

ARI NETWORK SERVICES INC /WI
Form 10-Q
June 16, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended April 30, 2014

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 000-19608

ARI Network Services, Inc.

(Exact name of registrant as specified in its charter)

WISCONSIN 39-1388360

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(State or other jurisdiction of incorporation or organization)(IRS Employer Identification No.)

10850 West Park Place, Suite 1200, Milwaukee, Wisconsin 53224

(Address of principal executive offices)

(414) 973-4300

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES NO

Indicate by check mark whether the registrant has submitted electronically 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 (S232.405 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 whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

(Do not check if a smaller reporting 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

As of June 9, 2014 there were 13,455,203 shares of the registrant's common stock outstanding.

ARI Network Services, Inc.

FORM 10-Q

FOR THE THREE MONTHS ENDED APRIL 30, 2014

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Item 1. Financial Statements

ARI Network Services, Inc.
 Consolidated Balance Sheets
 (Dollars in Thousands, Except per Share
 Data)

	(Unaudited) April 30 2014	(Audited) July 31 2013
ASSETS		
Cash and cash equivalents	\$ 1,034	\$ 2,195
Trade receivables, less allowance for doubtful accounts of \$427 and \$220 at April 30, 2014 and July 31, 2013, respectively	1,840	945
Work in process	161	154
Prepaid expenses and other	1,080	934
Deferred income taxes	2,896	2,938
Total current assets	7,011	7,166
Equipment and leasehold improvements:		
Computer equipment and software for internal use	2,523	2,641
Leasehold improvements	671	609
Furniture and equipment	3,256	2,561

	6,450	5,811
Less		
accumulated		
depreciation		
and		
amortization	(4,502)	(3,948)
Net equipment		
and leasehold		
improvements	1,948	1,863
Capitalized		
software		
product costs:		
Amounts		
capitalized for		
software		
product costs	22,298	20,814
Less		
accumulated		
amortization	(18,098)	(16,604)
Net capitalized		
software		
product costs	4,200	4,210
Deferred		
income taxes	3,496	3,451
Other long		
term assets	78	141
Other		
intangible		
assets	3,744	4,099
Goodwill	12,326	12,198
Total assets	\$ 32,803	\$ 33,128

ARI Network Services, Inc.
 Consolidated Balance Sheets
 (Dollars in Thousands, Except per Share Data)

	(Unaudited) April 30 2014	(Audited) July 31 2013
LIABILITIES		
Current borrowings on line of credit	\$ -	\$ -
Current portion of long-term debt	619	450
Current portion of earn-out payable	301	303
Accounts payable	554	710
Deferred revenue	7,849	8,571
Accrued payroll and related liabilities	1,425	1,434
Accrued sales, use and income taxes	132	147
Other accrued liabilities	504	316
Current portion of capital lease obligations	200	24
Total current liabilities	11,584	11,955
Long-term debt	3,544	4,050
Common stock warrants at fair value	282	254
Long-term portion of earn-out payable	171	418
Capital lease obligations	279	169
Other long term liabilities	217	233
Total non-current liabilities	4,493	5,124
Total liabilities	16,077	17,079

**SHAREHOLDERS'
EQUITY**

Cumulative preferred stock, par value \$.001 per share, 1,000,000 shares authorized; 0 shares issued and outstanding at April 30, 2014 and July 31, 2013, respectively	-	-
Junior preferred stock, par value \$.001 per share, 100,000 shares authorized; 0 shares issued and outstanding at April 30, 2014 and July 31, 2013, respectively	-	-
Common stock, par value \$.001 per share, 25,000,000 shares authorized; 13,440,141 and 12,976,588 shares issued and outstanding at April 30, 2014 and July 31, 2013, respectively	13	13
Additional paid-in capital	105,784	104,816
Accumulated deficit	(89,038)	(88,762)
Other accumulated comprehensive loss	(33)	(18)
Total shareholders' equity	16,726	16,049
Total liabilities and shareholders' equity	\$ 32,803	\$ 33,128

See accompanying notes

ARI Network Services, Inc.
Consolidated Statements of Operations
(Dollars in Thousands, Except per Share Data)
(Unaudited)

	Three months ended April 30		Nine months ended April 30	
	2014	2013	2014	2013
Net revenue	\$ 8,176	\$ 8,228	\$ 24,471	\$ 21,648
Cost of revenue	1,560	1,885	4,806	5,014
Gross profit	6,616	6,343	19,665	16,634
Operating expenses:				
Sales and marketing	2,291	2,324	7,190	5,459
Customer operations and support	1,638	1,545	5,029	4,106
Software development and technical support (net of capitalized software product costs)	679	672	2,016	1,995
General and administrative	1,289	1,541	4,490	4,457
Depreciation and amortization (exclusive				

of amortization of software product costs included in cost of revenue)	354	334	1,014	953
Loss on impairment of long-lived assets	-	420	-	420
Net operating expenses	6,251	6,836	19,739	17,390
Operating income (loss)	365	(493)	(74)	(756)
Other income (expense):				
Interest expense	(68)	(197)	(216)	(534)
Loss on debt extinguishment	-	(682)	-	(682)
(Gain) loss on change in fair value of stock warrants	4	-	(28)	-
Gain on change in fair value of earn-out payable	-	-	26	-
Gain on change in fair value	-	64	-	64

of contingent assets				
Other income (expense), net	12	(1)	27	7
Total other income (expense)	(52)	(816)	(191)	(1,145)
Income (loss) before provision for income tax	313	(1,309)	(265)	(1,901)
Income tax benefit (expense)	(153)	738	(11)	1,447
Net income (loss) \$	160	\$ (571)	\$ (276)	\$ (454)

