair value measurements. Additionally, the standard now requires disclosure of changes in unrealized gains and losses for the period included in other comprehensive income (loss) for recurring Level 3 fair value measurements held at the end of each reporting period and the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements. ASU 2018-13 is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. An entity is permitted to early adopt all of the disclosure changes or early adopt only the removed disclosure requirements and delay adoption of the additional disclosures until the effective date of this amendment. We are currently evaluating the impact of adopting this guidance on our consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13, *Financial Instruments—Credit Losses*. The main objective is to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date. The amendments in this update replace the incurred loss methodology with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to calculate credit loss estimates. For trade receivables and loans, entities will be required to estimate lifetime expected credit losses. The amendments are effective for public business entities for fiscal years and interim periods beginning after December 15, 2019. The Company is evaluating the impact that adoption will have on its consolidated financial statements.

NOTE 4: REVENUE RECOGNITION

On January 1, 2018, the Company adopted ASC 606 using the modified retrospective method for all contracts not completed as of the date of adoption. Results for reporting periods beginning on or after January 1, 2018 are presented under ASC 606, while prior period amounts are not adjusted and continue to be reported under the accounting standards in effect for the prior period. Under this method, we concluded that the cumulative effect of applying this guidance was not material to the financial statements and no adjustment to the opening balance of accumulated deficit was required on the adoption date.

Under ASC 606, the Company accounts for revenue using the following steps:

- Identify the contract, or contracts, with a customer
- Identify the performance obligations in the contract
- Determine the transaction price
- Allocate the transaction price to the identified performance obligations
- Recognize revenue when, or as, the Company satisfies the performance obligations

The Company combines contracts with the same customer into a single contract for accounting purposes when the contracts are entered into at or near the same time and the contracts are negotiated as a single commercial package, consideration in one contract depends on the other contract, or the services are considered a single performance obligation. If an arrangement involves multiple performance obligations, the items are analyzed to determine the separate units of accounting, whether the items have value on a standalone basis and whether there is objective and reliable evidence of their standalone selling price. The total contract transaction price is allocated to the identified performance obligations based upon the relative standalone selling prices of the performance obligations. The standalone selling price is based on an observable price for services sold to other comparable customers, when available, or an estimated selling price using a cost plus margin approach.

The Company estimates the amount of total contract consideration it expects to receive for variable arrangements by determining the most likely amount it expects to earn from the arrangement based on the expected quantities of services it expects to provide and the contractual pricing based on those quantities. The Company only includes some or a portion of variable consideration in the transaction price when it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is subsequently resolved. The Company considers the sensitivity of the estimate, its relationship and experience with the client and variable services being performed, the range of possible revenue amounts and the magnitude of the variable consideration to the overall arrangement. The Company receives variable consideration in very few instances.

As discussed in more detail below, revenue is recognized when a customer obtains control of promised goods or services under the terms of a contract and is measured as the amount of consideration the Company expects to receive in exchange for transferring goods or providing services. The Company does not have any material extended payment terms as payment is due at or shortly after the time of the sale. Observable prices are used to determine the standalone selling price of separate performance obligations or a cost plus margin approach when one is not available. Sales, value-added and other taxes collected concurrently with revenue producing activities are excluded from revenue.

The Company recognizes contract assets or unbilled receivables related to revenue recognized for services completed but not yet invoiced to the clients. Unbilled receivables are recorded as accounts receivable when the Company has an unconditional right to contract consideration. A contract liability is recognized as deferred revenue when the Company invoices clients in advance of performing the related services under the terms of a contract. Deferred revenue is recognized as revenue when the Company has satisfied the related performance obligation.

Deferred contract acquisition costs were evaluated for inclusion in other assets; however, the Company elected to use the practical expedient for recording an immediate expense for those incremental costs of obtaining contracts, including certain design/engineering services, commissions, incentives and payroll taxes, as these incremental and recoverable costs have terms that do not exceed one year.

The Company provides innovative digital marketing technology and solutions to retail companies, individual retail brands, enterprises and organizations throughout the United States and in certain international markets. The Company’s technology and solutions include: digital merchandising systems and omni-channel customer engagement systems, interactive digital shopping assistants, advisors and kiosks, and other interactive marketing technologies such as mobile, social media, point-of-sale transactions, beaconing and web-based media that enable our customers to transform how they engage with consumers.

We typically generate revenue through the following sources:

- Hardware:
 - System hardware sales – displays, computers and peripherals
- Services and Other:
 - Professional implementation and installation services
 - Software design and development services
 - Software as a service, including content management
 - Maintenance and support services

The following table disaggregates the Company’s revenue by major source for the three months ended March 31, 2019:

<i>(in thousands)</i>	Three Months Ended March 31, 2019
Hardware	\$ 1,641
Services:	
Installation Services	2,372
Software Development Services	3,976
Managed Services	1,495
Total Services	7,843
Total Hardware and Services	\$ 9,484

System hardware sales

System hardware revenue is recognized generally upon shipment of the product or customer acceptance depending upon contractual arrangements with the customer in instances in which the sale of hardware is the sole performance obligation. Shipping charges billed to customers are included in hardware sales and the related shipping costs are included in hardware cost of sales. The cost of freight and shipping to the customer is recognized in cost of sales at the time of transfer of control to the customer. System hardware revenues are classified as “Hardware” within our disaggregated revenue.

Installation services

The Company performs outsourced installation services for customers and recognizes revenue upon completion of the installations. Installation services also includes engineering services performed as part of an installation project.

When system hardware sales include installation services to be performed by the Company, the goods and services in the contract are not distinct, so the arrangement is accounted for as a single performance obligation. Our customers control the work-in-process and can make changes to the design specifications over the contract term. Revenues are recognized over time as the installation services are completed based on the relative portion of labor hours completed as a percentage of the budgeted hours for the installation. Installation services revenues are classified as "Installation Services" within our disaggregated revenue.

The aggregate amount of the transaction price allocated to installation service performance obligations that are partially unsatisfied as of March 31, 2019 were \$0.

Software design and development services

Software and software license sales are revenue when a fixed fee order has been received and delivery has occurred to the customer. Revenue is recognized generally upon customer acceptance (point-in-time) of the software product and verification that it meets the required specifications. Software is delivered to customers electronically. Software design and development revenues are classified as "Software Development Services" within our disaggregated revenue.

Software as a service

Software as a service includes revenue from software licensing and delivery in which software is licensed on a subscription basis and is centrally hosted. These services often include software updates which provide customers with rights to unspecified software product upgrades and maintenance releases and patches released during the term of the support period. Contracts for these services are generally 12-36 months in length. We account for revenue from these services in accordance with ASC 985-20-15-5 and recognize revenue ratably over the performance period. Software as a service revenues are classified as "Managed Services" within our disaggregated revenue.

Maintenance and support services

The Company sells support services which include access to technical support personnel for software and hardware troubleshooting. The Company offers a hosting service through our network operations center, or NOC, allowing the ability to monitor and support its customers' networks 7 days a week, 24 hours a day. These contracts are generally 12-36 months in length. Revenue is recognized over the term of the agreement in proportion to the costs incurred in fulfilling performance obligations under the contract. Maintenance and Support revenues are classified as "Managed Services" within our disaggregated revenue.

Maintenance and support fees are based on the level of service provided to end customers, which can range from monitoring the health of a customer's network to supporting a sophisticated web-portal to managing the end-to-end hardware and software of a digital marketing system. These agreements are renewable by the customer. Rates for maintenance and support, including subsequent renewal rates, are typically established based upon a fee per location, per device, or a specified percentage of net software license fees as set forth in the arrangement. These contracts are generally 12-36 months in length. Revenue is recognized ratably and evenly over the service period.

