

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

FORM 10-K

(Mark One)

- ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended September 30, 2017
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from _____ to _____

Commission File No. 0-18492

DLH HOLDINGS CORP.

(Exact name of registrant as specified in its charter)

New Jersey
(State or other jurisdiction of
incorporation or organization)
3565 Piedmont Road, NE
Atlanta, Georgia
(Address of principal executive offices)

22-1899798
(I.R.S. Employer
Identification No.)

30305
(Zip Code)

(770) 554-3545

(Registrant's telephone number, including area code)

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

| <u>Title of Each Class</u> | <u>Name of Each Exchange on Which Registered</u> |
|--|--|
| COMMON STOCK, PAR VALUE \$.001 PER SHARE | THE NASDAQ STOCK MARKET, LLC |

Securities registered pursuant to Section 12(g) of the Securities Exchange Act: **NONE**

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act 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 and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

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

- Large accelerated filer Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company) 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 accountant 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

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant's most recently completed second fiscal quarter March 31, 2017 was \$29,835,551.

APPLICABLE ONLY TO CORPORATE REGISTRANTS

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date: On November 30, 2017 there were 11,882,494 shares outstanding of common stock of the Registrant.

DOCUMENTS INCORPORATED BY REFERENCE

List hereunder the following documents if incorporated by reference and the Part of the Form 10-K (e.g., Part I, Part II, etc.) into which the document is incorporated: (1) Any annual report to security holders; (2) Any proxy or information statement; and (3) Any prospectus filed pursuant to Rule 424(b) or (e) under the Securities Act of 1933.

Part III of this report incorporates information by reference from the Company's definitive proxy statement, which proxy statement is due to be filed with the Securities and Exchange Commission not later than 120 days after September 30, 2017.

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PART I

FORWARD-LOOKING STATEMENTS

Certain information included or incorporated by reference in this document may not address historical facts and, therefore, could be interpreted to be “forward-looking statements” as that term is defined in the Private Securities Litigation Reform Act of 1995 and other federal securities laws. All statements other than statements of historical fact are statements that could be deemed forward-looking statements, including projections of financial performance; statements of plans, strategies and objectives of management for future operations; any statement concerning developments, performance or industry rankings relating to products or services; any statements regarding future economic conditions or performance; any statements of assumptions underlying any of the foregoing; and any other statements that address activities, events or developments that DLH intends, expects, projects, believes or anticipates will or may occur in the future. Forward-looking statements may be characterized by terminology such as “believe,” “anticipate,” “expect,” “should,” “intend,” “plan,” “will,” “estimates,” “projects,” “strategy” and similar expressions. These statements are based on assumptions and assessments made by the Company’s management in light of its experience and its perception of historical trends, current conditions, expected future developments and other factors it believes to be appropriate. These forward-looking statements are subject to a number of risks and uncertainties that include but are not limited to the factors set forth under Item 1A, Risk Factors in this Annual Report on Form 10-K. Any such forward-looking statements are not guarantees of future performance (financial or operating), and actual results, developments and business decisions may differ materially from those envisioned by such forward-looking statements. The forward-looking statements included herein apply only as of the date of this Annual Report on Form 10-K. The Company disclaims any duty to update such forward-looking statements, all of which are expressly qualified by the foregoing.

ITEM 1. BUSINESS

Overview

DLH Holdings Corp. (“DLH” or the “Company” and also referred to as “we,” “us” and “our”) is a full-service provider of professional healthcare and social services to government agencies including the Department of Veteran Affairs (“VA”), Department of Health and Human Services (“HHS”), Department of Defense (“DoD”), and other government agencies. Incorporated in New Jersey in 1969, the Company principally operates through its subsidiaries.

DLH manages its operations from its principal executive offices at 3565 Piedmont Road NE, Building 3 Suite 700, Atlanta, Georgia 30305. We employ over 1,400 skilled employees working in more than 30 locations throughout the United States.

Our business offerings are focused on three primary sources of revenue within the Federal health services market space, as follows:

- Department of Defense and veteran health services, approximately 62% of our current business base;
- Human services and solutions, approximately 34% of our current business base; and
- Public health and life sciences, approximately 4% of our current business base.

Defense and veterans’ health solutions: DLH provides a wide range of healthcare services and delivery solutions to the Department of Veteran Affairs, US Army Medical Materiel Command and its subordinate US Army Medical Research Acquisition Activity, Navy Bureau of Medicine and Surgery, Defense Health Agency and Army Medical Command. We believe that our DLH-developed tools and processes, including SPOT-m™ and e-PRAT™, along with our cloud-based case management system have been major contributors in differentiating the company within this Federal market.

Advancing the technology readiness level of new development items is a critical priority of our federal agency customers. Our project managers and biomedical engineers perform state-of-the-art research and development, testing and evaluation, and development of new medical systems and devices intended to enhance the medical readiness of troops in combat theaters across the globe. Our medical logistics support assists the uniformed services plan for fielding these new systems and devices. We deliver clinical drug and alcohol counseling services to Navy installations worldwide as part of the clinical preceptorship program, thereby improving the sailor health and readiness. DLH provides a range of case management, physical and behavioral health examinations and associated medical administration services to enhance the assessment and transition process for military personnel readiness commands and individual service members. DLH is also engaged in efforts to alleviate homelessness among Veterans. We provide a range of professional case management services to support Veterans’ transition back into the community. These services include mental health evaluations, behavioral readiness, skills assessment, career counseling, and job preparation services.

DLH is on the forefront of ensuring that veterans receive their out-patient prescriptions on time, each day, through the VA CMOP pharmacy program which has been recognized for service excellence, citing the JD Powers evaluation of mail order pharmacy for each of the past eight years. DLH is proud of our contributions to the VA in achieving these outstanding results. We believe that our operational efficiency and expertise is well-aligned with the VA strategic goals to manage and improve operations and to deliver seamless and integrated support. Our unique capabilities and solutions help the VA optimize efficiency and help ensure program accountability as well as better service.

Human services and solutions: DLH provides a wide range of human services and solutions to the Department of Health and Human Services' Office of Head Start and the Department of Homeland Security. DLH provides a systems-based approach toward assuring that underserved children and youth throughout the country are getting proper educational and environmental support, including health, nutritional, parental, and behavioral services during their formative years - services that are critical to ensuring the long-term health of the nation. Performance verification of grantees delivering such services nationwide is conducted using an evolving system of monitoring, evaluation, tracking and reporting tools against selected key performance indicators relative to school readiness. Large scale federally-funded, regionally managed, and locally delivered services demand innovative monitoring and protocol systems integration to ensure productive and cost-effective results. DLH provides the enterprise-level IT system architecture design, migration plan, and ongoing maintenance (including call center) to manage the implementation using experienced subject matter experts and project management resources.

Public health and life sciences: DLH provides a wide range of services to Department of Health and Human Services' Center for Disease Control and Prevention, the Department of the Interior, and the Department of Agriculture. DLH services include advancing disease prevention methods and health promotion to underserved and hard to reach at-risk communities through development of strategic communication campaigns, research on emerging trends, health informatics analyses, and application of best practices including mobile, social, and interactive media. The company leverages evidence-based methods and web technology to drive health equity to our most vulnerable populations through public engagement. For at-risk wildlife, DLH conducts biological research and surveys covering waterways in key parts of the country to protect and conserve aquatic populations as well as manage wetlands and habitats through environmental assessments. Projects often involve highly specialized expertise and research methodologies. This work is often very seasonal with regard to resources and funding.

Customers

Presently, the Company derives 100% of its revenue from agencies of the Federal government, primarily as a prime contractor but also as a subcontractor to other Federal prime contractors. A major customer is defined as a customer from whom the Company derives at least 10% of its revenues.

Our largest customer continues to be the VA, which comprised approximately 62% and 72% of revenue for the twelve months ended September 30, 2017 and 2016, respectively. Additionally, HHS represents a major customer, comprising 34% and 13% of revenue for the twelve months ended September 30, 2017 and 2016 respectively. Substantially all accounts receivable, including unbilled accounts receivable, are from agencies of the U.S. Government as of September 30, 2017 and 2016. We believe that the credit risk associated with our receivables is limited due to the creditworthiness of these customers. See Note 4, Supporting Financial Information-Accounts Receivable.

As of September 30, 2017, duration of contract awards from the VA and HHS range from approximately one to four years. These agreements are subject to the Federal Acquisition Regulations. While there can be no assurance as to the actual amount of services that the Company will ultimately provide to VA and HHS under its current contracts, we believe that our strong working relationships and our effective service delivery will result in our customers retaining DLH for the full duration of the contract term. The Company's results of operations, cash flows and financial condition would be materially adversely affected in the event that we were unable to continue our relationship with VA or HHS.

Backlog

At September 30, 2017, the total backlog was approximately \$167 million. Total backlog as of September 30, 2016 was approximately \$233 million. Backlog represents total estimated contract value of predominantly multi-year government contracts and will vary depending upon the timing of new/renewal contract awards. Backlog is based upon customer commitments that the Company believes to be firm over the remaining performance period of our contracts. While no assurances can be given that existing contracts will result in earned revenue in any future period, or at all, the Company's major customers have historically exercised their contractual renewal options.

Backlog value is quantified from management judgment and assumptions about the volume of services based on past volume trends and current planning developed with the customer. Our backlog may consist of both funded and unfunded amounts under existing contracts including option periods. At September 30, 2017, our funded backlog was approximately \$74 million and our unfunded backlog was \$93 million.

The value of multi-client, competitive Indefinite Delivery/Indefinite Quantity ("IDIQ") contract awards is included in backlog computation only when a task order is awarded. The award of an IDIQ contract does not represent a firm order for services and is subject to competitive bidding. Generally, under an IDIQ contract, the government is not obligated to order a minimum of services or supplies from its contractor, irrespective of the total estimated contract value.

Position and Distribution of Services and Solutions in Our Markets

Our strengths in the markets in which we compete and the manner in which we are positioned within them, are enhanced by a number of features including, but not limited to:

- high barriers for entry into the selected markets in which we serve;
- specialized credentials and licenses held by a substantial component of our employee base;
- prime contractor position in contracts representing 95% of our revenue;
- strong past performance record, as evidenced by our VA customer scoring the highest in overall satisfaction in the J.D. Power National Pharmacy Study over the past eight years; and
- targeted expansion in critical national priority markets with Federal budget stability.

The Company operates primarily through prime contracts awarded through full and open competition by the government. The Company has a diverse mix of contract vehicles with various agencies of the United States Government, which supports our overall corporate growth strategy. The majority of our contracts are time and materials type contracts. The Company has developed and continues to leverage a suite of solution offerings in a Lean Six Sigma environment, geared toward enhancing performance and productivity while reducing costs to its US government clients. We also provide services under IDIQ and government wide acquisition contracts, such as General Services Administration (GSA) schedule contracts and currently hold multiple GSA schedule contracts, under which we provide services that constitute a significant percentage of our total revenue. These Federal contract schedules are renewed on a recurring basis for a multi-year period.

Competitive Landscape

Full and open competition and long business development cycles are characteristics of the government and defense industry in which we operate. For major program competition, the business acquisition cycle typically ranges from 18 to 36 months. Companies may pursue work either as prime contractor or partner with other companies in a subcontractor role. Those competing as prime contractors normally expend substantially more resources than those in subcontractor roles. We partner and compete with several large and small-business companies in pursuit of acquiring new business.

Our competitor and comparable companies include operating units within, among others: Booz Allen Hamilton Holding Corp., CACI International, Inc., CSRA, Inc., Engility Holdings, Inc., ICF International, Inc., Leidos Holdings, Inc., Mantech International Corp., MAXIMUS, Inc., RTI, UnitedHealth Group, Inc., VSE Corporation and Westat, Inc..

DLH competes with these companies by leveraging our differentiating suite of tools and uniquely integrating people and processes resulting in highly competitive proposals and a solid track record of past performance. We compete for awards through a full and open competition on a "best-value basis". The Company draws heavily from its consistent high quality past performance ratings, proven and evolving technical differentiators, key personnel credentials and growing market recognition to compete. The Company believes that our track record, knowledge and processes with respect to government contract bidding processes represent significant competitive advantages.

Our recent and future success in this competitive landscape hinges on our ability to continue to uniquely integrate people, processes and technology tools to deliver best value solutions for our targeted clients (both government and industry partners). Additionally, our ability to remain cost-competitive remains important.

Intellectual Property

Because our business involves providing services to government entities, our operations generally are not substantially dependent upon obtaining and/or maintaining copyright or trademark protections, although our operations make use of such protections and benefit from them as discriminators in competition. We claim copyright, trademark and other proprietary rights in a variety of intellectual property, including each of our proprietary computer software and data products and the related documentation. DLH holds two registered trademarks, e-PRAT[®] and SPOT-m[®], that optimize resource allocation and supply chain management processes in connection with our business process management services. We maintain a number of trade secrets that contribute to our success and competitive distinction and endeavor to accord such trade secrets adequate protection to ensure their continuing availability.

Government Regulation

Our business is affected by numerous laws and regulations relating to the award, administration and performance of U.S. Government contracts. In addition, many federal and state laws materially affect the Company's operations. These laws relate to ethics, labor, tax, and employment matters. As any employer, DLH is subject to federal and state statutes and regulations governing their standards of business conduct with the government. The development of additional statutes and regulations and interpretation of existing statutes and regulations with respect to our industry can be expected to evolve over time. Through its corporate membership with the Professional Services Council and other affiliations, DLH monitors proposed and pending regulations from relevant congressional committees and government agency policies that have potential impact upon our industry and our specific strategically targeted markets. As with any commercial enterprise, DLH cannot predict with certainty the nature or direction of the development of Federal statutes and regulations that will affect its business operations. See Risk Factors in Part I, Item 1A.

Employee Relations

As of September 30, 2017, the Company employed over 1,400 employees performing in over 30 locations throughout the U.S. Management believes that it has good relations with its employees. In October 2014, employees at our Chicago location approved the adoption of union representation for non-management employees. Union representation has been certified for these employees and collective bargaining discussions are ongoing. Management does not expect this agreement to materially impact results of operations.

Corporate

Our principal executive offices are located at 3565 Piedmont Road NE, Building 3 Suite 700, Atlanta, Georgia 30305. Our telephone number is 770.554.3545 and our website is www.dlhcorp.com. References herein to our website are provided purely as a convenience and do not constitute, and should not be viewed as, incorporation by reference of the information contained on, or available through, the website.

Principal Executive Officers

Our principal executive officers are:

| Name | Age | Positions |
|---------------------|-----|---|
| Zachary C. Parker | 60 | President, Chief Executive Officer and Director |
| Kathryn M. JohnBull | 58 | Chief Financial Officer |
| Kevin Wilson | 52 | President, DLH Solutions, Inc. |
| Helene Fisher | 53 | President, Danya International, LLC. |

Zachary C. Parker became Chief Executive Officer and President of DLH Holdings Corp. in February 2010. He has over 25 years of experience with the government services market, including DoD, holding several senior and executive management positions in addition to business development posts. His tenure includes approximately 19 years with Northrop Grumman, 7 years with GE Government Services (now Leidos Holdings, Inc.), and 3 and 2 years with VSE Corporation and VT Group, respectively. Prior to joining DLH, Mr. Parker held executive positions, including President and previously Executive Vice President for Business Development, within VT Group, from March 2008 to February 2010. His executive development includes the GE Crotonville Executive Development Program, Darden Executive Leadership Program, Northrop Grumman Action Leadership Program, Wharton Earned Value Management, California Institute of Technology Strategic Marketing Program, and is Lean Six Sigma Green Belt certified among other professional and technical certifications. Mr. Parker is active in both professional and community associations including the Governmental Affairs Committee and the Veteran Affairs Task Force of the Washington DC-based Professional Services Council and has served as industry co-chair of the Government/ Industry Partnership Executive council. He is an advisory board member of Hero Health Hire (a non-profit entity). He has also

served as board member on joint venture companies in the government services business. Mr. Parker earned his bachelor's degree from California State University, Northridge (with honors) specializing in Human Factors Engineering and has completed post-graduate studies.

Kathryn M. JohnBull was named Chief Financial Officer on June 25, 2012. She has over 25 years of experience within the government services market, principally with publicly-traded companies who experienced substantial organic and acquisitive growth. From January 2008 to June 2012, Ms. JohnBull was a senior financial executive with QinetiQ North America, serving in both corporate and operating group roles, including as Senior Vice President—Finance for its overall operations. From August 2002 to December 2007, Ms. JohnBull served as Operations Segment Chief Financial Officer for MAXIMUS, Inc, a publicly-traded provider of business process outsourcing, consulting and systems solutions. Prior industry positions, with emphasis on tax and treasury, were with BDM International, Inc. and United Defense. Ms. JohnBull is a certified public accountant and from 1985 to 1988 was with Arthur Andersen & Company as a tax manager and staff. Ms. JohnBull received a Bachelor of Business Administration, summa cum laude, from the University of Tulsa.

Kevin Wilson was appointed as the President of our subsidiary DLH Solutions in October 2008, previously serving as the Director of DLH Solutions from June 2007 through September 2008. From January 2004 to June 2007, Mr. Wilson served as the Director of Strategic Alliances of government services provider SAIC, Inc., where he was responsible for business development in the domestic and foreign defense markets. From March 1997 to January 2004, Mr. Wilson was the Program Manager for a multiyear defense services contract with Endress Hauser Systems & Gauging. Mr. Wilson also worked at Tracer Research Corporation from January 1990 to March 1997, where he was Project Manager for the United States Air Force, Air Combat Command professional services contract. Mr. Wilson holds a BS in Business Marketing from Northwest Missouri State University.