Weighted average common shares outstanding:				
Basic	13,394	10,548	13,235	9,055
Diluted	13,790	10,548	13,235	9,055
Net income (loss) per common share:				
Basic \$	0.01	\$ (0.05)	\$ (0.02)	\$ (0.05)
Diluted\$	0.01	\$ (0.05)	\$ (0.02)	\$ (0.05)

See accompanying notes

Consolidated Statements of Comprehensive Income
(Dollars in Thousands)
(Unaudited)

	Three months ended April 30		Nine months ended April 30	
	2014	2013	2014	2013
Net income (loss) \$	160	\$ (571)	\$ (276)	\$ (454)

Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustments	(8)	(10)	(15)	(15)
Total other comprehensive loss	(8)	(10)	(15)	(15)
Comprehensive income (loss) \$	152	\$ (581)	\$ (291)	\$ (469)

See accompanying notes

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ARI Network Services, Inc.
 Consolidated Statements of Cash
 Flows
 (Dollars in Thousands)
 (Unaudited)

	Nine months ended April 30	
	2014	2013
Operating activities:		
Net income (loss)	\$ (276)	\$ (454)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Amortization of software products	1,494	1,312
Amortization of discount related to present value of earnout	(12)	(21)
Amortization of bank loan fees	90	265
Stock based interest expense	-	38
Depreciation and other amortization	1,014	953
Loss on impairment of long-lived assets	-	420
	-	(64)

Gain on change in fair value of contingent assets		
Gain on liquidation of split dollar life insurance policy	-	682
Loss on change in fair value of stock warrants	28	-
Gain on change in fair value of contingent liabilities	(26)	-
Provision for bad debt allowance	176	106
Deferred income taxes	(3)	(1,537)
Stock based compensation related to stock options and restricted stock	329	620
Net change in assets and liabilities:		
Trade receivables	(1,068)	(310)
Work in process	(7)	(7)
Prepaid expenses and other	(29)	(72)
Other long term assets	(56)	(207)
Accounts payable	(157)	66
Deferred revenue	(722)	(426)
Accrued payroll and related liabilities	110	284
	(15)	(99)

Accrued sales, use and income taxes		
Other accrued liabilities	172	(45)
Net cash provided by operating activities	\$ 1,042	\$ 1,504
Investing activities:		
Purchase of equipment, software and leasehold improvements	(592)	(493)
Cash received on earnout from disposition of a component of the business	101	147
Cash paid related to earn-out	(250)	-
Cash paid for assets related to acquisition	(200)	(2,479)
Software developed for internal use	(29)	(9)
Software development costs capitalized	(1,391)	(1,279)
Net cash used in investing activities	\$ (2,361)	\$ (4,113)
Financing activities:		
Net borrowings under line of credit	-	750
Payments on long-term debt	(337)	(8,172)
Borrowings under long-term debt	-	6,000
Proceeds from capital lease	312	-

obligations incurred		
Payments of capital lease obligations	(44)	(208)
Payment of stock issuance fees	-	(451)
Proceeds from issuance of common stock	237	4,511
Net cash provided by financing activities	\$ 168	\$ 2,430
Effect of foreign currency exchange rate changes on cash	(10)	(7)
Net change in cash and cash equivalents	(1,161)	(186)
Cash and cash equivalents at beginning of period	2,195	1,350
Cash and cash equivalents at end of period	\$ 1,034	\$ 1,164
Cash paid for interest	\$ 222	\$ 544
Cash paid for income taxes	\$ 70	\$ 50

Noncash investing and financing activities		
Issuance of common stock in connection with acquisitions	\$ 164	\$ 101
Debt issued in connection with acquisitions	-	3,000
Accrued liabilities assumed in connection with acquisitions	-	4,728
Issuance of common stock in connection with debt retirement	-	300
Issuance of common stock warrants in connection with a securities purchase agreement	-	2,333
Issuance of common stock in connection with debt issuance and loan fees	-	585
Issuance of common stock related to payment of director compensation	251	176
Issuance of common stock related to payment of	172	199

employee
compensation
Contingent
liabilities
incurred in
connection
with
acquisition - 749

See accompanying notes

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Notes to Unaudited Consolidated Financial Statements

1. Description of the Business and Significant Accounting Policies

Description of the Business

ARI Network Services, Inc. (“ARI” or “the Company”) creates software-as-a-service (“SaaS”) and data-as-a-service (“DaaS”) solutions that help equipment manufacturers, distributors and dealers in selected vertical markets to Sell More Stuff!™ – online and in-store. We remove the complexity of selling and servicing new and used inventory, parts, garments, and accessories (“PG&A”) for customers in the outdoor power equipment (“OPE”), powersports, automotive tire and wheel (“ATW”), home medical equipment (“HME”), marine, recreational vehicle (“RV”) and appliances industries. Our innovative products are powered by a proprietary library of enriched original equipment and aftermarket content that spans more than 469,000 models from over 1,400 manufacturers. More than 22,000 equipment dealers, 195 distributors and 140 manufacturers worldwide leverage our web and eCatalog platforms to Sell More Stuff!™

We were incorporated in Wisconsin in 1981. Our principal executive office and headquarters is located in Milwaukee, Wisconsin. The office address is 10850 West Park Place, Suite 1200, Milwaukee, WI 53224, and our telephone number at that location is (414) 973-4300. Our principal website address is www.arinet.com. ARI also maintains operations in Duluth, Minnesota; Cypress, California; Floyds Knobs, Indiana; and Leiden, The Netherlands.

