

Digitiliti Inc
Form 10-K
April 16, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended: December 31, 2011

or

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

For the transition period from _____ to _____

Commission File Number: 000-53235

DIGITILITI, INC.

(Exact Name of Registrant as specified in its Charter)

Delaware

26-1408538

(State or other Jurisdiction of Incorporation
or Organization)

(I.R.S. Employer Identification No.)

266 East 7th Street, 4th Floor

St. Paul, Minnesota 55101

(Address of Principal Executive Offices)

(651) 925-3200

(Registrant's Telephone Number, including area code)

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act: Common Stock, par value \$0.001

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 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 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 Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during

the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K 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 IV 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:

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

Market Value of Non-Affiliate Holdings

State the aggregate market value of the voting and non-voting common stock held by non-affiliates computed by reference to the price at which the common stock was last sold, or the average bid and asked price of such common stock, as of the last business day of the Registrant's most recently completed second quarter.

At June 30, 2011, the aggregate market value of the shares of voting and non-voting common stock held by non-affiliates was approximately \$4,111,983, based on 68,533,042 shares being held by such persons and the closing price of \$0.06 for the Registrant's common stock on the Pink OTC Markets, Inc. (the "Pink Sheets") on June 30, 2011.

Outstanding Shares

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date:

Class	Outstanding at April 13, 2012
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Common Stock, \$.001 par value per share	70,683,241 shares
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Documents Incorporated by Reference

None.

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PART I

FORWARD-LOOKING STATEMENTS

In this Annual Report, references to “Digitiliti, Inc.,” “Digitiliti,” the “Company,” “we,” “us,” “our” and words of similar import refer to Digitiliti, Inc., a Delaware corporation (the “Registrant”); and such references also include our wholly-owned subsidiary, Digitiliti, Inc., a Minnesota corporation, which was formerly named “Storage Elements, Inc.,” our predecessor (sometimes called “Storage” herein).

This Annual Report contains certain forward-looking statements, and for this purpose, any statements contained in this Annual Report that are not statements of historical fact may be deemed to be forward-looking statements. Without limiting the foregoing, words such as “may,” “will,” “expect,” “believe,” “anticipate,” “estimate,” “continue” or comparable terminology are intended to identify forward-looking statements. These statements by their nature involve substantial risks and uncertainties, and actual results may differ materially depending on a variety of factors, many of which are not within our control. These factors include, but are not limited to, economic conditions generally and in the markets in which we may participate, competition within our chosen industry, technological advances and any failure by us to successfully develop continuing business relationships and customers or to successfully fund our current and intended operations.

ITEM 1: BUSINESS

We were organized under the name “Cyclone Holdings, Inc.” as a holding company under Delaware Law on March 31, 2006.

On February 27, 2007, we changed our name to “Digitiliti, Inc.”

We acquired Storage Elements, Inc (the “Storage Merger”), effective August 17, 2007, and we became a successor to Storage and its business operations, with Storage becoming our wholly-owned subsidiary. References are often made to “Storage” throughout this Annual Report to provide a clearer understanding of the information presented. We also changed the name of Storage to “Digitiliti, Inc.” As a result, we both share the same name, respectively, in the States of Delaware and Minnesota.

Currently, our principal executive offices are located at 266 East 7th Street, 4th Floor, St. Paul, Mn 55101, (651) 925-3000.

On March 13, 2008, we acquired a commercially-proven technology from StorageSwitch, LLC, a Colorado limited liability company (“StorageSwitch”), which led to the development of our new product discussed below under the heading “Business-DigiLIBE.” Since then we have made significant changes to the product, and it is now called the “Universal Archive Platform”.

Our business is developing and delivering superior archiving and information management technologies and methodologies enabling our customers to manage, control, protect and access their information and data simply and cost effectively. Our traditional business is providing a cost effective on-line data protection and data recovery solution to the small to medium business (“SMB”) and small to medium enterprise (“SME”) markets through our DigiBAK service.”. This on-line cloud storage management solution helps organizations properly manage and protect their entire network from one centralized location.

Our emerging business product, released in the first quarter of 2010, is called the Universal Archive Platform, DigiLIBE. We believe that DigiLIBE is a game-changing product that addresses the desperate need for a fiscally responsible, integrated system to manage the increasing growth, volume, and diversity of unstructured data that now represents up to 85% of enterprise information and continues to grow rapidly. Content chaos is overwhelming companies’ ability to meet compliance, utilize collaboration tools and optimize storage needs for their virtualized infrastructures.

DigiBAK and DigiLIBE are complementary products with DigiBAK providing cloud storage backup and recovery of structured data and operating system files and DigiLIBE offers archiving and information management and life-cycle control of unstructured data from end-user through archiving and back to the end user.

Our Internet website address is www.Digitiliti.com. The information on this website is not incorporated by reference into this Annual Report on Form 10-K. We make available free of charge through our website annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, Forms 3, 4 and 5 filings, and all amendments to those reports and filings as soon as reasonably practicable after such material is electronically filed with, or furnished

to, the Securities and Exchange Commission (“SEC”).

