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, 2022

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: 000-22405

WaveDancer, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**54-1167364**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

12015 Lee Jackson Memorial Highway
Suite 210
Fairfax, Virginia 22033

(Address of principal executive offices, Zip Code)

(703) 383-3000

(Registrant's telephone number, including area code)

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

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	**WAVD**	**The Nasdaq Stock Market LLC**

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, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:
17,396,697 shares of common stock, par value $0.001 per share, as of May 10, 2022.

WAVEDANCER, INC.
FORM 10-Q

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

WAVEDANCER, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

	March 31, 2022	December 31, 2021
ASSETS		
Current assets		
Cash and cash equivalents	$ 2,999,201	$ 4,931,302
Accounts receivable	1,672,072	1,664,862
Prepaid expenses and other current assets	458,719	276,990
Total current assets	5,129,992	6,873,154
Intangible assets, net of accumulated amortization of $550,925 and $201,032	7,699,075	8,048,968
Goodwill	7,585,269	7,585,269
Right-of-use operating lease asset	627,977	672,896
Property and equipment, net of accumulated depreciation and amortization of $361,338 and $347,886	103,577	105,256
Other assets	77,100	77,100
Total assets	$ 21,222,990	$ 23,362,643
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	$ 302,323	$ 650,499
Accrued payroll and related liabilities	611,497	524,055
Commissions payable	250,043	224,250
Other accrued liabilities	816,536	204,080
Contract liabilities	149,692	186,835
Operating lease liability - current	192,128	192,128
Total current liabilities	2,322,219	1,981,847
Operating lease liability - non-current	460,505	507,120
Deferred income taxes	441,498	1,167,504
Other liabilities	2,296,928	2,265,000
Total liabilities	5,521,150	5,921,471
Stockholders' equity		
Common stock, $0.001 par value 100,000,000 shares authorized; 18,987,313 and 18,882,313 shares issued, 17,344,697 and 17,239,697 shares outstanding as of March 31, 2022 and December 31, 2021, respectively	18,987	18,882
Additional paid-in capital	32,128,334	31,789,464
Accumulated deficit	(15,515,270)	(13,436,963)
Treasury stock, 1,642,616 shares at cost	(930,211)	(930,211)
Total stockholders' equity	15,701,840	17,441,172
Total liabilities and stockholders' equity	$ 21,222,990	$ 23,362,643

The accompanying notes are an integral part of the financial statements

WAVEDANCER, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE (LOSS) INCOME
(Unaudited)

	Three months ended March 31,	
	2022	2021
Revenues		
Professional fees	$ 2,066,690	$ 2,439,259
Software sales	928,822	980,321
Total revenues	2,995,512	3,419,580
Cost of revenues		
Cost of professional fees	1,712,015	1,467,699
Cost of software sales	907,432	932,231
Total cost of revenues	2,619,447	2,399,930
Gross profit	376,065	1,019,650
Selling, general and administrative expenses	2,714,342	680,250
Acquisition costs	434,702	70,530
(Loss) income from operations	(2,772,979)	268,870
Other income (expense):		
Interest expense	(19,319)	(1,459)
Other income (expense), net	(12,015)	3,404
(Loss) income before provision for income taxes	(2,804,313)	270,815
Income tax benefit	(726,006)	-
Net (loss) income	$ (2,078,307)	$ 270,815
Comprehensive (loss) income	$ (2,078,307)	$ 270,815
Net (loss) income per common share - basic	$ (0.12)	$ 0.02
Net (loss) income per common share - diluted	$ (0.12)	$ 0.02
Weighted average common shares outstanding		
Basic	17,294,808	11,282,671
Diluted	17,294,808	12,286,216

The accompanying notes are an integral part of the financial statements

WAVEDANCER, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Three months ended March 31,	
	2022	2021
Cash flows from operating activities:		
Net (loss) income	$ (2,078,307)	$ 270,815
Adjustments to reconcile net (loss) income to net cash (used in) provided by operating activities:		
Depreciation and amortization	363,345	5,383
Stock-based compensation	312,176	27,711
Income tax benefit	(726,006)	-
Amortization of right-of-use assets	44,919	25,494
Non-cash interest expense	19,319	-
Change in fair value of contingent consideration liability	12,609	-
Changes in operating assets and liabilities:		
Accounts receivable	(7,210)	256,268
Prepaid expenses and other current assets	(181,729)	36,476
Contract assets	-	(131,943)
Other assets	-	33,513
Accounts payable	(348,176)	88,567
Contract liabilities	(37,143)	(491,388)
Accrued payroll and related liabilities and other accrued liabilities	699,898	(25,986)
Operating lease liability	(46,615)	(27,232)
Commissions payable	25,793	95,168
Net cash (used in) provided by operating activities	(1,947,127)	162,846
Cash flows from investing activities		
Acquisition of property and equipment	(11,773)	(4,612)
Net cash used in investing activities	(11,773)	(4,612)
Cash flows from financing activities		
Borrowing under revolving line of credit	-	500,000
Proceeds from issuance of stock	-	495,999
Proceeds from exercise of stock options	26,799	3,550
Net cash provided by financing activities	26,799	999,549
Net (decrease) increase in cash and cash equivalents	(1,932,101)	1,157,783
Cash and cash equivalents, beginning of year	4,931,302	1,858,160
Cash and cash equivalents, end of year	$ 2,999,201	$ 3,015,943
Supplemental cash flow Information		
Interest paid	$ 1,002	$ -

The accompanying notes are an integral part of the financial statements

WAVEDANCER, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
(Unaudited)

	Three months ended March 31, 2022				
	Common Stock	Additional Paid-In Capital	Accumulated Deficit	Treasury Stock	Total
Balances at December 31, 2021	$ 18,882	$ 31,789,464	$ (13,436,963)	$ (930,211)	17,441,172
Net loss	-	-	(2,078,307)	-	(2,078,307)
Stock option compensation	-	312,176	-	-	312,176
Issuance of stock from exercise of options	105	26,694	-	-	26,799
Balances at March 31, 2022	$ 18,987	$ 32,128,334	$ (15,515,270)	$ (930,211)	$ 15,701,840

	Three months ended March 31, 2021				
Balances at December 31, 2020	$ 129,043	$ 14,720,065	$ (12,305,514)	$ (930,211)	$ 1,613,383
Net income	-	-	270,815	-	270,815
Stock option compensation	-	27,711	-	-	27,711
Stock issued	3,306	492,693	-	-	495,999
Issuance of stock from exercise of options	250	3,300	-	-	3,550
Balances at March 31, 2021	$ 132,599	$ 15,243,769	$ (12,034,699)	$ (930,211)	$ 2,411,458

The accompanying notes are an integral part of the financial statements

Note 1. Summary of Significant Accounting Policies

Organization and Business

WaveDancer, Inc. ("WaveDancer"), formerly known as Information Analysis Incorporated ("IAI"), is engaged in providing professional services to U.S. government agencies to modernize information technology services, in selling and supporting third-party software, primarily Adobe products, to U.S. government agencies, and, with our December, 2021 acquisition of Gray Matters, Inc. ("GMI" or "Gray Matters"), in providing a blockchain enabled supply chain management software solution. With the acquisition of GMI, we began implementing a strategy that will expand our offerings well beyond systems modernization services and sales of third-party software. We manage our business as a single operating unit and in one reportable segment.