Helene Fisher was appointed as President of our Danya International LLC subsidiary commencing on January 3, 2017. Ms. Fisher has extensive industry experience working on high profile federal government programs. Prior to joining DLH, from 2013 to December 2016 she held leadership positions with MAXIMUS Federal Solutions, LLC as Vice President/Program Director, including responsibility for operations and program performance of a major initiative for the Department of Health and Human Services and several Federal Civilian agencies. Prior to joining MAXIMUS, she held the position of Vice President, Federal Healthcare/Defense/Homeland Security Solutions with Xerox Federal Solutions, LLC from 2009 to 2012. Earlier in her career she held various senior and managerial positions with Northrop Grumman Information Systems and Lockheed Martin Enterprise Solutions & Services. Ms. Fisher holds Project Management Professional (PMP) and Information Technology Infrastructure Library (ITIL) certifications. Ms. Fisher previously served as a U.S. Army Officer, Signal Corps, Captain. She earned a Bachelor of Science degree in Mathematics/Computer Science from Prairie View A&M University, and a Master of Arts degree in Computer Information and Resources from Webster University.

Available Information

We file registration statements, periodic and current reports, proxy statements, and other materials with the Securities and Exchange Commission (SEC). You may read and copy any materials we file with the SEC at the SEC's Public Reference Room at 100 F Street, NE, Room 1580, Washington, DC 20549. You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains a website at www.sec.gov that contains reports, proxy and information statements and other information regarding issuers that file electronically with the SEC, including our filings. We make our public filings with the SEC, including our Annual Report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all exhibits and amendments to these reports available free of charge on our website, <http://www.dlhcorp.com>, as soon as reasonably practicable after we file such material with the SEC. We also make available on our website reports filed by our executive officers and directors on Forms 3, 4 and 5 regarding their ownership of our securities. These materials are available in the "Investor Relations" portion of our website, under the link "SEC Filings." We also use our website to make generally available important information about our company. Important information, including press releases, presentation and financial information regarding our company, is routinely posted on and accessible on the Investor Relations subpage of our website, which is accessible by clicking on the tab labeled "Investor Relations" on our website home page. Information contained on our website is not part of this Annual Report on Form 10-K or any other filings we make with the SEC.

ITEM 1A. RISK FACTORS

As provided for under the Private Securities Litigation Reform Act of 1995 ("1995 Reform Act"), we wish to caution shareholders and investors that the following important factors, among others discussed throughout this Annual Report on Form 10-K for the fiscal year ended September 30, 2017, have affected, and in some cases could affect, our actual results of operations and cause our results to differ materially from those anticipated in forward looking statements made herein. Our business, results of operations, cash flows and financial condition may be materially and adversely affected due to any of the

following risks. The risks described below are not the only ones we face. Additional risks we are not presently aware of or that we currently believe are immaterial may also impair our business operations. The trading price of our common stock could decline due to any of these risks. In assessing these risks, you should also refer to the other information contained or incorporated by reference in this Annual Report on Form 10-K, including our consolidated financial statements and related notes.

Risks Relating to Our Business and Our Industry

We depend on contracts with the Federal government for virtually all of our revenue and our business could be seriously harmed if the Federal government decreased or ceased doing business with us or changed its budgets or budgetary priorities.

Presently, the Company derives 100% of its revenue from agencies of the Federal government, primarily as a prime contractor but also as a subcontractor to other Federal prime contractors. A major customer is defined as a customer from whom the Company derives at least 10% of its revenues.

Our largest customer continues to be the VA, which comprised approximately 62% and 72% of revenue for the twelve months ended September 30, 2017 and 2016, respectively. Additionally, HHS represents a major customer, comprising 34% and 13% of revenue for the twelve months ended September 30, 2017 and 2016 respectively. Substantially all accounts receivable, including unbilled accounts receivable, are from agencies of the U.S. Government as of September 30, 2017 and 2016. Accordingly, we remain dependent upon the continuation of our relationships with the VA and HHS. We believe that the credit risk associated with our receivables is limited due to the creditworthiness of these customers.

As of September 30, 2017, awards from VA and HHS have anticipated periods of performance ranging from approximately one to four years. These agreements are subject to the Federal Acquisition Regulations. While there can be no assurance as to the actual amount of services that the Company will ultimately provide to VA and HHS under its current contracts, we believe that our strong working relationships and our effective service delivery support ongoing performance for the contract term.

Because we derive all of our revenue from contracts with the Federal government, the success and development of our business will continue to depend on our successful participation in Federal government contract programs. In recent years past, we have seen frequent debates regarding the scope of funding of our customers, thereby leading to budgetary uncertainty for our Federal customers. Future instances of this uncertainty may result in reduced awards, postponements in procurement of services and delays in collection of payments, which may affect our results of operations. Therefore, period-to-period comparisons of our operating results may not be a good indication of our future performance. In the event the budgets or budgetary priorities of the U.S. Government entities with which we do business are delayed, decreased or underfunded, our consolidated revenues and results of operations could be materially and adversely affected.

Loss of our GSA schedule contracts or other contracting vehicles could impair our ability to win new business and perform under existing contracts.

We currently hold multiple GSA schedule contracts, including a Federal supply schedule contract for professional and allied healthcare services and the logistics worldwide services contract. If we were to lose one or more of these contracts or other contracting vehicles, we could lose a significant revenue source and our operating results and financial condition could be materially and adversely affected.

We may experience fluctuations in our revenues and operating results from period to period.

Our quarterly revenue and operating results may fluctuate significantly and unpredictably in the future. We have expended, and will continue to expend, substantial resources to enhance our health services offerings and expansion into the Federal health market. We may incur growth expenses before new business revenue is realized, thus showing lower profitability in a particular period or consecutive periods. We may be unable to achieve desired levels of revenue growth due to circumstances that are beyond our control, as already expressed regarding competition, government budgets, and the procurement process in general. Although we continue to manage our operating costs and expenses, there is no guarantee that we will significantly increase future revenue and profit in any particular future period. Revenue levels achieved from our customers, the mix of solutions that we offer and our performance on future contracts will affect our financial results.

Future legislative or government budgetary and spending changes could negatively impact our business.

U.S. Government programs are subject to annual congressional budget authorization and appropriation processes. For many programs, Congress appropriates funds on a fiscal year basis even though the program performance period may extend over

several years. Consequently, programs are often partially funded initially and additional funds are committed only as Congress makes further appropriations. Further, congressional seats may change during election years, and the balance of spending priorities may change along with them. The election of the new President of the United States in November 2016 is also changing Federal spending priorities. These potential shifts in spending priorities could result in lower funding for our VA and Head Start programs.

Our growth into government markets may be impacted by measures in place since March 2013, when the federal government began operating under sequestration required by the Budget Control Act of 2011 (BCA). Under sequestration, reductions in both defense and civil agency expenditures have taken place in each of the government's fiscal years since 2013 and, unless the BCA is amended or repealed, will continue through the government's Fiscal Year 2021.

VA programs, which accounted for approximately 62% and 72% of Company revenue for the twelve months ended September 30, 2017 and 2016, respectively, were exempt from the spending caps established under Federal government sequestration targets enacted in 2013.

A final FY2018 budget was not passed into law prior to October 1, 2017. Consequently, a continuing resolution (CR) was passed into law on September 8, 2017 and subsequently extended through December 22, 2017. The CR essentially continues funding at FY17 levels but will not allow for contracts for new services to be initiated. To continue operating after the CR December 22, 2017 expiration date, Congress will need to pass, and the President will need to sign, a new CR or more comprehensive budget bill. The Company does not believe these measures will have a material impact on our current business base for fiscal year 2018, however, any delays in addressing funding may delay in addressing funding may delay the timing of awards for new business.

The U.S. Government contract bid process is highly competitive, complex and sometimes lengthy, and is subject to protest and implementation delays.

Many of our contracts and task orders with the Federal government are awarded through a competitive bidding process, which is complex and sometimes lengthy. We expect that much of the business that we will seek in the foreseeable future will continue to be awarded through competitive bidding. Many of our competitors are larger and have greater resources than we do, larger client bases and greater brand recognition. Our competitors, individually or through relationships with third parties, may be able to provide clients with different or greater capabilities or benefits than we can provide. If we are unsuccessful in competing with these other companies, our revenues and margins may materially decline.

In addition, the federal government has implemented regulations that are intended to promote its goal of supporting small business contractors. Various agencies within the federal government have policies that support small business goals, including the adoption of the "Rule of Two" by the Veterans Administration. The effect of these set-aside provisions may limit our ability to compete for prime contractor positions on programs that we have targeted for growth.

Overall, the competitive bidding process presents a number of risks, including the following: (i) we expend substantial cost and managerial time and effort to prepare bids and proposals for contracts that we may not win, and to defend those bids through any protest process; (ii) we may be unable to estimate accurately the resources and cost structure that will be required to service any contract we win; and (iii) we may encounter expenses and delays if our competitors protest or challenge awards of contracts to us in competitive bidding, and any such protest or challenge could result in the resubmission of bids on modified specifications, or in the termination, reduction or modification of the awarded contract. There can be no assurance that we will win any particular bid, or that we will be able to replace business lost upon expiration or completion of a contract, and the termination or non-renewal of any of our significant contracts could cause our actual results to differ materially and adversely from those anticipated.

If a bid is won and a contract awarded, there still is the possibility of a bid protest or other delays in implementation. Our business could be adversely affected by delays caused by our competitors protesting major contract awards received by us, resulting in the delay of the initiation of work. It can take many months to resolve protests by one or more of our competitors of contract awards we receive. The resulting delay in the startup and funding of the work under these contracts may cause our actual results to differ materially and adversely from those anticipated, and there can be no assurance that such protest process or implementation delays will not have a material adverse effect on our financial condition or results of operations in the future.

Our business may suffer if we or our employees are unable to obtain the security clearances or other qualifications we and they need to perform services for our clients.

Many federal government contracts require us to have security clearances and employ personnel with specified levels of education, work experience and security clearances. Depending on the level of clearance, security clearances can be difficult and time-consuming to obtain. If we or our employees lose or are unable to obtain necessary security clearances, we may not be able to win new business and our existing clients could terminate their contracts with us or decide not to renew them. To the extent we cannot obtain or maintain the required security clearances for our employees working on a particular contract, we may not derive the revenue anticipated from the contract, which could cause our results to differ materially and adversely from those anticipated.

Our business is regulated by complex federal procurement laws and regulations, and we are subject to periodic compliance reviews by governmental agencies.

We must comply with complex laws and regulations relating to the formation, administration, and performance of federal government contracts. These laws and regulations create compliance risk and affect how we do business with our federal agency clients, and may impose added costs on our business. The government may in the future reform its procurement practices or adopt new contracting rules and regulations, including cost accounting standards, that could be costly to satisfy or that could impair our ability to obtain new contracts.

Our performance on our U.S. Government contracts and our compliance with applicable laws and regulations, including submission of invoices to our customers, are subject to audit by the government. The scope of any such audits could span multiple fiscal years. If a government review or investigation uncovers illegal activities or activities not in compliance with a particular contract's terms or conditions, we may be subject to civil and criminal penalties and administrative sanctions, including termination of contracts, forfeiture of profits, harm to our reputation, suspension of payments, fines, and suspension or debarment from doing business with Federal government agencies. Any of these events could lead to a material reduction in our revenues, cash flows and operating results. Further, as the reputation and relationships that we have established and currently maintain with government personnel and agencies are important to our ability to maintain existing business and secure new business, damage to our reputation or relationships could have a material adverse effect on our revenue and operating results.

U.S. Government contracts may be terminated at will and we may not receive the full amounts authorized under the contracts included in our backlog, which could reduce our revenue in future periods below the levels anticipated.

Many of the U.S. Government programs in which we participate as a contractor or subcontractor may extend for several years. The U.S. Government may modify, curtail or terminate its contracts and subcontracts for convenience and to the extent that a contract award contemplates one or more option years, the Government may decline to exercise such option periods. Accordingly, the maximum contract value specified under a government contract or task order awarded to us is not necessarily indicative of the revenue that we will realize under that contract. Due to our dependence on these programs, the modification, curtailment or termination of our major programs or contracts may have a material adverse effect on our results of operations and financial condition. In addition, our contracts may only be partially funded at any point during their term, and some of the work intended to be performed under such contracts will remain unfunded pending subsequent appropriations of funds to the contract by the procuring agency. Our backlog consists of funded backlog, which is based on amounts actually committed by a client for payment for goods and services, and unfunded backlog, which is based upon management's estimate of the future potential of our existing contracts and task orders, including options, to generate revenue. Our backlog may not result in actual revenue in any particular period, or at all, which could cause our actual results to differ materially and adversely from those anticipated.

Our business growth and profitable operations require that we develop and maintain strong relationships with other contractors with whom we partner or otherwise depend.

We may enter into future teaming ventures with other companies, which carry risk in regards to maintaining strong, trusted working relationships in order to successfully fulfill contract obligations. Teaming arrangements may include being engaged as a subcontractor to a prime contractor, engaging a subcontractor on a contract for which we are the prime contractor, or entering into a joint venture with another company. We may lack control over fulfillment of such contracts, and poor performance on the contract could impact our customer relationship, even if we perform as required. We expect to depend on relationships with other contractors for a portion of our revenue in the foreseeable future. Our revenue and operating results could differ materially and adversely from those anticipated if any such prime contractor or teammate chooses to offer directly to the client services of the type that we provide or if they team with other companies to provide those services.

Our employees, or those of our teaming partners, may engage in misconduct or other improper activities which could harm our business.

We are exposed to risk from misconduct or fraud by our employees, or employees of our teaming partners. Such violations could include intentional disregard for Federal government procurement regulations, engaging in unauthorized activities,

seeking reimbursement for improper expenses, or falsifying time records. Employee misconduct could also involve the improper use of our clients' sensitive or classified information and result in a serious harm to our reputation. While we have appropriate policies in effect to deter illegal activities and promote proper conduct, it is not always possible to deter employee misconduct. Precautions to prevent and detect this activity may not be effective in controlling such risks or losses, which could materially and adversely affect our business, results of operations, financial condition, cash flows, and liquidity.

Our profits and revenues could suffer if we are involved in legal proceedings, investigations and disputes.

We are exposed to legal proceedings, investigations and disputes. In addition, in the ordinary course of our business we may become involved in legal disputes regarding personal injury or employee disputes. While we provision for these types of incidents through commercial third party insurance carriers, we often defray these types of cost through higher deductibles. Any unfavorable legal ruling against us could result in substantial monetary damages by losing our deductible portion of carried insurance. We maintain insurance coverage as part of our overall legal and risk management strategy to lower our potential liabilities. If we sustain liabilities that exceed our insurance coverage or for which we are not insured, it could have a material adverse impact on our results of operations, cash flows and financial condition, including our profits, revenues and liquidity.

We are dependent upon certain of our management personnel and do not maintain "key personnel" life insurance on our executive officers.

Our success to date has resulted in part from the significant contributions of our executive officers. Our executive officers are expected to continue to make important contributions to our success. As of September 30, 2017, certain of our officers are under employment contracts. However, we do not maintain "key person" life insurance on any of our executive officers. Loss for any reason of the services of our key personnel could materially affect our operations.

We may not be fully covered by the insurance we procure and our business could be adversely impacted if we were not able to renew all of our insurance plans.

Although we carry multiple lines of liability insurance (including coverage for medical malpractice and workers' compensation), they may not be sufficient to cover the total cost of any judgments, settlements or costs relating to any present or future claims, suits or complaints. If we are unable to secure renewal of our insurance contracts or the renewal of such contracts with favorable rates and with competitive benefits, our business could be adversely affected. In addition, sufficient insurance may not be available to us in the future on satisfactory terms or at all. Our placement of employees increases our potential liability for negligence and professional malpractice and such liabilities may not become immediately apparent. Any increase in our costs of insurance will impact our profitability to the extent that we cannot offset these increases into our costs of services. If the insurance we carry is not sufficient to cover any judgments, settlements or costs relating to any present or future claims, suits or complaints, our business, financial condition, results of operations and liquidity could be materially adversely affected.

Our financial condition may be affected by increases in employee healthcare claims and insurance premiums, unemployment taxes and workers' compensation claims and insurance rates.

Our current workers' compensation and medical plans are partially self-funded insurance programs. The Company currently pays base premiums plus actual losses incurred, not to exceed certain individual and aggregate stop-loss limits. In addition, health insurance premiums, state unemployment taxes and workers' compensation rates for the Company are in large part determined by our claims experience. These categories of expenditure comprise a significant portion of our direct costs. If we experience a large increase in claim activity, our direct expenditures, health insurance premiums, unemployment taxes or workers' compensation rates may increase. Although we employ internal and external risk management procedures in an attempt to manage our claims incidence and estimate claims expenses and structure our benefit contracts to provide as much cost stability as reasonably possible given the self-funded nature of our plans, we may not be able to prevent increases in claim activity, accurately estimate our claims expenses or pass the cost of such increases on to our clients. Since our ability to incorporate such increases into our fees to our clients is constrained by contractual arrangements with our clients, a delay could occur before such increases could be reflected in our fees, which may reduce our profit margin. As a result, such increases could have a material adverse effect on our financial condition, results of operations and liquidity.

