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

FORM 10-Q

☑ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2022
Or
☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission File Number 001-41092

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)

Registrant's telephone number, including area code: (703) 383-3000

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

Title of each class	Trading Symbol	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, a 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 Exchange Act).

Yes ☐ No ☑

Number of shares outstanding by each class of common stock, as of November 7, 2022:

Common Stock, $0.001 par value – 19,165,548 shares outstanding

This document is also available through our website at http://ir.wavedancer.com/.

WAVEDANCER, INC.
FORM 10-Q

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

WAVEDANCER, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

	September 30, 2022	December 31, 2021
ASSETS		
Current assets		
Cash and cash equivalents	$ 1,521,651	$ 4,931,302
Accounts receivable	1,532,174	1,664,862
Prepaid expenses and other current assets	302,443	276,990
Total current assets	3,356,268	6,873,154
Intangible assets, net of accumulated amortization of $1,250,711 and $201,032	6,999,289	8,048,968
Goodwill	5,330,645	7,585,269
Right-of-use operating lease asset	536,455	672,896
Property and equipment, net of accumulated depreciation and amortization of $381,473 and $347,886	305,729	105,256
Other assets	79,305	77,100
Total assets	$ 16,607,691	$ 23,362,643
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	$ 227,560	$ 650,499
Accrued payroll and related liabilities	701,652	524,055
Commissions payable	225,096	224,250
Other accrued liabilities	680,269	204,080
Contract liabilities	37,686	186,835
Operating lease liability - current	203,342	192,128
Total current liabilities	2,075,605	1,981,847
Operating lease liability - non-current	353,486	507,120
Deferred tax liabilities, net	154,252	1,167,504
Other liabilities	1,394,467	2,265,000
Total liabilities	3,977,810	5,921,471
Stockholders' equity		
Common stock, $0.001 par value 100,000,000 shares authorized; 20,808,654 and 18,882,313 shares issued, 19,135,603 and 17,239,697 shares outstanding as of September 30, 2022 and December 31, 2021, respectively	20,809	18,882
Additional paid-in capital	35,315,514	31,789,464
Accumulated deficit	(21,741,231)	(13,436,963)
Treasury stock, 1,673,051 and 1,642,616 shares at cost, as of September 30, 2022 and December 31, 2021, respectively	(965,211)	(930,211)
Total stockholders' equity	12,629,881	17,441,172
Total liabilities and stockholders' equity	$ 16,607,691	$ 23,362,643

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

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

	Three months ended September 30, 2022	2021
Revenues		
Professional fees	$ 2,114,012	$ 2,798,105
Software sales	192,367	1,501,820
Total revenues	2,306,379	4,299,925
Cost of revenues		
Cost of professional fees	1,724,040	1,832,812
Cost of software sales	100,717	1,488,238
Total cost of revenues, excluding depreciation and amortization	1,824,757	3,321,050
Gross profit	481,622	978,875
Selling, general and administrative expenses	2,926,243	1,023,897
Acquisition costs	38,617	39,245
Goodwill impairment	2,254,624	-
Loss from operations	(4,737,862)	(84,267)
Other income (expense)		
Interest expense	(20,437)	(15,055)
Other income, net	3,188	3,795
Loss before provision for income taxes	(4,755,111)	(95,527)
Deferred income tax benefit	54,592	-
Net loss	$ (4,700,519)	$ (95,527)
Comprehensive loss	$ (4,700,519)	$ (95,527)
Net loss per common share - basic	$ (0.26)	$ (0.01)
Net loss per common share - diluted	$ (0.26)	$ (0.01)
Weighted average common shares outstanding		
Basic	18,382,131	12,596,126
Diluted	18,382,131	12,596,126

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

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

	Nine months ended September 30,	
	2022	2021
Revenues		
Professional fees	$ 7,025,396	$ 8,565,639
Software sales	2,593,877	3,885,828
Total revenues	9,619,273	12,451,467
Cost of revenues		
Cost of professional fees	5,401,666	5,698,407
Cost of software sales	2,430,139	3,798,607
Total cost of revenues, excluding depreciation and amortization	7,831,805	9,497,014
Gross profit	1,787,468	2,954,453
Selling, general and administrative expenses	8,880,973	2,523,340
Acquisition costs	829,478	192,530
Change in fair value of contingent consideration	(930,000)	-
Goodwill impairment	2,254,624	-
(Loss) income from operations	(9,247,607)	238,583
Other income (expense)		
Interest expense	(59,574)	(31,738)
Other income, net	3,977	11,600
(Loss) income before provision for income taxes	(9,303,204)	218,445
Deferred income tax benefit	998,936	-
Net (loss) income	$ (8,304,268)	$ 218,445
Comprehensive (loss) income	$ (8,304,268)	$ 218,445
Net (loss) income per common share - basic	$ (0.47)	$ 0.02
Net (loss) income per common share - diluted	$ (0.47)	$ 0.02
Weighted average common shares outstanding		
Basic	17,688,528	11,957,878
Diluted	17,688,528	12,584,914

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

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

	Nine months ended September 30, 2022	Nine months ended September 30, 2021
Cash flows from operating activities		
Net (loss) income	$ (8,304,268)	$ 218,445
Adjustments to reconcile net (loss) income to net cash used in operating activities:		
Depreciation and amortization	1,083,266	111,123
Goodwill impairment	2,254,624	-
Stock-based compensation	1,455,835	220,455
Deferred income tax benefit	(1,013,252)	-
Amortization of right-of-use assets	136,441	54,652
Non-cash interest expense	59,467	-
Change in fair value of contingent consideration liability	(930,000)	-
Changes in operating assets and liabilities:		
Accounts receivable	132,688	(820,954)
Prepaid expenses and other current assets	84,842	(140,015)
Contract assets	-	210,688
Accounts payable	(422,939)	508,408
Contract liabilities	(149,149)	(868,839)
Accrued payroll and related liabilities and other accrued liabilities	653,786	63,404
Operating lease liability	(142,420)	(37,989)
Commissions payable	846	54,812
Net cash used in operating activities	(5,100,233)	(425,810)
Cash flows from investing activities		
Acquisition of property and equipment	(234,060)	(56,010)
Acquisition of Tellenger, net of cash acquired	-	(2,233,884)
Net cash used in investing activities	(234,060)	(2,289,894)
Cash flows from financing activities		
Borrowing under revolving line of credit	-	502,306
Repayments under revolving line of credit	-	(100,000)
Borrowing under long-term note	-	1,000,000
Repayments of long-term note	-	(251,849)
Proceeds from issuance of stock	1,887,000	3,294,554
Proceeds from exercise of stock options	37,642	95,146
Net cash provided by financing activities	1,924,642	4,540,157
Net (decrease) increase in cash and cash equivalents	(3,409,651)	1,824,453
Cash and cash equivalents, beginning of year	4,931,302	1,858,160
Cash and cash equivalents, end of year	$ 1,521,651	$ 3,682,613
Supplemental cash flow Information		
Interest paid	$ 1,002	$ 32,197
Non-cash investing and financing activities		
Value of common stock issued in connection with:		
Common stock purchase agreement	$ 112,500	$ -
Acquisition of Tellenger, Inc.	$ -	$ 200,000