Basis of Presentation

These consolidated financial statements include the financial statements of ARI and its wholly-owned subsidiary, ARI Europe B.V. We eliminated all significant intercompany balances and transactions in consolidation. Certain reclassifications were made to amounts previously reported in our financial statements in order to conform to the current presentation related to certain shared corporate overhead expenses which were reclassified between sales and marketing, customer operations and support, software development and technical support and general and

administrative expenses. This had no impact on gross profit, total operating expenses or net income (loss). All adjustments that, in the opinion of management, are necessary for a fair presentation for the periods presented have been reflected as required by Regulation S-X, Rule 10-01.

Significant Accounting Policies

Our accounting policies are fully described in the footnotes to our Consolidated Financial Statements for the fiscal year ended July 31, 2013, which appear in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on October 29, 2013. There were no material changes to our accounting policies during the nine months ended April 30, 2014.

Revenue Recognition

In accordance with Financial Accounting Standard 605-25 "Revenue from Multiple Element Arrangements", revenues from subscription fees for use of our software, access to our catalog content, and software maintenance and support fees are all recognized ratably over the contractual term of the arrangement, as vendor specific objective evidence does not exist for these elements. ARI considers all arrangements with payment terms extending beyond 12 months not to be fixed or determinable and evaluates other arrangements with payment terms longer than normal to determine whether the arrangement is fixed or determinable. If the fee is not fixed or determinable, revenue is recognized as payments become due from the customer. Arrangements that include acceptance terms beyond the standard terms are not recognized until acceptance has occurred. If collectability is not considered probable, revenue is recognized when the fee is collected.

Arrangements that include professional services are evaluated to determine whether those services are essential to the functionality of other elements of the arrangement. Types of services that are considered essential to software subscription arrangements include customizing complex features and functionality in a product's base software code or developing complex interfaces within a customer's environment. When professional services are considered essential to software license arrangements, the professional service revenue is recognized pursuant to contract accounting using the percentage-of-completion method with progress-to-completion measured based upon labor hours incurred. Professional services revenue for

set-up and integration of hosted websites, or other services considered essential to the functionality of other elements of this type of arrangement, is amortized over the term of the contract. When professional services are not considered essential, the revenue allocable to the professional services is recognized as the services are performed. When the current estimates of total contract revenue and contract cost indicate a loss, a provision for the entire loss on the contract is made in the period the amount is determined.

Revenue for variable transaction fees, primarily for use of the shopping cart feature of our websites, is recognized as it is earned. Amounts received for shipping and handling fees are reflected in revenue. Costs incurred for shipping and handling are reported in cost of revenue.

Amounts invoiced to customers prior to recognition as revenue, as discussed above, are reflected in the accompanying balance sheets as deferred revenue.

Trade Receivables, Credit Policy and Allowance for Doubtful Accounts

Trade receivables are uncollateralized customer obligations due on normal trade terms, most of which require payment within thirty (30) days from the invoice date. Payments of trade receivables are allocated to the specific invoices identified on the customer's remittance advice or, if unspecified, are applied to the earliest unpaid invoices.

The carrying amount of trade receivables is reduced by an allowance that reflects management's best estimate of the amounts that will not be collected. Management individually reviews receivable balances that exceed ninety (90) days from the invoice date and, based on an assessment of current creditworthiness, estimates the portion of the balance that will not be collected. The allowance for potential doubtful accounts is reflected as an offset to trade receivables in the accompanying balance sheets.

Capitalized and Purchased Software Product Costs

Certain software development and acquisition costs are capitalized when incurred. Capitalization of these costs begins upon the establishment of technological feasibility. The establishment of technological feasibility and the on-going assessment of recoverability of software costs require considerable judgment by management with respect to certain external factors, including, but not limited to, the determination of technological feasibility, anticipated future gross revenue, estimated economic life and changes in software and hardware technologies.

The annual amortization of software products is the greater of the amount computed using: (a) the ratio that current gross revenue for the network or a software product bear to the total of current and anticipated future gross revenue for the network or a software product, or (b) the straight-line method over the estimated economic life of the product which currently runs from two to nine years. Amortization starts when the product is available for general release to customers. The Company capitalizes costs of developing specific software enhancements on an on-going basis; all other software development and support expenditures are charged to expense in the period incurred.

Fair Value Assets and Liabilities

ARI uses the three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include Level 1, defined as observable inputs such as quoted market prices in active markets; Level 2, defined as inputs other than quoted market prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions. The asset's or liability's fair value measurement level within the hierarchy is based on the lowest level of any input that is significant to the fair value measurement.

Common Stock Warrants

ARI has periodically issued common stock warrants in connection with debt and equity financing arrangements. The terms of the agreements are assessed to determine whether the instrument qualifies as an equity arrangement or a debt arrangement. Arrangements determined to be derivatives are recorded at fair value as liabilities on the balance sheet, with periodic gains and losses related to the change in fair value recorded to earnings on the Statements of Operations. The Company recorded a gain related to the change in fair value of common stock warrants of \$4,000 for the three months ended April 30, 2014 and a loss of \$28,000 for the nine months ended April 30, 2014, compared to \$0 for the three and nine months ended April 30, 2013.

Legal Provisions

ARI may be periodically involved in legal proceedings arising from contracts, patents or other matters in the normal course of business. We reserve for any material estimated losses if the outcome is probable and can be reasonably estimated. We had no legal provisions for the three or nine months ended April 30, 2014 or 2013, respectively.

Deferred Loan Fees and Debt Discounts

Fees associated with securing debt are capitalized and included in prepaid and other and other long term assets on the balance sheets. Stock issued as consideration for debt financing is recorded to debt discount, reducing the carrying amount of the debt on the balance sheets. Deferred loan fees and debt discounts are amortized to interest expense over the life of the debt using the effective interest method.