If we are unable to attract qualified personnel, our business may be negatively affected.

We rely heavily on our ability to attract and retain qualified professionals and other personnel who possess the skills, experience and licenses necessary in order to provide our solutions for our assignments. Our business is materially dependent upon the continued availability of such qualified personnel. Our inability to secure qualified personnel would have a material adverse effect on our business. The cost of attracting qualified personnel and providing them with attractive benefits packages may be higher than we anticipate and, as a result, if we are unable to pass these costs on to our clients, our profitability could

decline. Moreover, if we are unable to attract and retain qualified personnel, the quality of our services may decline and, as a result, we could lose clients.

We are exposed to increased costs and risks associated with complying with increasing and new regulation of corporate governance and disclosure standards.

Since the effectiveness for us of the Sarbanes-Oxley Act of 2002, we spend an increasing amount of management's time and resources (both internal and external) to comply with changing laws, regulations and standards relating to corporate governance and public disclosures. This compliance requires management's annual review and evaluation of our internal control systems. This process has caused us to engage outside advisory services and has resulted in additional accounting and legal expenses. We may encounter problems or delays in completing these reviews and evaluation and the implementation of improvements. If we are not able to timely comply with the requirements set forth in the Sarbanes-Oxley Act of 2002, we might be subject to sanctions or investigation by regulatory authorities. Any such action could materially adversely affect our business and our stock price.

We are highly dependent on the proper functioning of our information systems.

We are highly dependent on the proper functioning of our information systems in operating our business. Critical information systems used in daily operations match employee resources and client assignments and track regulatory credentialing. They also perform payroll, billing and accounts receivable functions. While we have multiple back up plans for these types of contingencies, our information systems are vulnerable to fire, storm, flood, power loss, telecommunication outages, physical or software break-ins and similar events. If our information systems become inoperable, or are otherwise unavailable, these functions would have to be accomplished manually, which in turn could impact our financial viability, due to the increased cost associated with performing these functions manually.

Our systems and networks may be subject to cybersecurity breaches.

Many of our operations rely heavily upon technology systems and networks to receive, input, maintain and communicate participant and client data pertaining to the programs we manage. If our systems or networks were compromised by a security breach, we could be adversely affected by losing confidential or protected information of program participants and clients, and we could suffer reputational damage and a loss of confidence from prospective and existing clients. Similarly, if our internal networks were compromised, we could be adversely affected by the loss of proprietary, trade secret or confidential technical and financial data. The loss, theft or improper disclosure of that information could subject the Company to sanctions under the relevant laws, lawsuits from affected individuals, negative press articles and a loss of confidence from our government clients, all of which could adversely affect our existing business, future opportunities and financial condition.

We may have difficulty identifying and executing acquisitions on favorable terms and therefore may grow at slower than anticipated rates.

One of our potential paths to key growth is to selectively pursue acquisitions. Through acquisitions, we may be able to expand our base of federal government customers, increase the range of solutions we offer to our customers and deepen our penetration of existing markets and customers. We may not identify and execute suitable acquisitions. To the extent that management is involved in identifying acquisition opportunities or integrating new acquisitions into our business, our management may be diverted from operating our core business. Without acquisitions, we may not grow as rapidly otherwise, which could cause our actual results to differ materially and adversely from those anticipated.

We may encounter other risks in regard to making acquisitions, including:

- increased competition for acquisitions may increase the costs of our acquisitions;
- non-discovery or non-disclosure of material liabilities during the due diligence process, including omissions by prior owners of any acquired businesses or their employees in complying with applicable laws or regulations, or their inability to fulfill their contractual obligations to the federal government or other customers; and
- acquisition financing may not be available on reasonable terms or at all.

Any of these risks could cause our actual results to differ materially and adversely from those anticipated.

We may have difficulty integrating the operations of companies we acquire, which could cause actual results to differ materially and adversely from those anticipated.

The success of our acquisition strategy will depend upon our ability to successfully integrate any businesses we may acquire in the future. The integration of these businesses into our operations may result in unforeseen operating difficulties, absorb significant management attention and require significant financial resources that would otherwise be available for the ongoing development of our business. These integration difficulties include the integration of personnel with disparate business backgrounds, the transition to new information systems, coordination of geographically dispersed organizations, loss of key employees of acquired companies, and reconciliation of different corporate cultures. For these or other reasons, we may be unable to retain key customers of acquired companies. Moreover, any acquired business may not generate the revenue or net income we expected or produce the efficiencies or cost-savings we anticipated. Any of these outcomes could cause our actual results to differ materially and adversely from those anticipated.

If our subcontractors do not perform their contractual obligations, our performance as a prime contractor and our ability to obtain future business could be materially and adversely impacted and our actual results could differ materially and adversely from those anticipated.

Our performance of government contracts may involve the issuance of subcontracts to other companies upon which we rely to perform all or a portion of the work we are obligated to deliver to our customers. Unsatisfactory performance by one or more of our subcontractors to deliver on a timely basis the agreed-upon supplies, perform the agreed-upon services, or appropriately manage their vendors may materially and adversely impact our ability to perform our obligations as a prime contractor. A subcontractor's performance deficiency could result in the government terminating our contract for default. A default termination could expose us to liability for excess costs of reprocurement by the government and have a material adverse effect on our ability to compete for future contracts and task orders. Depending upon the level of problem experienced, such problems with subcontractors could cause our actual results to differ materially and adversely from those anticipated.

We have incurred debt in connection with an acquisition and we must make the scheduled principal and interest payments on the facility and maintain compliance with other debt covenants.

On May 2, 2016, we entered into a loan agreement with Fifth Third Bank under which the bank agreed to provide (i) a \$25.0 million senior secured term loan (the "Term Loan") with a five year maturity date and (ii) a two (2) year revolving loan facility in an aggregate amount of up to \$10 million (the "Revolving Loan Facility"). Specifics of the loan agreement are discussed in Note 5 to this report.

The loan agreement requires compliance with a number of financial covenants and contains restrictions on our ability to engage in certain transactions. Among other matters, we must comply with limitations on: granting liens; incurring other indebtedness; maintenance of assets; investments in other entities and extensions of credit; mergers and consolidations; and changes in nature of business. Also, the loan agreement requires us to comply with certain financial covenants including a minimum fixed charge coverage ratio and a Funded Indebtedness to Adjusted EBITDA ratio. In addition to monthly payments of the outstanding indebtedness, the loan agreement also requires prepayments of a percentage of excess cash flow, as defined in the loan agreement. Accordingly, a portion of our cash flow from operations will be dedicated to the repayment of our indebtedness.

The loan agreement provides for customary events of default following which the bank may, at its option, terminate the commitments under the loan agreement, stop making additional credit available, declare amounts outstanding, including principal and accrued interest and fees, payable immediately, and enforce any and all rights and interests of the lenders. The defined events of default include, among other things, a payment default, covenant default or defaults on other indebtedness or judgments in excess of a stipulated amount, change of control events, suspension or disbarment from contracting with the federal government and the material inaccuracy of our representations and warranties. If we are unable to make the scheduled principal and interest payments on the loan agreement or maintain compliance with other debt covenants, we may be in default under the loan agreement, which would likely have a material adverse effect on our business, financial condition and results of operations.

We have a substantial amount of goodwill on our balance sheet. Future write-offs of goodwill may have the effect of decreasing our earnings or increasing our losses.

We have previously obtained growth through acquisitions of other companies and businesses. Under existing accounting standards, we are required to periodically review goodwill assets for possible impairment. In the event that we are required to write down the value of any assets under these pronouncements, it may materially and adversely affect our earnings. See the more detailed discussion appearing as part of our Management's Discussion and Analysis of Financial Condition and Results of Operations in Item 7 herein.

We have a significant amount of net operating loss carry forwards which we may not be able to utilize in certain circumstances.

At September 30, 2017, we had net operating losses, or NOLs, of approximately \$31.5 million and \$1.8 million for U.S. and state tax return purposes, respectively. Our U.S. NOLs begin to expire in 2021 and continue to expire through 2033. Based upon our current estimate of future taxable earnings, we expect to fully utilize these NOLs; however future taxable income may vary significantly from our current estimate.

We may be significantly impacted by proposed tax legislation.

Subsequent to our fiscal year end, both branches of Congress passed major federal tax reform legislation. While the exact terms of the legislation will not be finalized until the reconciliation process is completed, the resulting bill may have a material impact to our business. The tax effects resulting from any changes in tax laws or tax rates are not permitted to be recognized until the period that includes the enactment date, which will occur when a bill is signed into law, and subjected to the full legislative process. The Company is closely monitoring the proposed legislation and is prepared to quantify and recognize any potential impact in the period in which the legislation is enacted.

Risks Relating To Our Stock

Our stock price may be volatile and your investment in our common stock may suffer a decline in value.

The price of our common stock could be subject to fluctuations and may decline in the future due to risks defined herein, or general changes in market conditions such as increased interest rates, a recession, or a change in Federal spending priorities.

Since we have not paid dividends on our common stock, you cannot expect dividend income from an investment in our common stock.

We have not paid any dividends on our common stock since our inception and do not contemplate or anticipate paying any dividends on our common stock in the foreseeable future. Current lenders do and future potential lenders may prohibit us from paying dividends without its prior consent. Therefore, holders of our common stock may not receive any dividends on their investment in us. Earnings, if any, may be retained and used to finance the development and expansion of our business.

We may issue preferred stock with rights senior to our common stock, which may adversely impact the voting and other rights of the holders of our common stock.

Our certificate of incorporation authorizes the issuance of "blank check" preferred stock with such designations, rights and preferences as may be determined from time to time by our board of directors up to an aggregate of 5,000,000 shares of preferred stock. Accordingly, our board of directors is empowered, without stockholder approval, to issue preferred stock with dividend, liquidation, conversion, voting or other rights, which would adversely affect the voting power or other rights of the holders of our common stock. In the event of issuance, the preferred stock could be utilized, under certain circumstances, as a method of discouraging, delaying or preventing a change in control of our Company, which could have the effect of discouraging bids for our Company and thereby prevent stockholders from receiving the maximum value for their shares. Although we have no present intention to issue any shares of our preferred stock, in order to discourage or delay a change of control of our Company, we may do so in the future. In addition, we may determine to issue preferred stock in connection with capital raising efforts and the terms of the stock so issued could have special voting rights or rights related to the composition of our Board.

The exercise of our outstanding common stock options and warrants may depress our stock price and dilute your ownership of the company.

As of September 30, 2017, the following options and warrants were outstanding:

- Executive and employee options to purchase 1.99 million shares of common stock, 1.33 million of which are vested and immediately exercisable. The weighted average exercise price of the outstanding stock options is \$3.83 per share.
- Warrants issued to Wynnefield Capital to purchase 53,619 shares of common stock with an exercise price of \$3.73 per share.

To the extent that these securities are exercised, dilution to our shareholders will occur. Moreover, the terms upon which we will be able to obtain additional equity capital may be adversely affected, since the holders of these securities can be expected to exercise them at a time when we would, in all likelihood, be able to obtain any needed capital on terms more favorable to us than the exercise terms provided by those securities.

Anti-takeover provisions in our Articles of Incorporation make a change in control of our Company more difficult.

The provisions of our Articles of Incorporation and the New Jersey Business Corporation Act, together or separately, could discourage potential acquisition proposals, delay or prevent a change in control and limit the price that certain investors might be willing to pay in the future for our common stock. Among other things, these provisions:

- require certain supermajority votes; and
- establish certain advance notice procedures for nomination of candidates for election as directors and for shareholders' proposals to be considered at shareholders' meetings.

In addition, the New Jersey Business Corporation Act contains provisions that, under certain conditions, prohibit business combinations with 10% shareholders and any New Jersey corporation for a period of five years from the time of acquisition of shares by the 10% shareholder. The New Jersey Business Corporation Act also contains provisions that restrict certain business combinations and other transactions between a New Jersey corporation and 10% shareholders.

Our executive officers, directors and significant stockholders will be able to influence matters requiring stockholder approval

As of September 30, 2017, our executive officers, directors and largest shareholder (Wynnefield Capital, Inc. and its affiliates) own approximately 47% of our outstanding common stock. Within this amount, Wynnefield Capital, Inc. and its affiliates own approximately 37% of our outstanding common stock. This concentration of ownership may have the effect of delaying, preventing or deterring a change in control of our company, could deprive our stockholders of an opportunity to receive a premium for their common stock as part of a sale or merger of our company and may negatively affect the market price of our common stock. These transactions might include proxy contests, tender offers, mergers or other purchases of common stock that could give our stockholders the opportunity to realize a premium over the then-prevailing market price for shares of our common stock.

In addition, persons associated with Wynnefield Capital, Inc. currently serve on our Board of Directors. As a result of this share ownership and relationships on our Board of Directors, our largest stockholder will be able to influence all affairs and actions of our company, including matters requiring stockholder approval such as the election of directors and approval of significant corporate transactions. The interests of our principal stockholders may differ from the interests of the other stockholders.

ITEM 1B. UNRESOLVED STAFF COMMENTS

There are no unresolved staff comments.

ITEM 2. PROPERTIES

Operations and Facilities

DLH's corporate headquarters are located at 3565 Piedmont Road NE, Building 3 Suite 700, Atlanta, Georgia 30305. The Company maintains a National Capital Region office in Silver Spring, Maryland.

In the fiscal year ended September 30, 2017, DLH's total lease expense for operations was approximately \$1.1 million.

The following is summary information on DLH's facilities as of September 30, 2017:

| <u>Location</u> | <u>Approximate Square Feet</u> | (\$ in thousands) | |
|---|------------------------------------|---|----------------------------|
| | | <u>Approximate Annual Lease Expense</u> | <u>Expiration Date</u> |
| Corporate Headquarters 3565 Piedmont Road, NE, Building 3, Suite 700 Atlanta, GA 30305 | 12,275 | \$306 | 4/30/2024 |
| National Capital Region Office 8737 Colesville Road, Suite 1100 Silver Spring, MD 20910 | 22,400 | \$623 | 4/30/2020 |

ITEM 3. LEGAL PROCEEDINGS

As a commercial enterprise and employer, the Company is subject to various claims and legal actions in the ordinary course of business. These matters can include professional liability, employment-relations issues, workers' compensation, tax, payroll and employee-related matters, other commercial disputes arising in the course of its business, and inquiries and investigations by governmental agencies regarding our employment practices or other matters. The Company is not aware of any pending or threatened litigation that it believes is reasonably likely to have a material adverse effect on its results of operations, financial position or cash flows.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED SHAREHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Principal Market

Our common stock is currently traded on The Nasdaq Capital Market under the symbol "DLHC."

Market Information

The ranges of high and low sales prices for the Company's common stock for the periods indicated below are:

Common Stock

| FISCAL YEAR 2017 | LOW | HIGH |
|------------------|---------|---------|
| 1st Quarter | \$ 4.47 | \$ 7.38 |
| 2nd Quarter | \$ 4.61 | \$ 6.72 |
| 3rd Quarter | \$ 4.10 | \$ 6.36 |
| 4th Quarter | \$ 5.33 | \$ 6.49 |

| FISCAL YEAR 2016 | LOW | HIGH |
|------------------|---------|---------|
| 1st Quarter | \$ 1.89 | \$ 4.47 |
| 2nd Quarter | \$ 2.50 | \$ 4.38 |
| 3rd Quarter | \$ 3.51 | \$ 5.32 |
| 4th Quarter | \$ 4.32 | \$ 5.72 |

The above quotations reported by Nasdaq, represent prices between dealers and do not include retail mark-ups, markdowns or commissions. Such quotations do not necessarily represent actual transactions. On September 29, 2017, the Company's common stock had a closing price of \$6.48 per share.

Dividends

The Company has not declared any cash dividends on its common stock since inception and has no present intention of paying any cash dividends on its common stock in the foreseeable future.

Approximate Number of Equity Security Holders

As of September 30, 2017, there were 11,767,369 shares of common stock outstanding held of record by approximately 146 persons. The number of stockholders of record is not representative of the number of beneficial stockholders due to the fact that many shares are held by depositories, brokers, or nominees. As of September 30, 2017, the Company estimates that there are approximately 1,423 beneficial owners of its common stock.

Sales of Unregistered Securities

During the period covered by this report, the Company did not issue any securities that were not registered under the Securities Act of 1933, as amended, except as has been reported in previous filings with the SEC or as set forth elsewhere herein.

Securities Authorized for Issuance under Equity Compensation Plans

DLH presently utilizes one shareholder-approved equity compensation plan under which it makes equity compensation awards available to officers, directors, employees and consultants. The table set forth below discloses outstanding and available awards under our equity compensation plans as of September 30, 2017. All grants of equity securities made to executive officers and directors are presently made under the 2016 Omnibus Equity Incentive Plan (the "2016 Plan"). Prior to the adoption of the 2016 Plan, awards of equity securities were made under the 2006 Long Term Incentive Plan.