Unaudited Interim Condensed Consolidated Financial Statements

The accompanying unaudited condensed consolidated financial statements ("financial statements") have been prepared in conformity with U.S. generally accepted accounting principles ("GAAP") for interim financial information and with the instructions for Form 10-Q and Article 8-03 of Regulation S-X. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). In the opinion of management, the financial statements include all adjustments necessary (which are of a normal and recurring nature) for the fair and not misleading presentation of the results of the interim periods presented. These unaudited interim condensed consolidated financial statements should be read in conjunction with the Company's audited financial statements for the year ended December 31, 2021 included in the Annual Report on Form 10-K filed by the Company with the SEC on April 12, 2022 (the "Annual Report"), as amended. The accompanying December 31, 2021, balance sheet was derived from the audited financial statements included in the Annual Report. The results of operations for any interim periods are not necessarily indicative of the results of operations for any other interim period or for a full fiscal year.

The condensed consolidated financial statements as of March 31, 2022 and for the three-month period ended March 31, 2022 include the accounts of WaveDancer and its consolidated subsidiaries (collectively, the "Company", "we" or "our"). All significant intercompany transactions and balances have been eliminated in consolidation.

There have been no changes in the Company's significant accounting policies as of March 31, 2022, as compared to the significant accounting policies disclosed in Note 1, "Summary of Significant Accounting Policies" in the Company's Annual Report.

Use of Estimates

Preparation of consolidated financial statements in conformity with GAAP requires us to make estimates and assumptions that affect the amounts reported and disclosed in the financial statements and the accompanying notes. Actual results could differ materially from these estimates due to uncertainties, including the effects of COVID-19. On an ongoing basis, we evaluate our estimates, including those related to the allowance for credit losses; fair values of financial instruments, intangible assets, and goodwill; useful lives of intangible assets and property and equipment; the valuation of stock-based compensation, the valuation of deferred tax assets and liabilities; and contingent liabilities, among others. We base our estimates on assumptions, both historical and forward looking, that are believed to be reasonable, and the results of which form the basis for making judgments about the carrying values of assets and liabilities.

Reclassification

Beginning with the three months ended March 31, 2022, our condensed consolidated statement of cash flows presents separately the amortization of the right-of-use operating lease asset as a non-cash adjustment from net income and the change in the operating lease liability due to cash payments as a change in operating assets and liabilities. Previously, the net of these amounts was reported as a change in operating assets and liabilities. Amounts on the statement of cash flows for the three months ended March 31, 2021 have been reclassified to conform to the current year presentation.

Income Taxes

Deferred tax assets and liabilities are computed based on the difference between the financial statement and tax basis of assets and liabilities and are measured by applying enacted tax rates and laws for the taxable years in which those differences are expected to reverse. In addition, a valuation allowance is required to be recognized if it is believed more likely than not that a deferred tax asset willnot be fully realized. Authoritative guidance prescribes a recognition threshold of more likely thannot, and a measurement attribute for all tax positions taken or expected to be taken on a tax return, in order for those positions to be recognized in the financial statements. The Company has analyzed its income tax positions using the criteria required by GAAP and concluded that as of March 31, 2022, and December 31, 2021, it has no material uncertain tax positions and no interest or penalties have been accrued.

Concentration of Credit Risk

During the three months ended March 31, 2022, the Company's prime contracts with U.S. government agencies represented 34.3% of revenue, subcontracts under federal procurements represented 65.1% of revenue, and 0.6% of revenue came from commercial and local government contracts. The terms of these contracts and subcontracts vary from single transactions to five years. One prime contract represented 27.9% of revenue, and three subcontracts under federal procurements represented 26.9%, 16.0%, and 11.0% of revenue, respectively. Revenue from one prime contractor under which the Company has multiple subcontracts represented 37.9% of the Company's revenue in aggregate.

During the three months ended March 31, 2021, the Company's prime contracts with U.S. government agencies represented 41.1% of revenue, subcontracts under federal procurements represented 57.6% of revenue, and 1.3% of revenue came from commercial contracts. The terms of these contracts and subcontracts vary from single transactions to five years. Within this group of prime contracts with U.S. government agencies, one software sales contract generated 23.6% of our revenue and one professional fee contract generated 10.6% of our revenue. One subcontract under a federal procurement generated 39.8% of our revenue, and all subcontracts under that prime contractor collectively generated 49.4% of our revenue.

The Company sold third-party software and maintenance contracts under agreements with one major supplier, accounting for 30.5% and 27.4% of total revenue during the three months ended March 31, 2022 and 2021, respectively.

As of March 31, 2022, the Company's accounts receivable included receivables fromthree subcontracts under federal procurements that represented 48.2%, 19.7%, and 10.3% of the Company's outstanding accounts receivable, respectively. Receivables from one prime contractor under which the Company has multiple subcontracts represented 67.9% of the Company's outstanding accounts receivable in aggregate.

As of March 31, 2021, accounts receivable balances related totwo professional services subcontracts under one prime contractor for projects atone federal agency collectively represented 91.7% of our outstanding accounts receivable, and which individually represented 72.4% and 19.3%, respectively.

COVID-19 Update

While we have not experienced a significant adverse impact on our business from the pandemic as ofMarch 31, 2022, the extent to which it will impact our business and operations will depend on future developments that are uncertain. We continue to monitor the impact of the COVID-19 pandemic on our customers, partners, employees and service providers.

Note 2. Revenue from Contracts with Customers

Revenue is recognized when all of the following steps have been taken and criteria met for each contract:

- ***Identification of the contract, or contracts, with a customer -*** A contract with a customer exists when (i) the Company enters into an enforceable contract with a customer that defines each party's rights regarding the goods or services to be transferred and identifies the payment terms related to these goods or services, (ii) the contract has commercial substance and the parties are committed to perform and, (iii) it determines that collection of substantially all consideration to which the Company will be entitled in exchange for goods or services that will be transferred is probable based on the customer's intent and ability to pay the promised consideration.

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

- ***Determination of the transaction price* -** The transaction price is determined based on the consideration to which the Company will be entitled in exchange for transferring goods or services to the customer adjusted for estimated variable consideration, if any. The Company typically estimates the transaction price impact of discounts offered to the customers for early payments on receivables or rebates based on sales target achievements. Constraints are applied when estimating variable considerations based on historical experience where applicable.

- ***Allocation of the transaction price to the performance obligations in the contract* -** If the contract contains a single performance obligation, the entire transaction price is allocated to the single performance obligation. Contracts that contain multiple performance obligations require an allocation of the transaction price to each performance obligation based on a relative standalone selling price basis. The Company determines standalone selling price by taking into account available information such as historical selling prices of the performance obligation, geographic location, overall strategic pricing objective, market conditions and internally approved pricing guidelines related to the performance obligations.

- ***Recognition of revenue when, or as, the Company satisfies performance obligations* -** The Company satisfies performance obligations either over time or at a point in time as discussed in further detail below. Revenue is recognized at or over the time the related performance obligation is satisfied by transferring a promised good or service to a customer.

Nature of Products and Services

We generate revenue from the sales of information technology professional services, sales ofthird-party software licenses and implementation and training services, sales of third-party support and maintenance contracts based on those software products, and incentive payments received fromthird-party software suppliers for facilitating sales directly between that supplier and a customer introduced by the Company. In addition, with the GMI acquisition, we expanded our offerings to include licensing and implementation services for proprietary blockchain based SCM software. We sell through our direct relationships with end customers and under subcontractor arrangements.