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

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

	Nine months ended September 30, 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
Net loss	-	-	(1,525,442)	-	(1,525,442)
Stock option compensation	-	529,565	-	-	529,565
Issuance of stock from exercise of options	52	8,340	-	-	8,392
Balances at June 30, 2022	19,039	32,666,239	(17,040,712)	(930,211)	14,714,355
Net loss	-	-	(4,700,519)	-	(4,700,519)
Stock option compensation	-	614,094	-	-	614,094
Stock issued	1,663	1,997,837	-	-	1,999,500
Issuance of stock from exercise of options	107	37,344	-	(35,000)	2,451
Balances at September 30, 2022	$ 20,809	$ 35,315,514	$ (21,741,231)	$ (965,211)	$ 12,629,881

	Nine months ended September 30, 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
Net income	-	-	43,157	-	43,157
Stock option compensation	-	111,862	-	-	111,862
Stock issued	683	197,872	-	-	198,555
Issuance of stock from exercise of options	3,600	76,395	-	-	79,995
Balances at June 30, 2021	136,882	15,629,898	(11,991,542)	(930,211)	2,845,027
Net loss	-	-	(95,527)	-	(95,527)
Stock option compensation	-	80,882	-	-	80,882
Stock issued	14,000	2,786,000	-	-	2,800,000
Issuance of stock from exercise of options	650	10,951	-	-	11,601
Balances at September 30, 2021	$ 151,532	$ 18,507,731	$ (12,087,069)	$ (930,211)	$ 5,641,983

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

WAVEDANCER, INC.
NOTES TO CONDENSED CONSOLIDATED 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 blockchain enabled supply chain management software solutions ("SCM"). With the acquisition of GMI, we began implementing a strategy to expand our offerings well beyond systems modernization services and sales of third-party software. Our Chief Executive Officer, as the chief operating decision maker ("CODM"), organizes our company, manages resource allocations, and measures performance among two operating and reportable segments: Tellenger and GMI.

Liquidity and Going Concern

During the nine months ended September 30, 2022, the Company generated a loss from operations of $9,247,607. As of September 30, 2022, the Company had working capital of $1,280,663, including cash and cash equivalents of $1,521,651, and had an accumulated deficit of $21,741,231 . The Company intends to continue to invest in its SCM platform and to execute its strategy to become a leading zero trust, blockchain-enabled cybersecurity company and believes strongly in the long-term viability of our strategy. However, executing our strategy requires additional sources of capital which we are pursuing, including acquisitions or mergers. There is no assurance that such activities will result in any transactions or provide additional capital, which creates substantial doubt about the Company's ability to continue as a going concern for at least one year from the date that the accompanying financial statements are issued.

The accompanying unaudited condensed consolidated financial statements have been prepared assuming that the Company will continue as a going concern, which contemplates continuity of operations, realization of assets, and satisfaction of liabilities in the ordinary course of business. The propriety of using the going-concern basis is dependent upon, among other things, the achievement of future profitable operations, the ability to generate sufficient cash from operations and potential other funding sources, in addition to cash on-hand, to meet its obligations as they become due. The Company's unaudited consolidated financial statements do not include any adjustment that might result from the outcome of this uncertainty.

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 September 30, 2022, and for the three- and nine-month periods ended September 30, 2022 include the accounts of WaveDancer and its condensed consolidated subsidiaries (collectively, the "Company", "we" or "our"). All significant intercompany transactions and balances have been eliminated in consolidation.

Other than disclosing our policy for software development costs since these costs are now, and will likely continue to be, material, and a clarification of our policy for goodwill and intangibles, both as discussed below, there have been no changes in the Company's significant accounting policies as of September 30, 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 condensed 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 impact of rising interest rates on valuation methods as discussed in Note 5 Fair Value Measurements. 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, including the underlying estimates of cash flows of our products and reporting units; 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 consideration 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 condensed consolidated statement of cash flows for the nine months ended September 30, 2021, have been reclassified to conform to the current year presentation.

Software Development Costs

The Company capitalizes costs related to software developed or obtained for internal use in accordance with the ASC350-40, Internal-Use Software (“ASC 350-40”). The following illustrates the various stages and related processes of computer software development in accordance with ASC350-40:

- Preliminary project stage: (a) conceptual formulation of alternatives; (b) evaluation of alternatives; (c) determination of existence of needed technology; and (d) final selection of alternatives. Internal and external costs incurred during the preliminary project stage are expensed as incurred.

- Application development stage: (a) design of chosen path, including software configuration and software interfaces; (b) coding; (c) installation to hardware; and (d) testing, including parallel processing phase. Internal and external costs incurred to develop internal-use computer software during the application development stage are capitalized.

- Post-implementation-operation stage: (a) training; and (b) application maintenance. Internal and external costs incurred during the post-implementation-operation stage are expensed as incurred.

The Company is continuing to develop its blockchain SCM software which it markets under a Software as a Service ("SaaS") model, whereby, a customer doesnot take possession of the Company’s software; rather, the software is accessed on an as-needed basis over the Internet.

Therefore, when the software is used to produce a product or in a process to provide a service to a customer, and the customer isnot given the right to obtain or use the software, the related costs are accounted for in accordance with ASC 350-40. When a hosting arrangement includes multiple modules or components, capitalized costs are amortized on a module-by-module basis. When a module or component is substantially ready for its intended use, amortization begins, regardless of whether the overall hosting arrangement is being placed in service in planned stages. If the module’s functionality is entirely dependent on the completion of one or more other modules, then amortization does not begin until that group of interdependent modules is substantially ready for use.

As of September 30, 2022 we had $214,251 of capitalized internal use software development costs andzero accumulated amortization. Capitalized software development costs are included in plant and equipment on the condensed consolidated balance sheets.