Equity Compensation Plan Information

| Plan Category | (a) Number of Securities to be issued upon exercise of outstanding options, warrants and rights | (b) Weighted Average exercise price of outstanding options, warrants and rights (or fair value at date of grant) | (c) Number of securities remaining available for future issuances under equity compensation plans (excluding securities reflected in column (a)) |
|---|--|--|--|
| Equity Compensation Plans Approved by Security Holders: | | | |
| Employee stock options | 1,993,500 | \$ 3.83 | 506,250 |

Registrant Repurchases of Securities

On September 18, 2013, the Company announced that our Board of Directors authorized a stock repurchase program (the Program) under which we could repurchase up to \$350 thousand of shares of our common stock through open market transactions in compliance with Securities and Exchange Commission Rule 10b-18, privately negotiated transactions, or other means. This repurchase program does not have an expiration date.

During fiscal fourth quarter ended September 30, 2017, the Company did not repurchase any shares of its common stock pursuant to the program. As of September 30, 2017 there is a total of \$77 thousand remaining for repurchases under the program.

The following table provides certain information with respect to the status of our stock repurchase program as of fourth quarter ended September 30, 2017:

| | (\$ in thousands) | | | |
|-----------------------------|----------------------------------|------------------------------|---|--|
| Period | Total Number of Shares Purchased | Average Price Paid Per Share | Total Number of Shares Purchased As Part of Publicly Announced Programs | Dollar Value of Shares that May Yet Be Purchased Under the Plan or Program |
| July 2017 | — | \$ — | — | \$ 77 |
| August 2017 | — | \$ — | — | \$ 77 |
| September 2017 | — | \$ — | — | \$ 77 |
| Fourth Quarter Total | — | \$ — | — | \$ 77 |

ITEM 6. SELECTED FINANCIAL DATA

We are a "smaller reporting company" as defined by Regulation S-K and as such, are not required to provide the information contained in this item pursuant to Regulation S-K.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward Looking and Cautionary Statements

You should read the following discussion in conjunction with the Condensed Consolidated Financial Statements and the notes to those statements included elsewhere in this Annual Report on Form 10-K for the year ended September 30, 2017. This discussion contains certain statements that are forward-looking within the meaning of the Private Securities Litigation Reform Act of 1995. Certain statements contained in this Management's Discussion and Analysis are forward-looking statements that involve risks and uncertainties. In addition, any statements that refer to expectations, projections or other characterizations of future events or circumstances are forward-looking statements. The forward-looking statements are not historical facts, but rather are based on current expectations, estimates, assumptions and projections about our industry and business. Our actual results could differ materially from the results contemplated by these forward-looking statements.

Business Overview:

DLH is a provider of technology-enabled business process outsourcing and program management solutions, primarily to improve and better deploy large-scale federal health and human service initiatives. DLH derives 100% of its revenue from agencies of the Federal government, providing services to several agencies including the Department of Veteran Affairs ("VA"), Department of Health and Human Services ("HHS"), and the Department of Defense ("DoD").

Publicly traded with more than 1,400 employees working in over 30 locations throughout the United States, DLH was recently recognized by GovWin IQ as a top service provider in the Health Services Spending category.

Our business offerings are now focused on three primary sources of revenue within the Federal health services market space, as follows:

- Department of Defense and veteran health services, approximately 62% of our current business base;
- Human services and solutions, approximately 34% of our current business base; and
- Public health and life sciences, approximately 4% of our current business base.

Forward Looking Business Trends:

DLH's mission is to become the most trusted provider of technology-enabled healthcare and public health services, medical logistics, and readiness enhancement services to active duty personnel securing the freedom of our nation, veterans, and civilian populations and communities. Our primary focus within the defense agency markets include military service members and veterans' requirements for telehealth services, behavioral healthcare, medication therapy management, health IT commodities, process management, clinical systems support, and healthcare delivery. Our primary focus within the civilian agency markets include healthcare and social programs delivery and readiness. These include compliance monitoring on large scale programs, technology-enabled program management, consulting, and digital communications solutions ensuring that

education, health, and social standards are being achieved within underserved and at risk populations. We believe these business development priorities will position DLH to expand within top national priority programs and funded areas.

Federal budget outlook for fiscal 2018:

The President of the United States' broad agenda calls for increased military and, in certain cases, domestic spending, with reduced spending on foreign programs. Most relevant to DLH's targeted markets, the President advocates the lifting of sequestration caps in the defense sector; increasing infrastructure spending in the United States; and tightening controls on immigration.

President Trump's plan to end the defense sequester and rebuild our military, without increasing the national debt, faces similar hurdles as those experienced during the Obama administration. Democratic leaders have thus far refused to increase money for military programs unless the increases are included for other non-defense programs. Barring a spending caps fix in the next few months, Congress will need to start planning fiscal 2018 with the assumption that those funding limits will stay in place.

A final FY2018 budget was not passed into law prior to October 1, 2017. Consequently, a continuing resolution (CR), H.R. was passed into law on September 8, 2017 and subsequently extended through December 22, 2017. The CR essentially continues funding at FY17 levels but will not allow for contracts for new services to be initiated. To continue operating after the CR December 22, 2017 expiration date, Congress will need to pass, and the President will need to sign, a new CR or more comprehensive budget bill. The Company does not believe these measures will have a material impact on our current business base for fiscal year 2018, however, any delays in addressing funding may delay the timing of awards for new business.

Department of Veterans Affairs (VA) health spending trends:

DLH continues to see critical need for expanded health care solutions within our sector of the Federal health market, largely focused on the needs of veterans and their families. Serving nearly nine million veterans each year, the VA operates the nation's largest integrated health care system, with more than 1,700 hospitals, clinics, community living centers, readjustment counseling centers, and other facilities.

On July 27, 2017, the House of Representatives approved the Department of Defense Appropriations Act for the 2018 fiscal year. The bill includes funding for the VA of \$182.3 billion, an increase of \$5.3 billion or 3% above the 2017 budgeted amounts. The fiscal 2018 VA funding includes Medical Care appropriations of approximately \$69.0 billion, which is \$5.7 billion (9.0%) above the 2017 budgeted level. The Senate Appropriations Committee approved a similar bill in July 2017. The Trump administration has expressed strong support for veterans and members of the armed forces, and we believe there is a reasonable expectation that fiscal year 2018 funding will be consistent with the House bill.

Department of Health and Human Services (HHS) spending trends:

HHS is the principal federal department charged with protecting the health of all Americans and providing essential human services. DLH has existing contracts with multiple agencies under HHS, and we are actively pursuing growth opportunities within this vital agency.

HHS spending priorities are being evaluated by the Trump administration with particular focus on the Affordable Care Act programs which are outside of our market space.

On July 19, 2017 the House Appropriations Committee approved a draft funding bill for Labor, Health and Human Services and Education. The bill cuts funding to lower-priority programs, while targeting investments in medical research, and biodefense. The draft FY2018 funding bill proposed an increase of \$22 million for the Head Start program. The Senate Appropriations Committee proposed a similar bill, with Head Start funding held even to fiscal 2017. While the new Administration's budget priorities for HHS are evolving, Head Start has historically received strong bipartisan support.

Large defense companies divesting from Federal services market:

Large government contractors have been divesting from the Federal services market to increase their focus on advanced military products, which typically generate higher margins than services. This trend may open up increased opportunities for smaller Federal service providers such as DLH.

Industry consolidation among federal government contractors:

There has been active consolidation and a strong increase in M&A activity among federal government contractors over the past few years that is we expect to continue into fiscal year 2018 and beyond, fueled by public companies leveraging strong balance sheets to pursue strategic acquisitions that supplement organic growth and create shareholder value. Companies often look to acquisitions that augment core capabilities, contracts, customers, market differentiators, stability, cost synergies, and higher margin and revenue streams. We plan continued focus on our core capabilities, as we look at potential future strategic acquisitions to grow our business and enhance shareholder value.

Potential small business team opportunities:

The Federal government has an overall goal of 23% of prime contracts flowing to small business contractors, primarily through the use of set-asides in Federal agency RFPs (requests for proposal). As a part of our growth plan, DLH may elect to team in support of such small businesses for specific pursuits that align with our corporate growth strategy.

Pending federal tax legislation:

Subsequent to our fiscal year end, both branches of Congress passed major federal tax reform legislation. A key feature of this legislation is a reduction of the corporate tax rate to 20%. While the exact terms of the legislation, including the effective date of the rate reduction, are subject to the reconciliation process, the resulting bill may have a material impact to our business. We estimate that the deferred tax asset of \$9.6 million on our balance sheet as of September 30, 2017 would be reduced by \$3 to \$4 million to reflect the rate reduction, should the bill pass as currently proposed. We would continue to derive the cash flow benefit of tax net operating losses offsetting future taxable income, though at a lower rate. The tax provision on future earnings would be similarly reduced to reflect the new corporate tax rate.

Results of Operations for Fiscal Year 2017 as Compared to Fiscal Year 2016

The following table summarizes, for the periods indicated, consolidated statements of operations data expressed in dollars in thousands except for per share amounts, and as a percentage of revenue:

| Consolidated Statement of Operations: | Year Ended | | | | Change in | |
|---------------------------------------|--------------------|--------------|--------------------|--------------|----------------|---------------|
| | September 30, 2017 | | September 30, 2016 | | \$ | % of Rev |
| Revenue | \$ 115,662 | 100.0 % | \$ 85,602 | 100.0 % | \$ 30,060 | — % |
| Direct expenses | 89,812 | 77.7 % | 67,776 | 79.2 % | 22,036 | (1.5) % |
| Gross margin | 25,850 | 22.3 % | 17,826 | 20.8 % | 8,024 | 1.5 % |
| General and administrative expenses | 17,466 | 15.1 % | 12,518 | 14.6 % | 4,948 | 0.5 % |
| Depreciation and amortization | 1,754 | 1.5 % | 1,244 | 1.5 % | 510 | — % |
| Income from operations | 6,630 | 5.7 % | 4,064 | 4.7 % | 2,566 | 1.0 % |
| Interest expense | (1,228) | (1.1)% | (823) | (1.0)% | (405) | (0.1) % |
| Acquisition cost | — | — % | (795) | (0.9)% | 795 | 0.9 % |
| Other income (expense), net | (1,228) | (1.1)% | (1,618) | (1.9)% | 390 | 0.8 % |
| Income before income taxes | 5,402 | 4.6 % | 2,446 | 2.9 % | 2,956 | 1.7 % |
| Income tax expense (benefit), net | 2,114 | 1.8 % | (938) | (1.1)% | 3,052 | 2.9 % |
| Net income | \$ 3,288 | 2.8 % | \$ 3,384 | 4.0 % | \$ (96) | (1.2)% |
| Net income per share-basic | \$ 0.29 | | \$ 0.34 | | \$ (0.05) | |
| Net income per share-diluted | \$ 0.27 | | \$ 0.30 | | \$ (0.03) | |

Revenues

Fiscal year 2017 revenue was \$115.7 million, an increase of \$30.1 million or 35.1% over the prior year period. The increase is due principally to the full year impact of the acquisition completed in May 2016, which contributed \$24.7 million and \$5.4 million from continued expansion on existing contract vehicles resulting from program management and customer satisfaction with our services.

Direct Expenses

Direct expenses generally comprise direct labor (including benefits), taxes and insurance, workers compensation expense, subcontract cost, and other direct costs. Direct expenses for the year ended September 30, 2017 were \$89.8 million, an increase of \$22.0 million, or 32.5% over prior year due principally to increased professional service costs attributed to increased revenue. As a percentage of revenue, direct expenses were 77.7%, a favorable reduction of (1.5)% with the improvement largely attributable to effective program management and cost efficiencies on existing contracts.

Gross Margin

Gross margin for the year ended September 30, 2017 was approximately \$25.9 million, an increase of approximately \$8.0 million or 45.0% over prior fiscal year on higher revenue and improved performance on contracts. As a percentage of revenue, our gross margin rate of 22.3% increased by 150 basis points, or 1.5%, over the prior year. Favorable gross margin results are due principally to expanded contribution from more differentiated contracts, and effective assignment of staff to deliver strong contract performance. We continue to focus on internal productivity measures to control costs and improve our gross margin.

General and Administrative Expenses

General and administrative (“G&A”) expenses primarily relate to functions such as operations overhead, corporate management, legal, finance, accounting, contracts administration, human resources, management information systems, and business development. Fiscal year 2017 G&A expenses were approximately \$17.5 million, an increase of \$4.9 million or

39.5% over the prior year period. As a percent of revenue, G&A expenses were 15.1%, an increase of approximately 0.5% over prior year period. The increase in expenses reflects the impact of the 2016 acquisition as well as investment in business development and management resources to grow the Company's business.

Depreciation and Amortization

This category comprises non-cash expenditures related to depreciation on fixed assets and the amortization of acquired definite-lived intangible assets. As a professional services organization, DLH has not required significant expenditures on capital equipment and other fixed assets. For the twelve months ended September 30, 2017, depreciation and amortization were approximately \$1.7 million, due principally to the amortization of acquired definite-lived intangible assets.

Income from Operations

Income from operations for the year ended September 30, 2017 was approximately \$6.6 million, an increase of approximately \$2.6 million over the prior fiscal year. The improvement is due principally to gross margin growth of \$8.0 million, partially offset by expense growth of \$4.9 million as described above.

Other Income (Expense), net

Other income (expense), net, typically includes items such as, interest expense and amortization of deferred financing costs on debt obligations, and other one-time or non-operational items that may contribute to other income or other expense depending upon the transaction. For the year ended September 30, 2017, other expense, net, was approximately \$(1.2) million compared to other expense, net of \$(1.6) million in the prior year, a favorable expense decrease of \$0.4 million over the prior year period. Current year other expense primarily includes interest and deferred financing expenses. Prior year other expense, net, primarily includes non-operational acquisition expense, interest and deferred financing expenses.

Income before Income Taxes

Income before taxes for fiscal year ended September 30, 2017 was approximately \$5.4 million, compared to \$2.4 million for the prior year; an increase of approximately \$3.0 million. The fiscal year 2017 increase is due principally to the increased gross margin, offset in part by increased G&A expenses.

Income Tax Expense (Benefit)

Income tax expense of \$2.1 million for fiscal year ended September 30, 2017 compares to a benefit of \$0.9 million in the prior year period. Prior year period included a \$1.8 million deferred tax benefit related to the release of a portion of our valuation allowance, recorded to reflect the amount of our deferred tax asset that we expect to realize in future years.

Net Income

Net income for the year ended September 30, 2017 was approximately \$3.3 million or \$0.29 and \$0.27 per basic and diluted share, respectively, compared to approximately \$3.4 million for the prior year period, or \$0.34 and \$0.30 per basic and diluted share. While income before taxes increased by \$3.0 million year over year, this increase was offset by an increase in income taxes year over year.

Non-GAAP Financial Measures for Fiscal 2017 and 2016

On a non-GAAP basis, Earnings Before Interest Tax Depreciation and Amortization ("EBITDA") adjusted for other non-cash charges ("Adjusted EBITDA" for year ended September 30, 2017 was approximately \$9.0 million, an increase of approximately \$3.3 million, or 56.7%, over the prior fiscal year. This increase was due principally to improved gross margin of approximately \$8.0 million, partially offset by expense growth of \$4.9 million as previously described.

We use Earnings Before Interest Tax Depreciation and Amortization ("EBITDA") adjusted for other items ("Adjusted EBITDA") as a supplemental non-GAAP measures of our performance. We define Adjusted EBITDA as net income/(loss) adjusted to exclude (i) interest and other expenses, including acquisition expenses, net, (ii) provision for or benefit from income taxes, if any, (iii) depreciation, amortization, and loss on disposition of fixed assets and (iv) G&A expenses — equity grants.

We exclude the following items in deriving Adjusted EBITDA:

- Acquisition expenses are excluded in the prior year period. We believe that excluding these expenses allow for improved comparability of results from period to period.
- Equity compensation is excluded because it is non-cash in nature. We believe that excluding this expense allows for improved comparability of results from period to period.

Non-GAAP measures of our performance are presented here and used by management to conduct and evaluate its business during its regular review of operating results for the periods presented. Management and the Company's Board utilize non-GAAP measures to help make decisions about the use of the Company's resources, analyze performance between periods, develop internal projections and measure management performance. We believe that non-GAAP measures can be useful to investors in evaluating the Company's ongoing operating and financial results and understanding how such results compare with the Company's historical performance. By providing non-GAAP measures as a supplement to GAAP information, we believe we are enhancing investors' understanding of our business and our results of operations.

Reconciliation of GAAP net income to adjusted EBITDA, a non-GAAP measure:

| | Twelve Months Ended | | |
|--|---------------------|-----------------|-----------------|
| | September 30, | | |
| | 2017 | 2016 | Change |
| Net income | \$ 3,288 | \$ 3,384 | \$ (96) |
| (i) Interest and other (income) expense (net): | | | |
| (i)(a) Interest and other expense | 1,228 | 823 | 405 |
| (i)(b) Acquisition expenses | — | 795 | (795) |
| (ii) Provision for taxes | 2,114 | (938) | 3,052 |
| (iii) Depreciation, amortization, and loss on fixed assets | 1,754 | 1,244 | 510 |
| (iv) G&A expenses - equity grants | 662 | 466 | 196 |
| Adjusted EBITDA | \$ 9,046 | \$ 5,774 | \$ 3,272 |

Liquidity and capital management

For the twelve months ended September 30, 2017, the Company generated operating income of \$6.6 million and net income of approximately \$3.3 million. Cash flows from operations totaled approximately \$6.5 million and \$6.0 million for the years ended September 30, 2017 and 2016, respectively. Increase in cash flow from operations was due principally to increased income from operations.