The DigiBAK business

Our DigiBAK solution can backup and restore emails and all company data on every machine in a network, including desktops, laptops, file and print servers. We provide storage through a “utility based computing” philosophy, where customers pay for the

gigabytes of data they store in DigiBAK's Vault facility.

Through our DigiBAK service, we combine powerful, agent-less backup software with our SAS 70 compliant facility, to deliver to our customers an efficient and effective online-offsite data backup and restore solution. Our facilities enable us to provide offsite disaster recovery emphasizing intraday protection and restore for all of our customer primary data centers and geographically dispersed offices or campus settings. Our SAS 70 compliant DigiBAK Vault facility is located at 511 6th Street South, Minneapolis, MN. It is a one of a kind facility providing web based on-demand backup/restore service with all the benefits of direct fiber access to a "Level 5" data center. The Vault has 24/7 onsite physical security, including security guards, motion detectors, security cameras, card-key access, separate cages with individual locking cabinets and ladder racking. It also has battery generator back up power, temperature and humidity controls and fire suppression systems. Geographically, we are located at the center point of the Metropolitan area network. Being centrally located at the focal point of the Twin Cities Fiber Channel and Gig loop, the pipeline for data and load capabilities are immense and this capability allows us to send data back and forth in real time.

We utilize both direct in-house sales and sales through business partner channels such as Value Added Resellers (VARs) and third party integrators. Our resellers have extensive data storage knowledge and expertise and an established customer base. Our sales plan targets reseller, Original Equipment Manufacturer and channel partnerships regionally and nationally that possess utility-oriented sales systems. We and our partners target vertical markets specifically in the Small Business Market (SMB) and the Small and Intermediate size Enterprises of 100 — 5000 employees with an average of four sites and five — 20 Terabytes of information to archive.

As a result of our sales and marketing efforts of our DigiBAK product, our customer base has expanded from approximately 20 in fiscal 2005 to approximately 100 in fiscal 2006, 508 in 2007, 731 in 2008, 789 in 2009, 890 in 2010 and 910 as of December 31, 2011. And, while our annual sales increased from \$402,638 in 2006 up to \$3,192,463 in 2009, in 2010 we began to experience a decline in annual sales posting \$2,143,882 in 2010 and \$1,480,154 as of December 31, 2011. Despite this strong overall customer trend, we continue to struggle with profitability because of increasing competitive pressure causing commodity-like pricing through cloud-like storage. While we have continued to grow our customer base, we have also had to adjust pricing to maintain competitive advantage. We have significantly improved our support infrastructure and have been able to hold our margins. We still need to raise cash in 2011 to grow our overall business, but we believe we are in a much better financial and expense position than we were a year ago through targeted expense reduction and debt conversion. The product features that we are offering to our clients we believe have superior functionality to the mainstream competition and fill a customer need. We expect this gain new business in 2012.

The Emerging New Universal Archive Platform (DigiLIBE) Product

In 2008, we began to pursue a strategy of expanding our solution to address the need of the industry for managing structured data through DigiBAK, but also provide information management abilities for the unstructured data. This effort led to the development and release of the product called Universal Archive Platform, DigiLIBE, a platform that is designed to consolidate together multiple disparate hardware and data storage environments to provide organizations with the ability to capture, classify, share, preserve, protect, achieve, and deliver the right information, to the right people, at the right time, helping them make informed business decisions. DigiLIBE should be understood as follows — as a company continues to virtualize their hardware and data storage environments, DigiLIBE provides a complementary virtualized environment for the company's primary asset — its information and data. It does not matter if the information is on a user machine, on a server, or in archive. A customer can control it, secure it, and access it and at the same time reduce its IT storage costs.

Growing both Business Segments:

We believe the benefits of our strategic decision to grow both the DigiBAK and DigiLIBE businesses are:

- (i) solving a major industry and customer problem of managing continually growing information volume and associated cost of storage and retrieval;
- (ii) ability to access a larger share of opportunity in the information management storage business;

(iii) offering significant technological advantages in control of information at the corporate policy level and ability to leverage knowledge from the information it creates; and

(iv) optimization of the synergistic allocation of capital and resources between both business.

DigiLIBE has received excellent feedback on the capability, performance, and function it delivers since its initial release. Our sales and prospecting efforts have also reaffirmed the potential of selling DigiBAK services as part of a DigiLIBE sale.

To date, Digitiliti has achieved market recognition and brand value having successfully established its presence in several vertical markets such as Finance, Legal, Telecom, Managed Service Provider, Healthcare, Information Technology Services, and Management Consulting. In June 2010, DigiLIBE won the Tech Awards Circle Gold Award in the Midrange Software category. In briefings, leading industry analysts have described DigiLIBE as a unique and potentially disruptive product integrating both the storage management and information management markets.

We believe DigiLIBE is a fiscally responsible solution at a price, performance, and ease of use level that disrupts the current competitors' point solution landscape and positions while exceeding customers' expectations and needs. We believe our new product represents a significant step toward our goal of becoming a technology leader in the information content and context management marketplace.