Deferred Income Taxes

The tax effect of the temporary differences between the book and tax bases of assets and liabilities and the estimated future tax benefit from tax net operating loss carryforwards is reported as deferred tax assets and liabilities in the balance sheet. An assessment of the likelihood that net deferred tax assets will be realized from future taxable income is performed at each reporting date or when events or changes in circumstances indicate that there may be a change in the valuation allowance. Because the ultimate realizability of deferred tax assets is highly subject to the outcome of future events, the amount established as a valuation allowance is considered to be a significant estimate that is subject to change in the near term. To the extent a valuation allowance is established or there is a change in the allowance during a period, the change is reflected with a corresponding increase or decrease in the income tax provision in the Statements of Operations.

2. Basic and Diluted Net Income per Share

Basic net income per common share is computed by dividing net income by the basic weighted average number of common shares outstanding during the period. Diluted net income per common share is computed by dividing net income by the weighted average number of common shares outstanding during the period and reflects the potential dilution using the treasury stock method, which calculates the number of common shares that could be purchased at market price with the proceeds that would occur if all of the Company's outstanding stock options and warrants that have a strike price below the market price were exercised.

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The following table is a reconciliation of basic and diluted net income per common share for the periods indicated (in thousands, except per share data):

	Three months ended April 30		Nine months ended April 30	
	2014	2013	2014	2013
Net income (loss)	\$ 160	\$ (571)	\$ (276)	\$ (454)
Weighted-average common shares outstanding	13,394	10,548	13,235	9,055
Effect of dilutive stock options and warrants	396	-	-	-
Diluted weighted-average common shares outstanding	13,790	10,548	13,235	9,055
Earnings per share				
Basic	\$ 0.01	\$ (0.05)	\$ (0.02)	\$ (0.05)
Diluted	\$ 0.01	\$ (0.05)	\$ (0.02)	\$ (0.05)
Options and warrants that could potentially dilute net income per share in the future that are not included in the computation of diluted net income per share, as their impact is anti-dilutive	200	2,531	1,520	2,531

3. Stock-based Compensation Plans

Stock Option Plans

We used the Black-Scholes model to value stock options granted. Expected volatility is based on historical volatility of the Company's stock. The expected life of options granted represents the period of time that options granted are expected to be outstanding. The risk-free rate for periods within the contractual term of the options is based on the United States Treasury yields in effect at the time of grant.

As recognizing stock-based compensation expense is based on awards ultimately expected to vest, the amount of recognized expense has been reduced for estimated forfeitures based on the Company's historical experience. Total stock compensation expense recognized by the Company was approximately \$63,000 and \$112,000 for the three and nine month periods ended April 30, 2014, respectively, and \$42,000 and \$127,000 for the same periods last year. There was approximately \$389,000 and \$194,000 of total unrecognized compensation costs related to non-vested options granted under the Company's stock option plans as of April 30, 2014 and 2013, respectively. There were no capitalized stock-based compensation costs at April 30, 2014 or July 31, 2013.

The fair value of each option granted was estimated in the period of issuance using the assumptions in the following table for the three and nine months ended April 30, 2014 and 2013:

	Three months ended April 30		Nine months ended April 30	
	2014	2013	2014	2013
Expected life (years)	5.07 years	n/a	5.07 years	10 years
Risk-free interest rate	1.5 %	n/a	1.4 %	1.7 %
Expected volatility	70.6 %	n/a	72.0 %	130.5 %
Expected forfeiture rate	27.2 %	n/a	14.2 %	- %
Expected dividend yield	- %	n/a	- %	- %
Weighted-average estimated fair value of options granted during the period	\$ 1.94	\$ n/a	\$ 1.96	\$ 1.25
Cash received from the exercise of stock options	\$ 95,755	\$ 570	\$ 244,792	\$ 9,453

2000 Stock Option Plan

The Company's 2000 Stock Option Plan (the "2000 Plan") had 1,950,000 shares of common stock authorized for issuance. Each incentive stock option that was granted under the 2000 Plan is exercisable for a period of not more than 10 years from the date of grant (five years in the case of a participant who is a 10% shareholder of the Company, unless the stock options are nonqualified), or such shorter period as determined by the Compensation Committee, and shall lapse upon the expiration of said period, or earlier upon termination of the participant's employment with the Company. The 2000 Plan expired on December 13, 2010, at which time it was terminated except for outstanding options. As a result, no new options may be granted under the 2000 Plan.

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Changes in option shares under the 2000 Plan during the three and nine months ended April 30, 2014 and 2013 were as follows:

	Number of Options	Wtd. Avg. Exercise Price	Wtd. Avg. Remaining Contractual Period (Years)	Aggregate Intrinsic Value
Outstanding at 1/31/13	997,961	\$ 1.41	4.72	\$ 459,617
Granted	-	n/a	n/a	n/a
Exercised	(3,800)	0.15	n/a	n/a
Forfeited	(687)	0.92	n/a	n/a
Outstanding at 4/30/13	993,474	\$ 1.41	4.49	\$ 1,074,015
Exercisable at 4/30/13	918,074	\$ 1.47	4.49	\$ 937,800
Outstanding at 1/31/14	822,074	\$ 1.55	3.21	\$ 1,514,709
Granted	-	n/a	n/a	n/a
Exercised	(65,111)	1.44	n/a	n/a
Forfeited	(1,313)	1.40	n/a	n/a
Outstanding at 4/30/14	755,650	\$ 1.56	3.12	\$ 1,148,668
Exercisable at 4/30/14	754,276	\$ 1.56	3.12	\$ 1,145,224