The Company also performs time and materials-based maintenance and repair work for customers. Revenue is recognized at a point in time when the performance obligation has been fully satisfied.

In addition to changes in the timing of when we record variable consideration, ASC 606 provided clarification about the classification of certain costs relating to revenue arrangements with customers. As a result of our analysis, we did not identify any components of our revenue transactions which required reclassification between gross and net presentation.

NOTE 5: BUSINESS COMBINATION

On November 20, 2018, the Company completed the Allure Acquisition. Pursuant to the Stock Purchase Agreement, the total purchase price was \$8,450, which was primarily funded using cash from the Company's public offering closed on November 19, 2018. The difference between the total purchase price and the net consideration transferred is driven by the cash acquired in the acquisition. The preliminary purchase price of Allure consisted of the following items:

<u>(in thousands)</u>	<u>Consideration</u>
Cash consideration for stock	\$ 6,300 ⁽¹⁾
Payable to former Allure management	1,021 ⁽²⁾
Seller note payable	900 ⁽³⁾
Earnout liability	250 ⁽⁴⁾
Total consideration	8,471
Cash acquired	(26) ⁽⁵⁾
Net consideration transferred	<u>\$ 8,445</u>

- (1) Cash consideration for outstanding shares of Allure common stock per Stock Purchase Agreement.
- (2) Represents a payable due to two former members of the Allure management team for a total of \$1,250 as a result of the acquisition; 30% due in November 2018 and 70% due in November 2019. The fair value of the payable as of the acquisition date was deemed to be \$1,021.
- (3) Represents a note payable due from Allure to Seller, under a pre-existing Seller Note which was amended and restated for this amount through the Stock Purchase Agreement. At the closing date, the estimated net working capital deficit of Allure was \$801 in excess of the target net working capital as defined in the stock purchase agreement. As of the acquisition date, Allure also had accounts payable to Seller for outsourced services of \$2,204. We agreed with the Seller to settle the estimated net working capital deficit through a reduction in the accounts payable to Seller as of the acquisition date and to further amend the Seller Note to include the remaining \$1,403 accounts payable due from Allure to Seller. The Seller Note thereby increased from \$900 per the Stock Purchase Agreement to \$2,303 at the opening balance sheet. That debt is represented by our issuance to the Seller of a promissory note accruing interest at 3.5% per annum. The promissory note will require us to make quarterly payments of interest through February 19, 2020, on which date the promissory note will mature and all remaining amounts owing thereunder will be due. We are able to prepay in whole or in part amounts owing under the promissory note, without penalty, at our option, at any time and from time to time.

- (4) The Stock Purchase Agreement contemplates additional consideration of \$2,000 to be paid by us to Seller in the event that acquiree revenue exceeds \$13,000, as defined in the underlying agreement. The fair value of the earnout liability was determined to be \$250 at the time of acquisition.
- (5) Represents the Allure cash balance acquired at acquisition.

The Company accounted for the Allure Acquisition using the acquisition method of accounting. The preliminary allocation of the purchase price is based on estimates of the fair value of assets acquired and liabilities assumed as of November 20, 2018. The Company is continuing to obtain information to determine the acquired assets and liabilities, including tax assets, liabilities and other attributes. The components of the preliminary purchase price allocation are as follows:

<i>(in thousands)</i>	Total
Accounts receivable	\$ 2,477
Unbilled receivables	221
Inventory	142
Prepaid expenses & other current assets	18
Property and equipment	177
Other assets	7
Identified intangible assets:	
Definite-lived trade names	340
Developed technology	1,770
Customer relationships	2,870
Goodwill	3,911
Accounts payable	(331)
Accrued expenses	(975)
Customer deposits	(503)
Deferred revenues	(276)
Accounts payable converted into Seller Note	(1,403)
Net consideration transferred	<u>\$ 8,445</u>

The preliminary fair value of the customer relationship intangible asset has been estimated using the income approach through a discounted cash flow analysis with the cash flow projections discounted using a rate of 26.0%. The cash flows are based on estimates used to price the Allure Acquisition, and the discount rates applied were benchmarked with reference to the implied rate of return from the Company's pricing model and the weighted average cost of capital.

The definite-lived trade name represents the Allure brand name as marketed primarily in the sports & entertainment, large venue and quick service restaurant verticals of the digital signage industry. The Company applied the income approach through an excess earnings analysis to determine the preliminary fair value of the trade name asset. The Company identified this asset as definite-lived as opposed to indefinite-lived as the Company plans to utilize the Allure trade name as a product name as opposed to go-to-market company name. The Company applied the income approach through a relief-from-royalty analysis to determine the preliminary fair value of this asset.

The developed technology assets are primarily comprised of know-how and functionality embedded in Allure's proprietary content management application which drives currently marketed products and services. The Company applied the income approach through a relief-from-royalty analysis to determine the preliminary fair value of this asset.

The Company is amortizing the identifiable intangible assets on a straight-line basis over the weighted average lives ranging from 5 to 15 years.

The table below sets forth the preliminary valuation and amortization period of identifiable intangible assets:

<i>(in thousands)</i>	Preliminary Valuation	Amortization Period
Identifiable intangible assets:		
Definite-lived trade names	\$ 340	5 years
Developed technology	1,770	7 years
Customer relationships	2,870	15 years
Total	<u>\$ 4,980</u>	

The Company estimated the preliminary fair value of the acquired property, plant and equipment using a combination of the cost and market approaches, depending on the component. The preliminary fair value of property, plant and equipment of \$177.

The excess of the purchase price over the preliminary estimated fair value of the tangible net assets and identifiable intangible assets acquired was recorded as goodwill and is subject to change upon final valuation. The factors contributing to the recognition of the amount of goodwill are based on several strategic and synergistic benefits that are expected to be realized from the Allure Acquisition. These benefits include a comprehensive portfolio of iconic customer brands, complementary product offerings, enhanced national footprint, and attractive synergy opportunities and value creation. None of the goodwill is expected to be deductible for income tax purposes.

The following unaudited pro forma information presents the combined financial results for the Company and Allure, adjusted for Allure's fiscal year ended March 31, as if the Allure Acquisition had been completed January 1, 2017. Prior to the Allure Acquisition, Allure had a fiscal year reporting from April 1 to March 31 annually. The pro forma financial information set forth below for the three months ended March 31, 2019 and 2018 includes Allure's pro forma information for the three month period January 1, 2018 through March 31, 2018.

<i>(in thousands, except earnings per common share)</i>	Three Months Ended March 31,	
	2019	2018
	(unaudited)	
Net sales	\$ 9,484	\$ 6,434
Net loss	\$ (184)	\$ (2,513)
Loss per common share	\$ (0.02)	\$ (0.91)

NOTE 6: FAIR VALUE MEASUREMENT

We measure certain financial assets, including cash equivalents, at fair value on a recurring basis. In accordance with ASC 820-10-30, fair value is a market-based measurement that should be determined based on the assumptions that market participants would use in pricing an asset or liability. As a basis for considering such assumptions, ASC 820-10-35 establishes a three-level hierarchy that prioritizes the inputs used in measuring fair value. The three hierarchy levels are defined as follows:

Level 1 — Valuations based on unadjusted quoted prices in active markets for identical assets.

Level 2 — Valuations based on observable inputs (other than Level 1 prices), such as quoted prices for similar assets at the measurement date; quoted prices in markets that are not active; or other inputs that are observable, either directly or indirectly.