We began providing on-line backup and recovery services to the small and medium business ("SMB") and small to medium enterprise ("SME") markets in 2005. This line of our business is referred to as our "DigiBAK" service. This data protection solution helps organizations easily manage and protect their entire network from one centralized location, with offsite redundancy. Our DigiBAK service can backup and restore data on every machine in a network, including desktops, laptops, file and print servers. The marketplace for on-line backup and recovery services is estimated to be a \$3 billion dollar opportunity.

The advantages of outsourcing on-line backup and disaster recovery for customers is that it eliminates cumbersome tape storage and internal infrastructure costs associated with the effort and capital to provide redundancy, disaster recovery and to comply with legal and regulatory requirements for information management. We combine a powerful, agent-less backup software, with our remote DigiBAK service, to deliver to our customers a powerful and effective online-offsite data backup and restore solution from our SAS 70 compliant data center located at 511 6th Street South, Minneapolis, MN.

Our Data Storage Center is located at 511 6th Street South, Minneapolis, MN. It is a one of a kind facility providing our web based on-demand backup/restore service with all of the benefits of direct fiber access to a "Level 5" data center. The Data Storage Center has 24/7 onsite physical security, including security guards, motion detectors, security cameras, card-key access, separate cages with individual locking cabinets and ladder racking. It also has battery generator back-up power, temperature and humidity controls and fire suppression systems. Geographically, we are located at the center point of the Metropolitan area network, being centrally located at the focal point of the Twin Cities Fiber Channel and Gig loop. The pipeline for data and load capabilities are immense, and this capability enables us to send data back and forth in real time.

At the customer site, DigiBAK administrator software is loaded on as many or as few workstations as desired and requires a valid logon code, helps to eliminate any unauthorized access; the administrator software console acts as the interface with DigiBAK in the Data Storage Center; and enables the configuration of all backups and restores. The DigiBAK backup software is totally agent-less, requiring no additional software to be installed on any machines. From the customer administration console, the customer sets retention policies, schedules automatic backups and initiates restores. The customer decides what files to backup: emails, Windows, Linux, Mac, Lotus, AS400 and many more. To ensure security and confidentiality, customer data sent to our Data Storage Center is encrypted and compressed. The encryption key is known only to the customer. The data can be unencrypted only by the customer, affected upon the need of a restore of information. Encrypted data is also highly compressed, making it extremely safe and impenetrable from viruses.

We currently have two storage vaults in our Data Storage Center; 1-105 Terabyte system and 1-95 Terabyte system. We built this vault infrastructure upon a third-party software system called Asigra to efficiently manage the volumes of data being transmitted and stored. When we fully consume existing storage capacity, we purchase additional Asigra licenses, as needed.

Customers are charged monthly for the gigabytes of data they store in our Data Storage Center. The compelling business case is that industry statistics (and our own actual experience) show that organizations grow data at a rate of 3% per month, so gigabyte billing per customer is estimated to grow at that approximate rate. This model provides ongoing revenue growth from our existing customer base. However, the down side of this growth is that it results in increased monthly and annual costs for customers. At some point, the costs are such that the business case for

outsourcing backup and recovery services can no longer be justified by larger customers.

In 2008, we began to develop a new product targeted to help customers deal with the ever-increasing burden of data growth and data proliferation that would also stem the potential of rising storage costs. In analyzing industry data growth issues, we determined that 80% of data being stored is either duplicate or proliferated, and 80% of that data is categorized as “unstructured” data, such as Word documents, PDF’s, Excel spread sheets, other Office documents, pictures and music, but with the greatest issue being emails. “Structured” data, representing 20% of data stored, is typically data contained in databases such as inventory, accounting data and the like. Our new product is named DigiLIBE, or the Universal Archive Platform, previously referred to as “Pyramid” in our previous reports and registration statements filed with the Securities and Exchange Commission.

The architecture of DigiLIBE was developed from the ground up, starting with the foundational database software purchased from StorageSwitch in March, 2008. During most of 2008, we refined and enhanced this base code and optimized it for our specific application. We struggled to define the overall architecture and went through a number of false starts in trying to develop the overall DigiLIBE system. In February, 2009, we brought in new management experienced in software development. We reorganized our development team and solidified the overall architecture of this product. We also identified significant areas of intellectual property in the architecture and design and filed for patent protection on these aspects.

In analyzing the opportunity for this product, it became clear that existing solutions to the problem of data growth did not address the root cause. They addressed pieces of the problem, attacking symptoms with “point” solutions such as de-duplication, Indexing, Compression, Mass Storage Devices, Archives and so forth. The aggregate industry opportunity for all these different solutions is estimated to be somewhere between \$30 billion and \$45 billion, and potentially even more, if you expanded beyond storage into e-discovery and business intelligence.

Our approach was to address the root cause of the data growth and proliferation problem/opportunity by providing one universal architecture, in a simple-to-implement solution. Throughout most of 2009, we worked diligently to complete this project, gathering continuous feedback from industry analysts, experts and potential customers. On December 19, 2009, we announced DigiLIBE as a break-through data management product.