	Number of Options	Wtd. Avg. Exercise Price	Wtd. Avg. Remaining Contractual Period (Years)	Aggregate Intrinsic Value
Outstanding at 7/31/12	1,099,769	\$ 1.41	5.06	\$ 105,849
Granted	-	n/a	n/a	n/a
Exercised	(16,600)	0.45	n/a	n/a
Forfeited	(89,695)	1.55	n/a	n/a
Outstanding at 4/30/13	993,474	\$ 1.41	4.49	\$ 1,074,015
Exercisable at 4/30/13	918,074	\$ 1.47	4.49	\$ 937,800
Outstanding at 7/31/13	986,786	\$ 1.41	4.22	\$ 1,564,296
Granted	-	n/a	n/a	n/a
Exercised	(212,611)	0.96	n/a	n/a
Forfeited	(18,525)	0.79	n/a	n/a
Outstanding at 4/30/14	755,650	\$ 1.56	3.12	\$ 1,148,668
Exercisable at 4/30/14	754,276	\$ 1.56	3.12	\$ 1,145,224

The range of exercise prices for options outstanding under the 2000 Plan was \$0.49 to \$2.74 at April 30, 2014 and 2013.

Changes in the 2000 Plan's non-vested option shares included in the outstanding shares above during the three and nine months ended April 30, 2014 and 2013 were as follows:

	Number of	Wtd. Avg. Exercise Price
	Options	
Non-vested at 1/31/13	75,587	\$ 0.68
Granted	-	n/a
Vested	-	n/a
Forfeited	(187)	0.92
Non-vested at 4/30/13	75,400	\$ 0.68
Non-vested at 1/31/14	1,374	\$ 0.57
Granted	-	n/a
Vested	-	n/a
Forfeited	-	n/a
Non-vested at 4/30/14	1,374	\$ 0.57
	Number of	Wtd. Avg. Exercise Price
	Options	
Non-vested at 7/31/12	78,087	\$ 0.69
Granted	-	n/a
Vested	-	n/a
Forfeited	(2,687)	0.73
Non-vested at 4/30/13	75,400	\$ 0.68
Non-vested at 7/31/13	27,461	\$ 0.64
Granted	-	n/a
Vested	(12,500)	0.67
Forfeited	(13,587)	0.63
Non-vested at 4/30/14	1,374	\$ 0.57

The weighted average remaining vesting period was .25 and .63 years at April 30, 2014 and 2013, respectively.

2010 Equity Incentive Plan

The Board of Directors adopted the ARI Network Services, Inc. 2010 Equity Incentive Plan (as amended, the “2010 Plan”) on November 9, 2010, and the plan was approved by the Company's shareholders in December 2010, and amendments to the 2010 Plan were approved by the Company’s shareholders in January 2014. The 2010 Plan is the successor to the Company’s 2000 Plan. There are 1,850,000 shares of Company common stock authorized for issuance under the 2010 Plan. Potential awards under the 2010 Plan include incentive stock options (“ISOs”) and non-statutory stock options (“NSOs”), shares of restricted stock or restricted stock units, stock appreciation rights (“SARs), and shares of common stock. Up to 1,525,000 of the shares authorized for issuance under the 2010 Plan may be used for common stock restricted stock or restricted stock unit awards.

The exercise price for options and stock appreciation rights under the 2010 Plan cannot be less than 100% of the fair market value of the Company’s common stock on the date of grant, and the exercise prices for options and stock appreciation rights cannot be repriced without shareholder approval, except to reflect changes to the capital structure of the Company as described in the 2010 Plan. The maximum term of options and stock appreciation rights under the 2010 Plan is ten (10) years. The 2010 Plan does not have liberal share counting provisions (such as provisions that would permit shares withheld for payment of taxes or the exercise price of stock options to be re-granted under the plan.

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Changes in option shares under the 2010 Plan during the three and nine months ended April 30, 2014 and 2013 were as follows:

	Number of Options	Wtd. Avg. Exercise Price	Wtd. Avg. Remaining Contractual Period (Years)	Aggregate Intrinsic Value
Outstanding at 1/31/13	449,335	\$ 1.17	9.11	\$ 284,393
Granted	-	n/a	n/a	n/a
Exercised	-	n/a	n/a	n/a
Forfeited	(42,000)	0.80	n/a	n/a
Outstanding at 4/30/13	407,335	\$ 1.20	8.91	\$ 523,647
Exercisable at 4/30/13	111,210	\$ 1.09	8.91	\$ 156,031
Outstanding at 1/31/14	426,085	\$ 1.76	8.67	\$ 693,641
Granted	106,666	3.29	n/a	n/a
Exercised	(1,750)	1.11	n/a	n/a
Forfeited	(375)	0.66	n/a	n/a
Outstanding at 4/30/14	530,626	\$ 2.07	8.72	\$ 573,095
Exercisable at 4/30/14	176,690	\$ 1.29	7.83	\$ 315,654
			Wtd. Avg. Remaining Contractual Period (Years)	Aggregate Intrinsic Value
Outstanding at 7/31/12	310,667	\$ 1.10	9.28	\$ 41,962
Granted	145,668	1.29	n/a	n/a
Exercised	(3,000)	0.66	n/a	n/a
Forfeited	(46,000)	0.79	n/a	n/a
Outstanding at 4/30/13	407,335	\$ 1.20	8.91	\$ 523,647
Exercisable at 4/30/13	111,210	\$ 1.09	8.91	\$ 156,031
Outstanding at 7/31/13	394,460	\$ 1.25	8.70	\$ 691,485
Granted	206,666	3.27	n/a	n/a
Exercised	(46,750)	0.89	n/a	n/a
Forfeited	(23,750)	1.09	n/a	n/a
Outstanding at 4/30/14	530,626	\$ 2.07	8.72	\$ 573,095
Exercisable at 4/30/14	176,690	\$ 1.29	7.83	\$ 315,654

The range of exercise prices for options outstanding under the 2010 Plan was \$.58 to \$3.30 and \$.58 to \$1.75 at April 30, 2014 and 2013, respectively.