Level 3 — Valuations based on inputs that are unobservable and involve management judgment and the reporting entity's own assumptions about market participants and pricing.

The following table presents information about the Company's warrant liabilities that are measured at fair value on a recurring basis, and indicates the fair value hierarchy of the valuation techniques the Company used to determine such fair value. See Note 14 for the inputs used for the probability weighted Black Scholes valuations at March 31, 2019.

Description	Fair Value	Quote Prices In Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
Warrant liabilities at December 31, 2018	\$ 21	-	-	\$ 21
Warrant liabilities at March 31, 2019	\$ 22	-	-	\$ 22

The change in level 3 fair value is as follows:

Warrant liability as of December 31, 2018	\$ 21
New warrant liabilities	-
Increase in fair value of warrant liability	1
Ending warrant liability as of March 31, 2019	<u>\$ 22</u>

As part of the Allure Acquisition, the Stock Purchase Agreement contemplated additional consideration of \$2,000 to be paid by us to Seller in the event that acquiree revenue exceeds \$13,000, as defined in the underlying agreement, for any of the trailing twelve-month periods measured as of December 31, 2019, March 31, 2020, June 30, 2020, September 30, 2020 and December 31, 2020. The fair value of the earnout liability was determined to be \$250 at the time of acquisition. There were no changes to the assumptions nor adjustments recorded to the fair value of the earnout liability as of March 31, 2019 given limited passage of time in the measurement period and performance in-line with those estimates utilized in developing the initial estimate.

NOTE 7: SUPPLEMENTAL CASH FLOW STATEMENT INFORMATION

	Three Months Ended March 31,	
	2019	2018
Supplemental Cash Flow Information		
Non-cash Investing and Financing Activities		
Issuance of warrants with term loan extensions / revolver draws	\$ -	\$ 266
Cash paid during the period for:		
Interest	\$ 80	\$ 168
Income taxes, net	\$ -	\$ -

NOTE 8: INTANGIBLE ASSETS*Intangible Assets*

Intangible assets consisted of the following at March 31, 2019 and December 31, 2018:

	March 31, 2019		December 31, 2018	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Technology platform	\$ 4,635	2,957	\$ 4,635	2,895
Customer relationships	5,330	2,536	5,330	2,477
Trademarks and trade names	1,020	588	1,020	553
	<u>10,985</u>	<u>6,081</u>	<u>10,985</u>	<u>5,925</u>
Accumulated amortization	6,081		5,925	
Net book value of amortizable intangible assets	<u>\$ 4,904</u>		<u>\$ 5,060</u>	

For the three months ended March 31, 2019 and 2018, amortization of intangible assets charged to operations was \$156 and \$232, respectively.

NOTE 9: LOANS PAYABLE

The outstanding debt with detachable warrants, as applicable, are shown in the table below. Further discussion of the notes follows.

Debt Type	Issuance Date	Principal	Maturity Date	Warrants	Interest Rate Information
A	6/30/2018	\$ 264	6/30/2021	-	0.0% interest ⁽¹⁾
B	1/16/2018	1,000	8/16/2020	61,729	8.0% interest ⁽²⁾
C	8/17/2016	3,000	8/16/2020	588,236	8.0% interest ⁽²⁾
D	11/19/2018	2,303	2/15/2020	-	3.5% interest ⁽³⁾
		<u>\$ 6,567</u>		<u>649,965</u>	
	Debt discount	(875)			
	Total debt	<u>\$ 5,692</u>			

A – Secured Disbursed Escrow Promissory Note with related party

B – Revolving Loan with related party

C – Term Loan with related party

D – Amended and Restated Seller Note from acquisition of Allure

(1) 0.0% interest per annum when total borrowings under the term and revolver loans, in aggregate, are below \$4,000 in principal (disregarding paid-in-kind (“PIK”) interest); 8.0% cash, when total borrowing under the term and revolver loans, in aggregate, exceed \$4,000 in principal (disregarding PIK interest)

(2) 8.0% cash interest per annum when total borrowings under the term and revolver loans, in aggregate, are below \$4,000 in principal (disregarding PIK interest); 8.0% cash, 2.0% PIK when total borrowing under the term and revolver loans, in aggregate, exceed \$4,000 in principal (disregarding PIK interest). If the Company does not successfully refinance the term loan debt facility (C above) with a third party by June 30, 2019, the cash portion of the interest rate will increase from 8.0% to 10.0% per annum.

(3) 3.5% simple cash interest per annum; interest payable quarterly with the first payment due on December 31, 2018 with payments of accrued interest continuing quarterly thereafter until the maturity date of February 20, 2020.

Obligations under the secured convertible promissory notes are secured by a grant of collateral security in all of the tangible assets of the co-makers pursuant to the terms of an amended and restated security agreement.

Term Notes and Secured Disbursed Escrow Promissory Note

On August 17, 2016, we entered into a Loan and Security Agreement with Slipstream, and obtained a \$3.0 million term loan, with interest thereon at 8% per annum. The term loan contains certain customary restrictions including, but not limited to, restrictions on mergers and consolidations with other entities, cancellation of any debt or incurring new debt (subject to certain exceptions), and other customary restrictions.

On January 16, 2018, we entered into the Third Amendment to the Loan and Security Agreement with Slipstream and obtained a \$1.0 million revolving loan, with interest thereon at 8% per annum, maturing on January 16, 2019, which was amended to August 16, 2020 in conjunction with the Fifth Amendment to the Loan and Security Agreement. In connection with the loan, we issued Slipstream a five-year warrant to purchase up to 61,729 shares of Creative Realities' common stock at a per share price of \$8.10 (subject to adjustment and subsequently adjusted to \$8.09 in April 2018). The fair value of the warrants was \$266, which was accounted for as an additional debt discount and is being amortized over the remaining life of the loan.

On April 27, 2018, we entered into the Fourth Amendment to the Loan and Security Agreement with Slipstream, under which we obtained a \$1.1 million revolving loan, with interest thereon at 8% per annum, provided, however, at all times when the aggregate outstanding principal amount of the Term Loan and the Revolving Loan (excluding the additional principal added pursuant to this proviso) exceeds \$4,000 then the Loan Rate shall be 10%, of which eight percent 8% shall be payable in cash and 2% shall be paid by the issuance of and treated as additional principal of the Term Loan ("PIK"); provided, further, however, that the Loan Rate with respect to the Disbursed Escrow Loan shall be 0%. The revolving loan was originally set to mature on January 16, 2019, which was amended to August 16, 2020 in conjunction with the Fifth Amendment to the Loan and Security Agreement. In connection with the loan, we issued the lender a five-year warrant to purchase up to 143,791 shares of Creative Realities' common stock at a per share price of \$7.65 (subject to adjustment). The fair value of the warrants was \$543, which was accounted for as an additional debt discount and is being amortized over the remaining life of the loan.

The Fourth Amendment to the Loan and Security Agreement included entry into a Secured Disbursed Escrow Promissory Note between the Company and Slipstream, and, effective June 30, 2018 we drew \$264 in conjunction with our exit from a previously leased operating facility. The principal amount of the Secured Disbursed Escrow Promissory Note will bear simple interest at the 8%; provided, further, however, that the Loan Rate with respect to the Secured Disbursed Escrow Promissory Note shall be 0% at all times when the aggregate outstanding principal amount of the Term Loan and the Revolving Loan (excluding the additional principal added pursuant to this proviso) is at or below \$4,000.