During this time, we attempted to sell our DigiBAK service business, but abandoned these efforts because we could not agree to terms with the potential buyer. As a result, we restructured the DigiBAK business to become more efficient, and reinitiated our effort to grow that business. A component of our new DigiLIBE business is also an “active” Vault where customers archive and can retrieve DigiLIBE information objects without the assistance of IT personnel. We believe customers are looking for a one stop shopping storage solution, so as our DigiLIBE business grows, we see the potential to also increase our DigiBAK business. Unstructured data (information objects) sent to the DigiLIBE vault and structured data and all other backups sent to the DigiBAK vault, are all done seamlessly and transparently for the customer.

As with DigiBAK, DigiLIBE’s Vault component is charged per gigabyte of customer storage. DigiLIBE also has a onetime charge for its software license and storage device, along with annual maintenance. We do not charge per client license fee as we believe it will discourage using the system to its full ability and capacity. While there are a limited number of direct sales, both products are distributed through industry resellers nationwide. DigiBAK and the DigiLIBE Vaults are basically service businesses where our resellers can benefit by providing and gaining ongoing service revenue. DigiLIBE has also a product component and a consulting services component, making it a compelling value equation for resellers.

Our vision for DigiLIBE is to change the way customers approach the problem of data growth and proliferation. In the past and current environment, customers have labored on implementing technologies to solve individual issues like using indexers to find data, de-duplication devices to control growth and email archivers to manage ever-growing email storage. DigiLIBE offers a different approach: one where technology is secondary to the problem solution, DigiLIBE provides organizations with the ability to focus their energy and resources on managing the content of information created and putting their content into context for competitive advantage, rather than concentrating on data growth problems.

Products, Software, Services and Related Technologies Utilized

The following information describes various products, services, software and other technologies utilized in our products and services. We will define these in two categories; (1) storage technologies, and (2) information technologies. Where it is not specifically indicated, technologies identified are common to both DigiLIBE and DigiBAK.

Storage Technologies:

We use industry standard computing hardware and operating systems in our products. Our goal is to use top-tier brand hardware and state of the art technology for overall system and network performance, reliability and maintainability. We employ SCSI hard drive protocol for speed and reliability and Level 5 RAID storage redundancy and fault-tolerance. We move data across high performance fiber channel networks between systems and from disks to computer processors. Our network switches are also top-tier vendor solutions.

In DigiBAK, we rebranded a third party application from Asigra, which manages and controls the data being archived and retrieved from the customer to our Data Storage Center. This solution provides the capability to efficiently and effectively move and manage very large blocks of data and to ensure the integrity and security of the information stored. It also provides the capability to track and report on storage volumes by customers, providing the basis for our monthly billing. We pay for their licenses and maintenance based on the number of systems and gigabytes of storage allocated. We also pay them an annual “Branding” fee to employ a

customer-facing Digitiliti brand.

The DigiLIBE Vault does not use any third party software. Secure storage is implemented in an industry standard database.

Archiving & Information Technologies:

This category is unique to our Universal Archive Platform, DigiLIBE. DigiLIBE moves and manages information objects, which, in effect, are human recognized content such as a Word document or an Excel spreadsheet.

Technologies employed in DigiLIBE include de-duplication to remove type of unstructured of information from the system. One of DigiLIBE's patent applications involves "global de-duplication." In other words, we de-duplicate objects from the time of creation to the time of archive — over the life-cycle of the object. We can assure there are no duplicates in the system. Another technology is indexing, where we save the contents of information objects so that a user can search not only for title, but for any information contained in the content of the object. And this indexing supports multiple languages. Other technologies include compression to reduce the object size and encryption to protect security of customer information. DigiLIBE information object technology also includes a policy engine to control factors like retention life, versioning and other options targeted to allow users and company executives to define information object storage parameters. Each information object has "meta-data" stored with the object. Meta-data is basic information about the object such as who stored it, what type of data is it, when was it stored and/or updated, what computer was its source and who accessed it. All these capabilities are integrated into one package with DigiLIBE and contained on one storage appliance called an "Information Director," making this a simple and easy to use information content and context delivery solution.

Principal Products or Services and their Markets

Markets

The on-line archiving market characterized by DigiBAK is projected to be a \$3 billion dollar opportunity. The market for DigiBAK is a horizontal market comprised of small and intermediate sized establishments and enterprises. The industry definition is SMB (Small and Medium Businesses) and SME (Small and Medium Enterprises) with up to 500 employees. Our DigiBAK customer profile is typically in the 50 to 1000 employee segment with 500 gigabytes to 3 terabytes of stored data. This business spans horizontally across all industry segments. However, regulated industries or those having significant concerns about data protection and disaster recovery tend to be the primary customer base. North America is the primary geographic region for our business. We expect to move into broader geographic areas within two years.