Changes in the 2010 Plan's non-vested option shares included in the outstanding shares above during the three and nine months ended April 30, 2014 and 2013 were as follows:

	Number of	Wtd. Avg. Exercise Price
	Options	
Non-vested at 1/31/13	337,875	\$ 1.19
Granted	-	n/a
Vested	-	n/a
Forfeited	(41,750)	0.81
Non-vested at 4/30/13	296,125	\$ 1.25
Non-vested at 1/31/14	247,645	\$ 2.10
Granted	106,666	3.29
Vested	-	n/a
Forfeited	(375)	0.66
Non-vested at 4/30/14	353,936	\$ 2.46
	Number of	Wtd. Avg. Exercise Price
	Options	
Non-vested at 7/31/12	192,707	\$ 1.12
Granted	145,668	1.29
Vested	-	-
Forfeited	(42,250)	0.80
Non-vested at 4/30/13	296,125	\$ 1.25
Non-vested at 7/31/13	177,145	\$ 1.25
Granted	206,666	3.27
Vested	(15,000)	0.84
Forfeited	(14,875)	0.84
Non-vested at 4/30/14	353,936	\$ 2.46

The weighted average remaining vesting period was 1.43 and 1.31 years at April 30, 2014 and 2013, respectively.

Employee Stock Purchase Plan

The Company's 2000 Employee Stock Purchase Plan, as amended, ("ESPP") has 575,000 shares of common stock reserved for issuance, of which 224,955 and 200,311 of the shares have been issued as of April 30, 2014 and July 31, 2013, respectively. All employees with at least six months of service are eligible to participate. Shares may be purchased at the end of a specified period at the lower of 85% of the market value at the beginning or end of the specified period through accumulation of payroll deductions, not to exceed 5,000 shares per employee per year.

Long-Term Executive Bonus Plan

The Compensation Committee adopted the Long-Term Executive Bonus Plan ("LTEB") for eligible executive officers of the Company effective beginning in fiscal 2013. The amount of the awards will be determined after the close of the fiscal year based on subjective and performance criteria. Except as otherwise provided by the Compensation Committee, awards will consist of (i) restricted stock based on a percentage of base salary and the number of shares granted will be based upon the closing price of the shares at the time the Committee determines the amount of the Award, which will be the same as the grant date of the restricted stock and (ii) cash, to cover the minimum withholding taxes on the Award. The restricted stock is granted under the 2010 Plan and vests in four installments, beginning on the date of grant and the next three anniversaries of the date of grant. Awards under the LTEB are expensed over the requisite service period plus the vesting period. The Company expensed approximately \$23,000 and \$123,000 for the three and nine months, respectively, ended April 30, 2014 and \$0 for the three and nine months ended April 30, 2013 related to the LTEB. A portion of this expense relates to the amortization of restricted shares issued and expensed over their vesting period (described below) and a portion relates to bonus expense accrued, but unissued, recognized over the requisite service period.

Restricted Stock

Pursuant to the 2010 Plan, there are 1,525,000 shares authorized for issuance in the form of shares of common stock, restricted stock or restricted stock units. The Company grants restricted stock to its directors as an annual retainer, its officers under the LTEB and from time to time to directors, officers or employees as discretionary compensation in place of cash. The Company recognized compensation expense of \$104,000 and \$217,000 for the three and nine months ended April 30, 2014 and \$67,000 and \$316,000 for the three and nine months ended April 30, 2013, respectively, related to restricted stock expensed over the vesting period.

The Compensation Committee has the ability, at its discretion, to grant restricted stock based on subjective factors as the Compensation Committee may deem appropriate, and granted 18,000 of restricted shares with a market price of \$1.25 on the date of grant, valued at \$22,000, in October 2012 as a discretionary bonus. 9,000 shares vested in October 2013 and the remaining 9,000 shares vest equally in October 2014 and October 2015. In connection with this grant, the Company expensed \$2,000 and \$6,000 during the three and nine months ended April 30, 2014 and \$2,000 and \$6,000 during the three and nine months ended April 30, 2013.

Changes in restricted shares of common stock under the 2010 Plan were as follows:

	Three months		Nine months ended	
	ended April 30		April 30	
	2014	2013	2014	2013
Beginning balance	133,260	85,500	85,500	-
Granted	5,288	50,525	129,548	229,609
Vested	-	(50,525)	(76,500)	(144,109)
Forfeited	-	-	-	-
Ending balance	138,548	85,500	138,548	85,500

4. Business Combinations

On November 1, 2013, the Company acquired substantially all of the assets of DUO Web Solutions (“DUO”) pursuant to an Asset Purchase Agreement dated November 1, 2013. DUO was a leading provider of social media and online marketing services for the powersports industry, which is in line with the Company’s strategy to grow the digital marketing services side of the business. The Company determined that the DUO assets acquired did not constitute a

business that is “significant” as defined in the applicable SEC regulations, nor did it have a material impact on the Company’s financial statements.

On November 28, 2012, the Company, through a wholly-owned subsidiary, completed the acquisition of the assets of the Retail Services Division of Fifty Below Sales & Marketing, Inc. (“50 Below”), a leading provider of eCommerce websites in the powersports, ATW and HME industries for a purchase price of \$5,000,000 and the assumption of contracts having deferred revenue (ongoing service requirements for which ARI will not receive payment) valued in the amount of \$4,601,000.