On November 19, 2018, we used proceeds from our public offering to repay Slipstream \$1,283, inclusive of \$125 of accrued interest, to reduce borrowings under the Loan and Security Agreement to an aggregate of \$4,264, comprised of \$3,000 term loan, \$1,000 revolving loan and \$264 secured disbursed escrow promissory note. The condensed consolidated balance sheet includes \$27 of accrued interest as of March 31, 2019 representing one month's interest at 8.0% on the \$4,000 outstanding balance.

On November 9, 2018, Slipstream, extended the maturity date of our term loan and revolver loan to August 16, 2020 through the Fifth Amendment to the Loan and Security Agreement. Our intent is to refinance our term loan with an unrelated third party in the first half of 2019. In conjunction with the extension of the maturity date of our term loan, we agreed that the interest rate would conditionally increase from 8.0% per annum to 10.0% per annum effective July 1, 2019 if we have not successfully completed such refinancing activity by June 30, 2019.

See Note 14 for the Black Scholes inputs used to calculate the fair value of the warrants.

Convertible Promissory Notes

On October 29, 2018, the holder of convertible promissory notes, Slipstream, agreed to convert \$4,955 of outstanding principal, including paid-in-kind interest and all accrued interest thereon into shares of our common stock and warrants at a conversion price equal to the lower of \$7.65, or 80% of the price at which shares of common stock were sold in the Public Offering. The conversion was contingent upon (i) the conversion of the Company's Series A Preferred Stock, and (ii) the successful completion of a Public Offering of at least \$10 million, each of which were successfully completed on November 19, 2018. In exchange for participation in the Public Offering, subject to a minimum participation requirement as agreed between the underwriters and the Company, and Slipstream's execution of a lock-up agreement, Slipstream received, as a one-time incentive, additional common stock and warrants in such number that decreased the effective conversion price of the convertible notes to 70% of the lowest of those scenarios outlined above. Upon completion of the Company's Public Offering on November 19, 2018, the convertible promissory notes were converted into shares of the Company's common stock. The Company issued 653,062 shares of common stock at the stated conversion rate and an additional 1,386,090 shares of common stock in exchange for conversion of the convertible promissory notes as a result of the one-time incentive. The lock-up agreement applied to all shares of common stock and warrants issued to Slipstream.

Amended and Restated Seller Note from acquisition of Allure

The Amended and Restated Seller Note represents a note payable due from Allure to Seller, under a pre-existing Seller Note which was amended and restated to a reduced amount of \$900 through the Stock Purchase Agreement. At the closing date, the estimated net working capital deficit of Allure was \$801 in excess of the target net working capital as defined in the Stock Purchase Agreement. As of the balance sheet date, Allure also had accounts payable to Seller for outsourced services of \$2,204. We agreed with the Seller to settle the estimated net working capital deficit through a reduction in the accounts payable to Seller as of the acquisition date and to further amend the Seller Note to include the remaining \$1,403 accounts payable due from Allure to Seller, resulting in a Seller Note of \$2,303. That debt is represented by our issuance to the Seller of a promissory note accruing interest at 3.5% per annum. The promissory note will require us to make quarterly payments of interest only through February 19, 2020, on which date the promissory note will mature and all remaining amounts owing thereunder will be due. The condensed consolidated balance sheet includes \$29 of accrued interest as of March 31, 2019 representing all interest accrued under the note since close of the Allure Acquisition. We are able to prepay in whole or in part amounts owing under the promissory note, without penalty, at our option, at any time and from time to time.

The promissory note is convertible into shares of Creative Realities common stock, at the seller's option on or after May 19, 2019, at an initial conversion price of \$8.40 per share, subject to customary equitable adjustments. Conversion of all amounts owing under the promissory note will be mandatory if the 30-day volume-weighted average price of our common stock exceeds 200% of the common stock trading price at the closing of the acquisition. We granted the seller customary registration rights for the shares of our common stock issuable upon conversion of the promissory note.

NOTE 10: COMMITMENTS AND CONTINGENCIES

Lease termination

On August 10, 2017, we announced the planned closure of our office facilities located at 22 Audrey Place, Fairfield, New Jersey 07004 which housed our previous operations center and ceased use of the facilities in February 2018. In ceasing use of these facilities, we recorded a one-time non-cash charge of \$474 to accrue for the remaining rent under the lease term, net of anticipated subtenant rental income.

Settlement of obligations

During the three months ended March 31, 2019, the Company wrote off obligations of \$7 and recognized a gain of \$7. There were no such settlements in the three months ended March 31, 2018.

Litigation

The Company is involved in various legal proceedings incidental to the operations of its business. The Company believes that the outcome of all such other pending legal proceedings in the aggregate will not have a material adverse effect on its business, financial condition, liquidity, or operating results.

Termination benefits

On December 21, 2018, the Company announced certain restructuring activities following completion of its acquisition of Allure and accrued one-time termination benefits related to severance to the affected employees of \$386, \$31 of which was paid prior to the year end date. During the three-months ended March 31, 2019, cash payments for termination benefits of \$92 were paid and a liability of \$263 remains included in accrued expenses on the condensed consolidated balance sheet.

NOTE 11: RELATED PARTY TRANSACTIONS

In addition to the financing transactions with Slipstream, a related party, discussed in Note 9, we have the following related party transactions.

On August 14, 2018, we entered into a payment agreement with 33 Degrees Convenience Connect, Inc., a related party that is approximately 17.5% owned by a member of our senior management (“33 Degrees”) outlining terms for repayment of \$2,567 of aged accounts receivable as of that date. The payment agreement stipulates a simple interest rate of 12% on aged accounts receivable to be paid on the tenth day of each month through the maturity date of December 31, 2019. Remaining payments due under the agreement as of March 31, 2019 were \$1,317, \$300 of which has been paid subsequent to the reporting date as of the date of this filing. Remaining payments of \$150 are to be paid on the first day of each month beginning June 1, 2019 through the maturity date, or December 31, 2019. All amounts under this note are included in accounts receivable in current assets as all amounts are expected to be collected within one year of the balance sheet date. Since inception of this agreement up to and through the filing date, all payments due under this agreement have been received from 33 Degrees timely, including monthly interest payments and payments for ongoing services.

Since the Company entered into the payment agreement with 33 Degrees, 33 Degrees has continued to purchase additional hardware and services from the Company, on a prepaid basis, in addition to making payments under the payment agreement. In aggregate, 33 Degrees has paid \$433 to the Company for new hardware and services above and beyond their contractual obligations under the payment agreement, primarily from 33 Degrees Menu Services, LLC (33 Degrees MS), a wholly-owned subsidiary of 33 Degrees.

On March 12, 2019 the Company entered into a security agreement and promissory note with 33 Degrees MS providing a line of credit of \$300 for hardware, installation and SaaS services. Under the agreement, product will be shipped and installed by the Company upon evidence of a valid purchase order from the ultimate payer being provided as collateral.

For the three months ended March 31, 2019 and 2018, the Company had sales to 33 Degrees of \$195, or 2.1%, and \$417, or 10.3%, respectively, of consolidated revenue. Accounts receivable due from 33 Degrees was \$1,516, or 17.3%, and \$1,933, or 30.0% of consolidated accounts receivable at March 31, 2019 and December 31, 2018, respectively.