We used \$1.3 million and \$32.7 million of cash in investing activities during fiscal 2017 and fiscal 2016, respectively. Payments in fiscal 2016 primarily relate to the acquisition of Danya International. Generally, we have relatively low capital expenditure requirements for our business, and expect these expenditures in the coming years to remain consistent with the levels reported in fiscal 2017, except as discussed above under "*Forward Looking Business Trends, Industry consolidation among government contractors*".

Cash used in financing activities during the fiscal year ended September 30, 2017 was \$3.7 million while cash provided by financing activities was \$24.6 during the fiscal year ended September 30, 2016. During the year ended September 30, 2017, we had net repayments of \$3.75 million under our credit facility, compared to total borrowing of \$23.4 million in fiscal 2016. The change was primarily related to proceeds we received to finance our acquisition of Danya International during the fiscal year ended September 30, 2016.

Sources of cash and cash equivalents

As of September 30, 2017, the Company's immediate sources of liquidity include cash and cash equivalents, accounts receivable, and access to its secured revolving line of credit facility with Fifth Third Bank. This credit facility provides us with access of up to \$10.0 million, subject to certain conditions including eligible accounts receivable. The Company's present operating liabilities are largely predictable and consist of vendor and payroll related obligations. Our current investment and financing obligations are adequately covered by cash generated from profitable operations.

Management's assessment of cash and cash equivalents at September 30, 2017

Management believes that: (a) cash and cash equivalents of approximately \$4.9 million as of September 30, 2017; (b) the amount available under its line of credit that was in effect at September 30, 2017 (which is limited to the amount of eligible assets); and (c) planned operating cash flow should be sufficient to support the Company's operations for twelve months from the date of these financial statements.

Loan Facility

A summary of our loan facilities and subordinated debt financing for the period ended September 30, 2017 is as follows:

| (\$ in Millions) | | | | | |
|--------------------------|---|-----------------|--------------|------------------|--|
| As of September 30, 2017 | | | | | |
| Lender | Arrangement | Loan Balance | Interest * | Maturity Date | |
| Fifth Third Bank | Secured term loan \$25 million ceiling (a) | \$ 19.7 | LIBOR + 3.0% | 05/01/21 | |
| Fifth Third Bank | Secured revolving line of credit \$10 million ceiling (b) | — | LIBOR + 3.0% | 05/01/18 | |

* Interest rate as of September 30, 2017 was 1.24%

(a) Represents the principal amounts payable on our Term Loan with Fifth Third Bank. The \$25.0 million term loan from Fifth Third Bank was funded at closing and is secured by liens on substantially all of the assets of the Company. The principal of the Term Loan is payable in fifty-nine consecutive monthly installments of \$312,500 beginning on June 1, 2016 with the remaining balance due on May 1, 2021.

The Term Loan agreement requires compliance with a number of financial covenants and contains restrictions on our ability to engage in certain transactions. Among other matters, we must comply with limitations on: granting liens; incurring other indebtedness; maintenance of assets; investments in other entities and extensions of credit; mergers and consolidations; and changes in nature of business. The loan agreement also requires us to comply with certain financial covenants including:

(i) a minimum fixed charge coverage ratio of at least 1.35 to 1.0 commencing with the quarter ending June 30, 2016, and for all subsequent periods, and

(ii) a Funded Indebtedness to Adjusted EBITDA ratio not exceeding the ratio of 3.25 to 1.0 for the period through September 30, 2017 to 2.5 to 1.0 for the period ending September 30, 2018 through maturity. Adjusted EBITDA ratio is calculated by dividing the Company's total interest-bearing debt by net income adjusted to exclude (i) interest and other expenses, including acquisition expenses, net, (ii) provision for or benefit from income taxes, if any, (iii) depreciation and amortization, and (iv) G&A expenses - equity grants.

In addition to monthly payments of the outstanding indebtedness, the loan agreement also requires prepayments of a percentage of excess cash flow, as defined in the loan agreement. Accordingly, a portion of our cash flow from operations will be dedicated to the repayment of our indebtedness. DLH is fully compliant with all covenants under the Loan Agreement with Fifth Third Bank.

(b) The secured revolving line of credit from Fifth Third Bank has a ceiling of up to \$10.0 million. Borrowing on the line of credit is secured by liens on substantially all of the assets of the Company.

The Company's total borrowing availability, based on eligible accounts receivables at September 30, 2017, was \$9.9 million. This capacity was comprised of \$0.6 million in a stand-by letter of credit and unused borrowing capacity of \$9.3 million.

The revolving line of credit is subject to loan covenants as described above in the Term Loan, and DLH is fully compliant with those covenants.

Contractual Obligations as of September 30, 2017

| Contractual obligations (Amounts in thousands) | Ref | Total | Payments Due By Period | | | |
|---|-----|------------------|------------------------|-----------------|-----------------|----------------------|
| | | | Next 12 Months | 2-3 Years | 4-5 Years | More than 5 Years |
| Debt Obligations | | \$ 19,688 | \$ 3,750 | \$ 7,500 | \$ 8,438 | \$ — |
| Facility leases | | 3,693 | 929 | 1,567 | 652 | 545 |
| Equipment operating leases | | 77 | 38 | 39 | — | — |
| Total Obligations | | <u>\$ 23,458</u> | <u>\$ 4,717</u> | <u>\$ 9,106</u> | <u>\$ 9,090</u> | <u>\$ 545</u> |

Off-Balance Sheet Arrangements

The Company did not have any off-balance sheet arrangements subsequent to, or upon the filing of our consolidated financial statements in our Annual Report as defined under SEC rules.

Effects of Inflation

Inflation and changing prices have not had a material effect on DLH's net revenues and results of operations, as DLH has been able to modify its prices and cost structure to respond to inflation and changing prices.

Critical Accounting Policies and Estimates

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates include valuation of goodwill, measurement of prepaid workers' compensation, valuation allowances established against deferred tax assets, measurement of payroll tax contingencies, accounts payable, workers' compensation claims, and accrued expenses and the valuation of derivative financial instruments associated with debt agreements. In addition, the Company estimates overhead charges and allocates such charges throughout the year. Actual results could differ from those estimates. In particular, a material reduction in the fair value of goodwill would have a material adverse effect on the Company's financial position and results of operations. For a detailed discussion on the application of these and other accounting policies, you should review the discussion under the caption *Significant Accounting Policies* in Note 6 of the notes to our Consolidated Financial Statements contained elsewhere in this Annual Report on Form 10-K.

Revenue Recognition

DLH's revenue is derived from professional and other specialized service offerings to US Government agencies through a variety of contracts, some of which are fixed-price in nature and/or sourced through Federal Supply Schedules administered by the General Services Administration ("GSA") at fixed unit rates or hourly arrangements. Revenue on time and materials contracts is recognized based on hours performed times the applicable hourly rate, plus materials and other direct costs incurred on the contract. Revenue on fixed fee for service contracts is recognized over the period of performance of the contract. Revenue on cost reimbursable contracts is recognized equal to allowable costs incurred, plus a ratable portion of the applicable fee.

We generally operate as a prime contractor, but have also entered into contracts as a subcontractor. Our Company's current business base is 95% prime contracts and 5% subcontracts. DLH recognizes and records revenue on government contracts when: (a) persuasive evidence of an arrangement exists; (b) the services have been delivered to the customer; (c) the sales price is fixed or determinable and free of contingencies or significant uncertainties; and (d) collectibility is reasonably assured.

Business Combinations

In accordance with Accounting Standards Codification 805, "Business Combinations" ("ASC 805") the Company records acquisitions under the purchase method of accounting, under which the acquisition purchase price is allocated to the assets acquired and liabilities assumed based upon the respective fair values. The company utilizes estimates and in some instances,

may retain the services of an independent third-party valuation firm to assist in determining the fair values of assets acquired, liabilities assumed, and contingent consideration granted. Such estimates and valuations require the Company to make significant assumptions. These assumption may include projections of future events and operating performance.

Goodwill

DLH continues to review its goodwill for possible impairment or loss of value at least annually or more frequently upon the occurrence of an event or when circumstances indicate that a reporting unit's carrying amount is greater than its fair value. At September 30, 2017, we performed a goodwill impairment evaluation. We performed a qualitative assessment of factors to determine whether it was necessary to perform the goodwill impairment test. Based on the results of the work performed, the Company has concluded that no impairment loss was warranted at September 30, 2017. Factors including non-renewal of a major contract or other substantial changes in business conditions could have a material adverse effect on the valuation of goodwill in future periods and the resulting charge could be material to future periods' results of operations. If an impairment write-off of all the goodwill becomes necessary in future periods, a charge of up to \$26.0 million would be expensed in the Consolidated Statement of Operations.

Long Lived Assets

Equipment and improvements are stated at cost. Depreciation and amortization are provided using the straight-line method over the estimated useful asset lives (3 to 7 years) and the shorter of the initial lease term or estimated useful life for leasehold improvements.

Certain costs incurred in the implementation of our Enterprise Resource Planning (ERP) system, including implementation labor, are capitalized as computer software costs. Costs incurred outside of the implementation stage are expensed as incurred. No amortization expense is recorded until the software is placed in service, after which the costs will be amortized on a straight-line basis over the estimated useful life of the software.

Intangible assets are estimated at a fair value and amortized on a straight-line basis over their assessed useful lives. The assessed useful lives of the assets are 10 years.

Income Taxes

DLH accounts for income taxes in accordance with the liability method, whereby deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities, using enacted tax rates in effect for the year in which the differences are expected to reverse. Deferred tax assets are reflected on the consolidated balance sheet when it is determined that it is more likely than not that the asset will be realized. This guidance also requires that deferred tax assets be reduced by a valuation allowance if it is more likely than not that some or all of the deferred tax asset will not be realized. The Company has adequate net operating loss carryforwards to offset against any taxable income in the current period. The Company recorded no valuation allowance as of September 30, 2017 and September 30, 2016, respectively.

Stock-based Equity Compensation

The Company uses the fair value-based method for stock-based equity compensation. Options issued are designated as either an incentive stock or a non-statutory stock option. No option may be granted with a term of more than 10 years from the date of grant. Option awards may depend on achievement of certain performance measures determined by the Compensation Committee of our Board. Shares issued upon option exercise are newly issued common shares. All awards to employees and non-employees are recorded at fair value on the date of the grant and expensed over the period of vesting. The Company uses a binomial option pricing model to estimate the fair value of each stock option at the date of grant. Any consideration paid by the option holders to purchase shares is credited to capital stock.

New Accounting Pronouncements

A discussion of recently issued accounting pronouncements is described in Note 3 in the Notes to Consolidated Financial Statements elsewhere in this Annual Report, and we incorporate such discussion by reference.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

DLH does not undertake trading practices in securities or other financial instruments and therefore does not have any material exposure to interest rate risk, foreign currency exchange rate risk, commodity price risk or other similar risks, which might otherwise result from such practices. DLH is not materially subject to fluctuations in foreign exchange rates, commodity prices or other market rates or prices from market sensitive instruments. DLH believes it does not have a material interest rate risk with respect to our prior workers' compensation programs, for which funds were deposited into trust for possible future payments of claims. DLH does not believe the level of exposure to interest rate fluctuations on its debt instruments is material given that the amount of our debt is subject to LIBOR plus 3.0% applied by the Lender. As of September 30, 2017 the Lender's interest rate was 4.24%.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTAL DATA

See attached Consolidated Financial Statements beginning on page F-1 attached to this Report on Form 10-K.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Our CEO and President and Chief Financial Officer, after evaluating the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) or 15d-15(e) under the Exchange Act) as of the end of the period covered by this report, has concluded that, based on the evaluation of these controls and procedures, our disclosure controls and procedures were effective at the reasonable assurance level to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms and that such information is accumulated and communicated to our management, including our CEO and President and Chief Financial Officer, to allow timely decisions regarding required disclosure.

Our management, including our CEO and President and Chief Financial Officer, does not expect that our disclosure controls and procedures or our internal controls will prevent all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within our company have been detected. Our management, however, believes our disclosure controls and procedures are in fact effective to provide reasonable assurance that the objectives of the control system are met.

Management's Report on Internal Control over Financial Reporting

Our management, under the supervision of our Chief Executive Officer and Chief Financial Officer, is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended). Our internal control over financial reporting is designed 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. The Company's internal control over financial reporting includes those policies and procedures that:

- (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company;
- (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the company; and
- (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

Management, including our Chief Executive Officer and Chief Financial Officer, conducted an evaluation of the effectiveness of our internal control over financial reporting as of September 30, 2017. In making this evaluation, management used the 2013 framework on Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on our evaluation under the framework on Internal Control-Integrated Framework, our management has concluded that our internal control over financial reporting was effective as of September 30, 2017.

This annual report does not include an attestation report of our independent registered public accounting firm regarding our internal control over financial reporting. Management's report was not subject to attestation by our independent registered public accounting firm pursuant to rules of the Securities and Exchange Commission.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Changes in Internal Controls over Financial Reporting

There have been no changes in the Company's internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) that occurred during the fourth fiscal quarter of our Company's fiscal year ended September 30, 2017, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

On November 9, 2017, an aggregate of 93,125 shares of Common Stock of the Company were granted to the non-employee members of the Company's Board of Directors, in accordance with the Company's compensation policy for non-employee directors.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by this item with respect to our executive officers is provided under the caption entitled "Executive Officers of the Company" in Part I of this Annual Report on Form 10-K and is incorporated by reference herein. The information required by this item with respect to our directors, board committees, and corporate governance matters will be set forth in our definitive Proxy Statement under the captions "Election of Directors," "Section 16(a) Beneficial Ownership Reporting Compliance" and "Corporate Governance" of the Proxy Statement, to be filed within 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K, and is incorporated herein by reference to our Proxy Statement.

We have adopted a written code of business conduct and ethics, which applies to our principal executive officer, principal financial or accounting officer or person serving similar functions and all of our other employees and members of our board of directors. We did not waive any provisions of the code of business ethics during the year ended September 30, 2017. If we amend, or grant a waiver under, our code of business ethics that applies to our principal executive officer, principal financial or accounting officer, or persons performing similar functions, we intend to post information about such amendment or waiver on our website.

ITEM 11. EXECUTIVE COMPENSATION

The information required by this Item will be set forth in our definitive Proxy Statement, to be filed within 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K, and is incorporated herein by reference to our Proxy Statement.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required by this Item will be set forth in our definitive Proxy Statement, to be filed within 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K, and is incorporated herein by reference to our Proxy Statement.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by this Item will be set forth in our definitive Proxy Statement, to be filed within 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K, and is incorporated herein by reference to our Proxy Statement.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by this Item will be set forth in our definitive Proxy Statement under the caption "Independent Registered Public Accounting Firm", to be filed within 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K, and is incorporated herein by reference to our Proxy Statement.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) (1) Financial Statements

The financial statements and schedules of DLH are included in Part II, Item 8 of this report beginning on page F-1.

(a) (2) Financial Statement Schedule

All schedules have been omitted since the required information is not applicable or because the information required is included in the Consolidated Financial Statements or the notes thereto.