The following tables show the allocation of the purchase price (in thousands):

	Purchase Price
Cash	\$ 1,500
Financed by note payable	3,500
Assumed liabilities	4,601
Purchase Price	\$ 9,601

	Purchase Allocation
Prepaid expenses	\$ 9
Furniture and equipment	106
Developed technology	950
Tradenames	130
Customer Relationships	2,180
Goodwill	6,226
Purchase Price Allocation	\$ 9,601

Intangible assets include the fair value of tradenames with a useful life of 2 years and customer relationships with a useful life of 15 years. Goodwill of \$6,226,000 represents the additional benefits provided to the Company by the acquisition of 50 Below through operational synergies. The acquisition of 50 Below increased the Company's portfolio of equipment dealer websites by 230% and is expected to accelerate ARI's opportunity to drive organic growth through the cross selling of new products. It also provided entry into new, potentially high growth markets, including ATW and HME. The combined customer benefits and operational efficiencies are expected to result in a stronger organization that can create more value for its customers, employees and shareholders than the sum of the stand alone business units. The Company acquired approximately \$7 million of tax deductible goodwill related to the 50 Below acquisition.

The following unaudited results of operations for the three and nine months ended April 30, 2014 and the three months ended April 30, 2013 reflect the actual results of the Company, which include the results of the 50 Below operation for the entire period. The unaudited pro forma information for the nine months ended April 30, 2013 reflects the historical results of operations of both companies, with pro forma adjustments as if the acquisition had occurred on August 1, 2012. The unaudited pro forma financial information presented is for information purposes only and does not purport to represent what the Company's and 50 Below's financial position or results of operations would have been had the acquisition in fact occurred on such date or at the beginning of the period indicated, nor does it project the Company's and 50 Below's financial position or results of operations for any future date or period.

	Three months ended		Nine months ended	
	April 30		April 30	
	2014	2013	2014	2013
Revenue	\$ 8,176	\$ 8,228	\$ 24,471	\$ 24,850
Net income (loss)	\$ 160	\$ (571)	\$ (276)	\$ (323)
Net income (loss) per common share:				
Basic	\$ 0.01	\$ (0.05)	\$ (0.02)	\$ (0.04)
Diluted	\$ 0.01	\$ (0.05)	\$ (0.02)	\$ (0.04)

Pro forma adjustments to net income include amortization costs related to internally developed technology and intangible assets, acquisition-related professional fees, interest expense on the debt incurred to acquire the assets of 50 Below and the related debt discount, and the tax effect of the historical 50 Below results of operations and the pro

forma adjustments at an estimated tax rate of 40% as follows:

	Three months ended April 30 2014		Nine months ended April 30 2014	
	2014	2013	2014	2013
Amortization of internally developed technology	\$ -	\$ -	\$ -	\$ 35
Amortization of intangible assets	-	-	-	68
Acquisition-related professional fees	-	-	-	(790)
Interest expense	-	-	-	172
Income tax benefit	-	-	-	(439)

On August 17, 2012, the Company acquired substantially all of the assets of Ready2Ride, Incorporated (“Ready2Ride”) pursuant to an Asset Purchase Agreement dated August 17, 2012. Ready2Ride was a marketer of aftermarket fitment data to the powersports industry, which furthered ARI’s differentiated content strategy and expanded ARI’s product offerings into aftermarket PG&A.

Consideration for the acquisition included \$500,000 in cash, 100,000 shares of the Company’s common stock, assumed liabilities totaling approximately \$419,000, a contingent hold-back purchase price of up to \$250,000 and a contingent earn-out purchase price ranging from, in aggregate, \$0 to \$1,500,000.

On October 22, 2013, the Company amended the Asset Purchase Agreement in relation to the earn-out payments as follows: (i) the first earn-out payment was composed of \$125,000 paid in October 2013 and 10,000 shares of common stock issued in November 2013; (ii) the second earn-out payment is composed of \$125,000 and 15,000 shares of common stock payable in September 2014; and (iii) the third earn-out payment is composed of \$125,000 and 15,000 shares of common stock payable in September 2015.

The contingent earn-out payable was initially measured at fair value on a recurring basis calculated using the present value of future estimated revenue over the next three years, which was originally estimated at \$500,000. Prior to the amendment, because the contingent earn-out payable had no comparable market data or significant observable inputs to determine fair value, it was classified as a Level 3 measurement. Because the amended Asset Purchase Agreement defines the future payments based on cash and Company stock actively traded, and the payments are no longer contingent on future events, the earn-out is now classified as a Level 1 fair value measurement. Unrealized gains and losses for changes in fair value are recognized in earnings.

The following table shows changes in the estimated holdback and earn-out payable (in thousands):

	Three months		Nine months	
	ended April 30		ended April 30	
	2014	2013	2014	2013
Beginning balance	\$ 455	\$ 825	\$ 721	\$ -
Original fair value of holdback and earn-out payable	-	-	-	749
Payments made	-	-	(283)	-
Imputed interest recognized	17	37	60	113
Gain on change in fair market value	-	-	(26)	-
Ending Balance	\$ 472	\$ 862	\$ 472	\$ 862

The balance of the holdback and the earn-out payable includes \$301,000 and \$303,000 in current portion of earn-out payable and \$171,000 and \$418,000 in long-term portion of earn-out payable on the unaudited balance sheet at April 30, 2014 and July 31, 2013, respectively, with estimated payments as follows (in thousands):

Year Ending July 31,	Holdback and Earn-out Payable
2014	\$ -
2015	315
2016	190
Total estimated payments	505
Less imputed interest	(33)
	\$ 472

Present
value of
holdback
and
earn-out
payable

The following tables show the estimated fair value and the allocation of the purchase price (in thousands):

	Purchase Price
Cash- net	\$ 478
Assumed	
liabilities	419
Holdback	250
Earnout	500
Common	
Stock	101
Purchase	
Price	\$ 1,748

	Purchase Price Allocation
Accounts	
receivable	\$ 43
Furniture and	
equipment	12
Unearned	
revenue	(86)
Developed	
technology	366
Customer	
Relationships	880
Goodwill	533
Purchase	
Price	
Allocation	\$ 1,748

Intangible assets consist primarily of customer contracts and relationships with an estimated useful life of 16 years. Goodwill consists of operating synergies, vendor relationships, new sales territories and industries. The Company determined that the Ready2Ride assets acquired as described above did not constitute a business that is “significant” as defined in the applicable SEC regulations.