Professional services are offered through several arrangements – through time and materials arrangements, fixed-price-per-unit arrangements, fixed-price arrangements, or combinations of these arrangements within individual contracts. Revenue under time and materials arrangements is recognized over time in the period the hours are worked or the expenses are incurred, as control of the benefits of the work is deemed to have passed to the customer as the work is performed. Revenue under fixed-price-per-unit arrangements is recognized at a point in time when delivery of units has occurred and units are accepted by the customer or are reasonably expected to be accepted. Generally, revenue under fixed-price arrangements and mixed arrangements is recognized either over time or at a point in time based on the allocation of transaction pricing to each identified performance obligation as control of each is transferred to the customer. For fixed-price arrangements under which documentary evidence of acceptance or receipt of deliverables is not present or withheld by the customer, the Company recognizes revenue when it has the right to invoice the customer. For fixed-price arrangements for which the Company is paid a fixed fee to make itself available to support a customer, with no predetermined deliverables to which transaction prices can be estimated or allocated, revenue is recognized ratably over time.

Third-party software licenses are classified as enterprise server-based software licenses or desktop software licenses, and desktop licenses are further classified by the type of customer and whether the licenses are bulk licenses or individual licenses. The Company’s obligations as the seller for each class differ based on its reseller agreements and whether its customers are government or non-government customers. Revenue from enterprise server-based sales to either government or non-government customers is usually recognized in full at a point in time based on when the customer gains use of the full benefit of the licenses, after the licenses are implemented. If the transaction prices of the performance obligations related to implementation and customer support for the individual contract is material, these obligations are recognized separately over time, as performed. Revenue for desktop software licenses for government customers is usually recognized on a gross basis at a point in time, based on when the customer’s administrative contact gains training in and beneficial use of the administrative portal. Revenue for bulk desktop software licenses for non-government customers is usually recognized on a gross basis at a point in time, based on when the customer’s administrative contact gains training in and beneficial use of the administrative portal. For desktop software licenses sold on an individual license basis to non-government customers, where the Company has no obligation to the customer after the third-party makes delivery of the licenses, the Company has determined it is acting as an agent, and the Company recognizes revenue upon delivery of the licenses only for the net of the selling price and its contract costs.

Third-party support and maintenance contracts for enterprise server-based software include a performance obligation under the Company's reseller agreements for it to be the first line of support (direct support) and second line of support (intermediary between customer and manufacturer) to the customer. Because of the support performance obligations, and because the amount of support is not estimable, the Company recognizes revenue ratably over time as it makes itself available to provide the support.

Incentive payments are received under reseller agreements with software manufacturers and suppliers where the Company introduces and courts a customer, but the sale occurs directly between the customer and the supplier or between the customer and the manufacturer. Since the transfer of control of the licenses cannot be measured from outside of these transactions, revenue is recognized when payment from the manufacturer or supplier is received.

Disaggregation of Revenue from Contracts with Customers

	Three months ended March 31,			
	2022		2021	
Contract Type	Amount	Percentage	Amount	Percentage
Services time & materials	$ 1,912,996	64.0%	$ 1,966,129	57.5%
Services fixed price over time	51,154	1.7%	16,800	0.5%
Services combination	9,000	0.3%	409,870	12.0%
Services fixed price per unit	93,540	3.1%	46,460	1.4%
Third-party software	863,038	28.7%	920,695	26.9%
Software support & maintenance	49,169	1.6%	16,939	0.5%
Incentive payments	16,615	0.6%	42,687	1.2%
Total revenue	$ 2,995,512	100.0%	$ 3,419,580	100.0%

Contract Balances

Accounts Receivable

Trade accounts receivable are recorded at the billable amount where the Company has the unconditional right to bill, net of allowances for doubtful accounts. The allowance for doubtful accounts is based on the Company's assessment of the collectability of accounts. Management regularly reviews the adequacy of the allowance for doubtful accounts by considering the age of each outstanding invoice, each customer's expected ability to pay and collection history, when applicable, to determine whether a specific allowance is appropriate. Accounts receivable deemed uncollectible are charged against the allowance for doubtful accounts when identified. There were no such allowances recognized as of March 31, 2022 and December 31, 2021.

Accounts receivable as of March 31, 2022 and December 31, 2021, consist of the following:

	March 31, 2022	December 31, 2021
Billed federal government	$ 1,625,138	$ 1,594,473
Unbilled receivables	46,934	70,389
Accounts receivable	$ 1,672,072	$ 1,664,862

Billed receivables from the federal government include amounts due from both prime contracts and subcontracts where the federal government is the end customer.

Contract Assets

Contract assets consist of assets resulting when revenue recognized exceeds the amount billed or billable to the customer due to allocation of transaction price, and of amounts withheld from payment of invoices as a financing component of a contract. There were no amounts recorded to contract assets as of March 31, 2022 or December 31, 2021. Changes in contract assets balances in the three months ended March 31, 2021, were as follows:

Balance as of December 31, 2020	$	210,688
Contract assets added		131,943
Balance as of March 31, 2021	$	342,631

Contract Liabilities

Contract liabilities consist of amounts that have been invoiced and for which the Company has the right to bill, but that have not been recognized as revenue because the related goods or services have not been transferred. Changes in contracts liabilities balances in the three months ended March 31, 2022 and 2021, are as follows:

Balance as of December 31, 2021	$	186,835
Contract liabilities added		19,280
Revenue recognized		(56,423)
Balance as of March 31, 2022	$	149,692
Balance as of December 31, 2020	$	946,884
Contract liabilities added		93,934
Revenue recognized		(585,322)
Balance as of March 31, 2021	$	455,496

Revenues recognized during the three months ended March 31, 2022 and 2021, from the balances as of December 31, 2021 and 2020, were $56,423 and $492,494, respectively.

Costs to Obtain or Fulfill a Contract

When applicable, the Company recognizes an asset related to the costs incurred to obtain a contract only if it expects to recover those costs and it would not have incurred those costs if the contract had not been obtained. The Company recognizes an asset from the costs incurred to fulfill a contract if the costs (i) are specifically identifiable to a contract, (ii) enhance resources that will be used in satisfying performance obligations in future and (iii) are expected to be recovered. There were no such assets as of March 31, 2022, and December 31, 2021. When incurred, these costs are amortized ratably over the periods of the contracts to which those costs apply.

Deferred Costs of Revenue

Deferred costs of revenue consist of the costs of third-party support and maintenance contracts for enterprise server-based software. These costs are reported under the prepaid expenses and other current assets caption on the Company's condensed consolidated balance sheets. The Company recognizes these direct costs ratably over time as it makes itself available to provide its performance obligation for software support, commensurate with its recognition of revenue. Changes in deferred costs of revenue balances in the three months ended March 31, 2022 and 2021, are as follows:

Balance as of December 31, 2021	$	154,218
Deferred costs added		2,800
Deferred costs expensed		(55,362)
Balance as of March 31, 2022	$	101,656

Balance as of December 31, 2020	$	89,068
Deferred costs added		17,406
Deferred costs expensed		(75,223)
Balance as of March 31, 2021	$	31,251

Note 3. Leases

The Company has two significant operating leases, one for its headquarters offices in Fairfax, Virginia and one for additional office space in Annapolis, Maryland. The leases both commenced in 2021 and have original lease terms ranging from 37 to 67 months and rental rates escalate by approximately 2.5% annually under both leases. The Company determines if an arrangement is a lease at inception. Operating leases are included in right-of-use operating lease assets and operating lease liabilities in the Company's condensed consolidated balance sheets as of March 31, 2022 and December 31, 2021.