Intangibles and Goodwill

The Company accounts for goodwill and other intangible assets in accordance with ASC Topic350, Goodwill – Intangibles and Other (“ASC 350”) and has concluded that it has two operating segments, which are also its two reporting units for purposes of goodwill impairment testing. Goodwill isnot amortized but instead tested for impairment (i) on at least an annual basis and (ii) when changes in circumstances indicate that it is more likely than not that the fair value of a reporting unitmay be below its carrying value. These circumstances include, but are not limited to, significant changes in performance relative to expected operating results; significant changes in the use of the assets; significant negative industry or economic trends; a significant decline in the Company’s stock price for a sustained period of time; and changes in the Company’s planned revenue or earnings. Management evaluates the recoverability of the Company’s goodwill annually on October 31 or more often as events or circumstances indicate the fair value of a reporting unit is below its carrying value, including goodwill. If the fair value of a reporting unit is less than its carrying value, an impairment loss is recorded to the extent that the reporting unit carrying amount exceeds the estimated fair value of the reporting unit.

Management evaluates the recoverability of the Company’s indefinite-lived intangible assets (tradenames) annually onOctober 31, or more often when events or circumstances indicate a potential impairment exists.

Management evaluates the recoverability of the Company’s finite-lived intangible assets and other long-lived assets when events or circumstances indicate a potential impairment exists. In determining if impairment exists, the Company estimates the undiscounted cash flows to be generated from the use and ultimate disposition of these assets or asset groups that contain those assets. If impairment is indicated based on a comparison of an asset group’s carrying values and the undiscounted cash flows, the impairment loss is measured as the amount by which the carrying amount of the asset group exceeds the fair value of the asset group.

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 September 30, 2022, and December 31, 2021, it has no material uncertain tax positions and no interest or penalties have been accrued. The Company expects that recent tax law changes contained in the Inflation Reduction Act and CHIPS Act will not have a material impact on its provision for income taxes.

Concentration of Credit Risk

During the three months ended September 30, 2022, the Company's prime contracts with U.S. government agencies represented 11.4% of revenue, subcontracts under federal procurements represented 82.8% of revenue, and 5.8% of revenue came from commercial and local government contracts. The terms of these contracts and subcontracts vary from single transactions to five years. Three subcontracts under federal procurements represented 30.9%, 21.3%, and 13.0% of revenue, respectively. Revenue from one prime contractor under which the Company has multiple subcontracts represented 49.9% of the Company's revenue in aggregate.

During the three months ended September 30, 2021, the Company's prime contracts with U.S. government agencies represented 37.0% of revenue and subcontracts under federal procurements represented 62.9% of revenue, and 0.2% of revenue came from commercial and local government contracts. The terms of these contracts and subcontracts vary from single transactions to five years. Three subcontracts under federal procurements represented 32.5%, 11.4%, and 10.6% of revenue, respectively. Revenue from one prime contractor under which the Company has multiple subcontracts represented 45.8% of the Company's revenue in aggregate.

During the nine months ended September 30, 2022, the Company's prime contracts with U.S. government agencies represented 32.8% of revenue, subcontracts under federal procurements represented 63.8% of revenue, and 3.3% of revenue came from commercial and local government contracts. One prime contract with a U.S. government agency represented 11.1% of revenue, and two subcontracts under federal procurements represented 25.8%, and 15.6% of revenue, respectively. Revenue from one prime contractor under which the Company has multiple subcontracts represented 38.9% of the Company's revenue in aggregate.

During the nine months ended September 30, 2021 the Company's prime contracts with U.S. government agencies represented 35.1% of revenue and subcontracts under federal procurements represented 63.5% of revenue, and 1.4% of revenue came from commercial and local government contracts. The terms of these contracts and subcontracts vary from single transactions to five years. One subcontract under federal procurements represented 33.1% of revenue. Revenue from one prime contractor under which the Company has multiple subcontracts represented 44.3% of the Company's revenue in aggregate.

The Company sold third-party software and maintenance contracts under agreements with one major supplier, accounting for 8.3% and 34.8% of total revenue during the three months ended September 30, 2022 and 2021, respectively, and 27.0% and 30.8% of total revenue during the nine months ended September 30, 2022 and 2021, respectively.

As of September 30, 2022, receivables from one prime contractor under which the Company has multiple subcontracts represented 66.8% of the Company's outstanding accounts receivable in aggregate.

As of September 30, 2021, receivables from one prime contractor under which the Company has multiple subcontracts represented 63.7% of the Company's outstanding accounts receivable in aggregate.

Note 2. Revenue from Contracts with Customers

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) andsecond 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 September 30,			
	2022		2021	
Contract Type	Amount	Percentage	Amount	Percentage
Services time & materials	$ 1,896,829	82.2%	$ 2,705,099	62.9%
Services fixed price over time	58,965	2.6%	19,175	0.5%
Services combination	50,440	2.2%	47,060	1.1%
Services fixed price per unit	107,778	4.7%	26,771	0.6%
Third-party software	59,076	2.6%	1,445,757	33.6%
Software support & maintenance	44,804	1.9%	48,421	1.1%
Incentive payments	88,487	3.8%	7,642	0.2%
Total revenue	$ 2,306,379	100.0%	$ 4,299,925	100.0%

	Nine months ended September 30,			
	2022		2021	
Contract Type	Amount	Percentage	Amount	Percentage
Services time & materials	$ 5,963,361	62.0%	$ 7,519,190	60.4%
Services fixed price over time	161,273	1.7%	452,726	3.6%
Firm fixed price	566,862	5.9%	-	-
Services combination	80,520	0.8%	506,331	4.1%
Services fixed price per unit	253,379	2.6%	87,391	0.7%
Third-party software	2,345,884	24.4%	3,683,967	29.6%
Software support & maintenance	142,891	1.5%	150,696	1.2%
Incentive payments	105,103	1.1%	51,166	0.4%
Total revenue	$ 9,619,273	100.0%	$ 12,451,467	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 September 30, 2022 and December 31, 2021.