(a) (3) Exhibits

The exhibits designated with an asterisk (*) are filed herewith. All other exhibits have been previously filed with the Commission and, pursuant to 17 C.F.R. Secs. 201.24 and 240.12b-32, are incorporated by reference to the document referenced in brackets following the descriptions of such exhibits. The exhibits designated with a number sign (#) indicate a management contract or compensation plan or arrangement.

| Exhibit No. | Description |
|---------------------|---|
| 2.1 | Equity Purchase Agreement among the Company, Danya International LLC, DI Holdings, Inc. and the owners named therein (filed as Exhibit 2.1 to Current Report on Form 8-K filed May 6, 2016) |
| 3.1 | Amended and Restated Certificate of Incorporation (filed as Exhibit A to Definitive Proxy Statement dated May 1, 2000 as filed with the Securities and Exchange Commission). |
| 3.2 | Amended By-Laws of Registrant adopted as of May 15, 2001 (filed as Exhibit 3.4 to the Registration Statement on Form S-4 File No. 333-61730). |
| 3.3 | Amended and restated By-Laws of Registrant adopted as of August 29, 2001 (filed as Exhibit 3.5 to the Registrant's Form S-3 filed on December 19, 2001). |
| 3.4 | Amendment to By-Laws of Registrant adopted November 8, 2007 (filed as Exhibit 3.1 to the Registrant's Current Report on Form 8-K filed on November 13, 2007). |
| 3.5 | Amendment to Amended and Restated Certificate of Incorporation of the Company (filed as Exhibit B to Definitive Proxy Statement dated March 13, 2008 as filed with the Securities and Exchange Commission). |
| 3.6 | Amendment to Amended and Restated Certificate of Incorporation of the Company filed June 25, 2012 (filed as Exhibit 3.1 to Current Report on Form 8-K filed on June 26, 2012). |
| 3.7 | Amendment to Amended and Restated Certificate of Incorporation filed February 12, 2015 (filed as Annex A to the Company's Proxy Statement dated December 31, 2014). |
| 4.1 | Specimen of the Common Stock Certificate * |
| 4.2 | Form of Term Note issued pursuant to the Loan Agreement (filed as Exhibit 4.1 to Current Report on Form 8-K filed May 6, 2016). |
| 4.3 | Form of Revolving Credit Note issued pursuant to the Loan Agreement (filed as Exhibit 4.2 to Current Report on Form 8-K filed May 6, 2016). |

- [4.4](#) [Form of Warrant issued to Subordinated Lenders \(filed as Exhibit 4.4 to Current Report on Form 8-K filed May 6, 2016\).](#)
- [10.1](#) # [Form of Stock Option Award under 2006 Long Term Incentive Plan \(filed as Exhibit 10.6 to Quarterly Report on Form 10-Q filed on February 16, 2010\).](#)
- [10.2](#) # [Employment Agreement between the Company and Kevin Wilson \(filed as Exhibit 10.1 to Current Report on Form 8-K dated October 3, 2013\).](#)
- [10.3](#) # [2006 Long Term Incentive Plan, as amended \(filed as Annex A to the Company's Proxy Statement dated January 3, 2014\).](#)
- [10.4](#) [Lease Agreement dated April 27, 2015 between DLH Holdings Corp. and Piedmont Center, 1-4 LLC \(filed as Exhibit 10.1 to Quarterly Report on Form 10-Q filed on August 5, 2015\)](#)
- [10.5](#) # [Amendment to Employment Agreement with Kevin Wilson \(filed as Exhibit 10.1 to Current Report on Form 8-K filed October 2, 2015\).](#)
- [10.6](#) # [2016 Omnibus Equity Incentive Plan \(incorporated by reference to Appendix A to the Company's definitive Proxy Statement dated January 15, 2016\).](#)
- [10.7](#) [Non-Competition Agreement between the Company and Jeffrey Hoffman \(filed as Exhibit 10.2 to Current Report on Form 8-K filed May 6, 2016\).](#)
- [10.8](#) [Loan Agreement among Fifth Third Bank, DLH Holdings Corp., DLH Solutions, Inc. and Danya International, LLC \(filed as Exhibit 10.3 to Current Report on Form 8-K filed May 6, 2016\).](#)
- [10.9](#) [Form of Security Agreement entered into pursuant to the Loan Agreement \(filed as Exhibit 10.4 to Current Report on Form 8-K filed May 6, 2016\).](#)
- [10.10](#) [Form of Pledge Agreement entered into pursuant to the Loan Agreement \(filed as Exhibit 10.5 to Current Report on Form 8-K filed May 6, 2016\).](#)
- [10.11](#) # [Form of Stock Option Award Agreement under the 2016 Omnibus Equity Incentive Plan \(filed as Exhibit 10.8 to Quarterly Report on Form 10-Q filed May 16, 2016\).](#)
- [10.12](#) [Registration Rights Agreement dated September 29, 2016 \(filed as Exhibit 10.2 to Current Report on 8-K filed on October 4, 2016\).](#)
- [10.13](#) # [Employment Agreement between the Company and Zachary C. Parker dated September 28, 2016 \(filed as Exhibit 10.1 to Current Report on 8-K filed on October 4, 2016\).](#)
- [10.14](#) # [Employment Agreement between the Company and Kathryn M. JohnBull dated July 5, 2017 \(filed as Exhibit 10.1 to Current Report on Form 8-K filed on July, 2017\).](#)
- [14.00](#) [Code of Ethics \(Exhibit 14.1 to Annual Report on Form 10-K for the fiscal year ended September 30, 2003\).](#)
- [21.00](#) * [Subsidiaries of Registrants.](#)
- [23.10](#) * [Consent of WithumSmith+Brown, PC](#)
- [31.10](#) * [Certification of Chief Executive Officer pursuant to Section 17 CFR 240.13a-14\(a\) or 17 CFR 240.15d-14\(a\).](#)
- [31.20](#) * [Certification of Chief Financial Officer pursuant to Section 17 CFR 240.13a-14\(a\) or 17 CFR 240.15d-14\(a\).](#)
- [32.10](#) * [Certification of Chief Executive Officer and Chief Financial Officer pursuant to 17 CFR 240.13a-14\(b\) or 17 CFR 240.15d-14\(b\) and Section 1350 of Chapter 63 of Title 18 of the United States Code.](#)
- [101.0](#) * The following financial information from the DLH Holdings Corp. Annual Report on Form 10-K for the fiscal year ended September 30, 2017, formatted in XBRL (eXtensible Business Reporting Language) and filed electronically herewith: (i) the Consolidated Balance Sheets; (ii) the Consolidated Statements of Operations; (iii) the Consolidated Statements of Cash Flows; (iv) the Consolidated Statements Of Shareholders' Equity and, (v) the Notes to the Consolidated Financial Statements.

DLH Holdings Corp. and Subsidiaries
Index to Consolidated Financial Statements

| | <u>Page</u> |
|---|----------------------------|
| <u>Report of Independent Registered Public Accounting Firm</u> | <u>F-2</u> |
| <u>Consolidated Statements of Operations for the years ended September 30, 2017 and 2016</u> | <u>F-3</u> |
| <u>Consolidated Balance Sheets as of September 30, 2017 and 2016</u> | <u>F-4</u> |
| <u>Consolidated Statements of Cash Flows for the years ended September 30, 2017 and 2016</u> | <u>F-5</u> |
| <u>Consolidated Statements of Changes in Shareholders' Equity for the years ended September 30, 2017 and 2016</u> | <u>F-6</u> |
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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of DLH Holdings Corp.

We have audited the accompanying consolidated balance sheets of DLH Holdings Corp. and Subsidiaries as of September 30, 2017 and 2016, and the related consolidated statements of operations, cash flows, and changes in shareholders' equity for each of the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of DLH Holdings Corp. and Subsidiaries as of September 30, 2017 and 2016, and the consolidated results of its operations and its cash flows for each of the years then ended, in conformity with accounting principles generally accepted in the United States of America.

/s/ WITHUMSMITH+BROWN, PC
WithumSmith+Brown, PC
New York, New York
December 12, 2017

DLH HOLDINGS CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(Amounts in thousands except per share amounts)

| | Year Ended | |
|--|-----------------|-----------------|
| | September 30, | |
| | 2017 | 2016 |
| Revenue | \$ 115,662 | \$ 85,602 |
| Direct expenses | 89,812 | 67,776 |
| Gross margin | 25,850 | 17,826 |
| General and administrative expenses | 17,466 | 12,518 |
| Depreciation and amortization | 1,754 | 1,244 |
| Income from operations | 6,630 | 4,064 |
| Interest expense | (1,228) | (823) |
| Acquisition cost | — | (795) |
| Income before income taxes | 5,402 | 2,446 |
| Income tax expense (benefit), net | 2,114 | (938) |
| Net income | \$ 3,288 | \$ 3,384 |
| | | |
| Earnings per share - basic | \$ 0.29 | \$ 0.34 |
| Earnings per share - diluted | \$ 0.27 | \$ 0.30 |
| | | |
| Weighted average common shares outstanding | | |
| Basic | 11,345 | 9,966 |
| Diluted | 12,352 | 11,220 |

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

DLH HOLDINGS CORP. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Amounts in thousands except par value of shares)

| | September 30, 2017 | September 30, 2016 |
|--|-----------------------|-----------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 4,930 | \$ 3,427 |
| Accounts receivable | 11,911 | 6,637 |
| Other current assets | 598 | 542 |
| Total current assets | 17,439 | 10,606 |
| Equipment and improvements, net | 1,391 | 644 |
| Deferred taxes, net | 9,639 | 11,415 |
| Goodwill and other intangible assets, net | 41,116 | 42,304 |
| Other long-term assets | 139 | 105 |
| Total assets | \$ 69,724 | \$ 65,074 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Debt obligations - current | \$ 3,601 | \$ 3,560 |
| Derivative financial instruments, at fair value | 306 | 204 |
| Accrued payroll | 3,723 | 3,616 |
| Accounts payable, accrued expenses, and other current liabilities | 10,895 | 7,136 |
| Total current liabilities | 18,525 | 14,516 |
| Total long term liabilities | 15,344 | 18,782 |
| Total liabilities | 33,869 | 33,298 |
| Commitments and contingencies | | |
| Shareholders' equity: | | |
| Common stock, \$.001 par value; authorized 40,008 shares; issued and outstanding 11,767 at September 30, 2017 and 11,148 at September 30, 2016 | 12 | 11 |
| Additional paid-in capital | 82,687 | 81,897 |
| Accumulated deficit | (46,844) | (50,132) |
| Total shareholders' equity | 35,855 | 31,776 |
| Total liabilities and shareholders' equity | \$ 69,724 | \$ 65,074 |

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

DLH HOLDINGS CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Amounts in thousands)

| | Year Ended September 30, | |
|---|-----------------------------|-----------------|
| | 2017 | 2016 |
| Operating activities | | |
| Net income | \$ 3,288 | \$ 3,384 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 1,724 | 1,244 |
| Amortization of debt financing costs as interest expense | 268 | 289 |
| Change in fair value of derivative financial instruments | 102 | 27 |
| Stock based compensation expense | 662 | 465 |
| Loss on retirement of equipment | 31 | 3 |
| Deferred taxes, net | 1,776 | (1,108) |
| Changes in operating assets and liabilities | | |
| Accounts receivable | (5,274) | (3,351) |
| Other current assets | (56) | (113) |
| Accounts payable, accrued payroll, accrued expenses and other current liabilities | 3,945 | 5,106 |
| Other long term assets/liabilities | 58 | 94 |
| Net cash provided by operating activities | 6,524 | 6,040 |
| Investing activities | | |
| Acquisition net of cash acquired | (250) | (32,241) |
| Purchase of equipment and improvements | (1,064) | (498) |
| Net cash used in investing activities | (1,314) | (32,739) |
| Financing activities | | |
| Net (repayments) borrowings on senior debt | (3,750) | 23,437 |
| Repayments of capital lease obligations | (86) | (94) |
| Payment of deferred financing costs | — | (1,333) |
| Proceeds from issuance of stock | — | 2,521 |
| Proceeds from stock option exercise | 129 | 37 |
| Net cash provided by (used in) financing activities | (3,707) | 24,568 |
| Net change in cash and cash equivalents | 1,503 | (2,131) |
| Cash and cash equivalents at beginning of period | 3,427 | 5,558 |
| Cash and cash equivalents at end of period | \$ 4,930 | \$ 3,427 |
| Supplemental disclosures of cash flow information | | |
| Cash paid during the period for interest | \$ 883 | \$ 454 |
| Cash paid during the period for income taxes | \$ 337 | \$ 124 |
| Non-cash equity consideration for acquisition | \$ — | \$ 2,500 |
| Warrants issued in connection with subordinated debt | \$ — | \$ 177 |

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

DLH HOLDINGS CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
For the years ended September 30, 2017 and 2016
(Amounts in thousands)

| | Common Stock | | Additional Paid-In Capital | Accumulated Deficit | Total Shareholders' Equity |
|--|---------------|--------------|----------------------------------|------------------------|----------------------------------|
| | Shares | Amount | | | |
| BALANCE, September 30, 2015 | 9,551 | \$ 10 | \$ 76,375 | \$ (53,516) | \$ 22,869 |
| Directors stock grants | 117 | — | 376 | — | 376 |
| Expense related to employee stock | — | — | 90 | — | 90 |
| Issuance of stock for acquisition | 670 | 1 | 2,499 | — | 2,500 |
| Exercise of stock options | 89 | — | 37 | — | 37 |
| Exercise of stock warrants | 11 | — | — | — | — |
| Rights offering net of expense offsets | 710 | — | 2,520 | — | 2,520 |
| Net income | — | — | — | 3,384 | 3,384 |
| BALANCE, September 30, 2016 | 11,148 | \$ 11 | \$ 81,897 | \$ (50,132) | \$ 31,776 |
| Directors stock grants | 103 | — | 521 | — | 521 |
| Expense related to employee stock | — | — | 141 | — | 141 |
| Exercise of stock options | 516 | 1 | 128 | — | 129 |
| Net Income | — | — | — | 3,288 | 3,288 |
| BALANCE, September 30, 2017 | 11,767 | \$ 12 | \$ 82,687 | \$ (46,844) | \$ 35,855 |

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

DLH HOLDINGS CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2017

1. Basis of Presentation

The accompanying unaudited consolidated financial statements include the accounts of DLH and its subsidiaries, all of which are wholly owned. All significant intercompany balances and transactions have been eliminated in consolidation. The accompanying financial statements have been prepared in accordance with generally accepted accounting principles and with the instructions to Form 10-K, Regulation S-X, and Regulation S-K.

2. Business Overview

DLH is a full-service provider of professional healthcare and social services to government agencies including the Department of Veteran Affairs ("VA"), Department of Health and Human Services ("HHS"), Department of Defense ("DoD"), and other government agencies. DLH Holdings Corp. (together with its subsidiaries, "DLH" or the "Company" and also referred to as "we," "us" and "our") manages its operations from its principal executive offices at 3565 Piedmont Road NE, Building 3 Suite 700, Atlanta Georgia 30305. We employ over 1,400 skilled employees working in more than 30 locations throughout the United States.

Presently, the Company derives 100% of its revenue from agencies of the Federal government, primarily as a prime contractor but also as a subcontractor to other Federal prime contractors. A major customer is defined as a customer from whom the Company derives at least 10% of its revenues.

Our largest customer continues to be the VA, which comprised approximately 62% and 72% of revenue for the twelve months ended September 30, 2017 and 2016, respectively. Additionally, HHS represents a major customer, comprising 34% and 13% of revenue for the twelve months ended September 30, 2017 and 2016, respectively. Substantially all accounts receivable, including unbilled accounts receivable, are from agencies of the U.S. Government as of September 30, 2017 and 2016. We believe that the credit risk associated with our receivables is limited due to the creditworthiness of these customers. See Note 4, Supporting Financial Information-Accounts Receivable.

As of September 30, 2017, awards from VA and HHS have anticipated periods of performance ranging from approximately one to up to three years. These agreements are subject to the Federal Acquisition Regulations. While there can be no assurance as to the actual amount of services that the Company will ultimately provide to VA and HHS under its current contracts, we believe that our strong working relationships and our effective service delivery support ongoing performance for the contract term. The Company's results of operations, cash flows and financial condition would be materially adversely affected in the event that we were unable to continue our relationship with VA or HHS.

3. New Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued amended guidance for revenue recognition. Subsequently, the FASB issued an amendment to defer for one year the effective date of the new guidance on revenue recognition, as well as issued additional clarifying amendments. The new guidance outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Additionally, the guidance requires improved disclosure to help the users of the financial statements better understand the nature, amount, timing, and uncertainty of revenue that is recognized. The new guidance supersedes most current revenue recognition guidance, including industry-specific guidance, and is effective for annual periods (including interim periods therein) beginning after December 15, 2017. The guidance allows either a full retrospective or modified retrospective transition method. The Company is evaluating the effects of this guidance.

In June 2014, the FASB issued guidance related to accounting for share-based payments for certain performance stock awards. In March 2016, the FASB issued updated guidance intended to simplify various aspects related to how share-based payments are accounted for and presented in the financial statements. The amendments in this update affect all entities that issue share-based payment awards to their employees. For public business entities, the amendments in this update are effective for annual

periods beginning after December 15, 2016, and interim periods within those annual periods. The Company has adopted this guidance and concluded that it will not significantly affect the Company.

In September 2015, the FASB issued guidance regarding business combinations for which the accounting is incomplete by the end of the reporting period in which the combination occurs, and during the measurement period have an adjustment to provisional amounts recognized. To simplify the accounting for adjustments made to provisional amounts recognized in a business combination, the amendments in this update eliminate the requirement to retrospectively account for those adjustments. The amendments in this update are effective for fiscal years beginning after December 15, 2015, including interim periods within those fiscal years. The amendments should be applied prospectively to adjustments to provisional amounts that occur after the effective date of this update, with earlier application permitted for financial statements that have not been issued. Refer to Note 4 for the impact of the adoption of this guidance.

In February 2016, the FASB issued new accounting guidance related to leases. This update, effective for the Company beginning October 1, 2019, will replace existing guidance in GAAP and will require lessees to recognize lease assets and lease liabilities on the balance sheet for all leases and disclose key information about leasing arrangements. When implemented, lessees and lessors will be required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach. As shown in Note 10, the Company currently has approximately \$3.7 million of lease obligations that would be evaluated as the implementation of this guidance becomes effective.

In January 2017, the FASB issued new accounting guidance related to goodwill. This update provides simplified testing for goodwill impairment which allows a comparison of the fair value of the reporting unit to its carrying amount, removing the prior requirement of determining fair value of all individual assets and liabilities of the reporting unit. This update is effective for the Company as of its fiscal year beginning October 1, 2020, with early adoption permitted for interim or annual goodwill impairment tests performed after January 1, 2017. The Company adopted this guidance for its annual goodwill impairment tests performed for the fiscal year ended September 30, 2017.

In July 2017, the FASB issued new accounting guidance related to certain equity-linked financial instruments with down round features, such as warrants. The guidance provides for a scope exception from derivative accounting if the instruments qualify for equity classification. Should the instruments qualify for equity classification, they would no longer be considered liabilities subject to fair value measurement at each reporting period. This update is effective for the Company as of its fiscal year beginning October 1, 2019, with early adoption permitted. The Company is evaluating this guidance.