Because of DigiLIBE's highly and uniquely integrated architecture, the market opportunity is less well defined. In order to complete a market opportunity assessment, one has to roll up the individual opportunity for each "point" solution offering. Our estimates are that this industry opportunity ranges from between \$30 to \$45 billion. It is new market defined by Gartner as Enterprise Information Archiving (EIA) market. They issued a new magic quadrant report in October 2010 for the first time on this market. Not a data management and control market, but an information content and context market transforming the current market definition of Primary Storage, Secondary Storage and Archival Storage to a market of Content and Context Management that not only includes Storage, but also includes Business Intelligence, e-Discovery and Information Policy. DigiLIBE's capability even makes the traditional file structures obsolete, encroaching into traditional operating system space, as it relates to file storage and file structures.

DigiLIBE's target market is similar to DigiBAK — SMB / SME. However the market segmentation has more vertical tendencies and targeted to Health Care, Finance, Legal and some sectors of government. However, DigiLIBE's policy engine and life cycle management make it ideal for any organization with regulatory compliance requirements. As with DigiBAK, North America is the primary geographic region for DigiLIBE sales, but we expect to move into broader geographic areas within two years.

Products

DigiBAK is an on-line data backup and restore service. DigiLIBE is both a product and a service offering. The product is our information management software contained in our Information Director storage appliance Customers pay a one-time fee for this appliance and a one-time software license fee, plus annual maintenance for this product. The service component is a monthly per-gigabyte fee for archiving. DigiLIBE has an "active" archive, meaning that

individual users have real-time access to archived data (assuming they are authorized). Customers can use Digitiliti's Data Storage Vault services, their own storage or a third party for active archiving. Another service component is consulting services to assist customers in enhancing the DigiLIBE policy engine and to customize workflow applications to put content into context. DigiBAK is an on-line data backup and recovery service. Both the DigiLIBE and DigiBAK services are charged by gigabyte of storage per month.

An additional opportunity for DigiLIBE is an OEM solution and business partnership where DigiLIBE software is placed on another vendor's storage appliance and sold under that vendor's brand.

Objectives

Through on-line research, engaging industry experts and through continuous customer contact, we have identified the most pressing data management issues SMB/SME managers struggle with today. Various ad-hoc collections of single purpose (point) software/hardware products and functions like data de-duplication, encryption or application integration are a few examples of some of the different data management issues we are addressing.

We believe our experience as a hybrid cloud backup/disaster recovery solution provider in the past 5 years brings us credibility in the market. We have learned from this experience and are in a better position going forward. One of the strengths of DigiLIBE is built from the heritage of our DigiBAK business. We believe that both our current business and our new product will complement each other with a very good chance that we can grow both in a complementary sales strategy where we provide an active archive for information objects of unstructured data and a traditional archive for all other data of customers. In effect, we can be the “cloud” provider, but with value added capability of using that content.

Targets

See “Markets,” above for our targeted market focus

“digitiliti” Product Operational Methodology

Our operational model is simply defined in these points:

• Develop simple and robust technologies. Mask technical complexity from IT and from the users.

• Develop technologies and process to scale sales through VARs

• Reduce total cost of ownership (TCO) of managing information and archiving for IT and organizations.

• Provide customers with the business knowledge of the content they create and store, to improve their efficiency and effectiveness.

Distribution Methods of the Products or Services

We sell and support our solutions and services through direct sales, and through relationships with Value-Added Resemarketers and third-party integrators (resellers). We have a current base of about 15 resellers in North America for DigiBAK, most of whom are local to a city or are regional in nature. Over 80% of our current base of more than 900 DigiBAK customers has been signed through resellers. For DigiLIBE, we are targeting regional and national resellers who can sell the product, deploy the product and provide on-going consulting services. With DigiBAK, our value to resellers is an on-going monthly revenue stream from on-line archive volumes. With DigiLIBE, we have a more compelling reseller model. Resellers not only get revenue from the one-time sale of the product, but they gain service revenue from the monthly archive volumes. They also have the opportunity to engage the customer in business services such as consulting on policy setting details, developing workflow applications to leverage information object content or to write information applications that turn content into context.

For DigiLIBE, another potential distribution channel is OEM — Original Equipment Manufacturer. We also market through traditional methods, including the web, trade publications, trade shows and advertising. We are aggressively pursuing a plan to use our web site to grow our direct sales by strategically improving our ability through the new site to go Viral. We are developing a limited function assessment tool that will be distributed through the new website and help IT professionals realize the value of the product and the reduction in their TCO.

Status of any Publicly Announced New Product or Service

Release 1 of DigiLIBE was announced on December 19, 2009.

Release 2 of DigiLIBE was announced on October, 2010. This release significantly improved the functionality, stability, and scalability of the product.

Release 3.5 of DigiLIBE was announced on February, 2011. This release provides new and improved features that created sharing, collocation and improved client connectivity. .

There are plans for additional releases and future content targeted for new features and functions and for market expansion both to smaller size organizations to the larger enterprises.