As of March 31, 2022 and December 31, 2021, the Company does not have any sales-type or direct financing leases.

The Company's operating lease asset represents its right to use an underlying asset for the lease term and lease liabilities represent its obligation to make lease payments arising from the lease. Operating lease assets and liabilities are recognized at the commencement date based on the present value of lease payments over the lease term. Since the lease does not provide an implicit rate, the Company uses its incremental borrowing rate based on the information available at commencement date in determining the present value of lease payments. The operating lease asset also includes any lease payments made and excludes lease incentives. Lease expense for lease payments is recognized on a straight-line basis over the lease term. The Company's lease agreement includes rental payments escalating annually for inflation at a fixed rate. These payments are included in the initial measurement of the operating lease liability and operating lease asset. The Company does not have any rental payments which are based on a change in an index or a rate that can be considered variable lease payments, which would be expensed as incurred.

The Company's lease agreements do not contain any material residual value guarantees or material restrictions or covenants.

The Company does not sublease any real estate to third parties.

As of March 31, 2022, our two operating leases had a weighted average remaining lease term of 42 months and a weighted average discount rate of 4.5%. Future lease payments under operating leases as of March 31, 2022 were as follows:

Remainder of 2022	$	168,042
2023		228,862
2024		174,721
2025		74,804
2026		70,220
Total lease payments		716,649
Less: discount		(64,016)
Present value of lease liabilities	$	652,633

The total expense incurred related to its operating leases was $56,414 and $26,122 for the three months ended March 31, 2022 and 2021, respectively, and is included in selling, general and administrative expenses on the condensed consolidated statements of operations.

Note 4. Fair Value Measurements

The Company defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value must maximize the use of observable inputs and minimize the use of unobservable inputs. The standard describes a fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value which are the following:

- Level 1—Quoted prices in active markets for identical assets or liabilities;

- Level 2—Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities; and
- Level 3—Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The following table represents the fair value hierarchy for the Company's financial instruments measured at fair value on a recurring basis as of March 31, 2022 and December 31, 2021:

	March 31, 2022			
	Level 1	Level 2	Level 3	Total
Cash equivalents:				
Money market funds	$ 151,231	$ -	$ -	$ 151,231
Other liabilities:				
Fair value of contingent consideration	$ -	$ -	$ 942,609	$ 942,609

	December 31, 2021			
	Level 1	Level 2	Level 3	Total
Cash equivalents:				
Money market funds	$ 1,600,663	$ -	$ -	$ 1,660,663
Other liabilities:				
Fair value of contingent consideration	$ -	$ -	$ 930,000	$ 930,000

The following table is a rollforward of the Level 3 fair value measurements.

Fair value of contingent consideration:	
December 31, 2021	$ 930,000
Change in fair value	12,609
March 31, 2022	$ 942,609

The change in fair value of contingent consideration is included in other income (expense) on the condensed consolidated statement of operations. There were no unrealized gains or losses included in income for the three months ended March 31, 2022.

Note 5. Acquisitions

Tellenger, Inc.

On April 7, 2021, the Company purchased all of the issued and outstanding shares of stock of Tellenger, Inc. ("Tellenger"). Tellenger is primarily engaged in providing professional services related to cybersecurity, cloud computing, and data analytics. Tellenger's customers include U.S. government agencies, either as a prime contractor or sub-contractor, as well as several national not-for-profit organizations. The purchase price of $2,515,357 was paid with $2,315,357 of cash and 68,264 shares of Company common shares valued at $200,000 as of the transaction closing date. The value of the shares was determined by the closing price as of the transaction date. Goodwill is attributable to human capital related intangible assets like the value of the acquired assembled workforce and strategic and enterprise related intangible assets including growth opportunities that are not reportable separately from goodwill. Goodwill also arises from recognizing deferred tax liabilities from intangible assets that are amortizable for financial reporting but not for income tax purposes. The transaction did not result in a step-up in tax basis and neither the intangible assets nor goodwill recorded for financial reporting purposes results in deductible amortization for tax purposes. The purchase price for Tellenger has been allocated as follows:

	Useful Lives (years)	Amounts	Valuation Methodology
Cash		$ 81,473	
Accounts receivable		611,471	
Other current assets		6,338	
Intangible assets with estimated useful lives:			
Customer relationships	8	1,090,000	Replacement cost and relief from royalty
Non-compete agreements	3	120,000	Multi-period excess earnings
Intangible assets with indefinite lives:			
Trade names		280,000	
Goodwill		785,000	
Total assets acquired		2,974,282	
Current liabilities		(458,925)	
Net assets acquired		$ 2,515,357	

Gray Matters, Inc.

On December 10, 2021, the Company purchased all the issued and outstanding shares of Gray Matters, Inc. ("GMI" or "Gray Matters"). GMI provides supply chain management software designed to aggregate customer data into a single, interconnected, blockchain secured framework. The purchase price of $11,005,100 comprises the following:

Net cash consideration	$	7,240,100
Buyer common stock		1,500,000
Fair value of deferred consideration		1,335,000
Fair value of contingent consideration		930,000
Total	$	11,005,100

Common stock consideration consisted of 436,481 shares of WaveDancer common stock valued at $1,500,000 as of the transaction closing date. The deferred consideration of $1,335,000 is the estimated present value as of the closing date of the $1,500,000 cash payment due to the selling shareholder of GMI (the "Seller") on the second anniversary of the acquisition. We applied a discount rate of 6% reflecting our recent secured borrowing rate adjusted to include a premium for the unsecured status of the deferred consideration liability. Accretion of the liability will be recorded as interest expense. For the three months ended March 31, 2022, we recorded $19,319 of interest expense. Contingent consideration has been estimated using a probability weighted average of possible outcomes, discounted to its net present value as of the acquisition date. We identified the set of possible outcomes and assigned probabilities to each by applying management judgment to the assumptions underlying the projections of 2022 revenue and gross profit. Under the terms of the purchase agreement, the Seller is eligible to receive from zero up to $4,000,000 of additional consideration, payable in cash, based on the amounts of revenue and gross profit achieved by GMI during the period from the acquisition date through December 31, 2022. We estimated that the outcomes to apply a probability weighting to range from $500,000 to $1,500,000, with an outcome of $1,000,000 given the highest probability weighting. The undiscounted probability weighted outcome was determined to be $1,000,000 and was discounted back to its present value of $930,000 as of December 31, 2021. We applied a discount rate of 6% reflecting our recent secured borrowing rate adjusted to include a premium for the unsecured status of the contingent consideration liability. The contingent consideration liability will be remeasured at fair value at the end of each reporting period and reported in the consolidated statements of operations until the liability is settled. We remeasured the contingent consideration liability as of March 31, 2022 and determined the undiscounted probability weighted outcome remains $1,000,000. We have calculated a final adjustment to net working capital due from the Seller, who is now an executive of WaveDancer, in the amount of $58,681 and have reflected that amount in other assets on the consolidated balance sheets as of March 31, 2022 and December 31, 2021.