On January 16, 2018, we entered into the Third Amendment to the Loan and Security Agreement with Slipstream Communications, LLC, a related party investor, under which we obtained a \$1.0 million revolving loan, with interest thereon at 8% per annum, maturing on January 16, 2019 (subsequently extended to August 2020). In connection with the loan, we issued the lender a five-year warrant to purchase up to 61,729 shares of Creative Realities’ common stock at a per share price of \$8.10 (subject to adjustment and subsequently adjusted to \$6.09 in November 2019). The fair value of the warrants was \$266, which is accounted for as an additional debt discount and amortized over the remaining life of the loan.

NOTE 12: INCOME TAXES

Our deferred tax assets are primarily related to net federal and state operating loss carryforwards (NOLs). We have substantial NOLs that are limited in its usage by IRC Section 382. IRC Section 382 generally imposes an annual limitation on the amount of NOLs that may be used to offset taxable income when a corporation has undergone significant changes in stock ownership within a statutory testing period. We have performed a preliminary analysis of the annual NOL carryforwards and limitations that are available to be used against taxable income. Based on the history of losses of the Company, there continues to be a full valuation allowance against the net deferred tax assets of the Company with a definite life.

For the three months ended March 31, 2019, we reported tax expense of \$21. The net deferred tax liability at March 31, 2019 of \$147 represents the liability relating to indefinite lived assets. This indefinite lived deferred tax liability is used as a source of taxable income to more likely than not realize some of the Company's indefinite lived deferred tax assets.

NOTE 13: CONVERTIBLE PREFERRED STOCK

The Series A Convertible Preferred Stock (the "preferred stock") entitled its holders to a 6% dividend, payable semi-annually in cash or in kind through the three-year anniversary of the original issue date, and from and after such three-year anniversary in duly authorized, validly issued, fully paid and non-assessable shares of common stock. The three-year anniversary of the initial investment date occurred during the second half of 2017 for \$5.2 million and the first quarter of 2018 for the remaining \$0.3 million originally issued preferred stock and therefore dividends on those investments will be paid via issuance of common shares at all future dividend dates.

On November 5, 2018, the shareholders of preferred stock agreed to convert the entire class of preferred stock into common stock at an exchange ratio of \$7.65 per share. The conversion was contingent upon a successful Public Offering of at least \$10 million, which the Company completed on November 19, 2018.

Holders of preferred stock received common stock at the stated conversion rate of \$7.65 per share, or 723,561 shares of common stock. Those holders of preferred stock who executed a customary lock-up agreement for a period continuing for 90 days after the consummation of the public offering were issued, as a one-time incentive, additional common stock and warrants, in such number as defined in underlying agreements. The Company issued an additional 1,123,367 shares of common stock in exchange for execution of such lock-up agreements. The lock-up agreements applied to all shares of common stock issued to convert the holder's preferred stock, and the additional shares of common stock and warrants, and underlying warrant shares, issued by the Company in exchange for the holder's execution of the lock-up agreement and participation in the public offering. As a result of this conversion, there remained no Series A Preferred Stock outstanding as of December 31, 2018.

On March 18, 2019, we filed Statements of Cancellation with the Secretary of State of the State of Minnesota that, effective upon filing, eliminated from the Company's Articles of Incorporation all matters set forth in the Certificates of Designation of Preferences, Rights and Limitations with respect to the Series A Convertible Preferred Stock and Series A-1 Convertible Preferred Stock of the Company. No shares of Series A Convertible Preferred Stock or Series A-1 Convertible Preferred Stock were issued or outstanding at the time of the filing of the Statements of Cancellation. A copy of the Statements of Cancellation were attached as Exhibit 3.1 and 3.2 to Form 8-K filed the same date.

As of March 31, 2018, the pro rata portion of earned dividends to be distributed as of June 30, 2018 were the equivalent of 3,822 Series A Preferred Stock, which represents 12,369 equivalent common shares based on the volume-weighted adjusted price utilized for conversion. The fair value of these shares are reflected at fair value as a dividend on preferred stock in the condensed consolidated statement of operations and do not impact net loss for the period. During the quarter ended March 31, 2018, there were no conversions of Convertible Preferred Stock into common stock.

NOTE 14: WARRANTS

On January 16, 2018, we entered into the Third Amendment to the Loan and Security Agreement with Slipstream, under which we obtained a \$1.0 million revolving loan, with interest thereon at 8% per annum, maturing on January 16, 2019 (subsequently extended to August 2020). In connection with the loan, we issued the lender a five-year warrant to purchase up to 61,729 shares of Creative Realities' common stock at a per share price of \$8.10 (subject to adjustment and subsequently adjusted to \$6.09 in November 2018). The fair value of the warrants on the issuance date was \$266, which is accounted for as an additional debt discount and amortized over the remaining life of the loan.

Listed below are the inputs used for the probability weighted Black Scholes option pricing model valuation for warrants issued during the three months ended March 31, 2019 and 2018.

Issuance Date	Expected Term at Issuance Date	Risk Free Interest Rate at Date of Issuance	Volatility at Date of Issuance	Stock Price at Date of Issuance
1/16/2018	5.00	2.36%	65.07%	\$ 7.80

Listed below are the inputs used for the probability weighted Black Scholes option pricing model valuation for those warrants classified in the condensed consolidated balance sheet as liabilities as of March 31, 2019.

Remaining Expected Term at March 31, 2019 (Years)	Risk Free Interest Rate at March 31, 2019	Volatility at March 31, 2019	Stock Price at March 31, 2019
0.39	2.42%	120.11%	\$ 2.71

A summary of outstanding liability and equity warrants is included below:

	Warrants (Equity)			Warrants (Liability)		
	Amount	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Amount	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life
Balance January 1, 2019	4,815,047	\$ 4.90	4.34	216,255	\$ 7.34	0.64
Warrants issued	-	-	-	-	-	-
Warrants expired	-	-	-	-	-	-
Balance March 31, 2019	4,815,047	\$ 4.90	4.09	216,255	\$ 7.34	0.39

NOTE 15: STOCK-BASED COMPENSATION

A summary of outstanding options is included below:

Range of Exercise Prices between	Number Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Options Exercisable	Weighted Average Exercise Price
\$5.40 - \$19.50	287,341	6.79	\$ 8.35	215,048	\$ 8.66
\$19.51 - \$23.70	1,000	4.79	23.70	1,000	\$ 23.70
\$23.71 - \$367.50	519	3.33	112.30	519	\$ 112.30
	288,860	6.78	\$ 8.59	216,567	

	Options Outstanding	Weighted Average Exercise Price
Balance, December 31, 2018	288,860	\$ 8.59
Granted	-	-
Exercised	-	-
Forfeited or expired	-	-
Balance, March 31, 2019	288,860	\$ 8.59

The weighted average remaining contractual life for options exercisable is 6.26 years as of March 31, 2019.

Stock Compensation Expense Information

ASC 718-10, *Stock Compensation*, requires measurement and recognition of compensation expense for all stock-based payments including warrants, stock options, restricted stock grants and stock bonuses based on estimated fair values. Under the Amended and Restated 2006 Equity Incentive Plan, the Company reserved 1,720,000 shares for purchase by the Company's employees and under the Amended and Restated 2006 Non-Employee Director Stock Option Plan the Company reserved 700,000 shares for purchase by the Company's employees. There are 12,186 options outstanding under the 2006 Equity Incentive Plan.

In October 2014, the Company's shareholders approved the 2014 Stock Incentive Plan, under which 7,390,355 shares were reserved for purchase by the Company's employees. In August 2018, a special meeting of shareholders was held in which the shareholders voted to amend the Company's 2014 Stock Incentive Plan to increase the reserve of shares authorized for issuance thereunder, from 7,390,355 shares to 18,000,000 shares. There are 276,674 options outstanding under the 2014 Stock Incentive Plan.