Competitive Business Conditions, Competitive Position in the Industry and Methods of Competition

For DigiBAK, we compete with multiple information protection and storage service providers in all geographic areas where we

operate. We also compete with current and potential customers' internal information protection and storage service capabilities, especially larger customers where data growth is driving costs to the point where outsourcing this service is cost prohibitive. The most important competitive factors are, in order of priority: price, reliability and service. Over the last few years, "Cloud" storage is emerging from a number of sources, including Amazon, Google, Barracuda and others. "Cloud" offers basic backup service for very low entry point and has attracted smaller business customers away from our more fully functional service.

Key national and international competitors for full function on-line archiving include Iron Mountain, EVault, HP, and EMC. These companies focus on larger enterprises and offer services similar to our services. Their competitive advantage is in financial strength, size and by the fact that they are also hardware providers. We differ in our competitive advantages by our agility, service and focus on small and intermediate businesses as our core business. Other competition is more limited and tends to be localized to geographic areas. These competitors operate with cost as a competitive advantage. However, they typically offer a subset of service and capabilities and are targeted more to smaller enterprises and establishments. Iron Mountain, EMC and some other large storage providers have made strategic purchases of companies offering point solutions, which when linked together, offer a subset of capabilities offered by DigiLIBE. They are clearly moving in a direction to offer a comprehensive solution to compete with DigiLIBE. The question is when will they reach that capability, and that is presently unknown.

Competitive landscape for DigiLIBE:

Currently, there is no known competitor providing the comprehensive and integrated capability found in DigiLIBE. We have been able to confirm this through calls with industry analysts. DigiLIBE's patent application architecture is "Client" based with a focus on the "Human" interface and on the need for information management and control, with content put into context. Most competitive products are individual "point" solutions offering technology to help solve a specific information area like content indexing or de-duplicating or archiving. Some companies are integrating multiple point solutions in a network to provide broader value, but most of this integration is done at the storage layer versus the client or human point of data creation. This architectural limitation leaves these competitors at a significant disadvantage relative to capturing key meta-data at point of creation that can be used to put content into context. It also leaves them in a high cost, high complexity environment. Key competitive factors are function/capability, simplicity and cost.

Competitors that have similar DigiLIBE function (with limitations) by integrating a number of point solutions together include EMC, Evault, IBM, NetApp, Symantec, and HP. No one of these competitors offers a complete suite except EMC. However, as stated, all these potential competitors' weaknesses are the "storage-centric architecture versus the client (human)-based design, and the cost of integrate and manage "point" solutions. It is difficult to assess how much reengineering or redesign would be required and how much time it would take for a top-tier competitor (like those listed above) to develop a cost and performance competitive solution to compete directly with DigiLIBE. It is more likely that a second-tier or startup company may introduce a product to compete with DigiLIBE. Our patents, if issued, will afford some level of protection against strongly similar architectural solutions.

Sources and Availability of Raw Materials and Names of Principal Suppliers

For DigiBAK, our principal supplier partners are Asigra, a software vendor providing system management tools; NetApp, which provides hardware and software and our data transmission supplier. Asigra is a provider of comprehensive software solutions and IT expertise to back up data to customers secure vaults. We pay for licenses and for annual maintenance agreements based on the gigabytes of storage used. We chose NetApp because we believed it to be robust and the best fit with the Asigra software. Our software/hardware infrastructure is built around the NetApp product (hardware and software) and the Asigra product (software). When we fully consume existing storage capacity, we purchase additional NetApp software and equipment or Asigra licenses as needed. Integra Telecom provides voice, data and IP services to businesses and other telecommunications companies in 80 metropolitan markets across the United States.

For DigiLIBE, all our software is developed in-house. We use the Microsoft Developers Suite to develop our software. Our hardware Information Director is industry standard and we outsource the product from multiple top-line vendors. Our DigiLIBE vault hardware is basically the same hardware as our Information Director. This hardware is industry standard that can be provided from many different sources.

Dependence on One or a Few Major Customers

Our customers trust us with the ability to archive, protect and retrieve their information assets. We serve customers throughout the United States in a diverse group of data intensive industries, including financial services, engineering and scientific, construction, health care, education and legal services, being the most important. We have strong relationships with our customers and high customer satisfaction with our sales and technical support, and those of our business partners.

Our DigiBAK business has grown to over 900 customers in 2011 across North America. Of those customers, approximately 72% of the revenue (based on gigabytes of stored data) is with our 10 largest customers. While loss of one or two of these large customers would present a challenge to continued revenue growth, our contracts are for three years. Further, larger customers drive more generic growth in data from the initial stored amounts over time. Our sales direction is toward more intermediate sized customers similar to those in our top 10. With the introduction of DigiLIBE, we offer customers alternatives to control their data growth as well as provide new functions. With the combination of DigiBAK and DigiLIBE, we expect to grow both of our data archiving businesses and retain larger customers who would otherwise leave the service because of escalating costs driven by their own data growth. Patents, Trademarks, Licenses, Franchises, Concessions, Royalty Agreements or Labor Contracts, including Duration Generally, we rely on a combination of patents, copyrights, trademarks, trade secrets (including know-how), employee intellectual property agreements, and third-party agreements to establish and protect proprietary rights in our products and technologies. It is our practice to seek protections in all jurisdictions where such protections are deemed useful and desirable to our business and competitive interests.