On May 12, 2022, the Company and Seller agreed to extend the settlement dates for the contingent consideration liability and the final adjustment to net working capital to December 10, 2023, which coincides with the due date of the deferred consideration. The deferred consideration and contingent consideration liabilities are classified as other liabilities on the condensed consolidated balance sheets and total $2,296,928 and $2,265,000 as of March 31, 2022 and December 31, 2021.

Goodwill is attributable to human capital related intangible assets like the value of the acquired assembled workforce and strategic and enterprise related intangible assets including growth opportunities that are not reportable separately from goodwill. Goodwill also arises from recognizing deferred tax liabilities from recording in the purchase accounting intangible assets that are amortizable for financial reporting but not for income tax purposes. The transaction did not result in a step-up in tax basis and the Company will carry over the legacy tax basis of $0 for all intangibles. Neither the intangible assets nor goodwill recorded for financial reporting purposes will generate deductible amortization for tax purposes.

The purchase price for GMI has been allocated as follows:

	Useful Lives (years)	Amounts	Valuation Methodology
Cash		$ 20,235	
Fixed assets		8,902	
Intangible assets with estimated useful lives:			
Technology	5	2,900,000	Replacement cost and relief from royalty
Customer relationships	6	3,860,000	Multi-period excess earnings
Goodwill		4,560,099	
Total assets acquired		11,349,236	
Current liabilities		(344,136)	
Net assets acquired		$ 11,005,100	

Supplemental Combined Pro Forma Information

The following unaudited pro forma financial information presents combined results of operations for the periods presented as if the acquisitions of both Tellenger and Gray Matters had been completed on January 1, 2020. The pro forma information includes adjustments to amortization expense for the intangible assets acquired and interest expense for the additional debt used to partially fund the Tellenger acquisition.

The pro forma data are for informational purposes only and arenot necessarily indicative of the consolidated results of operations of the combined business had the acquisitions of both Tellenger and Gray Matters occurred on January 1, 2020, or the results of future operations of the combined business. For instance, planned or expected operational synergies following the acquisition are not reflected in the pro forma information. Consequently, actual results will differ from the unaudited pro forma information presented below.

	For the three months ended March 31,	
	2022	2021
Revenues	$ 2,995,512	$ 4,577,405
Net (loss) income	$ (2,078,307)	$ (577,394)

Note 6. Goodwill and Intangible Assets

Information regarding our intangible assets and goodwill is as follows:

	Weighted Average Useful Life (Years)	December 31, 2021	Additions	March 31, 2022
Intangible assets with estimated useful lives				
Technology	5.0	$ 2,900,000	$ -	$ 2,900,000
Customer relationships	6.4	4,950,000	-	4,950,000
Non-compete agreements	3.0	120,000	-	120,000
Accumulated amortization		(201,032)	(349,893)	(550,925)
Sub-total		7,768,968	(349,893)	7,419,075
Intangible assets with indefinite lives				
Trade names	Indefinite	280,000	-	280,000
Net identifiable intangible assets		$ 8,048,968	$ (349,893)	$ 7,699,075
Goodwill	Indefinite	$ 7,585,269	$ -	$ 7,585,269

There was no impairment charge to intangible assets or goodwill for the three months ended March 31, 2022. There were no intangible assets or goodwill recorded as of December 31, 2020 or March 31, 2021.

As of March 31, 2022, expected amortization expense relating to purchased intangible assets for each of the next five years and thereafter is as follows:

Remainder of 2022	$ 1,049,679
2023	1,399,572
2024	1,369,635
2025	1,359,576
2026	1,326,854
Thereafter	913,759
Total	$ 7,419,075

Note 7. Stock-Based Compensation

We have three stock-based compensation plans. The 2006 Stock Incentive Plan was adopted in 2006 ("2006 Plan") and had options granted under it through April 12, 2016. The 2016 Stock Incentive Plan was adopted in 2016 ("2016 Plan") and had options granted under it through November 15, 2021. On October 11, 2021, the Board of Directors approved the 2021 Stock Incentive Plan ("2021 Plan") and on December 2, 2021, our shareholders approved the plan.

The Company recognizes compensation costs only for those shares expected to vest on a straight-line basis over the requisite service period of the awards. Fair values of option awards granted in the three months ended March 31, 2022 and 2021, were estimated using the Black-Scholes option pricing model under the following assumptions:

	Three months ended March 31, 2022	Three months ended March 31, 2021
Risk-free interest rate	1.91% - 2.41%	0.46% - 0.92%
Dividend yield	0%	0%
Expected term (years)	5.75 - 6.00	5.00
Expected volatility	45.8% - 46.1%	92.6% - 93.8%

Determining the assumptions for the expected term and volatility requires management to exercise significant judgement. The expected term represents the weighted-average period that options granted are expected to be outstanding giving consideration to vesting schedules. Since the Company does not have an extended history of actual exercises, the Company has estimated the expected term using a simplified method which calculates the expected term as the average of the time-to-vesting and the contractual life of the awards. Given the limited public market for the Company's stock, the Company has elected to estimate its expected volatility by benchmarking its volatility to that of several public company issuers that operate within its market segment. The guideline companies' volatility was increased by a size adjustment premium to compensate for the difference in size between the guideline companies and the Company in its calculation. The first issuance for which this benchmarking was applied was effective with options granted on March 31, 2021.

There were 912,000 options with grant date fair values totaling $2,074,670 and 145,000 options with grant date fair values totaling $176,900 granted during the three months ended March 31, 2022, and 2021, respectively. There were 105,000 options and no options exercised during the three months ended March 31, 2022, and 2021, respectively. As of March 31, 2022, there was $2,966,854 of total unrecognized compensation cost related to nonvested share-based compensation arrangements granted under the stock incentive plans; that cost is expected to be recognized over a weighted-average period of 11 months.

Total compensation expense related to these plans was $312,176 and $27,711 for the three months ended March 31, 2022, and 2021, respectively and is included in selling, general and administrative expenses on the condensed consolidated statements of operations.

Note 8. Revolving Line of Credit and Notes Payable

On April 16, 2021, the Company entered into a revolving line of credit with Summit Community Bank ("Summit") that provides for on-demand or short-term borrowings of up to $1,000,000 at a variable interest rate equal to the greater of 3.25% or the prime rate as published in *The Wall Street Journal*, and subject to a borrowing base calculated using outstanding accounts receivable. Borrowings under the line of credit are secured by the assets of the Company. The line expired on April 16, 2022. As of March 31, 2022 and December 31 2021, there was no outstanding balance under this line of credit and there were no borrowings or repayments during the three months ended March 31, 2022.

The Company previously had a revolving line of credit with another bank ("prior LOC") providing for demand or short-term borrowings of up to $1,000,000 at an interest rate of the greater of 4.0% or LIBOR +3.5%. The prior LOC originally was due to expire on July 31, 2021 and was secured by the assets of the Company. The Summit line of credit was used to pay off the prior LOC and it was closed on May 3, 2021.

On April 16, 2021, we entered into a $1 million term loan agreement with Summit Community Bank. The term of the loan was two years with monthly installments comprising a fixed principal amount plus interest accruing at a fixed rate of 4.89%. The loan was collateralized by a security interest in substantially all the assets of the Company. On December 30, 2021, we fully repaid the outstanding balance of the loan.