4. Supporting Financial Information

Accounts receivable

| | | (in thousands) | |
|---------------------------------------|-----|-----------------------|-----------------------|
| | Ref | September 30, 2017 | September 30, 2016 |
| Billed receivables | | \$ 11,862 | \$ 5,265 |
| Unbilled receivables | | 49 | 1,372 |
| Total accounts receivable | | 11,911 | 6,637 |
| Less: Allowance for doubtful accounts | (a) | — | — |
| Accounts receivable, net | | \$ 11,911 | \$ 6,637 |

Ref (a): Accounts receivable are non-interest bearing, unsecured and net of an allowance for doubtful accounts. We evaluate our receivables on a quarterly basis and determine whether an allowance is appropriate based on specific collection issues. Our allowance for doubtful accounts was zero at both September 30, 2017 and September 30, 2016. Our allowance for doubtful accounts is assessed based on Company policy of specific identification for aged items. The Company generally does not have delinquent receivables due to the nature of its business.

Other current assets

| | (in thousands) | |
|--|-----------------------|-----------------------|
| Ref | September 30, 2017 | September 30, 2016 |
| Prepaid insurance and benefits | \$ 240 | \$ 168 |
| Other receivables and prepaid expenses | 358 | 374 |
| Other current assets | \$ 598 | \$ 542 |

Equipment and improvements, net

| | (in thousands) | |
|--|-----------------------|-----------------------|
| Ref | September 30, 2017 | September 30, 2016 |
| Furniture and equipment | \$ 331 | \$ 638 |
| Computer equipment | 715 | 202 |
| Computer software | (a) 1,108 | 309 |
| Leasehold improvements | 66 | 38 |
| Total fixed assets | 2,220 | 1,187 |
| Less accumulated depreciation and amortization | (829) | (543) |
| Equipment and improvements, net | \$ 1,391 | \$ 644 |

Ref (a): The Company is in the process of configuring a new Enterprise Resource Planning (ERP) system. Capitalized costs include \$741 thousand of software licenses and implementation labor related to application development. Since the asset has not been placed in service, no depreciation related to the asset has been recognized. Prior to the asset being placed in service a useful life will be determined.

Ref (b): Equipment and improvements are stated at cost. Depreciation and amortization are provided using the straight-line method over the estimated useful asset lives (3 to 7 years) and the shorter of the initial lease term or estimated useful life for leasehold improvements. Maintenance and repair costs are expensed as incurred. Depreciation of equipment was \$287 thousand and \$188 thousand for the years ended September 30, 2017 and September 30, 2016 respectively.

Goodwill and Intangibles

| | (in thousands) | | | | |
|--|------------------|------------------------|---------------|---------------|---------------|
| Ref | Goodwill | Customer Relationships | Non Compete | Trade Name | Total |
| Gross Balance as of September 30, 2016 | \$ 34,745 | \$ 7,247 | \$ 1,370 | \$ — | 43,362 |
| Measurement period adjustment | (8,756) | 9,379 | (890) | 517 | 250 |
| Adjusted Gross Balance at September 30, 2017 | \$ 25,989 | \$ 16,626 | \$ 480 | \$ 517 | 43,612 |

| | (in thousands) | | | | |
|--|------------------|----------------------------|---------------------------|----------------|------------------|
| Ref. | Goodwill | Customer Relationships (a) | Non Compete Agreement (a) | Trade Name (a) | Total |
| Accumulated amortization at September 30, 2016 | \$ — | \$ (993) | \$ (65) | \$ — | \$ (1,058) |
| Prior period amortization adjustment | — | 300 | 45 | (21) | 324 |
| Current period amortization | — | (1,662) | (48) | (52) | (1,762) |
| Total accumulated amortization | — | (2,355) | (68) | (73) | (2,496) |
| Net balance at September 30, 2017 | \$ 25,989 | \$ 14,271 | \$ 412 | \$ 444 | \$ 41,116 |

The financial statements at September 30, 2016 reflected a preliminary estimate of purchase accounting, its allocation to acquired intangibles and resulting amortization. As of December 31, 2016 the Company completed its valuation of the May 2016 transaction and finalized the adjustments to the estimated values recognized at September 30, 2016. Therefore the Company recognized a net increase to the fair value of intangibles in the amount of \$9.0 million with a corresponding decrease to goodwill. Additionally, the change to the estimated amounts resulted in a decrease in amortization of \$0.3 million in the current period.

Ref (a): Intangible assets subject to amortization. The intangibles are amortized on a straight-line basis over their estimated useful lives of 10 years. Total amount of amortization expense for the year ended September 30, 2017 was \$1.4 million.

Estimated amortization expense for future years:

| | (in thousands) | |
|------------|----------------|---------------|
| Year 1 | \$ | 1,762 |
| Year 2 | | 1,762 |
| Year 3 | | 1,762 |
| Year 4 | | 1,762 |
| Year 5 | | 1,762 |
| Thereafter | | 6,317 |
| | \$ | 15,127 |

Accounts payable, accrued expenses and other current liabilities

| | (in thousands) | |
|--|-----------------------|-----------------------|
| | September 30, 2017 | September 30, 2016 |
| Accounts payable | \$ 5,205 | \$ 4,324 |
| Accrued benefits | 1,831 | 1,197 |
| Accrued bonus and incentive compensation | 1,544 | 508 |
| Accrued workers compensation insurance | 1,598 | 981 |
| Other accrued expenses | 717 | 126 |
| Accounts payable, accrued expenses, and other current liabilities | \$ 10,895 | \$ 7,136 |

Debt obligations

| | (in thousands) | |
|--|-----------------------|-----------------------|
| | September 30, 2017 | September 30, 2016 |
| Bank term loan | Ref (a) \$ 19,688 | \$ 23,438 |
| Less unamortized debt issuance costs | (961) | (1,222) |
| Net bank debt obligation | 18,727 | 22,216 |
| Less current portion of bank debt obligations | (3,601) | (3,560) |
| Long term portion of bank debt obligation | \$ 15,126 | \$ 18,656 |

Ref (a): Maturity of the bank debt obligation as follows, in thousands:

| | | |
|-----------------------------------|-----------|---------------|
| Year 1 | \$ | 3,750 |
| Year 2 | | 3,750 |
| Year 3 | | 3,750 |
| Year 4 | | 8,438 |
| Total bank debt obligation | \$ | 19,688 |

Interest expense

| | | (in thousands) | |
|--|-----|---------------------|-----------------|
| | | Twelve Months Ended | |
| | | September 30, | |
| | Ref | 2017 | 2016 |
| Interest expense | (a) | \$ (883) | \$ (454) |
| Amortization of deferred financing costs as interest expense | (b) | (268) | (289) |
| Change in fair value of derivative financial instruments | | (102) | (27) |
| Other income (expense), net | | 25 | (53) |
| Interest expense, net | | \$ (1,228) | \$ (823) |

Ref (a): Interest expense on borrowing

Ref (b): Amortizations of expenses related to securing financing

5. Cash and Credit Facilities

A summary of our loan facilities and subordinated debt financing for the period ended September 30, 2017 is as follows:

| (\$ in Millions) | | | | |
|--------------------------|---|--------------|---------------|---------------|
| As of September 30, 2017 | | | | |
| Lender | Arrangement | Loan Balance | Interest | Maturity Date |
| Fifth Third Bank | Secured term loan \$25 million ceiling (a) | \$ 19.7 | LIBOR* + 3.0% | 05/01/21 |
| Fifth Third Bank | Secured revolving line of credit \$10 million ceiling (b) | \$ — | LIBOR* + 3.0% | 05/01/18 |

* LIBOR rate as of September 30, 2017 was 1.24%

(a) Represents the principal amounts payable on our Term Loan with Fifth Third Bank. The \$25.0 million term loan from Fifth Third Bank is secured by liens on substantially all of the assets of the Company. The principal of the Term Loan is payable in fifty-nine consecutive monthly installments of \$312,500 with the remaining balance due on May 1, 2021.

The Term Loan agreement requires compliance with a number of financial covenants and contains restrictions on our ability to engage in certain transactions. Among other matters, we must comply with limitations on: granting liens; incurring other indebtedness; maintenance of assets; investments in other entities and extensions of credit; mergers and consolidations; and changes in nature of business. The loan agreement also requires us to comply with certain financial covenants including:

(i) a minimum fixed charge coverage ratio of at least 1.35 to 1.0 commencing with the quarter ending June 30, 2016, and for all subsequent periods, and

(ii) a Funded Indebtedness to Adjusted EBITDA ratio not exceeding the ratio of 2.99 to 1.0 at closing and thereafter a ratio ranging from 3.25 to 1.0 for the period through September 30, 2017 to 2.5 to 1.0 for the period ending September 30, 2018 through maturity. Adjusted EBITDA ratio is calculated by dividing the Company's total interest-bearing debt by net income adjusted to exclude (i) interest and other expenses, including acquisition expenses, net, (ii) provision for or benefit from income taxes, if any, (iii) depreciation and amortization, and (iv) G&A expenses - equity grants.

In addition to monthly payments of the outstanding indebtedness, the loan agreement also requires prepayments of a percentage of excess cash flow, as defined in the loan agreement. Accordingly, a portion of our cash flow from operations will be dedicated to the repayment of our indebtedness. DLH is fully compliant with all covenants under the Loan Agreement with Fifth Third Bank.

(b) The secured revolving line of credit from Fifth Third Bank has a ceiling of up to \$10.0 million. Borrowing on the line of credit is secured by liens on substantially all of the assets of the Company.

The Company's total remaining borrowing availability, based on eligible accounts receivables at September 30, 2017, was \$9.9 million. This capacity was comprised of \$0.6 million in a stand-by letter of credit and unused borrowing capacity of \$9.3 million.

The revolving line of credit is subject to loan covenants as described above in the Term Loan, and DLH is fully compliant with those covenants.

6. Significant Accounting Policies

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates include valuation of goodwill and intangible assets, valuation allowances established against accounts receivable and deferred tax assets, measurement of loss development on workers' compensation claims, and fair value of derivatives. We evaluate these estimates and judgments on an ongoing basis and base our estimates on historical experience, current and expected future outcomes, third-party evaluations and various other assumptions that we believe are reasonable under the circumstances. The results of these estimates form the basis for making judgments about the carrying values of assets and liabilities as well as identifying and assessing the accounting treatment with respect to commitments and contingencies. We revise material accounting estimates if changes occur, such as more experience is acquired, additional information is obtained, or there is new information on which an estimate was or can be based. Actual results could differ from those estimates. In particular, a material reduction in the fair value of goodwill could have a material adverse effect on the Company's financial position and results of operations. We account for the effect of a change in accounting estimate during the period in which the change occurs.

Revenue Recognition

DLH's revenue is derived from professional and other specialized service offerings to US Government agencies through a variety of contracts, some of which are fixed-price in nature and/or sourced through Federal Supply Schedules administered by the General Services Administration ("GSA") at fixed unit rates or hourly arrangements. Revenue on time and materials contracts is recognized based on hours performed times the applicable hourly rate, plus materials and other direct costs incurred on the contract. Revenue on fixed fee for service contracts is recognized over the period of performance of the contract. Revenue on cost reimbursable contracts is recognized equal to allowable costs incurred, plus a ratable portion of the applicable fee.

We generally operate as a prime contractor, but have also entered into contracts as a subcontractor. Our company's current business base is 95% prime contracts and 5% subcontracts. DLH recognizes and records revenue on government contracts when: (a) persuasive evidence of an arrangement exists; (b) the services have been delivered to the customer; (c) the sales price is fixed or determinable and free of contingencies or significant uncertainties; and (d) collectibility is reasonably assured.

Business Combinations

In accordance with Accounting Standards Codifications 805, "Business Combinations" ("ASC 805") the Company records acquisitions under the purchase method of accounting, under which the acquisition purchase price is allocated to the assets acquired and the liabilities assumed based upon the respective fair values. The Company utilizes some estimates and in some instances, may retain the services of an independent third-party valuation firm to assist in determining the fair values of assets acquired, liabilities, assumed, and contingent considerations granted. Such estimates and valuation require the Company to make significant assumptions. These assumptions may include projections of future events and operating performance.

Fair Value of Financial Instruments

The carrying amounts of the Company's cash and cash equivalents, accounts receivable, unbilled revenues, accrued expenses, accrued earn outs payable, and accounts payable approximate fair value due to the short-term nature of these instruments. The fair values of the Company's debt instruments approximate fair value because the underlying interest rates approximate market rates that the Company could obtain for similar instruments at the balance sheet dates.

Goodwill and other intangible assets

We have used the acquisition method of accounting for the May 2016 transaction, whereby the assets acquired and liabilities assumed are recognized based upon their estimated fair values at the acquisition date. The financial statements at September 30, 2016 reflected a preliminary estimate of purchase accounting, its allocation to acquired intangibles and resulting amortization. As of December 31, 2016 the Company completed its valuation and finalized the adjustments to the estimated values recognized at September 30, 2016. Therefore the Company recognized a net increase to the fair value of intangibles in the amount of \$9.0 million with a corresponding decrease to goodwill. Additionally, the change to the estimated amounts resulted in a decrease in amortization of \$0.3 million in the current period.

DLH continues to review its goodwill and other intangible assets for possible impairment or loss of value at least annually or more frequently upon the occurrence of an event or when circumstances indicate that a reporting unit's carrying amount is greater than its fair value.

At September 30, 2017 we performed a goodwill impairment evaluation on the year-end carrying value of approximately million \$26 million. We performed a qualitative assessment of factors to determine whether it was necessary to perform the goodwill impairment test. Based on the results of the work performed, the Company has concluded that no impairment loss was warranted at September 30, 2017. For the twelve months ended September 30, 2017, the Company determined that no change in business conditions occurred which would have a material adverse effect on the valuation of goodwill. Notwithstanding this evaluation, factors including non-renewal of a major contract or other substantial changes in business conditions could have a material adverse effect on the valuation of goodwill in future periods and the resulting charge could be material to future periods' results of operations.

Long Lived Assets

Equipment and improvements are stated at cost. Depreciation and amortization are provided using the straight-line method over the estimated useful asset lives (3 to 7 years) and the shorter of the initial lease term or estimated useful life for leasehold improvements.

Certain costs incurred in the implementation of our Enterprise Resource Planning (ERP) system, including implementation labor, are capitalized as computer software costs. Costs incurred outside of the implementation stage are expensed as incurred. No amortization expense is recorded until the software is placed in service, after which the costs will be amortized on a straight-line basis over the estimated useful life of the software.

Intangible assets are estimated at a fair value and amortized on a straight-line basis over their assessed useful lives. The assessed useful lives of the assets are 10 years.

Income Taxes

DLH accounts for income taxes in accordance with the liability method, whereby deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities, using enacted tax rates in effect for the year in which the differences are expected to reverse. Deferred tax assets are reflected on the consolidated balance sheet when it is determined that it is more likely than not that the asset will be realized. This guidance also requires that deferred tax assets be reduced by a valuation allowance if it is more likely than not that some or all of the deferred tax asset will not be realized. We account for uncertain tax positions by recognizing the financial statement effects of a tax position only when, based upon the technical merits, it is "more-likely-than-not" that the position will be sustained upon examination. We had no uncertain tax positions at either September 30, 2017 and 2016. We report interest and penalties as a component of income tax expense. In the fiscal quarters ended September 30, 2017 and 2016, we recognized no interest and no penalties related to income taxes.

Stock-based Equity Compensation

The Company uses the fair value-based method for stock-based equity compensation. Options issued are designated as either an incentive stock or a non-statutory stock option. No option may be granted with a term of more than 10 years from the date of grant. Option awards may depend on achievement of certain performance measures determined by the Compensation Committee of our Board. Shares issued upon option exercise are newly issued common shares. All awards to employees and non-employees are recorded at fair value on the date of the grant and expensed over the period of vesting. The Company uses a binomial option pricing model to estimate the fair value of each stock option at the date of grant. Any consideration paid by the option holders to purchase shares is credited to capital stock.

Cash and Cash Equivalents

We consider all highly liquid investments with an original maturity of three months or less when purchased to be cash equivalents. We maintain cash balances at financial institutions that are insured by the Federal Deposit Insurance Corporation ("FDIC") up to \$250,000. Deposits held with financial institutions may exceed the \$250,000 limit.

Earnings per Share

Basic earnings per share is calculated by dividing income available to common shareholders by the weighted average number of common stock outstanding and restricted stock grants that vested or are likely to vest during the period. Diluted earnings per share is calculated by dividing income available to common shareholders by the weighted average number of basic common shares outstanding, adjusted to reflect potentially dilutive securities. Diluted earnings per share is calculated using the treasury stock method.

7. Stock-based compensation and equity grants

Stock-based compensation expense

Options issued under equity incentive plans were designated as either an incentive stock or a non-statutory stock option. No option was granted with a term of more than 10 years from the date of grant. Exercisability of option awards may depend on achievement of certain performance measures determined by the Compensation Committee of our Board. Shares issued upon option exercise are newly issued shares. As of September 30, 2017, there were 0.5 million shares available for grant under the Company's 2016 Omnibus Equity Incentive Plan.