In 2008, we applied for and have a patent pending an Information Area Network Patent representing the underlying technology and process of our DigiLIBE product. Key claims filed in January, 2010 include; (1) file creation, metadata attribution and storage, (2) persistent access to files, (3) file policies and (4) global de-duplication.

We have customary software licenses required to conduct current and intended operations. We are in the process of filing certain service mark applications that are deemed to be necessary or beneficial to us.

We have or are party to the following service agreements that are deemed to be material.

StorageSwitch, LLC

In January 2008, we executed a nonbinding Letter of Intent (the "LOI") with StorageSwitch to purchase selective existing software technology and in March 2008 we signed and completed a Technology Purchase Agreement for a purchase of certain technology software with a total payment of \$250,000 cash and 500,000 shares of our common stock that were restricted securities. We also entered into a Consulting Service Agreement with a monthly payment of \$25,000 and monthly issuance of 24,960 shares of our common stock that were also "restricted securities". This Consulting Services Agreement terminated on August 1, 2008.

Vision to Practice, Inc.

On February 6, 2008, we entered into a Consulting Agreement with Vision to Practice, Inc., a Minnesota corporation ("Vision"), to assist in bringing our new product initiatives to market utilizing the technology software purchased from StorageSwitch. We pay semi-monthly payments of \$7,680 based on full-time service provided to us under this Consulting Agreement. We also issued to the consultant's principal a comprehensive stock option package that vest over multiple years of service. Vision is owned by Rodd Johnson.

This Consulting Agreement contains various provisions regarding independent contractor status, confidentiality, due performance and care in performing services, notice of disputes and time for correction, arbitration of disputes and indemnification by Vision, among other provisions, a copy of which was filed as an Exhibit to our Form 10. The Scope of Work outline referenced in the Consulting Agreement is not filed as an Exhibit as it considered confidential and proprietary information to us and our storage technology. See Part IV, Item 15.

Research and Development Costs during the Last two Fiscal Years

In 2010 and 2011, we incurred research and development expenses of \$447,476 and \$992,210, respectively to develop our new DigiLIBE product offering. We announced DigiLIBE on December 19, 2009, and launched Release 1 of our new DigiLIBE product in June 2010, and release 2 of DigiLIBE was in October of 2010, and release 3.5 in February of 2011.

Number of Total Employees and Number of Full Time Employees

At year end 2010, our employee headcount was 20 full-time employees and one subcontractor. At year end 2011 our employee headcount was 13 full-time employees and one subcontractor. We utilized contract employees for specific skills required in short-term activities. We hire full-time employees where we intend to focus on strategic skill needs. Over the past two years, we have focused on maintaining a small and highly productive team and intend to continue as such.

Reports to Security Holders

We are required to file annual reports on Form 10-K and quarterly reports on Form 10-Q with the Securities Exchange Commission, and on a regular basis, are required to timely disclose certain material events (e.g., changes in corporate control; acquisitions or dispositions of a significant amount of assets other than in the ordinary course of business; and bankruptcy) in a Current Report on Form 8-K.

You may read and copy any materials that we file with the Securities and Exchange Commission at the Securities and Exchange Commission's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549, on official business days during the hours of 10:00 am to 3:00 pm. You may obtain information on the operation of the Public Reference Room by calling the Commission at 1-800-SEC-0330. You may also find all of the reports that we have filed electronically with the Securities and Exchange Commission at their Internet site www.sec.gov.

ITEM 1A: RISK FACTORS

Risks Related to Our Business

We have not recorded annual profitable operations since our inception, and continued losses may require us to curtail or terminate our business operations.

We have experienced operating losses each year since our inception. Our revenues decreased by \$663,728 to \$1,480,154 in 2011 compared to \$2,143,882 in 2010, with our net loss decreasing to \$3,988,543 for the year ended December 31, 2011, compared to the net loss of \$6,414,639 for the year ended December 31, 2010. We may still incur additional future operating losses. Without raising new capital, continued losses on our operations may require us to curtail or terminate our business operations. Our operating results may fluctuate significantly and any failure to meet financial expectations may disappoint securities analysts or investors and result in a decline in our common stock price on the Pink Sheets or any other nationally recognized quotation system upon which our common stock may be publicly traded in the future.

Our substantial short term debt could adversely affect our financial condition and our ability to continue our present and planned business operations.

As of December 31, 2011, and December 31, 2010, we had long term debt in the form of our 12% and 8% convertible notes in the amount of \$1,374,259 and \$250,000, respectively.