To provide additional net working capital support, the Company borrowed $150,000 from the sellers of Tellenger for a period of 90 days from the closing date of April 7, 2021, without interest accumulation. The sellers were repaid in July 2021.

Note 9. Private Offerings of Common Stock

In March 2021, the Company sold 330,666 unregistered shares of its common stock in a private offering at a price of $1.50 per share from which it raised aggregate gross proceeds of $495,999.

On August 26, 2021, the Company sold 1,400,000 units at a price of $2.00 per unit, each unit consisting of one unregistered share of common stock and one warrant exercisable at $3.00 for one share of common stock, in a private offering from which it raised aggregate gross proceeds of $2,800,000. The warrants expire on August 31, 2026. 1,400,000 shares of common stock issuable upon exercise of warrants in connection with the offering have been reserved for issuance. The warrants are classified as equity.

On December 10, 2021, the Company sold 3,289,526 units at a price of $3.04 in a private offering from which it raised $10,000,000 resulting in the issuance of a like number of shares of common stock and Series A warrants exercisable for 657,933 shares of common stock. The warrants are exercisable at a price of $4.50 per share, with the warrants exercisable from January 1, 2023 through December 31, 2026. If the shares underlying the warrants are not registered when the warrants become exercisable, the warrants can be exercised on a cashless basis. The warrants are subject to mandatory exercise if, commencing January 1, 2024, the volume weighted average price per share for 10 consecutive trading days equals or exceeds $12.50. The warrants are classified as equity.

The total offering costs associated with the sales of unregistered shares of common stock in 2021 were not material.

Note 10. Income Taxes

During the three-month period ended March 31, 2022, the Company's effective tax rate was 25.89%. The Company records income taxes using an estimated annual effective tax rate for interim reporting. The primary factors contributing to the difference between the federal statutory rate and the Company's effective tax rate for the three-month period ended March 31, 2022 were state taxes and permanent items. During the three-month period ended March 31, 2021, the Company's effective tax rate was 0%. The primary factors contributing to the difference between the statutory tax rate and the effective tax rate for the quarter ended March 31, 2021, is primarily driven by the presence of a full valuation allowance in all jurisdictions.

Note 11. (Loss) Income Per Share

Basic loss per share excludes dilution and is computed by dividing loss available to common shareholders by the weighted-average number of shares outstanding for the period. Diluted earnings (loss) per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock, except for periods when the Company reports a net loss because the inclusion of such items would be antidilutive. The antidilutive effect of 778,196 shares from stock options and 530,435 shares from warrants were excluded from diluted shares for the three months ended March 31, 2022. The dilutive effect of outstanding options and warrants is reflected in earnings per share by use of the treasury stock method. No shares were excluded from diluted shares for the three months ended March 31, 2021.

The following is a reconciliation of the amounts used in calculating basic and diluted net (loss) income per common share:

	2022	2021
Net (loss) income	$ (2,078,307)	$ 270,815
Basic weighted average shares outstanding	17,294,808	11,282,671
Dilutive effect of warrants and/or options	-	1,003,545
Diluted weighted average shares outstanding	17,294,808	12,286,216
Basic (loss)/earnings per share	$ (0.12)	$ 0.02
Diluted (loss)/earnings per share	$ (0.12)	$ 0.02

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

Cautionary Statement Regarding Forward-Looking Statements

This Form 10-Q contains forward-looking statements regarding our business, customer prospects, or other factors that may affect future earnings or financial results that are subject to the safe harbor created by the Private Securities Litigation Reform Act of 1995. Such statements involve risks and uncertainties which could cause actual results to vary materially from those expressed in the forward-looking statements. Investors should read and understand the risk factors detailed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2021 (“Annual Report”) and in other filings with the Securities and Exchange Commission.

We operate in a rapidly changing environment that involves a number of risks, some of which are beyond our control. This list highlights some of the risks which may affect future operating results. These are the risks and uncertainties we believe are most important for you to consider. Additional risks and uncertainties, not presently known to us, which we currently deem immaterial, or which are similar to those faced by other companies in our industry or business in general, may also impair our business operations. If any of the following risks or uncertainties actually occurs, our business, financial condition and operating results would likely suffer. These risks include, among others, the following:

- Our business is subject to risks related to our pending acquisition of Knowmadics, Inc. which is subject to shareholder approval as of the date of this filing.
- Our business is subject to risks related to our acquisition of Gray Matters, Inc.
- Recent, past and future acquisitions and investments could disrupt our business and harm our financial condition and operating results.
- Our business is subject to risks related to the COVID-19 pandemic and the conflict in Ukraine.
- Our operating history and recent and proposed changes to our business model make it difficult to evaluate our current business and prospects and may increase the risk that we will not be successful.
- We have had operating losses in three of each of the last four years and may not achieve or maintain profitability in the future.
- If the cybersecurity, Internet of Things (“IoT”), enterprise resource planning (“ERP”), command and control (“C2”), or supply chain management (“SCM”) markets are not receptive to our solutions, our sales will not grow as quickly as anticipated, or at all, and our business, results of operations and financial condition would be harmed.
- A portion of our revenue is expected to be generated by sales to government entities, which are subject to a number of challenges and risks.
- We face intense competition and could lose market share to our competitors, which could adversely affect our business, financial condition, and results of operations.
- We rely on our management team and other key employees and will need additional personnel to grow our business, and the loss of one or more key employees or our inability to hire, integrate, train and retain qualified personnel, including members for our board of directors, could harm our business.
- Our business is subject to risks related to the use of blockchain and distributed ledger technology.
- We are dependent on a few key customer contracts for a significant portion of our future revenue, and a significant reduction in services to one or more of these contracts would reduce our future revenue and harm our anticipated operating results.
- Our proprietary rights may be difficult to enforce or protect, which could enable others to copy or use aspects of our products or subscriptions without compensating us.
- Our use of open-source software in our products and subscriptions could negatively affect our ability to sell our products and subscriptions and subject us to possible litigation.
- We are dependent on information technology, and disruptions, failures or security breaches of our information technology infrastructure could have a material adverse effect on our operations.
- We depend on computing infrastructure operated by Amazon Web Services (“AWS”), Microsoft, and other third parties to support some of our solutions and customers, and any errors, disruption, performance problems, or failure in their or our operational infrastructure could adversely affect our business, financial condition, and results of operations.
- Failure to comply with governmental laws and regulations could harm our business.
- We are subject to risks associated with our strategic investments, and impairments in the value of our investments could negatively impact our financial results.

- Our failure to raise additional capital or generate the significant capital necessary to expand our operations and invest in new products and subscriptions could reduce our ability to compete and could harm our business.

- The requirements of being a public company may strain our resources, divert management's attention, and affect our ability to attract and retain qualified board members.

- If we are not able to maintain and enhance our brand and our reputation as a provider of high-quality security solutions and services, our business and results of operations may be adversely affected.

In some cases, you can identify forward-looking statements by terms such as "may," "will," "should," "could," "would," "expect," "plans," "anticipates," "believes," "estimates," "projects," "predicts," "intends," "potential" and similar expressions intended to identify forward-looking statements. These statements reflect our current views with respect to future events and are based on assumptions and subject to risks and uncertainties. Given these uncertainties, you should not place undue reliance on these forward-looking statements. We discuss many of these risks in greater detail under the heading "Risk Factors" in Item 1A of our 2021 10-K. Also, these forward-looking statements represent our estimates and assumptions only as of the date of this report. Except as required by law, we assume no obligation to update any forward-looking statements after the date of this report.