Compensation expense recognized for the issuance of stock options for the three months ended March 31, 2019 and 2018 was as follows:

	Three Months Ended March 31,	
	2019	2018
Stock-based compensation costs included in:		
Costs of sales	\$ -	\$ (6)
Sales and marketing expense	-	6
General and administrative expense	41	64
Total stock-based compensation expense	<u>\$ 41</u>	<u>\$ 64</u>

At March 31, 2019, there was approximately \$488 of total unrecognized compensation expense related to unvested share-based awards. Generally, this expense will be recognized over the next three years and will be adjusted for any future forfeitures as they occur.

Stock-based compensation expense is based on awards ultimately expected to vest. ASC 718-10-55 allows companies to either estimate forfeitures at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates or elect to account for forfeitures as they occur by reversing compensation cost when the award is forfeited. Our accounting policy is to account for forfeitures as they occur by recording a cumulative-effect adjustment in the period in which forfeitures occur.

On September 20, 2018, the Compensation Committee of the Board of Directors proposed, and the Board of Directors approved, an aggregate award of 166,667 shares of common stock to our current CEO in light of performance and growth of certain key customer relationships. Of those shares granted, 133,334 were deemed to be awarded and fully vested as of such date, with the remaining 33,333 shares restricted to vest upon the Company's recognition in accordance with GAAP of approximately \$6,200 of revenue which is currently deferred on the Company's balance sheet. During the three-months ended September 30, 2018, the Company recorded compensation expense for those vested awards based on the grant-date close price of the Company's common stock, or \$7.50, resulting in a non-cash, non-recurring compensation expense in the period of \$1,000. The remaining expense to be recognized upon vesting of the restricted shares is \$250. The conditions have not been met as of March 31, 2019 for those remaining shares to vest and no compensation expense has been recorded.

NOTE 16: SIGNIFICANT CUSTOMERS

Major Customers

We had 3 customers that in the aggregate accounted for 44% and 40% of accounts receivable as of March 31, 2019 and December 31, 2018, respectively, which includes transactions with 33 Degrees for both periods.

We had 2 and 4 customers that accounted for 42% and 66% of revenue for the three months ended March 31, 2019 and 2018, respectively, of which 33 Degrees represented 2.1% and 10.3% for the same periods, respectively.

NOTE 17: LEASES

We have entered into various non-cancelable operating lease agreements for certain of our offices and office equipment. Our leases have original lease periods expiring between 2019 and 2023. Many leases include one or more options to renew. We do not assume renewals in our determination of the lease term unless the renewals are deemed to be reasonably assured at lease commencement. Our lease agreements do not contain any material residual value guarantees or material restrictive covenants.

The components of lease costs, lease term and discount rate are as follows:

(in thousands)	Three Months Ended March 31, 2019
Finance lease cost	
Amortization of right-of-use assets	\$ 8
Interest	2
Operating lease cost	197
Total lease cost	<u>\$ 207</u>
Weighted Average Remaining Lease Term	
Operating leases	4.0 years
Finance leases	1.6 years
Weighted Average Discount Rate	
Operating leases	10.0%
Finance leases	13.3%

The following is a schedule, by years, of maturities of lease liabilities as of March 31, 2019:

(in thousands)	Operating Leases	Finance Leases
The remainder of 2019	\$ 528	\$ 27
2020	681	22
2021	630	3
2022	377	-
2023	375	-
Thereafter	-	-
Total undiscounted cash flows	<u>2,591</u>	<u>52</u>
Less imputed interest	(463)	\$ (5)
Present value of lease liabilities	<u>\$ 2,128</u>	<u>\$ 47</u>

Supplemental cash flow information related to leases are as follows:

	Three Months Ended March 31, 2019
Cash paid for amounts included in the measurement of lease liabilities:	
Operating cash flows from operating leases	\$ 191
Operating cash flows from finance leases	\$ 1
Financing cash flows from finance leases	\$ 8
Lease liabilities arising from obtaining right-of-use assets:	
Operating leases	\$ -
Finance leases	\$ -

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations Forward-Looking Statements

The following discussion contains various forward-looking statements within the meaning of Section 21E of the Exchange Act. Although we believe that, in making any such statement, our expectations are based on reasonable assumptions, any such statement may be influenced by factors that could cause actual outcomes and results to be materially different from those projected. When used in the following discussion, the words “anticipates,” “believes,” “expects,” “intends,” “plans,” “estimates” and similar expressions, as they relate to us or our management, are intended to identify such forward-looking statements. These forward-looking statements are subject to numerous risks and uncertainties that could cause actual results to differ materially from those anticipated. Factors that could cause actual results to differ materially from those anticipated, certain of which are beyond our control, are set forth under the caption “Risk Factors” in the Company’s Form 10-K for the year ended December 31, 2018 as filed with the Securities and Exchange Commission on March 28, 2019.

Our actual results, performance or achievements could differ materially from those expressed in, or implied by, forward-looking statements. Accordingly, we cannot be certain that any of the events anticipated by forward-looking statements will occur or, if any of them do occur, what impact they will have on us. We caution you to keep in mind the cautions and risks described in this document and to refrain from attributing undue certainty to any forward-looking statements, which speak only as of the date of the document in which they appear. We do not undertake to update any forward-looking statement.

Overview

Creative Realities, Inc. is a Minnesota corporation that provides innovative digital marketing technology solutions to a broad range of companies, individual brands, enterprises, and organizations throughout the United States and in certain international markets. We have expertise in a broad range of existing and emerging digital marketing technologies across 18 vertical markets, as well as the related media management and distribution software platforms and networks, device and content management, product management, customized software service layers, systems, experiences, workflows, and integrated solutions. Our technology and solutions include: digital merchandising systems and omni-channel customer engagement systems; content creation, production and scheduling programs and systems; a comprehensive series of recurring maintenance, support, and field service offerings; interactive digital shopping assistants, advisors and kiosks; and, other interactive marketing technologies such as mobile, social media, point-of-sale transactions, beaconing and web-based media that enable our customers to transform how they engage with consumers.

Our main operations are conducted directly through Creative Realities, Inc. and our wholly owned subsidiaries Allure Global Solutions, Inc., a Georgia corporation, Creative Realities Canada, Inc. a Canadian corporation and ConeXus World Global, LLC, a Kentucky limited liability company. Our other wholly owned subsidiary Creative Realities, LLC, a Delaware limited liability company, has been effectively dormant since October 2015, the date of the merger with ConeXus World Global, LLC.

We generate revenue in our business by:

- consulting with our customers to determine the technologies and solutions required to achieve their specific goals, strategies and objectives;
- designing our customers’ digital marketing experiences, content and interfaces;
- engineering the systems architecture delivering the digital marketing experiences we design – both software and hardware – and integrating those systems into a customized, reliable and effective digital marketing experience;
- managing the efficient, timely and cost-effective deployment of our digital marketing technology solutions for our customers;
- delivering and updating the content of our digital marketing technology solutions using a suite of advanced media, content and network management software products; and
- maintaining our customers’ digital marketing technology solutions by: providing content production and related services; creating additional software-based features and functionality; hosting the solutions; monitoring solution service levels; and responding to and/or managing remote or onsite field service maintenance, troubleshooting and support calls.

These activities generate revenue through: bundled-solution sales; consulting services, experience design, content development and production, software development, engineering, implementation, and field services; software license fees; and maintenance and support services related to our software, managed systems and solutions.