Accounts receivable as of September 30, 2022 and December 31, 2021, consist of the following:

	September 30, 2022	December 31, 2021
Billed federal government	$ 1,491,705	$ 1,594,473
Billed commercial	40,469	-
Unbilled receivables	-	70,389
Accounts receivable	$ 1,532,174	$ 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 ofSeptember 30, 2022 or December 31, 2021. Changes in contract assets balances in the nine months ended September 30, 2021, were as follows:

Balance as of December 31, 2020	$	210,688
Contract assets added		131,923
Balance as of March 31, 2021		342,611
Contract assets added		134,657
Balance as of June 30, 2021		477,268
Contract assets added		45,895
Reduction in contract assets		(523,163)
Balance as of September 30, 2021	$	-

Contract Liabilities

Contract liabilities consist of amounts that have been invoiced and for which the Company has the right to bill, but that havenot been recognized as revenue because the related goods or services have not been transferred. Changes in contracts liabilities balances in the three months and nine months ended September 30, 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
Contract liabilities added		87,612
Revenue recognized		(71,461)
Balance as of June 30, 2022		165,843
Contract liabilities added		2,491
Revenue recognized		(130,648)
Balance as of September 30, 2022	$	37,686

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
Contract liabilities added		4,815
Revenue recognized		(354,427)
Balance as of June 30, 2021		105,884
Contract liabilities added		79,640
Revenue recognized		(107,479)
Balance as of September 30, 2021	$	78,045

Revenues recognized during the three months ended September 30, 2022 and 2021, from the balances as of December 31, 2021 and 2020, were $48,708 and $58,556, respectively. Revenues recognized during the nine months ended September 30, 2022 and 2021, from the balances as of December 31, 2021 and 2020, were $160,809 and $946,884, 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 September 30, 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 and nine months ended September 30, 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
Deferred costs expensed	(53,434)
Balance as of June 30, 2022	48,222
Deferred costs expensed	(48,222)
Balance as of September 30, 2022	$ -

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
Deferred costs added	11,188
Deferred costs expensed	(16,681)
Balance as of June 30, 2021	25,758
Deferred costs added	194,686
Deferred costs expensed	(33,118)
Balance as of September 30, 2021	$ 187,326

Note 3. Segment Financial Information

In periods earlier than the quarter ended September 30, 2022, we managed our business as a single operating segment. During the quarter ended September 2022, we reassessed our business strategy and our CODM changed his approach to managing the business and allocating resources. As a result, we determined that we have two operating segments: Tellenger and Blockchain SCM. Tellenger provides professional services, primarily to US government agencies, related to legacy software migration and modernization, developing web-based and mobile device solutions, including dynamic electronic forms development and conversion, and data analytics. The Blockchain SCM segment is an early-stage business focused on developing, marketing, and selling a SaaS supply chain management platform built on blockchain technology.

No separate revenues and operating income for the Blockchain SCM operating segment are presented for the three- and nine-month periods ended September 30, 2021, since we did not own this SCM business during such prior periods.

	Three Months Ended 9/30/22				Nine Months Ended 9/30/22			
	Tellenger	Blockchain SCM	Corporate	Consolidated	Tellenger	Blockchain SCM	Corporate	Consolidated
Revenue	$ 2,306,379	$ -	$ -	$ 2,306,379	$ 9,052,411	$ 566,862	$ -	$ 9,619,273
Operating income (loss)	$ 250,712	$ (3,292,257)	$ (1,696,317)	$ (4,737,862)	$ 661,394	$ (4,124,511)	$ (5,784,490)	$ (9,247,607)
Interest expense				(20,437)				(59,574)
Other income, net				3,188				3,977
Loss before provision for income taxes				$ (4,755,111)				$ (9,303,204)

Corporate operating loss primarily includes stock-based compensation expenses, acquisition-related costs, and other expenses related to executive, legal, finance, tax, and investor relations expenses.

	As of September 30, 2022			
	Tellenger	Blockchain SCM	Corporate	Consolidated
Intangible assets	$ 1,225,844	$ 5,773,445	$ -	$ 6,999,289
Total assets	$ 6,858,228	$ 7,137,786	$ 2,611,677	$ 16,607,691

Note 4. 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 September 30, 2022 and December 31, 2021.

As of September 30, 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 September 30, 2022, our two operating leases had a weighted average remaining lease term of 37 months and a weighted average discount rate of 5.0%. Future lease payments under operating leases as of September 30, 2022, were as follows:

Remainder of 2022	$	56,639
2023		228,862
2024		174,721
2025		74,804
2026		70,220
Total lease payments		605,246
Less: discount		(48,418)
Present value of lease liabilities	$	556,828

The total expense incurred related to its operating leases was $53,560 and $15,985 for the three months ended September 30, 2022 and 2021, respectively, and $164,280 and $68,229 for the nine months ended September 30, 2022 and 2021, respectively, and is included in selling, general and administrative expenses on the condensed consolidated statements of operations.

Note 5. 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 September 30, 2022 and December 31, 2021:

	September 30, 2022			
	Level 1	Level 2	Level 3	Total
Cash equivalents:				
Money market funds	$ 980,112	$ -	$ -	$ 980,112

	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

See Note 6 below for an explanation of the decrease in fair value of contingent consideration related to the acquisition of Gray Matters, Inc.

The following table is a roll-forward 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
Change in fair value	(942,609)
June 30, 2022	-
Change in fair value	-
September 30, 2022	$ -

There were no unrealized gains or losses included in income for thethree or nine months ended September 30, 2022.

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

The following table is a summary of gains and losses on assets measured at fair value on a nonrecurring basis:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2022	2021	2022	2021
Impairment of goodwill	$ 2,254,624	$ -	$ 2,254,624	$ -

During the third quarter of 2022, our Gray Matters reporting unit, which is the same as our Blockchain SCM operating segment, experienced delays in receiving approval from its government customer of certain milestone achievements specified in our contract with that customer. This delay, in turn, resulted in a decline in the reporting unit's estimated future cash flows. Accordingly, we performed an interim goodwill impairment test as of September 30, 2022, prior to our annual impairment test.

As a result of the interim goodwill impairment test, the estimated fair value of the Gray Matters reporting unit was determined to be lower than its carrying value. In the third quarter of 2022, we recorded a non-cash pre-tax and after-tax charge of $2,254,624 to impair the carrying value of this reporting unit's goodwill under the caption, "Goodwill impairment" in the accompanying condensed consolidated statement of operations and comprehensive (loss) income. There were no tax benefits associated with the goodwill impairment charge, since the Gray Matters goodwill is not deductible for tax purposes. The fair value of the reporting unit was determined using an income approach based on a discounted cash flow ("DCF") model which requires a complex series of judgments about future events and uncertainties and relies heavily on estimates of expected cash flows and like an appropriate discount rate and terminal growth rate. Any changes in key assumptions, including failure to grow the revenue and improve the profitability of GMI, or other unanticipated events and circumstances, may affect such estimates. Fair value assessments of the reporting unit are considered a Level 3 measurement due to the significance of unobservable inputs developed using company specific information. The discount rate and terminal growth rate used in our 2022 third quarter interim impairment test for the Gray Matters reporting unit were 22.5% and 3.0%, respectively.