Stock-based compensation expense, shown in the table below, is recorded in general and administrative expenses included in our statement of operations:

| | Ref | (in thousands) | |
|----------------------------|-----|----------------|--------|
| | | Year Ended | |
| | | September 30, | |
| | | 2017 | 2016 |
| DLH employees | | \$ 166 | \$ 90 |
| Non-employee directors | (a) | 496 | 376 |
| Total stock option expense | | \$ 662 | \$ 466 |

Ref (a): Equity grants, in accordance with DLH compensation policy for non-employee directors.

Unrecognized stock-based compensation expense

| | Ref | (in thousands) | |
|---|-----|----------------|-------|
| | | Period Ended | |
| | | September 30, | |
| | | 2017 | 2016 |
| Unrecognized expense for DLH employees | (a) | \$ 299 | \$ 18 |
| Unrecognized expense for non-employee directors | (b) | — | 24 |
| Total unrecognized expense | | \$ 299 | \$ 42 |

Ref (a): Compensation expense for the portion of equity awards for which the requisite service has not been rendered is recognized as the requisite service is rendered. The compensation expense for that portion of awards has been based on the grant-date fair value of those awards as calculated for recognition purposes under applicable guidance. For options that vest based on the Company's common stock achieving and maintaining defined market prices, the Company values the awards with a binomial model that utilizes various probability factors and other criterion in establishing fair value of the grant. The related compensation expense is recognized over the derived service period determined in the valuation. This expense is expected to be recognized within the next 27 months.

Ref (b): Unrecognized stock expense related to prior years equity grants of restricted stock to non-employee directors, based on performance criteria, in accordance with DLH compensation policy for non-employee directors.

Stock option activity for the year ended September 30, 2017:

The aggregate intrinsic value in the table below represents the total pretax intrinsic value (i.e., the difference between the Company's closing stock price on the last trading day of the period and the exercise price, times the number of shares) that would have been received by the option holders had all option holders exercised their in the money options on those dates. This amount will change based on the fair market value of the Company's stock.

| | Ref | (in thousands) Number of Shares | Weighted Average Exercise Price | (in years) Weighted Average Remaining Contractual Term | (in thousands) Aggregate Intrinsic Value |
|---|-----|---------------------------------------|--|---|---|
| Options outstanding, September 30, 2015 | | 2,324 | \$1.40 | 6.8 | \$ 3,649 |
| Granted | (a) | 25 | \$2.80 | | |
| Canceled | | (123) | \$1.40 | | |
| Options outstanding, September 30, 2016 | | 2,226 | \$1.40 | 5.8 | \$ 7,581 |
| Granted | (a) | 400 | \$5.94 | | |
| Exercised | | (632) | \$1.28 | | |
| Options outstanding, September 30, 2017 | | 1,994 | \$3.83 | 6.4 | \$ 8,489 |

Ref (a): Option grants to DLH employees in the fiscal year ended September 30, 2017 were valued using a binomial model, under the following criteria:

| | September 30, | |
|-------------------------|-----------------|----------|
| | 2017 | 2016 |
| Risk free interest rate | 2.46% | 1.01% |
| Contractual term | 10 years | 10 years |
| Dividend yield | —% | —% |
| Expected lives | 10 years | 10 years |
| Expected volatility | 144% | 106% |
| Fair value per option | \$0.93 - \$1.47 | \$2.55 |

Stock options shares outstanding, vested and unvested for the period ended:

| | Ref | (in thousands) Number of Shares September 30, | |
|------------------------|-----|---|-------|
| | | 2017 | 2016 |
| Vested and exercisable | (a) | 1,327 | 1,909 |
| Unvested | (b) | 667 | 317 |
| Options outstanding | | 1,994 | 2,226 |

Ref (a): Weighted average exercise price of vested and exercisable shares was \$1.45 and \$1.48 at September 30, 2017 and 2016, respectively. Aggregate intrinsic value was \$6.8 million and \$6.4 million at September 30, 2017 and 2016, respectively. Weighted average contractual term remaining was 5.0 years and 6.0 years at September 30, 2017 and 2016, respectively.

Ref (b): Certain awards vest upon satisfaction of certain performance criteria.

8. Fair Value of Financial Instruments

In partial consideration for the subordinated debt provided by Wynnefield Capital (referred to in Note 5), we issued warrants to purchase 53,619 shares of common stock. As of September 30, 2017, the warrants are outstanding and their fair value was determined to be \$306 thousand. The fair value is estimated using the binomial pricing model. The fair value is subjective and is affected by the changes in inputs to the valuation model including the fair value per share of the underlying stock, the expected term of each warrant, volatility of the Company's stock, and risk free rate based on the U.S. Treasury yield curves.

Key assumptions used in the valuation of the warrants at issuance include the following:

| | |
|-------------------------|---------|
| Risk free interest rate | 1.63% |
| Contractual term | 5 years |
| Dividend yield | —% |
| Expected lives | 5 years |
| Expected volatility | 147% |
| Fair value per warrant | \$5.71 |

The Company recorded a change on the revaluation of the warrant liability of \$102 thousand for the year ended September 30, 2017. The change is recorded and classified in other income (expense) in the accompanying consolidated financial statement of operations.

Given the provisions that may reduce the exercise price of these warrants in the event that other convertible securities or options have a lower price, these warrants are classified as a liability. The Company measures certain financial assets and liabilities at fair value on a recurring basis. The Company determines fair value based upon the exit price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants, as determined by either the principal market or the most advantageous market. Inputs used in the valuation techniques to derive fair values are classified based on a three level hierarchy. These levels are:

Level 1 - Quoted prices (unadjusted) in active markets that are accessible at the measurement date for assets or liabilities. The fair value hierarchy gives the highest priority to Level 1 inputs.

Level 2 - Observable prices that are based on inputs not quoted on active markets, but corroborated by market data. Observable inputs are based on market data obtained from independent sources.

Level 3 - Unobservable inputs are used when little or no market data is available. The fair value hierarchy gives the lowest priority to Level 3 inputs.

The Company has issued warrants to purchase stock as described above. The liability is classified as a Level 3 expense for all periods.

Change in Level 3 liabilities for the year ended September 30, 2017:

| | Beginning Balance | Realized/ Unrealized | Purchases and | Ending Balance | Change in Unrealized (gains) losses for liabilities held at |
|---|----------------------|-------------------------|------------------|--------------------|--|
| | October 1, 2016 | (Gains) Losses | Settlements | September 30, 2017 | September 30, 2017 |
| Warrant issued to acquire common stock | \$ 204 | \$ 102 | \$ — | \$ 306 | \$ 102 |

The Company has other financial instruments, including accounts receivable, accounts payable, loan payable, notes payable, and accrued expense. Due to the short term nature of these instruments, DLH estimates that the fair value of all financial instruments at September 30, 2017 and September 30, 2016 does not differ materially from the aggregate carrying values of these financial instruments recorded in the accompanying consolidated balance sheets.

9. Earnings Per Share

Basic earnings per share is calculated by dividing income available to common shareholders by the weighted average number of common shares outstanding and restricted stock grants that vested or are likely to vest during the period. Diluted earnings per share is calculated by dividing income available to common shareholders by the weighted average number of basic common shares outstanding, adjusted to reflect potentially dilutive securities. Diluted earnings per share is calculated using the treasury stock method.

(in thousands)

Year Ended
September 30,

2017 2016

Numerator:

| | | |
|------------|----------|----------|
| Net income | \$ 3,288 | \$ 3,384 |
|------------|----------|----------|

Denominator:

| | | |
|--|--------|-------|
| Denominator for basic net income per share - weighted-average outstanding shares | 11,345 | 9,966 |
|--|--------|-------|

Effect of dilutive securities:

| | | |
|------------------------------------|-------|-------|
| Stock options and restricted stock | 1,007 | 1,254 |
|------------------------------------|-------|-------|

| | | |
|--|--------|--------|
| Denominator for diluted net income per share - weighted-average outstanding shares | 12,352 | 11,220 |
|--|--------|--------|

| | | |
|----------------------------|-------------|---------|
| Net income per share-basic | (a) \$ 0.29 | \$ 0.34 |
|----------------------------|-------------|---------|

| | | |
|------------------------------|-------------|---------|
| Net income per share-diluted | (a) \$ 0.27 | \$ 0.30 |
|------------------------------|-------------|---------|

Ref (a): For fiscal year ended September 30, 2016, we realized a \$0.9 million tax benefit, net, related to the release of a portion of our valuation allowance to reflect the amount of our deferred tax asset that we expect to realize in future years. This resulted in an increase of net income per share basic and diluted of \$0.09 and \$0.08, respectively, for the prior year period.

10. Commitments and Contingencies

Contractual Obligations as of September 30, 2017:

| Contractual obligations (Amounts in thousands) | Ref | Total | Payments Due By Period | | | |
|---|------------------|------------------|------------------------|-----------------|-----------------|----------------------|
| | | | Next 12 Months | 2-3 Years | 4-5 Years | More than 5 Years |
| Debt obligations | \$ 19,688 | \$ 19,688 | \$ 3,750 | \$ 7,500 | \$ 8,438 | \$ — |
| Facility leases | \$ 3,693 | \$ 3,693 | \$ 929 | \$ 1,567 | \$ 652 | \$ 545 |
| Equipment operating leases | 77 | 77 | 38 | 39 | — | — |
| Total Contractual Obligations | \$ 23,458 | \$ 23,458 | \$ 4,717 | \$ 9,106 | \$ 9,090 | \$ 545 |

Workers Compensation

We accrue workers compensation expense based on claims submitted, applying actuarial loss development factors to estimate the costs incurred but not yet recorded. Our accrued liability for claims development for the periods ended September 30, 2017 and September 30, 2016 was \$1.6 million and \$1.0 million, respectively.

Legal Proceedings

As a commercial enterprise and employer, the Company is subject to various claims and legal actions in the ordinary course of business. These matters can include professional liability, employment-relations issues, workers' compensation, tax, payroll and employee-related matters, other commercial disputes arising in the course of its business, and inquiries and investigations by governmental agencies regarding our employment practices or other matters. The Company is not aware of any pending or threatened litigation that it believes is reasonably likely to have a material adverse effect on its results of operations, financial position or cash flows.

11. Related Party Transactions

The Company has determined that for the period ended September 30, 2017 and through the filing date of this report, there were no significant related party transactions that have occurred which require disclosure through the date that these financial statements were issued.

12. Income Taxes

DLH accounts for income taxes in accordance with the liability method. Under this method, deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities, using enacted tax rates in effect for the year in which the differences are expected to reverse. Deferred tax assets are reflected on the balance sheet when it is determined that it is more likely than not that the asset will be realized. This guidance also requires that deferred tax assets be reduced by a valuation allowance if it is more likely than not that some or all of the deferred tax asset will not be realized.

DLH recorded a \$0.9 million benefit for income tax, net, for fiscal year ended September 30, 2016. The benefit related principally to the release of our valuation allowance, to reflect the amount of our deferred tax asset that we expect to realize in future years. That release was based upon our estimate of future taxable earnings based on results generated. To project taxable income in the future periods, we first estimated revenue for the carryforward period based on the expected performance under current contracts, plus expected changes in the contract base. Using these estimates of revenue, we assumed a proportional level of book income as was generated from the revenues recorded in each fiscal year. We further assumed that tax goodwill amortization would continue through its 15 year life and that amortization of intangibles would continue through their respective lives.

Using the taxable income projections, we calculated the amount of net operating loss (NOL) utilization that would be achieved within each loss year's carryforward period. Our estimate of future taxable income is revised at least annually or more frequently upon the occurrence of an event which warrants a new estimate.

At September 30, 2017 the Company had net operating losses of approximately \$31.5 million and \$1.8 million for U.S. and state tax return purposes, respectively. The NOLs begin to expire in 2021 and continue to expire through 2033.

An analysis of DLH's deferred tax asset and liability is as follows:

| (amounts in thousands) | Year Ended | |
|---|-----------------|------------------|
| | September 30, | |
| | 2017 | 2016 |
| Deferred income tax asset (liability): | | |
| Net operating loss carry forwards and tax credits | \$ 10,786 | \$ 12,387 |
| AMT credit carryforward | 316 | 231 |
| Stock based compensation | 236 | 172 |
| Fixed and intangible assets | (3,243) | (2,580) |
| Accrued expenses | 1,303 | 918 |
| Other items, net | 241 | 287 |
| Net deferred tax asset | <u>\$ 9,639</u> | <u>\$ 11,415</u> |

The significant components of the expense (benefit) for income taxes from continuing operations are summarized as follows:

| (amounts in thousands) | Year Ended | |
|----------------------------|---------------|--------------|
| | September 30, | |
| | 2017 | 2016 |
| Current expense (benefit) | \$ 338 | \$ 170 |
| Deferred expense (benefit) | 1,776 | (1,108) |
| Total expense (benefit) | <u>2,114</u> | <u>(938)</u> |

The following table indicates the significant differences between the federal statutory rate and DLH's effective tax rate for continuing operations:

| (amounts in thousands) | Year Ended September 30, | |
|-------------------------------|-----------------------------|-----------------|
| | 2017 | 2016 |
| Federal statutory rate | \$ 1,837 | \$ 831 |
| State taxes, net | 260 | 71 |
| Other permanent items | 17 | (86) |
| Change in valuation allowance | — | (1,754) |
| | <u>\$ 2,114</u> | <u>\$ (938)</u> |

We file income tax returns in the U.S. federal jurisdiction and in various state jurisdictions. We are no longer subject to income tax examinations for years before 2014.

13. Quarterly Financial Data (Unaudited)

A summary of quarterly information is as follows (in thousands, except per share data)

| | 2017 Quarters | | | |
|-----------------------------------|---------------|-----------------|---------------|-----------------|
| | First | Second | Third | Fourth |
| Revenue | \$ 26,111 | \$ 29,905 | \$ 29,256 | \$ 30,390 |
| Gross margin | 5,811 | 6,401 | 6,385 | 7,253 |
| Income from operations | 889 | 1,839 | 1,753 | 2,149 |
| Other income (expense), net | (364) | (255) | (269) | (340) |
| Income before income taxes | 525 | \$ 1,584 | 1,484 | 1,809 |
| Income tax expense(benefit) | 201 | \$ 605 | 539 | 769 |
| Net income | \$ 324 | \$ 979 | \$ 945 | \$ 1,040 |
| Earnings (loss) per share: | | | | |
| Basic | \$ 0.03 | \$ 0.09 | \$ 0.08 | \$ 0.09 |
| Diluted | \$ 0.03 | \$ 0.08 | \$ 0.08 | \$ 0.08 |

| | 2016 Quarters | | | |
|--|-----------------|---------------|---------------|-----------------|
| | First | Second | Third (1) | Fourth |
| Revenue | \$ 16,559 | \$ 16,934 | \$ 24,989 | \$ 27,120 |
| Gross margin | 2,917 | 3,224 | 5,456 | 6,229 |
| Income from operations | 382 | 689 | 1,668 | 1,325 |
| Other expense | (575) | (127) | (374) | (542) |
| Income (loss) before income taxes | (193) | 562 | 1,294 | 783 |
| Income tax expense(benefit) (2) | (77) | 225 | 518 | (1,604) |
| Net income (loss) | \$ (116) | \$ 337 | \$ 776 | \$ 2,387 |
| Earnings (loss) per share: | | | | |
| Basic | \$ (0.01) | \$ 0.03 | \$ 0.08 | \$ 0.23 |
| Diluted | \$ (0.01) | \$ 0.03 | \$ 0.07 | \$ 0.20 |

(1) Reflects impact of acquisition completed May 2016.

(2) Refer to Note 12, Income Taxes, for detailed explanation of the income tax benefit recorded in fourth quarter 2016.

14. Employee Benefit Plans

As of September 30, 2017, DLH and its subsidiaries maintain the DLH 401(k) Plan (the "401(k) Plan") , a defined contribution and supplemental pension plan for the benefit of its eligible employees. DLH may provide a discretionary matching contribution of a participant's elective contributions under the 401 (k) Plan. DLH recorded related expense of \$154.4 thousand in fiscal 2017 and \$142.0 thousand in fiscal year 2016. A participant is always fully vested in his or her elective contributions and vests in Company matching contributions over a four year period.

15. Subsequent Events

On November 10, 2017, an aggregate of 93,125 shares of common stock of the Company were issued to the non-employee members of the Company's Board of Directors, in accordance with DLH's compensation policy for non-employee directors. The shares vested immediately, and stock expense of approximately \$563 thousand was recognized accordingly. This transaction will be reflected in the Company's first quarter results for fiscal year 2018.

On November 29-December 1, 2017, the Company granted 217,500 incentive stock options to certain executive and non-executive employees, pursuant to the Company's 2016 Omnibus Equity Incentive Plan. The options will vest and become exercisable upon the satisfaction of certain conditions.

Subsequent to our fiscal year end, both branches of Congress passed major federal tax reform legislation. While the exact terms of the legislation will not be finalized until the reconciliation process is completed, the resulting bill may have a material impact to our business. The tax effects resulting from any changes in tax laws or tax rates are not permitted to be recognized until the period that includes the enactment date, which will occur when a bill is signed into law, and subjected to the full legislative process. The Company is closely monitoring the proposed legislation and is prepared to quantify and recognize any potential impact in the period in which the legislation is enacted.

Management has evaluated subsequent events through the date that the Company's financial statements were issued. Based on this evaluation, the Company has determined that no further subsequent events have occurred which require disclosure through the date that these financial statements were issued.