Our Sources of Revenue

We generate revenue through digital marketing solution sales, which include system hardware, professional and implementation services, software design and development, software licensing, deployment, and maintenance and support services.

We currently market and sell our technology and solutions primarily through our sales and business development personnel, but we also utilize agents, strategic partners, and lead generators who provide us with access to additional sales, business development and licensing opportunities.

Our Expenses

Our expenses are primarily comprised of three categories: sales and marketing, research and development, and general and administrative. Sales and marketing expenses include salaries and benefits for our sales, business development solution management and marketing personnel, and commissions paid on sales. This category also includes amounts spent on marketing networking events, promotional materials, hardware and software to prospective new customers, including those expenses incurred in trade shows and product demonstrations, and other related expenses. Our research and development expenses represent the salaries and benefits of those individuals who develop and maintain our proprietary software platforms and other software applications we design and sell to our customers. Our general and administrative expenses consist of corporate overhead, including administrative salaries, real property lease payments, salaries and benefits for our corporate officers and other expenses such as legal and accounting fees.

Critical Accounting Policies and Estimates

The Company's significant accounting policies are described in Note 2 of the Company's Condensed Consolidated Financial Statements included elsewhere in this filing. The Company's Condensed Consolidated Financial Statements are prepared in conformity with accounting principles generally accepted in the United States. Certain accounting policies involve significant judgments, assumptions, and estimates by management that could have a material impact on the carrying value of certain assets and liabilities and disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Our actual results could differ from those estimates.

Results of Operations

Note: All dollar amounts reported in Results of Operations are in thousands, except per-share information.

Three Months Ended March 31, 2019 Compared to Three Months Ended March 31, 2018

The tables presented below compare our results of operations and present the results for each period and the change in those results from one period to another in both dollars and percentage change.

	For the three months ended		Change	
	March 31,		Dollars	%
	2019	2018		
Sales	\$ 9,484	\$ 4,066	\$ 5,418	133%
Cost of sales	5,803	2,557	3,246	127%
Gross profit	3,681	1,509	2,172	144%
Sales and marketing expenses	697	503	194	39%
Research and development expenses	373	321	52	16%
General and administrative expenses	2,290	1,703	587	34%
Depreciation and amortization expense	286	327	(41)	-13%
Lease termination expense	-	474	(474)	-100%
Total operating expenses	3,646	3,328	318	10%
Operating income/(loss)	35	(1,819)	1,854	-102%
Other income/(expenses):				
Interest expense	(204)	(574)	370	-64%
Change in fair value of warrant liability	(1)	197	(198)	-101%
Gain on settlement of obligations	7	-	7	100%
Other income/(expense)	-	4	(4)	-100%
Total other income/(expense)	(198)	(373)	175	-47%
Net income/(loss) before income taxes	(163)	(2,192)	2,029	-93%
Provision from income taxes	(21)	(46)	25	-54%
Net income/(loss)	\$ (184)	\$ (2,238)	\$ 2,054	-92%

Sales

Sales increased by \$5,418, or 133%, in the three months ended March 31, 2019 as compared to the same period in 2018 primarily as the result of (i) completed work on a material software development project for approximately \$2,083, (ii) the recognition of revenue from the sale of software licenses for a project previously recorded as deferred revenue of \$1,802 and (iii) revenues from acquired customers of Allure, which were not reflected in 2018. The remaining increase was the result of the continued growth of sales within our key existing customer relationships.

Gross Profit

Gross profit margin increased \$2,172 in absolute dollars from \$1,509 to \$3,681, or 144%, primarily as a result of the increase in sales and an expansion of gross profit margin. Gross profit margin increased to 38.8% in 2019 from 37.1% in 2018 during the same period. The increase in gross profit margin percentage is the result of sales mix during the period, which saw services revenue increase to 82.7% of revenues in the period combined with improvements in hardware cost through increased purchasing power. Gross profit margin from services revenues decreased to 43.9% from 48.6% primarily as the result of one \$876 project with a margin below 10%, without which our services gross profit margin was 48.6%.

Sales and Marketing Expenses

Sales and marketing expenses generally include the salaries, taxes, and benefits of our sales and marketing personnel, as well as trade show activities, travel, and other related sales and marketing costs. Sales and marketing expenses increased by \$194, or 39%, in 2019 compared to 2018. The increase was primarily due to an expansion in the sales organization as a result of the Allure Acquisition and increased participation in industry trade shows in the three months ended March 31, 2019 as compared to the same period in the prior year.

Research and Development Expenses

Research and development expenses increased by \$52, or 16%, in 2019 compared to 2018 as the result of an increase in amortization expense related to capitalized software and salary costs driven by an increased investment in products and offerings in the most recent twelve months.

General and Administrative Expenses

Total general and administrative expenses increased by \$587, or 34%, in 2019 compared to 2018, primarily as the result of increased headcount, benefits, rent and office expenses from the Allure Acquisition.

Depreciation and Amortization Expenses

Depreciation and amortization expenses decreased by \$41, or 13%, in 2019 compared to 2018. This decrease was primarily a result of the reduction in amortization expense related to a lower cost basis in intangible assets as certain assets become fully amortized, partially offset by amortization expense recorded on intangible assets acquired in the acquisition of Allure.

Interest Expense

See Note 9 to the Condensed Consolidated Financial Statements for a discussion of the Company's debt and related interest expense obligations.

Change in Fair Value of Warrant Liability

See Note 6 to the condensed consolidated financial statements for a discussion of the Company's non-cash change in warrant liability for the three months ended March 31, 2019, the methodology for which is consistent for the three months ended March 31, 2018. The change in the fair value of the warrant liability resulted in a loss in the three months ended March 31, 2019 of \$1.

Gain on Settlement of Obligations

During the three months ended March 31, 2019, the Company wrote off obligations of \$7 and recognized a gain of \$7. There were no such settlements in the three months ended March 31, 2018.

Summary Unaudited Quarterly Financial Information

The following represents unaudited financial information derived from the Company's quarterly financial statements:

Quarters ended	March 31, 2019	December 31, 2018	September 30, 2018	June 30, 2018	March 31, 2018
Net sales	\$ 9,484	\$ 5,229	\$ 6,001	\$ 7,179	\$ 4,066
Cost of sales	5,803	3,346	2,260	4,089	2,557
Gross profit	3,681	1,883	3,741	3,090	1,509
Operating expenses, inclusive of one-time lease termination expense, excluding depreciation and amortization	3,360	3,827	3,919	2,773	3,001
Depreciation/amortization	286	204	330	324	327
Operating (loss)/income	35	(2,148)	(508)	(7)	(1,819)
Other expenses/(income)	219	4,744	370	605	419
Net (loss)/income	\$ (184)	\$ (6,892)	\$ (878)	\$ (612)	\$ (2,238)

Supplemental Operating Results on a Non-GAAP Basis

The following non-GAAP data, which adjusts for the categories of expenses described below, is a non-GAAP financial measure. Our management believes that this non-GAAP financial measure is useful information for investors, shareholders and other stakeholders of our company in gauging our results of operations on an ongoing basis. We believe that EBITDA is a performance measure and not a liquidity measure, and therefore a reconciliation between net loss/income and EBITDA and Adjusted EBITDA has been provided. EBITDA should not be considered as an alternative to net loss/income as an indicator of performance or as an alternative to cash flows from operating activities as an indicator of cash flows, in each case as determined in accordance with GAAP, or as a measure of liquidity. In addition, EBITDA does not take into account changes in certain assets and liabilities as well as interest and income taxes that can affect cash flows. We do not intend the presentation of these non-GAAP measures to be considered in isolation or as a substitute for results prepared in accordance with GAAP. These non-GAAP measures should be read only in conjunction with our consolidated financial statements prepared in accordance with GAAP.