Note 6. 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 didnot 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. Gray Matters 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 nine months ended September 30, 2022, we recorded $59,467 of interest expense.

Contingent consideration was estimated as of the acquisition date 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 June 30, 2022 and determined that the undiscounted probability weighted outcome had decreased to zero and we reduced the liability amount accordingly and for the nine months ended September 30, 2022 we have recognized $930,000 of income.

The deferred consideration liability is included in other liabilities on the condensed consolidated balance sheets and totals $1,394,467 and $1,335,000 as of September 30, 2022 and December 31, 2021, respectively.

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, 2021. The pro forma information includes adjustments to amortization expense for the intangible assets acquired.

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, 2021, 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.

	Three months ended September 30,		Nine months ended September 30,	
	2022	2021	2022	2021
Revenues	$ 2,306,379	$ 4,299,925	$ 9,619,273	$ 13,677,429
Net loss	$ (4,700,519)	$ (802,424)	$ (8,304,268)	$ (2,128,680)

Note 7. Intangible Assets and Goodwill

Information regarding our intangible assets is as follows:

	Weighted Average Useful Life (Years)	December 31, 2021	Additions	September 30, 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)	(1,049,679)	(1,250,711)
Sub-total		7,768,968	(1,049,679)	6,719,289
Intangible assets with indefinite lives				
Trade names	Indefinite	280,000	-	280,000
Net identifiable intangible assets		$ 8,048,968	$ (1,049,679)	$ 6,999,289

Information regarding our goodwill for each operating segment is as follows:

	Tellenger	Blockchain SCM	Corporate	Consolidated
Goodwill, gross				
Balance at December 31, 2021	$ 785,000	$ 4,560,098	$ 2,240,171	$ 7,585,269
Additions	-	-	-	-
Balance at September 30, 2022	785,000	4,560,098	2,240,171	7,585,269
Cumulative impairment loss				
Balance at December 31, 2021	-	-	-	-
Impairment expense	-	(2,254,624)	-	(2,254,624)
Balance at September 30, 2022	-	(2,254,624)	-	(2,254,624)
Goodwill, net				
Balance at December 31, 2021	$ 785,000	$ 4,560,098	$ 2,240,171	$ 7,585,269
Balance at September 30, 2022	$ 785,000	$ 2,305,474	$ 2,240,171	$ 5,330,645

See Note 5, Fair Value Measurements, for a discussion of goodwill impairment charges.

As of September 30, 2022, expected amortization expense relating to purchased intangible assets for each of the nextfive years and thereafter is as follows:

Remainder of 2022	$ 349,893
2023	1,399,572
2024	1,369,635
2025	1,359,576
2026	1,326,854
Thereafter	913,759
Total	$ 6,719,289

Note 8. 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 2021 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 September 30, 2022 and 2021, and the nine months ended September 30, 2022 and 2021, were estimated using the Black-Scholes option pricing model under the following assumptions:

	Three months ended September 30,		Nine Months ended September 30,	
	2022	2021	2022	2021
Risk-free interest rate	2.85% - 2.90%	0.84%	1.91% - 2.90%	0.46% - 0.92%
Dividend yield	0%	0%	0%	0%
Expected term (years)	3.25 - 6.00	5.00	3.25 - 6.00	5.00
Expected volatility	45.9% - 48.1%	46.8%	45.8% - 48.5%	47.1% - 92.6%

Determining the assumptions for the expected term and volatility requires management to exercise significant judgment. 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.

There were 265,000 options with grant date fair values totaling $157,300 and 30,000 options with grant date fair values totaling $34,500 granted during the three months ended September 30, 2022 and 2021, respectively. There were 1,177,000 options with grant date fair values totaling $2,231,970, and 302,500 options with grant date fair values totaling $363,550 granted during the nine months ended September 30, 2022 and 2021, respectively. There were 107,000 and 65,000 options exercised during the three months ended September 30, 2022 and 2021, respectively. There were 264,000 options and 450,000 options exercised during the nine months ended September 30, 2022 and 2021, respectively. As of September 30, 2022, there was $2,019,066 of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted under the stock incentive plans. That cost is expected to be recognized over a weighted-average period of 9.4 months.

Total compensation expense related to these plans was $614,094 and $80,882 for the three months ended September 30, 2022 and 2021, respectively, and $1,455,835 and $220,455 for the nine months ended September 30, 2022 and 2021, respectively, and is included in selling, general and administrative expenses on the condensed consolidated statements of operations.

Note 9. Revolving Line of Credit and Notes Payable

On September 30, 2022, the Company entered a revolving line of credit with Summit Community Bank (“Summit”) that provided for on-demand or short-term borrowings of up to $1,000,000 at a variable interest rate equal to the prime rate as published in *The Wall Street Journal*, with a minimum rate of 3.99% and a maximum rate of 20.00%, 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. As of September 30, 2022, there was no outstanding balance under this line of credit and there were no borrowings or repayments during the nine months ended September 30, 2022. As of September 30, 2022 there is $1,000,000 of borrowing availability under this line of credit.

On April 16, 2021, the Company entered a revolving line of credit with Summit Community Bank (“Summit”) that provided 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 December 31 2021, there was no outstanding balance under this line of credit and there were no borrowings or repayments during the nine months ended September 30, 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 10. Common Stock Purchase Agreement

On July 8, 2022, we entered into a Common Stock Purchase Agreement (the "Purchase Agreement") and a Registration Rights Agreement (the "Registration Rights Agreement") with B. Riley Principal Capital II, LLC ("B. Riley"). Pursuant to the Purchase Agreement, subject to certain limitations and conditions, the Company has the right, but not the obligation, to sell to B. Riley up to $15,000,000 of shares of the Company's common stock, par value $0.001 per share ("Common Stock"), from time to time. Sales of Common Stock to B. Riley under the Purchase Agreement, and the timing of any such sales, are solely at the Company's option, and the Company is under no obligation to sell any securities to B. Riley under the Purchase Agreement. Pursuant to the Registration Rights Agreement, the Company agreed to file a registration statement with the Securities Exchange Commission (the "SEC") to register under the Securities Act of 1933, as amended (the "Securities Act") the resale by B. Riley of up to 4,500,000 shares of Common Stock that the Company may issue or elect, in the Company's sole discretion, to issue and sell to B. Riley, from time to time under the Purchase Agreement. We issued 89,835 common shares valued at $112,500 to B. Riley as a commitment fee. The cost of the shares is included in prepaid expenses and other current assets on the condensed consolidated balance sheet and will be charged to additional paid in capital as shares are sold under the ELOC. As of September 30, 2022, no shares have been sold to B. Riley under the Purchase Agreement.