The results of operations related to the 50 Below, Ready2Ride and DUO acquisitions since the date of acquisition are included in the consolidated statements of income for the periods presented. It is impracticable to segregate this information as the acquired businesses have been integrated into the operations of ARI and are no longer readily identifiable.

5. Disposition of a Component of an Entity

On March 1, 2011, the Company entered into an Asset Purchase Agreement (the “Agreement”) with Globalrange Corporation (“Globalrange”). Under the terms of the Agreement, the Company sold to Globalrange certain rights and assets relating to our electronic data interchange business for the agricultural chemicals industry (the “AgChem EDI Business”). Because the AgChem EDI Business was not a separate entity or reportable segment, the transaction was recorded as a disposition of a component of an entity.

As part of the purchase price for the AgChem EDI Business, Globalrange agreed to assume certain liabilities of ARI relating to the AgChem EDI Business, primarily consisting of unearned revenue (as defined in the Agreement). Globalrange will make earn-out payments to ARI annually over a four-year period following the closing date, with an initial pre-payment of \$80,000. The amounts of such earn-out payments are determined based on collections received by Globalrange relating to the AgChem EDI Business during such period, and will be subject to a floor and cap, in accordance with the terms of the Agreement.

The contingent earn-out receivable is measured at fair value on a recurring basis calculated using the present value of future estimated revenue over the next three years. Unrealized gains and losses for changes in fair value are recognized in earnings. Because the contingent earn-out receivable has no comparable market data or significant observable inputs to determine fair value, it is classified as a Level 3 measurement. The primary factors used to determine the fair value include: (i) the estimated future revenue related to the business recognized by the buyer over the next three years; and (ii) the estimated risk free interest rate of a market participant. Increases in the estimated future revenue related to the business sold, which has the most impact on the fair value of the contingent earn-out receivable, would cause the fair value of the earn-out to increase.

The amount of the earn-out receivable was originally estimated at \$580,000 less an imputed discount of \$97,000, based on the present value of the estimated earn-out payments, discounted at 14%, which was the prevailing rate of interest charged on the Company's debt at the time of the sale. The discount is amortized to interest income, which is included in other income on the consolidated statements of income, over the life of the earn-out.

An assessment of the expected future cash flows of the earn-out receivable is performed annually in the third fiscal quarter based on historical receipts over the previous twelve-month period. Changes in estimate and cash received in excess of expected cash receipts are recorded as a gain or loss in other expense (income). The Company assessed the fair value of the expected future cash flows of the earn-out receivable and had no change in estimated fair value for the three and nine months ended April 30, 2014, and recorded a gain related to the change in estimated fair value of the earn-out receivable of \$26,000 for the three and nine months ended April 30, 2013.

The remaining earn-out receivable is composed of \$70,000 included in prepaid expenses and other on the unaudited balance sheet at April 30, 2014, with estimated receivables as follows (in thousands):

Year Ending July 31,	
2014	\$ 26
2015	51
Total estimated payments	77
Less imputed interest	(7)
Present value of earn-out receivable	\$ 70

The following table shows changes in the earn-out receivable during the three and nine months ended April 30, 2014 and 2013 respectively (in thousands):

	Three months ended April 30		Nine months ended April 30	
	2014	2013	2014	2013
Beginning balance	\$ 131	\$ 132	\$ 160	\$ 218
Net receipts	(65)	(45)	(102)	(147)
Imputed interest recognized	4	5	12	21
Change in estimate	-	64	-	64
Ending balance	\$ 70	\$ 156	\$ 70	\$ 156

6. Other Intangible Assets

Amortizable intangible assets include customer relationships, trade names and employee non-compete agreements associated with the Company's acquisitions.

Amortizable intangible assets are composed of the following at April 30, 2014 and 2013 (in thousands):

	Three months ended April 30, 2013			Nine months ended April 30, 2013			Wgtd avg remaining life
	Cost Basis	Accumulated Amortization	Net Value	Cost Basis	Accumulated Amortization	Net Value	
Customer Relationships							
Beginning Balance	\$ 7,064	\$ (2,853)	\$ 4,211	\$ 4,004	\$ (2,654)	\$ 1,350	
Activity	-	(115)	(115)	3,060	(314)	2,746	
Ending Balance	\$ 7,064	\$ (2,968)	\$ 4,096	\$ 7,064	\$ (2,968)	\$ 4,096	11.79
Trade Names							
Beginning Balance	\$ 383	\$ (200)	\$ 183	\$ 253	\$ (164)	\$ 89	
Activity	-	(30)	(30)	130	(66)	64	
Ending Balance	\$ 383	\$ (230)	\$ 153	\$ 383	\$ (230)	\$ 153	1.4
Total Intangibles							
Beginning Balance	\$ 7,447	\$ (3,053)	\$ 4,394	\$ 4,257	\$ (2,818)	\$ 1,439	
Activity	-	(145)	(145)	3,190	(380)	2,810	

Ending Balance	\$ 7,447	\$ (3,198)	\$ 4,249
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