Our Business

Founded in 1979 as Information Analysis Incorporated, the Company changed its name to WaveDancer, Inc. and converted from a Virginia corporation to a Delaware corporation in December 2021. The Company is in the business of developing and maintaining information technology ("IT") systems, modernizing client information systems, and performing other IT-related professional services to government and commercial organizations.

The Company is an IT provider primarily for the benefit of federal government agencies. At present, we primarily apply our technology, services and experience to legacy software migration and modernization, developing web-based and mobile device solutions, including dynamic electronic forms development and conversion, data analytics, and we are in the process of acquiring talent and expertise in developing cybersecurity and cloud services practices. Our focus is on enterprise IT solutions primarily relating to system modernization, cloud-based solutions and cybersecurity protection.

Since the Company's inception, we have performed software development and conversion projects for over 100 commercial and government customers including, but not limited to, the Department of Agriculture, Department of Defense, Department of Education, Department of Homeland Security, Department of the Treasury, U.S. Small Business Administration, U.S. Army, U.S. Air Force, Department of Veterans Affairs, and General Dynamics Information Technology (formerly Computer Sciences Corporation, CSRA).

Modernization has been a core competency of the Company for over 20 years. We have modernized over 100 million lines of COBOL code for over 35 governmental and commercial customers. We maintain a pool of skilled COBOL programmers. This provides us with competitive advantage as the labor pool of such programmers is shrinking as aging software professionals retire. Our business has also historically relied upon the reselling of applications, primarily for forms development.

Through our acquisition in April 2021 of Tellenger, Inc. ("Tellenger"), which is now a wholly-owned subsidiary of the Company, we acquired competencies in web-based solutions and cybersecurity. Tellenger is a boutique IT consulting and software development firm specializing in modernization, software development, cybersecurity, cloud solutions, and data analytics. We believe combining web-based solutions with system modernization will provide us with the skill sets that are needed to migrate legacy systems to the cloud. We foresee this as a key component of our modernization growth since there are billions of lines of code, in both the governmental and commercial sectors, that eventually must be modernized. It is also our intention to better leverage our resources, largely gained through the acquisition of Tellenger, to take advantage of the growth in the cybersecurity market.

In December 2021, we announced the reorganization of our entire professional services practice into Tellenger, and as a result, our professional services are contained in a single entity. Through Tellenger, we perform services such as business process re-engineering, cloud migrations, and Software-as-a-Service ("SaaS") implementations on behalf of clients in the private and public sector with an aim to increase productivity, gain efficiencies, and achieve key performance indicators. Tellenger is appraised at Capability Maturity Model Integration (CMMI) Level 3.

Through our acquisition of Gray Matters, Inc. and in connection with our business transformation strategy which we discuss below, in December 2021 we gained access to blockchain and encryption algorithm technology. Gray Matters specializes in the supply chain management ("SCM") industry and in United States intelligence, national security and diplomatic organizations. Gray Matters uses a "Zero Trust" product and is designed to secure and monitor the lifecycle of manufacturing through destruction and recycling.

We refer to the products and services offered by Tellenger and WaveDancer prior to the acquisition of GMI as "Legacy IAI".

Our Strategy

Our strategy is to grow our business organically as well as through acquisitions.

Through the acquisitions of Tellenger and Gray Matters in 2021, we began to reposition our legacy professional services business by allocating resources away from third-party product reselling and toward professional services, which management viewed as higher margin, including within the SCM sector. In assessing the Company's repositioning, management observed cybersecurity practices as evolving toward a zero-trust approach, the integration of blockchain as enhancing SCM, and the proliferation of Internet of Things ("IoT") devices that were taking organizational networks to the edge. With respect to its focus on IoT, on March 18, 2022 the Company agreed to acquire Knowmadics, Inc. ("Knowmadics"). The acquisition remains subject to stockholder approval of share issuances contemplated under the definitive purchase agreement and our obtaining financing to fund the purchase price under the agreement. Additionally, we have been seeking to purchase other technology companies whose businesses complement the Company's existing business and whose personnel would better enable us to compete for engagements in our focus areas.

To grow organically, we have hired and plan to continue to hire, business development personnel and intend to become more proactive in bidding as a prime contractor on government proposals and in expanding our outreach to larger prime contractors for subcontract and teaming opportunities.

Results of Operations

Three Months Ended March 31, 2022 versus Three Months Ended March 31, 2021

Revenue

Total revenue was $2,995,512 for the three months ended March 31, 2022, compared with $3,419,580 in the prior year quarter, a decrease of $424,068, or 12.4%. The decrease consists of: 1) professional services decrease of $372,569 including a decrease of $1,058,515 from Legacy IAI before the Tellenger acquisition, partially offset by $685,949 of revenue generated by the contracts from the Tellenger acquisition; and 2) third-party software sales decrease of $51,499. The decline in revenue for Legacy IAI before the Tellenger acquisition has three main drivers: 1) one contract for which the 2021 first quarter included significant levels of overtime in connection with meeting an accelerated milestone, while in the 2022 quarter we did not devote overtime resources to the project ($556 thousand); 2) one contract that has transitioned to a maintenance phase where in 2021 we had revenues associated with systems conversion ($329 thousand); and 3) one contract that ended in 2021 ($227 thousand).

Gross Profit

Gross profit decreased by $643,585 or 63.1%, to $376,065, in the first quarter of 2022 as compared to the first quarter of 2021. This year over year gross profit decrease comprises the following elements: 1) core professional services business of $269,132; 2) third-party software sales of approximately $26,700; and 3) approximately $347,753 of costs for a contract for which we were unable to recognize revenue during the quarter. The decrease related to our core professional services business was driven primarily by the comparable 2021 period including significant levels of overtime in connection with meeting an accelerated milestone while in the 2022 quarter we did not devote overtime resources to the project. The reduction of gross profit from expiring or reduced contracts in Legacy IAI before the Tellenger acquisition were mostly offset by the addition of gross profits generated by the contracts from the Tellenger acquisition. For the contract for which we did not recognize revenue in the quarter, we anticipate that we will recognize revenue in both the second and third quarters of 2022 that will be directly related to the costs incurred in the first quarter this year.

Selling, General and Administrative Expenses

SG&A expenses have increased significantly since the second half of 2021 when we began to implement the transformative strategy described in the *Our Strategy* section above and in the Annual Report. The following table shows the major elements of SG&A expenses for the three months ended March 31, 2022 and 2021 and the increases between quarters:

	2022	2021	Increase
Legal and professional fees	$ 624,763	$ 78,981	$ 545,782
Personnel costs	969,388	460,851	508,537
Intangibles amortization	349,893	-	349,893
Stock-based compensation	312,176	27,711	284,465
Governance and investor relations	161,687	33,932	127,755
IT and office expenses	143,019	48,305	94,714
Marketing expenses	49,041	5,155	43,886
All other	104,375	25,315	79,060
	$ 2,714,342	$ 680,250	$ 2,034,092

Acquisition Costs

We incurred expenses totaling $434,702 in the first quarter of 2022 primarily related to the pending acquisition of Knowmadics. These expenses include legal and other fees to conduct due diligence and to negotiate and draft legal documents.