Note 11. Private Offerings of Common Stock

During August 2022 the Company sold 1,572,506 unregistered shares of its common stock in a private offering at a price of $1.20 per share from which it raised aggregate gross proceeds of $1,887,000.

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 2022 and 2021 were not material.

Note 12. Income Taxes

During the three- and nine-month periods ended September 30, 2022, the Company's effective tax rate was 2.2% and 13.6%, respectively. 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- and nine-month periods ended September 30, 2022 were state taxes, changes in valuation allowance, and permanent items. A valuation allowance was recorded during the three-month period ended September 30, 2022 increasing the tax benefit by $54,592. During the three- and nine-month periods ended September 30, 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 three- and nine-month periods ended September 30, 2021, is primarily driven by the presence of a full valuation allowance in all jurisdictions.

Note 13. (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 437,352 shares from stock options andzero shares from warrants were excluded from diluted shares for thethree months ended September 30, 2022, and the antidilutive effect of 570,090 shares from stock options and150,000 shares from warrants were excluded from diluted shares for thenine months ended September 30, 2022. The dilutive effect of outstanding options and warrants is reflected in earnings per share by use of the treasury stock method. The antidilutive effect of 672,373 shares were excluded from diluted shares for the three months ended September 30, 2021.

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

	Three months ended September 30,		Nine months ended September 30,	
	2022	2021	2022	2021
Net (loss) income	$ (4,700,519)	$ (95,527)	$ (8,304,268)	$ 218,445
Basic weighted average shares outstanding	18,382,131	12,596,126	17,688,528	11,957,878
Dilutive effect of warrants and/or options	-	-	-	627,036
Diluted weighted average shares outstanding	18,382,131	12,596,126	17,688,528	12,584,914
Basic (loss)/earnings per share	$ (0.26)	$ (0.01)	$ (0.47)	$ 0.02
Diluted (loss)/earnings per share	$ (0.26)	$ (0.01)	$ (0.47)	$ 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 occur, our business, financial condition and operating results would likely suffer. These risks include, among others, the following:

- Our ability to successfully execute our business plan and necessary transition activities following the 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 Gray Matters business currently has one key customer and since our acquisition of GMI in December 2022, there have been delays in the timing of revenue recognition vs our initial expectations. Continued delays in recognizing revenue for GMI could have an adverse impact on the carrying value of the intangible assets and goodwill that was recorded in connection with the acquisition of GMI.
- 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 a 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.

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. 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 September 30, 2022 and 2021

Revenue

Total revenue was $2,306,379 for the three months ended September 30, 2022, compared with $4,299,925 in the prior year quarter, a decrease of $1,993,546, or 46.4%. All of the decrease is from our Tellenger segment since we did not recognize revenue for Blockchain SCM this quarter and did not have the segment last year.

Tellenger

The decrease in revenue of $1,993,546 consists of lower professional services revenue totaling $684,093 and lower third-party software sales of $1,309,453. The decline in professional services revenue is driven primarily by one software modernization project where we had deployed more resources, and billed more overtime, in 2021 in order to achieve a particular milestone whereas in the third quarter of 2022 we had fewer resources and less overtime from those resources. The reduction in sales of third-party software is the result of our decision to de-emphasize these sales since they generate gross margins in the low single digits.

Gross Profit

Gross profit decreased by $497,253 or 50.8%, to $481,622 for the three months ended September 30, 2022 as compared to $978,875 in the prior year quarter.

Tellenger

The decrease in gross profit includes a decrease from professional services of 317,261, partially offset by an increase in margin on third-party software sales of $78,068. The reduced margin on professional services is driven by the reduced revenues discussed above as well as a change in the mix of contracts generating revenue and the related billing rates resulting in a reduction in our gross profit rate to 30.7% from 34.5%.

Blockchain SCM

We recorded a negative gross profit of $258,060 in our Blockchain SCM operating segment. As noted above, we experienced delays in receiving approval from our government customer of certain milestone achievements specified in our contract with that customer. However, we continued to incur costs supporting the contract resulting in negative gross profit.

Selling, General and Administrative Expenses

Selling, general and administrative ("SG&A") expenses have increased significantly since the second half of 2021 when we began to implement our transformative strategy described in the *Our Strategy* section above and in our Annual Report. The following table shows the major elements of SG&A expenses for the three months ended September 30, 2022 and 2021 and the increases between periods:

	Three Months Ended September 30,		
	2022	2021	Increase
Personnel costs	$ 1,076,928	$ 572,588	$ 504,340
Legal and professional fees	445,163	142,766	302,397
Intangibles amortization	349,893	44,061	305,832
Stock-based compensation	614,094	80,882	533,212
Governance and investor relations	97,800	64,153	33,647
IT and office expenses	44,814	30,017	14,797
Marketing expenses	68,122	7,001	61,121
All other	229,429	82,429	147,000
	$ 2,926,243	$ 1,023,897	$ 1,902,346

Acquisition Costs

We incurred acquisition expenses totaling $38,617 in the three months ended September 30, 2022 as compared to $39,245 in the corresponding quarter in 2021. These expenses include fees for legal, tax and audit professional services as well as other costs to conduct due diligence and finalize a transaction.

Goodwill Impairment

During the third quarter of 2022, our Gray Matters reporting unit, which is in our Blockchain SCM segment, experienced delays in receiving approval from its government customer of certain milestone achievements specified in our contract with that customer. This delay, in turn, results in a decline in the reporting unit's estimated future cash flows. Accordingly, we performed an interim goodwill impairment test in accordance with the amended goodwill guidance for this reporting unit prior to our annual impairment test.

As a result of the test, the estimated fair value of this reporting unit was determined to be lower than the carrying value and we recorded a non-cash charge of $2,254,624 to impair the carrying value of this reporting unit's goodwill.