From April 2009 through October 2009, we raised \$750,000 from the sale of 12% convertible debt and warrants that were secured against the assets associated with our DigiBAK vault located in the base of the former Minneapolis federal Reserve Bank. These notes reflected a 24-month maturity date. To address the debt concerns reflected above, in June 2010 we initiated an Incentive Offer that requested all of our unsecured and secured convertible debt holders to convert their convertible notes at a preferential \$0.20 per share conversion rate. In response to this offer, we converted \$2,537,300 of its unsecured convertible debt and \$728,673 of accrued interest into 16,329,868 shares of the Company's common stock. In addition, we converted \$650,000 of our secured convertible stock and \$74,187 of accrued interest into 724,187 shares of the Company's Series A Convertible Preferred Debt. During the year ended December 31, 2010, we raised \$420,000 through the issuance of 420,000 shares of Series B Convertible Preferred Stock. Each share of Series B Convertible Preferred Stock is convertible into 5 common shares at the option of the holder and is entitled to annual cumulative dividends at the rate of 5%.

To satisfy a significant debt obligation owed to certain shareholders and to address cash flow concerns, on February 28, 2011, we completed the placement of \$1,182,844 of Secured Convertible Promissory Note (the "Notes") and Warrants (collectively, the "First Secured Convertible Debt Offering"). The Lenders in the First Secured Convertible Debt Offering paid a 10% discount for their investment, resulting in a "stepped-up" basis in their individual Notes for a total principal amount of \$1,301,128. The Notes bear interest at the rate of 12% per annum, have an 18-month maturity date and are convertible to common shares at \$0.20 per share. The Notes are secured by a first lien on all assets of the Company. In conjunction with the First Secured Convertible Debt Offering, the Lenders received warrants to purchase an aggregate of 3,252,821 common shares. The warrants vested immediately, have a five year term, a \$0.30 exercise price and are redeemable by the Company in the event of an acquisition.

In an effort to address low cash concerns, in June 2011, we initiated a Junior Secured Convertible Debt Offering that provides for the sale of up to an aggregate principal amount of \$1,500,000 Junior Secured Convertible Promissory Notes (the "Junior Notes") and Warrants. The investors in this Junior Secured Convertible Debt Offering receive five-year warrants to purchase that number of common shares equal to 10% of the principal amount of their Junior

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Note(s) divided by the exercise price of \$.06 per share. The Junior Notes bear interest at 8% per annum, have a 24-month maturity date and are secured by the assets of the Company with the repayment being subordinated to the repayment of all secured notes previously issued by the Company.

On June 28, 2011, we closed on the first \$500,000 tranche of the Junior Secured Convertible Debt Offering. In conjunction

with the closing of the first tranche of the Junior Secured Convertible Debt Offering, the investors received warrants to purchase an aggregate of 833,333 common shares. The warrants vested immediately, have a five year term and an exercise price of \$0.06 per share.

On September 15, 2011, we broke escrow on the remaining \$1,000,000 available under the second tranche of the \$1,500,000 Junior Secured Convertible Debt Offering by closing on \$550,000 of proceeds from the sale of the Junior Notes. In conjunction with the sale of \$550,000 of these Junior Notes, the investors received an aggregate of 916,667 common stock warrants. The warrants vested immediately, have a five year term and an exercise price of \$0.06 per share.

On December 5, 2011, we broke escrow on the third tranche of the \$1,500,000 Junior Secured Convertible Debt Offering by closing on \$30,000 of proceeds from the sale of Junior Notes. In conjunction with the sale of \$30,000 of these Junior Notes, the investors received an aggregate of 50,000 common stock warrants. The warrants vested immediately, have a five year term and an exercise price of \$0.06 per share.

On December 31, 2011, we closed the third tranche of the \$1,500,000 Junior Secured Convertible Debt Offering by converting \$379,534 of existing convertible debt and accrued interest into the Junior Secured Convertible Debt Offering. In conjunction with the conversion of this \$379,534, the investors received an aggregate of 682,556 common stock warrants. The warrants vested immediately, have a five year term and an exercise price of \$0.06 per share.

We plan to continue to raise additional funds in the form of equity or debt offerings, secured and otherwise, and we are continuing to evaluate alternative incentive programs to reduce and/or eliminate this debt. If we are unable to pay these notes when due, including interest, and the holders of these convertible notes do not elect to convert them to purchase shares of our common stock or extend them, our financial condition could worsen substantially, and we may be required to cease operations entirely.

We also have substantial amount of other current liabilities as of December 31, 2011, that are principally comprised of the following: notes payable to related parties of \$66,000; notes payable of \$45,933; current maturities of convertible notes \$1,212,098; current maturities of convertible notes - related parties \$42,114, trade accounts payable \$820,308; related party accounts payables of \$35,287, deferred income \$6,040 and accrued expenses \$694,892; for total current liabilities of \$2,922,672. See also Notes to the Consolidated Financial Statements.

Our substantial indebtedness could have important adverse consequences on our ability to carry on our present and planned business operations.

For example, it could:

- make it more difficult for us to satisfy our obligations with respect to the current or new debt financing, if any is offered in the future;
- fund the selling and marketing expenses that support the national roll-out of DigiLIBE;
- make us more sensitive to adverse economic conditions than some of our competitors with less debt;
- limit our ability to fund future working capital, acquisitions, capital expenditures and other general corporate requirements;