Income (Loss) from Operations

Loss from operations was $2,772,979 in the first quarter of 2022 compared to income from operations of $268,870 in 2021, a difference of $3,041,849. The decrease in income from operations is the result of the decrease in gross profit of $643,585 and the increase in SG&A expenses and acquisition costs totaling $2,398,264, as discussed above.

Liquidity and Capital Resources

As of March 31, 2022, we had $3.0 million of cash on hand consisting of bank deposits and money market funds. Our business is not fixed asset intensive, and we have no commitments for capital expenditures. We have two office leases with lease commitments totaling $0.2 million for the next twelve months and $0.5 million during the remainder of their terms which end in 2024 and 2026. In connection with the acquisition, we are required to pay the seller of Gray Matters (the "Seller") $1.5 million in December 2023. Also, the Seller is entitled to additional consideration of up to $4 million contingent on the performance of Gray Matters for the year ending December 31, 2022. Our balance sheet as of March 31, 2022 reflects an estimated $1 million for that contingent liability. The settlement of that contingent liability which was originally due by approximately April 30, 2023 has been adjusted, by agreement between the Company and Seller, to December 2023, to coincide with the payment date of the deferred consideration due to the Seller.

To meet our liquidity commitments and continue to execute our strategy for the next twelve months and beyond, assuming we consummate the acquisition of Knowmadics, we intend to use a combination of cash on hand, the ability of Legacy IAI, Gray Matters and Knowmadics to generate cash from operations, and approximately $7.0 million from the approximately $66.5 million we intend to raise in connection with the pending Knowmadics acquisition, of which no assurance can be provided. See "*—Impact of Acquisitions and Transformation of Our Business*" in our Annual Report for more information on the pending Knowmadics acquisition and the funds we intend to raise in connection therewith.

To meet our liquidity commitments and continue to execute our strategy through the end of 2022 and beyond, if we do not consummate the acquisition of Knowmadics, we intend to use a combination of cash on hand, cash generated from the operations of Legacy IAI and Gray Matters, and we will reduce our operating expense cost structure to align with this scenario which will provide additional operating cash flow.

Based on our current cash position and operating plan, we anticipate that we will be able to meet our cash requirements for at least one year from the filing date of this Quarterly Report on Form 10-Q.

We have no off-balance-sheet arrangements that have or are likely to have a material current or future effect on our financial condition, or changes in financial condition, liquidity or capital resources or expenditures.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

Our management, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, and people performing similar functions, has evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act), as of March 31, 2022 (the "Evaluation Date"). Based upon this evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of the Evaluation Date, our disclosure controls and procedures are effective to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act (i) is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and (ii) is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

Changes in Internal Controls over Financial Reporting

There were no changes in the Company's internal control over financial reporting during the quarter ended March 31, 2022, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Inherent Limitations on Effectiveness of Controls

Because of the inherent limitations in all control systems, no control system can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected. These inherent limitations include the realities that judgments in decision making can be faulty and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of a person, by collusion of two or more people or by management override of the control. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and may not be detected. Notwithstanding these limitations, we believe that our disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

None.

Item 1A. Risk Factors

"Item 1A. Risk Factors" of our annual report on Form 10-K for the year ended December 31, 2021, as amended, includes a discussion of our risk factors. There have been no material changes from the risk factors described in our annual report on Form 10-K for the year ended December 31, 2021.

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

We had no sales of unregistered securities in the quarter ended March 31, 2022.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Item 6. Exhibits

10.1	Stock and Warrant Purchase Agreement dated as of March 18, 2022, by and among, in addition to the Company, the holders of the outstanding shares of common stock and warrants of Knowmadics, Inc., and Knowmadics, Inc.	Incorporated by reference from the Registrant's Form 8-K filed March 24, 2022
10.2	Executive employment agreement between the Company and Timothy G. Hannon. dated March 22, 2022	Incorporated by reference from the Registrant's Form 8-K filed March 24, 2022
31.1	Certification of Chief Executive Officer Pursuant to Rules 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934	Filed with this Form 10-Q
31.2	Certification of Chief Financial Officer Pursuant to Rules 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934	Filed with this Form 10-Q
32.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	Filed with this Form 10-Q
32.2	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	Filed with this Form 10-Q
101.INS	XBRL Instance Document	Filed with this Form 10-Q
101.SCH	XBRL Taxonomy Extension Schema	
101.CAL	XBRL Taxonomy Extension Calculation Linkbase	
101.DEF	XBRL Taxonomy Extension Definition Linkbase	
101.LAB	XBRL Taxonomy Extension Label Linkbase	
101.PRE	XBRL Taxonomy Extension Presentation Linkbase	
104	Cover Page Interactive Data File (embedded within the Inline XBRL and contained in Exhibit 101)	

SIGNATURES

In accordance with the requirements of the Exchange Act of 1934, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

WaveDancer, Inc.
(Registrant)

Date: May 16, 2022 By: /s/ G. James Benoit, Jr.
G. James Benoit,
Chief Executive Officer

Date: May 16, 2022 By: /s/ Timothy G. Hannon
Timothy G. Hannon,
Chief Financial Officer

Exhibit 31.1

CERTIFICATION of Chief Executive Officer Pursuant to Rules 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934

I, G. James Benoit, certify that:

1. I have reviewed this quarterly report on Form 10-Q of WaveDancer, 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.

Date:	May 16, 2022	By:	/s/ G. James Benoit, Jr.
			G. James Benoit
			Chief Executive Officer

A signed original of this written statement required by Section 302 has been provided to WaveDancer, Inc. and will be retained by WaveDancer, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

Exhibit 31.2

CERTIFICATION of Chief Financial Officer Pursuant to Rules 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934

I, Timothy G. Hannon, certify that:

1. I have reviewed this quarterly report on Form 10-Q of WaveDancer, 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.

Date: May 16, 2022

By: /s/ Timothy G. Hannon
Timothy G. Hannon
Chief Financial Officer

A signed original of this written statement required by Section 302 has been provided to WaveDancer, Inc. and will be retained by WaveDancer, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

Exhibit 32.1

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO SECTION 906
OF THE SARBANES-OXLEY ACT OF 2002

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code), I, G. James Benoit, Chief Executive Officer of WaveDancer, Inc., a Delaware corporation (the "Company"), do hereby certify, to the best of my knowledge, that:

1 the Company's Quarterly Report on Form 10-Q for the period ended March 31, 2022, as filed with the Securities and Exchange Commission on the date hereof, (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 result of operations of the Company for the periods presented therein.

Date: May 16, 2022

By: /s/ G. James Benoit, Jr.
G. James Benoit
Chief Executive Officer

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

Exhibit 32.2

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO SECTION 906
OF THE SARBANES-OXLEY ACT OF 2002

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code), I, Timothy G. Hannon, Chief Financial Officer of WaveDancer, Inc., a Delaware corporation (the “Company”), do hereby certify, to the best of my knowledge, that:

1 the Company's Quarterly Report on Form 10-Q for the period ended March 31, 2022, as filed with the Securities and Exchange Commission on the date hereof, (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 result of operations of the Company for the periods presented therein.

Date: May 16, 2022

By: /s/ Timothy G. Hannon
Timothy G. Hannon
Chief Financial Officer

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