(Loss) Income from Operations

Loss from operations was $4,737,862 in the third quarter of 2022 compared to a loss from operations of $84,267 in the corresponding quarter in 2021, an increase in the loss of $4,653,595. The increase in the loss from operations is primarily the result of the decrease in gross profit of $497,253 and the increase in SG&A expenses of $1,902,346, all as discussed above, and approximately $3.3 million of the increased loss is attributable to the Blockchain SCM operating segment that was acquired with GMI in December 2021.

Results of Operations – Nine Months Ended September 30, 2022 and 2021

Revenue

Total revenue was $9,619,273 for the nine months ended September 30, 2022, as compared to $12,451,467 in the comparable period in 2021, a decrease of $2,832,194, or 22.7%. The decrease includes $3,399,057 from the Tellenger operating segment, partially offset by the $566,862 of year-to-date revenue from the Blockchain SCM operating segment for which there is no prior year amount since this operating segment is the GMI business acquired in December 2021.

Tellenger

The $3,399,057 revenue decrease comprises a decrease in professional services revenue of $2,107,105 and a decrease in third-party software sales of $1,291,951. The professional services revenue decrease includes three primary declining items: 1) one contract for which much of 2021 included a greater number of resources deployed and more overtime billed in connection with meeting an accelerated milestone as compared to 2022 when we have not had as many resources deployed nor overtime billed ($1,635 thousand); 2) one contract that has transitioned to a maintenance phase where in 2021 we had revenues associated with systems conversion ($335 thousand); and 3) one contract that ended in 2021 ($563 thousand). These declining items were partially offset by increased revenues from having a full nine months of the Tellenger, Inc. acquisition in 2022 versus just over 6 months in 2021 ($421 thousand). The reduction in sales of third-party software is the result of our decision to de-emphasize these sales since they generate gross margins in the low single digits.

Gross Profit

Gross profit was $1,787,468 for the nine months ended September 30, 2022, as compared to $2,954,453 in the comparable period in 2021, a decrease of $1,166,985 or 39.5%. The decrease includes $615,545 from the Tellenger operating segment and $551,440 of year-to-date negative gross margin from the Blockchain SCM operating segment for which there is no prior year amount since this operating segment is the GMI business acquired in December 2021.

Tellenger

The $615,545 gross profit decrease comprises a decrease in gross profit from professional services of $692,062, partially offset by increased gross profit from third-party software sales of $76,517. The decline in gross profit from professional services includes two primary declining items: 1) one contract for which much of 2021 included a greater number of resources deployed and more overtime billed in connection with meeting an accelerated milestone as compared to 2022 when we have not had as many resources deployed nor overtime billed ($706 thousand); and 2) one contract that has transitioned to a maintenance phase where in 2021 we had revenues associated with systems conversion ($209 thousand). These declining items were partially offset by increased gross profit from having a full nine months of the Tellenger acquisition in 2022 versus just over three months in 2021 ($269 thousand).

Selling, General and Administrative Expenses

SG&A expenses have increased significantly since the second half of 2021 when we began to implement our transformative strategy described in the *Our Strategy* section above and in our Annual Report. The following table shows the major elements of SG&A expenses for the nine months ended September 30, 2022 and 2021 and the increases between periods:

	Nine Months Ended September 30,		
	2022	2021	Increase
Personnel costs	$ 3,383,189	$ 1,477,112	$ 1,906,077
Legal and professional fees	1,511,578	236,110	1,275,468
Intangibles amortization	1,049,679	87,912	961,767
Stock-based compensation	1,455,835	220,455	1,235,380
Governance and investor relations	376,904	156,698	220,206
IT and office expenses	190,551	76,682	113,869
Marketing expenses	224,910	16,877	208,033
All other	688,327	251,494	436,833
	$ 8,880,973	$ 2,523,340	$ 6,357,633

Acquisition Costs

We incurred acquisition expenses totaling $829,478 for the nine months ended September 30, 2022 as compared to $192,530 for the nine months ended September 30, 2021. The current year's expenses were incurred primarily in connection with the terminated acquisition of Knowmadics. These expenses include fees for legal, tax and audit professional services as well as other costs to conduct due diligence and finalize a transaction.

Change in Fair Value of Contingent Consideration

Under the terms of the Gray Matters purchase agreement, the Seller is eligible to receive 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. In the purchase accounting for GMI in the fourth quarter of 2021, we recorded a contingent liability of $930,000 based on our estimate for GMI's expected performance for 2022. Since that initial estimate there have been delays in the timing of realizing revenue that have pushed a material amount of the projected revenue and related gross profit outside of the one-year measurement period of the Seller's earnout provision. As of September 30, 2022 we estimated that the contingent consideration was no longer probable of being realized by the seller and removed the contingent consideration liability. The result of writing down the contingent liability has been the recognition of non-cash operating income of $930,000 as discussed in Note 5.

Goodwill Impairment

During the third quarter of 2022, our Gray Matters reporting unit, which is the same as our Blockchain SCM operating segment, experienced delays in receiving approval from its government customer of certain milestone achievements specified in our contract with that customer. This delay, in turn, resulted in a decline in the reporting unit's estimated future cash flows. Accordingly, we performed an interim goodwill impairment test as of September 30, 2022.

As a result of the test, the estimated fair value of this reporting unit was determined to be lower than the carrying value and we recorded a non-cash charge 254,624 to impair the carrying value of this reporting unit's goodwill.

(Loss) Income from Operations

Loss from operations was $9,247,607 for the nine months ended September 30, 2022 compared to income from operations of $238,583 for the nine months ended September 30, 2021, a decrease of $9,486,190. The decrease in income from operations is the result of the decrease in gross profit of $1,166,985 and the increase in SG&A expenses and acquisition costs totaling $6,994,581, and the goodwill impairment of $2,254,624, partially offset by the income from the change in fair value of contingent consideration recorded in connection with the Gray Matters acquisition of $930,000, all as discussed above. Approximately $4.1 million of the decrease in income from operations is attributable to the Blockchain SCM operating segment that was acquired with GMI in December 2021.

Critical Accounting Estimate

Our accounting policies are described in Note 1 of our consolidated financial statements –*Organization and Summary of Significant Accounting Policies*. We prepare our consolidated financial statements in conformity with US GAAP, which require us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the year. Actual results could differ from those estimates. We consider the following policies and estimates to be most critical in understanding the judgments involved in preparing our financial statements for the three and nine months ended September 30, 2022 and the uncertainties that could affect our results of operations, financial condition and cash flows.