Quarters ended	March 31, 2019	December 31, 2018	September 30, 2018	June 30, 2018	March 31, 2018
GAAP net loss	\$ (184)	\$ (6,892)	\$ (878)	\$ (612)	\$ (2,238)
Interest expense:					
Amortization of debt discount	156	447	415	487	345
Other interest	48	145	273	265	229
Depreciation/amortization	328	311	330	437	391
Income tax expense/(benefit)	21	(214)	(128)	(102)	46
EBITDA	\$ 368	\$ (6,203)	\$ 12	\$ 475	\$ (1,227)
Adjustments					
Change in warrant liability	1	(602)	(27)	(11)	(197)
Gain on settlement of obligations	(7)	(86)	(169)	(39)	-
Lease termination expense	-	-	-	-	474
Debt conversion expense	-	5,055	-	-	-
CEO share grant compensation expense	-	-	1,000	-	-
Severance charges	-	385	-	-	-
Deal & transaction costs	-	710	-	-	-
Other expense/(income)	-	(1)	6	5	(4)
Adjusted EBITDA	\$ 362	\$ (742)	\$ 822	\$ 430	\$ (954)

Liquidity and Capital Resources

We have incurred net losses for the years ended December 31, 2018 and 2017 and have negative cash flows from operating activities as of December 31, 2018. For the three months ended March 31, 2019 and 2018 we recognized net loss of \$184 and \$2,238, respectively. As of March 31, 2019, we had cash and cash equivalents of \$2,248 and working capital deficit of \$5,555, which includes \$662 representing current maturities of operating leases brought onto the consolidated balance sheet January 1, 2019 upon adoption of ASU 2016-02.

On November 9, 2018, Slipstream Communications, LLC, (“Slipstream”) a related party (see Note 9), extended the maturity date of our term loan and revolving loan to August 16, 2020. Our intent is to refinance our term loan and revolving loan with an unrelated third party in the first half of 2019. In conjunction with the extension of the maturity date of our term loan, we agreed that the cash portion of the interest rate would conditionally increase from 8.0% per annum to 10.0% per annum effective July 1, 2019 if we have not successfully completed such refinancing activity by June 30, 2019.

See Note 9 to the Condensed Consolidated Financial Statements for a discussion of the Company’s debt obligations.

Operating Activities

As of December 31, 2018, we had an accumulated deficit of \$36,851. The cash flows used in operating activities was \$232 and \$1,112 for the three months ended March 31, 2019 and 2018, respectively. The cash flows used in operating activities was driven by the Company’s net loss and reductions in deferred revenue and customer deposits combined with collections on accounts receivable, offset partially by an increase in accrued expenses and non-cash expenses including amortization of share-based compensation and debt discount.

Investing Activities

Net cash used in investing activities during the three months ended March 31, 2019 was \$230 compared to \$149 during the same period in 2018. The use of cash in both periods represents acquisition of capital assets, primarily related to the capitalization of software costs. We currently do not have any material commitments for capital expenditures as of March 31, 2019, nor do we anticipate any significant expenditures in 2019.

Financing Activities

Net cash provided by/(used in) financing activities during the three months ended March 31, 2019 was (\$8) compared to \$1,000 for the same period in 2018. The decrease was the result of no proceeds from related party loans in the three months ended March 31, 2019.

Contractual Obligations

We have no material commitments for capital expenditures, and we do not anticipate any significant capital expenditures for the remainder of 2019.

Off-Balance Sheet Arrangements

During the three months ended March 31, 2019, we did not engage in any off-balance sheet arrangements set forth in Item 303(a) (4) of Regulation S-K.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

An evaluation was performed under the supervision and with the participation of our management, including our Chief Executive Officer (principal executive officer) and Chief Financial Officer (principal financial officer), of the effectiveness of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (“Exchange Act”), as of the end of the period covered by this report. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Based on our evaluation and those criteria, management identified that the Company’s internal control over financial reporting was not effective as of March 31, 2019 and that a material weakness exists as the result of a deficient process to close the monthly consolidated financial statements and prepare comprehensive and timely account analysis.

A material weakness is a control deficiency (within the meaning of Public Company Accounting Oversight Board (PCAOB) Auditing Standard No. 5) or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected on a timely basis. Management plans to expand the scope of its remediation of its internal controls over financial reporting at the consolidated level and has developed a plan to complete the remediation of the foregoing deficiencies in 2019.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting that occurred during the quarter ended March 31, 2019 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

We were not party to any material legal proceedings as of May 9, 2019, and there were no such proceedings pending during the period covered by this Report.

Item 1A. Risk Factors

As a smaller reporting company, we are not required to provide the information required by this Item; however, the discussion of our business and operations should be read together with the Risk Factors set forth in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 28, 2019. Such risks and uncertainties have the potential to affect our business, financial condition, results of operations, cash flow, strategies or prospects in a material and adverse manner.

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

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Item 6. Exhibits

<u>Exhibit No.</u>	<u>Description</u>
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31.1	Chief Executive Officer Certification pursuant to Exchange Act Rule 13a-14(a).
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31.2	Chief Financial Officer Certification pursuant to Exchange Act Rule 13a-14(a).
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32.1	Chief Executive Officer Certification pursuant to 18 U.S.C. Section 1350.
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32.2	Chief Financial Officer Certification pursuant to 18 U.S.C. Section 1350.
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101.INS	XBRL Instance Document
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101.SCH	XBRL Taxonomy Extension Schema
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101.CAL	XBRL Taxonomy Extension Calculation Linkbase
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101.DEF	XBRL Taxonomy Extension Definition Linkbase
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101.LAB	XBRL Taxonomy Extension Label Linkbase
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101.PRE	XBRL Taxonomy Extension Presentation Linkbase
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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.

Date: May 9, 2019

Creative Realities, Inc.

By /s/ Richard Mills
Richard Mills
Chief Executive Officer

By /s/ Will Logan
Will Logan
Chief Financial Officer

**CHIEF EXECUTIVE OFFICER CERTIFICATION
PURSUANT TO EXCHANGE ACT RULE 13a-14(a)**

I, Richard Mills, certify that:

1. I have reviewed this annual report on Form 10-Q for the three months ended March 31, 2019, of Creative Realities, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: May 9, 2019

By: /s/ Richard Mills

Richard Mills

Chief Executive Officer

**CHIEF FINANCIAL OFFICER CERTIFICATION
PURSUANT TO EXCHANGE ACT RULE 13a-14(a)**

I, Will Logan, certify that:

1. I have reviewed this annual report on Form 10-Q for the three months ended March 31, 2019, of Creative Realities, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: May 9, 2019

By: /s/ Will Logan

Will Logan

Chief Financial Officer

**CHIEF EXECUTIVE OFFICER CERTIFICATION
PURSUANT TO 18 U.S.C. SECTION 1350**

In connection with the Annual Report of Creative Realities, Inc. (the "Company") on Form 10-Q for the three months ended March 31, 2019, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Richard Mills, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

Dated: May 9, 2019

By: /s/ Richard Mills

Richard Mills

Chief Executive Officer

**CHIEF FINANCIAL OFFICER CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350**

In connection with the Annual Report of Creative Realities, Inc. (the "Company") on Form 10-Q for the three months ended March 31, 2019, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Will Logan, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

Dated: May 9, 2019

By: /s/ Will Logan

Will Logan

Chief Financial Officer