Goodwill Impairment Testing

As discussed in Note 5 to our interim consolidated financial statements, during the third quarter of 2022, our Gray Matters reporting unit experienced delays in receiving approval from its government customer of certain milestone achievements specified in our contract with that customer. This delay, in turn, results in a decline in the reporting unit's estimated future cash flows. Accordingly, we performed an interim goodwill impairment test as of September 30, 2022. As a result of the test, the estimated fair value of this reporting unit was determined to be lower than the carrying value and we recorded a non-cash charge of $2,254,624 to impair the carrying value of the Gray Matters reporting unit goodwill.

We believe that the Gray Matters reporting unit may be at risk of failing future quantitative impairment tests if it continues to experience declining estimated future cash flows. Impairment charges are non-cash in nature and, as with current impairment charges, any future impairment charges will not impact our cash needs or liquidity. The key assumptions in the September 30, 2022 goodwill impairment test for the Gray Matters reporting unit are as follows: the unit is expected to begin generating positive cash flows within the next several years, a discount rate of 22.5%, and a terminal cash flow growth rate of 3%.

The estimated fair value of our Tellenger reporting unit significantly exceeded its carrying value as of September 30, 2022.

Liquidity and Capital Resources

On September 30, 2022, the Company had working capital of approximately $1.3 million, including cash and cash equivalents of $1.5 million, generated operating losses in 2022 and at September 30, 2022 had an accumulated deficit of $21.7 million. As discussed below, our ability to generate sufficient cash flows to meet our obligations for the twelve months following the issuance of these financial statements is dependent upon factors which are sufficiently outside of management's control as to cast substantial doubt about our ability to continue as a going concern.

Beginning in August 2021 we embarked on a transformative strategy to reposition the Company as a leader in the Zero-Trust, blockchain and Secure Supply Chain marketplace. In December 2021 we acquired Gray Matters, Inc. ("GMI") whose blockchain and encryption algorithm technology was built to solve real-world problems through purpose-built innovation in secure Supply Chain Management (SCM) in United States government organizations. After closing on the GMI acquisition, we focused on the second of our two intended foundational acquisitions, Knowmadics, Inc. ("KMI"), a leading Internet of Things (IoT) remote device management and monitoring platform company. After announcing a definitive agreement in March of 2022, we terminated the agreement on June 6, 2022 due to our inability to raise the funds required to complete the deal under its original terms. Beginning in late 2021 and through the third quarter of 2022 we have hired salespeople, marketers, and software engineers, developed and implemented sales and marketing programs, and expanded our compliance, governance, and administrative infrastructure to support our long-term strategy. At the same time, we have experienced delays in the adoption of our SCM platform by our primary government customer. The result has been a sharp increase in operating expenses, without growth in revenue and gross margins, and negative operating cash flows. In August 2022 we sold 1,572,506 unregistered shares of our common stock in a private offering at a price of $1.20 per share from which we raised aggregate gross proceeds of $1,887,000.

We intend to continue to invest in our SCM platform and to execute our strategy to become a leading zero trust, blockchain-enabled cybersecurity company and believe strongly in the long-term viability of our strategy. We do not have any material contractual obligations or capital expenditures that we are committed to expend over the next 12 months related to these or other activities. We have no outstanding debt that we are required to repay over the next 12 months and have no off-balance-sheet arrangements that are likely to have a material future effect on our financial condition, or changes in financial condition, liquidity or capital resources or expenditures. We used cash from operating activities of approximately $5 million through the first 9 months of 2022 and anticipate that our operating activities may use in excess of that amount over the next 12 months, including satisfying our current liabilities of approximately $2.1 million as of September 30, 2022 and our other typical operating expenses, including payroll for our workforce and other costs. We may also pursue growth in revenue and profitability via acquisition or merger and we plan to implement measures to reduce our operating expense cost structure. We may consider asset sales and other actions to reshape our business.

However, the Company will require additional capital to support its strategy. Other sources of liquidity include our bank line of credit which had $1 million of availability as of September 30, 2022, as well as the Common Stock Purchase Agreement we entered into with B. Riley Principal Capital II, LLC on July 8, 2022 (the "ELOC"), which will enable us to raise additional capital under an equity line of credit. However, the amount of capital we can raise under the ELOC is a function of our trading volume and the market price of our common shares. Without an increase in our recent share price and trading volumes, we do not anticipate that the ELOC will be able to meaningfully support our capital needs. There can be no assurance that additional capital will be available on terms acceptable to us, or at all.

The accompanying unaudited condensed consolidated financial statements have been prepared assuming that the Company will continue as a going concern, which contemplates continuity of operations, realization of assets, and satisfaction of liabilities in the ordinary course of business. The propriety of using the going-concern basis is dependent upon, among other things, the achievement of future profitable operations, the ability to generate sufficient cash from operations and potential other funding sources, in addition to cash on-hand, to meet its obligations as they become due. The Company's unaudited consolidated financial statements do not include any adjustment that might result from the outcome of this uncertainty.

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 September 30, 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 September 30, 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

From August 11 through August 16, 2022, the Company sold 1,572,506 shares of common stock at a price of $1.20 per share in a private placement offering from which it raised aggregate gross proceeds of $1,887,000. The Company relied upon Rule 506(b) of Regulation D in issuing these shares. No placement fees or commissions were paid in connection with the offering. The proceeds are for use for general corporate purposes.

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	Inline XBRL Instance Document	Filed with this Form 10-Q
101.SCH	Inline XBRL Taxonomy Extension Schema	
101.CAL	Inline XBRL Taxonomy Extension Calculation Linkbase	
101.DEF	Inline XBRL Taxonomy Extension Definition Linkbase	
101.LAB	Inline XBRL Taxonomy Extension Label Linkbase	
101.PRE	Inline XBRL Taxonomy Extension Presentation Linkbase	
104	Cover Page Interactive Data File (embedded within the Inline XBRL document 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: November 21, 2022 By: /s/ G. James Benoit, Jr.
G. James Benoit,
Chief Executive Officer

Date: November 21, 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, Jr., 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: November 21, 2022

By: /s/ G. James Benoit, Jr.
G. James Benoit, Jr.
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: November 21, 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, Jr., 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 September 30, 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: November 21, 2022

By: /s/ G. James Benoit, Jr.
G. James Benoit, Jr.
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 September 30, 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: November 21, 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.